WORLD TRADE
ORGANIZATION

WORLD TRADE REPORT 2007

WTO MEMBERS

(As of 27 July 2007)

Albania
Angola
Antigua and Barbuda
Argentina
Armenia
Australia
Austria
Bahrain, Kingdom of
Bangladesh
Barbados
Belgium
Belize
Benin
Bolivia
Botswana
Brazil
Brunei Darussalam
Bulgaria
Burkina Faso
Burundi
Cambodia
Cameroon
Canada
Central African Republic
Chad
Chile
China
Colombia
Congo
Costa Rica
Côte d'Ivoire
Croatia
Cuba
Cyprus
Czech Republic
Democratic Republic of the Congo
Denmark
Djibouti
Dominica
Dominican Republic
Ecuador
Egypt
El Salvador
Estonia
European Communities
Fiji
Finland
Former Yugoslav Republic of Macedonia (FYROM)
France
Gabon
The Gambia
Georgia
Germany
Ghana
Greece
Grenada
Guatemala
Guinea
Guinea Bissau
Guyana
Haiti
Honduras
Hong Kong, China
Hungary
Iceland
India
Indonesia
Ireland
Israel
Italy
Jamaica
Japan
Jordan
Kenya
Korea, Republic of
Kuwait
Kyrgyz Republic
Latvia
Lesotho
Liechtenstein
Lithuania
Luxembourg
Macao, China
Madagascar
Malawi
Malaysia
Maldives
Mali
Malta
Mauritania
Mauritius
Mexico
Moldova
Mongolia
Morocco
Mozambique
Myanmar
Namibia
Nepal
Netherlands
New Zealand
Nicaragua
Niger
Nigeria
Norway
Oman
Pakistan
Panama
Papua New Guinea
Paraguay
Peru
Philippines
Poland
Portugal
Qatar
Romania
Rwanda
Saint Kitts and Nevis
Saint Lucia
Saint Vincent & the Grenadines
Saudi Arabia
Senegal
Sierra Leone
Singapore
Slovak Republic
Slovenia
Solomon Islands
South Africa
Spain
Sri Lanka
Suriname
Swaziland
Sweden
Switzerland
Chinese Taipei
Tanzania
Thailand
Togo
Tonga
Trinidad and Tobago
Tunisia
Turkey
Uganda
United Arab Emirates
United Kingdom
United States of America
Uruguay
Venezuela (Bolivarian Republic of)
Viet Nam
Zambia
Zimbabwe

This report is also available in French and Spanish
(Price: CHF 60.00)

To order, please contact:
WTO Publications
World Trade Organization
154, rue de Lausanne
CH-1211 Geneva 21
Tel: (41 22) 739 52 08
Fax: (41 22) 739 54 58
Email: publications@wto.org

ISBN 978-92-870-3401-4
Printed in Switzerland
© World Trade Organization 2007

World Trade Organization

WORLD TRADE REPORT 2007

Six decades of multilateral trade cooperation: What have we learnt?

FOREWORD

The World Trade Report 2007 is the fifth in a series launched in 2002. This year's Report marks sixty years of multilateralism in trade through the GATT/WTO. On 1 January 1948 the GATT came into being with 23 signatories. Six decades on, at the beginning of next year, we celebrate a WTO with over 150 Members. This is an institution that has changed and grown in fascinating ways, striving to meet the challenges posed by increasingly complex trade relations in a globalizing world. The GATT/WTO has evolved from its comparatively modest focus in the early years on reducing and binding tariffs on manufactured goods to encompass a deeper and wider set of disciplines across a range of policy areas. At the same time, over sixty years the system has brought together a growing number of nations at different levels of development, with varied policy priorities, in a cooperative endeavour to forge an international trade policy regime that promises mutual gain.

When we take a long view, as this Report does, it is plain to see that thanks to the commitment and vision of successive governments and cohorts of negotiators, the GATT/WTO has been one of the most successful examples ever of sustained international economic cooperation. At times when progress is slow and agreement elusive, it is as well to remind ourselves of the success story that underpins our institution, and of the challenge of preserving that tradition of cooperation that has served the world so well.

Nobody claims that the record of the multilateral trading system is beyond reproach, that it has always struck the right balance or that it does not need to adapt to new circumstances. Much can be improved and much remains to be done. I do not believe this is a contentious statement. Indeed, how else would we explain repeated efforts to negotiate improved outcomes, or the willingness of governments to allow the dispute settlement arrangements to yield the kind of results we have witnessed over the years? These are clear indications of a commitment not just to the system, but also to improve the system. A desire to adapt and strengthen the system is a mainstream reaction of any responsible government, and many governments continue to work hard to shape new agreements and make existing ones work better, as they have done throughout the history of the GATT/WTO.

As in previous years, the Report begins with a brief account of recent trade developments, and this year also includes two short essays, one marking the tenth anniversary of the Information Technology Agreement and the other discussing the relationship between global current account imbalances and world trade. Turning to its core topic, the Report starts with a summary account of international trade cooperation before the Second World War. While the second half of the nineteenth century is looked upon as a time when international trade cooperation flourished, the first half of the twentieth century is drawn in much bleaker terms – when economies shrank, cooperative arrangements crumbled, trade policy was erratic and often protectionist, and countries eventually went to war. Lessons learned from that period bolstered the determination of post-war leaders to craft international cooperative arrangements in the economic sphere that would impart stability and predictability upon a foundation of pre-commitment to a set of policies. Implicit in this approach was a recognition that viable institutions are needed to sustain order and continuity.

The Report devotes some space to reviewing what theorists have to say about why governments are motivated to cooperate with one another through an institution like the WTO. The approach is multi-disciplinary and takes up arguments made by economists, political economists, international relations theorists and lawyers. The array of different and sometimes complementary explanations for cooperation is rich. Economists, for example, emphasize the additional economic gains that flow from reciprocal trade liberalization. Political economists think about how electoral politics can help to shape decisions about cooperation and how international commitments can influence the relative strength of competing interests within the domestic economy. International relations theorists seek to explain cooperation in terms of managing power relationships, distributional conflict and shared ideas and beliefs. Legal theorists emphasize the role of "constitutions" such as international trade agreements in defending public interests and constraining government action.

Among the most important insights that a review of the theories of cooperation offers is that motivations for cooperating in the trade field vary enormously among the parties involved. This means that if cooperative efforts are to succeed and bargains are to endure, negotiating packages must contain enough for everyone. Failure of any party to appreciate this imperative will frustrate agreement. Moreover, even successful agreements can prove fragile, they may be incomplete in the sense that negotiating parties could not come to full closure on every detail, and they cannot necessarily foresee future developments that may modify interests among parties over time. For all these reasons, sustaining agreements is an endeavour in need of continuing attention – agreements will not simply take care of themselves.

Having considered why governments might be motivated to cooperate on trade, the Report goes on to discuss some design and content issues involved in building an institution to support trade cooperation. The Report discusses non-discrimination and reciprocity as core features of the GATT/WTO, and notes the two major exemptions from non-discrimination contemplated in the Agreements – regional trade agreements and special and differential treatment. It also considers the negotiating and dispute settlement functions, contingency protection provisions, decision-making, and transparency and surveillance. This discussion is a precursor to the historical analysis of the evolution of the multilateral trading system in policy as opposed to architectural terms.

The longest section of the Report is an exploration of the history of the multilateral trading system, with particular emphasis on a range of policy issues and challenges that have arisen over the years, and many of which are still with us today. Perhaps the most significant achievement of the GATT/WTO has been its contribution to a continuing process of trade liberalization among developed countries in the sphere of manufactured goods. This has been achieved through successive rounds of negotiation, and the story is told in some detail in the Report. The GATT/WTO has been less successful when it comes to agriculture and trade in services, continuing efforts in these domains notwithstanding. Many developing countries have liberalized their trade significantly in recent years, but only a limited amount of this liberalization has been reflected in GATT/WTO commitments.

As far as the trade rules are concerned, the GATT/WTO has made a valuable contribution over the years to greater stability, certainty and fairness in trade. But the rules are not perfect and there is always room for improvement. This is one reason why governments continue to negotiate and to seek out further mutually advantageous accommodation. Like trade liberalization, crafting better rules remains a work in progress.

In recounting the history of sixty years of multilateralism, the Report has focused on a selection of issues that have arisen over the years and played a dominant role in the evolution of the system. These issues include dispute settlement, developing countries in the trading system, regionalism, decision-making, and the formation of the negotiating agenda. The GATT/WTO dispute settlement arrangements have been a very prominent part of the success story of the institution. The system has contributed significantly to the rule of law in trade matters, bringing greater certainty and predictability, and repeatedly demonstrating the commitment of Members to the WTO. The rules and procedures surrounding dispute settlement have been greatly strengthened and streamlined over the years, and Members are still working to improve them further.

A major challenge for the GATT/WTO has been how to incorporate developing countries into the trading system in ways that bring genuine benefits to these countries. The long-standing debate on special and differential treatment for developing countries has several facets, which together encapsulate the essence of what is at stake – the pace of liberalization in developing countries, non-reciprocal preferential access to other markets, and development-friendly trading rules. The question is how to strike an equitable balance between rights and obligations so as to ensure that the trading system contributes to development and growth. The issues have not proven easy. Much work remains to be done here, by all parties. We need deeper and more focused engagement if we are to make the trading system responsive to the aspirations of all its Members.

Regionalism and its relationship to multilateralism has been widely written about and discussed. The Report has carefully reviewed the issues. Many reasons have been put forward to explain the veritable explosion of regional and especially bilateral agreements recently. The complicated reality about regional agreements is that they are neither all good nor all bad. They can be constructive contributions to greater economic opportunity, or they can be characterized by exclusivity, discrimination and distortion. Design and intent are of the essence here. Most policymakers and commentators are inclined to the view that the less discrimination there is in the trading system, the better the prospects for shared gains and stable trade relations. Multilateral approaches to trade are preferable and the real challenge for governments is to reap whatever gains are for the taking in the regional context without undermining the pursuit of multilateral solutions, even though these can be harder to attain. Governments have just taken an important step in the direction of promoting coherence by accepting the new transparency exercise in the WTO that will allow us to understand better what is actually going on in trade policy at the regional and bilateral level. Despite the voluminous literature on regional trading arrangements, a lot of generally available information is still lacking on the policy content of these arrangements

A more process-related challenge that the GATT/WTO has struggled with over the years is decision-making. Consensus has been at the core of decision-making since the beginning, and suggestions that we should move away from this and rely on the voting procedures provided for in the WTO Agreement have never enjoyed significant support among Members. At the same time, consensus does not guarantee meaningful participation by all parties in decision-making. Progress has certainly been made in tackling this question since the establishment of the WTO, but we still need to work on it, including in relation to the way negotiations are structured. Several issues are important here, not least the bottom-up as opposed to the top-down approach to negotiations and the concept of the single undertaking. At the end of the day, what we need is the right balance between negotiating efficiency and inclusiveness. Also relevant to the decision-making process is the question of the contribution and role of non-state actors. The relationship with NGOs has certainly improved from where it was, for example, at the Seattle Ministerial Meeting. Our challenge is to ensure that this relationship continues to evolve in a positive direction.

The Report briefly takes up a thorny issue to which no easy answer exists – that of how the content of the negotiating agenda of the WTO should be established. Many of the sharpest divisions among the GATT/WTO membership over the years have turned on this question. What should be in and what should be out? Additionally, if something is in, there are many more or less far-reaching ways in which the issue in question might be covered by WTO rules. The Report concludes that no satisfactory theory or conceptual framework exists to allow us to make clear determinations on this question. Motivations vary as to why some governments want to include certain negotiating issues and others do not. One factor that should explicitly be taken into account – perhaps more explicitly than in the past – is that there may be distributional consequences among the parties to a negotiation, especially where internal measures involving policy harmonization are concerned. This is not an argument against including an issue, rather it is a recipe for facilitating progress towards deals that are perceived to be in the common interest of the membership. At the end of the day, the decision whether to include an issue will be political in nature, but it would be desirable for political decisions to be taken on the basis of well-founded evidence on the advantages of international cooperation on the issue concerned. The multilateral trading system does not stand alone and cannot be seen apart from other policy areas and international institutions. This reality means that an additional challenge is to ensure coherence among policies and institutions – a lack of such coherence can be costly in inefficiency terms.

The story of sixty years of multilateralism in trade relations under the GATT/WTO has been told in largely historical terms, and even then, it has not been possible to cover all aspects of this history in a Report of this length. But more importantly, it is obvious that we are dealing with living history. The topics that have been subject to the closest focus here in terms of the policy challenges they pose are still with us. Moreover, it is not difficult to think of other issues that we need to take on or focus upon more closely as we go forward. There are many such issues, and at the risk of sounding a little arbitrary in my selection, I will mention just a few. The relationship between environmental challenges such as global warming and trade is one candidate. Trade and energy is another. I believe a further important area where we are only scratching the surface is trade in services. There is a growing realization of the fundamental importance of service industries in almost

all activity in modern economies, yet we remain far behind in our ability to solidify international cooperation in this field. As with services, we have worked a good deal in the field of standards and have well developed agreements on standards. But as globalization proceeds, and as traditional trade barriers continue to tumble, standards and regulation assume greater importance in determining the conditions of competition and marking the interface between public policy and market access. I believe this is an area where more focus will be called for, especially in relation to the thorny issue of regulation and discrimination.

Another issue is closer to home, involving how we do business within the WTO. We need to think more about the monitoring and surveillance functions of the institution – a good part of this task would be aimed at encouraging constructive discussion and engagement on common interests. At present, we lack much information, both policy-related and statistical, in part because governments have not been as diligent as they might in meeting their notification obligations. As an institution we legislate and litigate, and I believe we do this reasonably well. But is there something of a “missing middle” where we should be engaged more in fostering dialogue that can bolster cooperation?

In sum, I hope that this Report will help in reminding us of the rich history and achievements of the GATT/WTO, and that we are further motivated to ensure we do the necessary to preserve and strengthen this institution and ensure its continuing contribution in a changing and uncertain world.

Pascal Lamy

Director-General

ACKNOWLEDGEMENTS

The World Trade Report 2007 was prepared under the general direction of Deputy Director-General Alejandro Jara. Patrick Low, Director of the Economic Research and Statistics Division, led the team responsible for writing the Report. The principal authors of the Report were Marc Bacchetta, K. Michael Finger, Matthias Helble, Marion Jansen, Alexander Keck, Mark Koulen, Pete Pedersen, Roberta Piermartini, Simon Schropp and Robert Teh. Trade statistics information was provided by the Statistics Group of the Economic Research and Statistics Division, coordinated by Hubert Escaith, Julia de Verteuil, Andreas Maurer and Jürgen Richtering. Karen McCusker contributed a subsection on restrictions to safeguard the balance of payments in developing countries.

Aishah Colautti of the Economic Research and Statistics Division assisted in the preparation of the graphical input, Souda Tandara of the Economic Research and Statistics Division prepared the Bibliographical Section. Research assistance was provided by Leila Baghdadi, Nishta Jogoo, Euan McMillan and Monia Mimouni. The invaluable comments on drafts at various stages of preparation by many colleagues in other Divisions in the WTO Secretariat are highly appreciated.

The authors also wish to thank the following individuals from outside the WTO Secretariat who took the time to provide comments on drafts of the Report: Kyle Bagwell, Richard Baldwin, Chad Bown, Marc Busch, Cedric Dupont, Manfred Elsig, Bernard Hoekman, Doug Irwin, Peter Kleen, Hildegunn Kyvik Nordås, Sheila Page, John Odell, Don Regan, Gregory Shaffer, Robert Staiger, and Alan Sykes.

The production of the Report was managed by Paulette Planchette of the Economic Research and Statistics Division in close cooperation with Jean-Guy Carrier and Serge Marin-Pache of the Information and Media Relations Division. Fatima Chaudhri, Paulette Planchette and Lidia Carlos Silvetti provided editorial assistance. Gratitude is also due to the translators in the Language Services and Documentation Division for their hard work.

DEDICATION

The team responsible for producing the World Trade Report 2007 would like to dedicate the Report to the memory of Bijit Bora. Bijit, who joined the Economic Research Section in 2001, participated in the design of the present Report and had started some of the writing before his very sad and untimely passing. Our colleague is sorely missed.

DISCLAIMER

The World Trade Report and any opinions reflected therein are the sole responsibility of the WTO Secretariat. They do not purport to reflect the opinions or views of Members of the WTO. The main authors of the Report also wish to exonerate those who have commented upon it from responsibility for any outstanding errors or omissions.

SUMMARY OF CONTENTS

FOREWORD BY THE DIRECTOR-GENERAL iii
ACKNOWLEDGEMENTS vii
DISCLAIMER viii
ABBREVIATIONS AND SYMBOLS xv
EXECUTIVE SUMMARY xix

I RECENT TRADE DEVELOPMENTS AND SELECTED TRENDS IN TRADE

A RECENT TRENDS IN INTERNATIONAL TRADE 1
B SELECTED TRADE DEVELOPMENTS AND ISSUES 13

II SIX DECADES OF MULTILATERAL TRADE COOPERATION: WHAT HAVE WE LEARNT?

A INTRODUCTION 33
B THE ECONOMICS AND POLITICAL ECONOMY OF INTERNATIONAL TRADE COOPERATION 35
C THE DESIGN OF INTERNATIONAL TRADE AGREEMENTS 111
D SIXTY YEARS OF THE MULTILATERAL TRADING SYSTEM: ACHIEVEMENTS AND CHALLENGES 179
E CONCLUSION: PRESENT AND FUTURE CHALLENGES 361

TECHNICAL NOTES 387

CONTENTS

FOREWARD BY THE DIRECTOR-GENERAL ... iii
ACKNOWLEDGEMENTS ... vii
DISCLAIMER ... viii
ABBREVIATIONS AND SYMBOLS ... xv
EXECUTIVE SUMMARY ... xix

I RECENT TRADE DEVELOPMENTS AND SELECTED TRENDS IN TRADE

A RECENT TRENDS IN INTERNATIONAL TRADE ... 1
1. Introduction: The state of the world economy and trade in 2006 ... 1
2. Real merchandise trade developments and output in 2006 ... 2
3. Nominal merchandise and commercial services trade developments in 2006 ... 5

CHARTS
Chart 1 Growth in the volume of world merchandise trade and GDP, 1996-2006 ... 2
Chart 2 Real merchandise trade growth by region, 2006 ... 4
Chart 3 Export prices of selected primary products, 2005 and 2006 ... 5
Chart 4 Dollar changes vis-à-vis selected major currencies, 2001-06 ... 6

TABLES
Table 1 GDP and merchandise trade by region, 2004-06 ... 3
Table 2 World exports of merchandise and commercial services, 2006 ... 6
Table 3 World exports of commercial services trade by major category, 2006 ... 10

APPENDIX TABLES
App Table 1 World merchandise trade by region and selected country, 2006 ... 11
App Table 2 World commercial services trade by region and selected country, 2006 ... 12

BOXES
Box 1 Textiles and clothing trade developments in 2006 ... 8

B SELECTED TRADE DEVELOPMENTS AND ISSUES ... 13
1. Ten years of the information technology agreement, 1996-2006 ... 13
2. Global imbalances and world trade ... 25

CHARTS
Chart 1 The expansion of world exports of IT products and other manufactures, 1996-2005 ... 16
Chart 2 World trade of IT products by region, 2005 ... 17
Chart 3 World exports of ITA products by category, 1996 and 2005 ... 20
Chart 4 Current account balances of selected economies, 1998-2006 ... 25
Chart 5 Average current account surpluses/deficits of OECD countries, 1988-2006 ... 26
Chart 6 US merchandise trade deficit as share of global trade, 1990-2005 ... 29
Chart 7 Pattern of previous US current account adjustments, 1970-91 ... 30

TABLES
Table 1 Information Technology Agreement (ITA) tariffs of selected economies ... 15
Table 2 US trade deficits with major trading partners, 2006 ... 30

APPENDIX TABLES
App Table 1 The thirty leading exporters and importers of IT products in 2005 ... 22
App Table 2 World exports of IT products by category, 1996-2005 ... 24

BOXES
Box 1 Defining openness in capital markets – revisiting the Feldstein-Horioka test 27

BIBLIOGRAPHY 32

II SIX DECADES OF MULTILATERAL TRADE COOPERATION: WHAT HAVE WE LEARNT?
A INTRODUCTION 33

B THE ECONOMICS AND POLITICAL ECONOMY OF INTERNATIONAL TRADE COOPERATION 35
1. The historical context for the failure of inter-war trade cooperation 35
2. The economics of trade policy cooperation among nations 50
3. Insights from international relations theories on international cooperation 64
4. The rationale for trade policy cooperation from a legal point of view: constitutional functions of international trade agreements 79
5. Diverse nations, diverse motives, diverse agreements 89
6. Conclusion: how to make sense of the various rationales for trade cooperation? 95
BIBLIOGRAPHY 99

C THE DESIGN OF INTERNATIONAL TRADE AGREEMENTS 111
1. The role of institutions 111
2. Trade liberalization 128
3. Securing the gains from liberalization 145
4. Contingency 152
5. Rules of enforcement and dispute resolution 155
6. Transparency 162
7. Conclusions 167
BIBLIOGRAPHY 168

D SIXTY YEARS OF THE MULTILATERAL TRADING SYSTEM: ACHIEVEMENTS AND CHALLENGES 179
1. From GATT to WTO: the building of an organization 179
2. Market access negotiations: liberalization and consolidation 201
3. The evolution of dispute settlement procedures: strengthening the rule of law 261
4. The expansion of GATT/WTO membership: accommodating developing countries 288
5. The challenge of regionalism 304
6. Doing business in the WTO 321
7. Deepening the multilateral trade agenda 342

E CONCLUSION: PRESENT AND FUTURE CHALLENGES 361
BIBLIOGRAPHY 363

CHARTS
Chart 1 Comparing rationales for trade agreements 95
Chart 2 Clustering rationales for trade agreements 96
Chart 3 Enforcement constraints in contracts 157
Chart 4 The importance of enforcement capacity and enforceability 158
Chart 5 Total number of circulated SPS notifications since 1995 239
Chart 6 Total number of TBT notifications since 1995 240
Chart 7 Count of antidumping initiations, 1980-2005 241
Chart 8 World merchandise exports and GDP, 1950-2005 243
Chart 9 WTO disputes by type of product 273
Chart 10 Developing and developed country membership in the GATT/WTO, 1948-2006 289

TABLES

Table 1 Applied tariff rates of major traders in 1913 and 1925 ... 41
Table 2 Trade war or trade cooperation? ... 51
Table 3 Trade contingent actions, initiations and measures, 1995-2005 ... 153
Table 4 GATT/WTO Trade Rounds, 1947-2007 ... 198
Table 5 GATT/WTO – 60 years of tariff reductions ... 207
Table 6 Tariff reductions of the Kennedy Round ... 208
Table 7 Tariff reductions of the Tokyo Round ... 209
Table 8 Tariff reductions of the Uruguay Round ... 209
Table 9 Pre- and post-Uruguay Round binding coverage for agricultural and non-agricultural products ... 221
Table 10 Uruguay Round commitments, agricultural products, selected developing countries ... 222
Table 11 Uruguay Round commitments, non-agricultural products, selected developing countries ... 223
Table 12 Simple average of bound and applied ad valorem import tariffs of newly acceded economies ... 225
Table 13 Number of developing and developed Contracting Parties having signed selected Tokyo Round Agreements, 1982-1995 ... 235
Table 14 Growth of trade by sector, 1950-2005 ... 244
Table 15 World exports and world GDP, 1870-2005 ... 244
Table 16 Total number of disputes over time and by country group ... 269
Table 17 Most frequent complainants and defendants ... 271
Table 18 Who targets whom? ... 271
Table 19 Disputes by type of measure ... 272
Table 20 Dispute settlement outcomes and direction of ruling ... 275
Table 21 Compliance record in WTO disputes ... 276
Table 22 NGO attendance at WTO Ministerial Conferences ... 337

BOXES

Box 1 Unilateral tariff setting in a political economy model ... 55
Box 2 A schematic overview over IR theories of cooperation ... 65
Box 3 The peace-promoting quality of trade ... 74
Box 4 Commonly utilized assumptions in externality-models of trade cooperation ... 112
Box 5 The role of IOs in attaining the equilibrium path ... 123
Box 6 Is the WTO a public good? ... 126
Box 7 Liberalization-related provisions in multilateral agreements ... 130
Box 8 Trade creation and trade diversion ... 138
Box 9 Explaining the Kemp-Wan Theorem ... 140
Box 10 GATT Article III "National Treatment on Internal Taxation And Regulation" ... 148
Box 11 The WTO dispute settlement mechanism (DSM) ... 161
Box 12 Estimates of tariff bindings of major developed countries in 1948 ... 204
Box 13 Case study 1: Brazil, 1947-94 ... 211
Box 14 Case study 2: India, 1947-94 ... 213
Box 15 Case studies 3 and 4: Senegal and Nigeria ... 215
Box 16 Case studies 5 and 6: Argentina and the Republic of Korea ... 217
Box 17 State trading in the GATT ... 227
Box 18 The elimination of quantitative restrictions in Europe ... 228
Box 19 Textiles: long exempt from GATT rules ... 229
Box 20 The phasing out of balance-of-payments restrictions by developing countries: two case studies ... 232
Box 21 Voluntary export restraints (VERs) ... 236
Box 22 Creating new trade relationships ... 247
Box 23 GATT Article XX ... 347

APPENDIX CHARTS

App Chart 1 World merchandise exports, 1900-1950 ... 44
App Chart 2 World merchandise export prices, 1900-1950 ... 45
App Chart 3 Volume growth of world merchandise exports, 1900-1950 ... 45
App Chart 4 Volume growth of world exports of manufactures and of manufacturing output, 1900-1950 ... 46

APPENDIX TABLES

App Table 1 World merchandise exports by selected economy, 1870-1938 47
App Table 2 World merchandise imports by selected economy, 1870-1938 48
App Table 3 Ratio of merchandise exports to GDP, 1870-2005 49
App Table 4 World merchandise exports by region and selected economy, 1948-2005 199
App Table 5 World merchandise imports by region and selected economy, 1948-2005 200
App Table 6 Applied tariff average rates for 13 European countries and industrial product groups, 1950 251
App Table 7 Applied tariff rates of selected developed GATT/WTO Members. 1952 and 2005 251
App Table 8 Status of tariff bindings: developed countries and industrial products, 1972-2000 252
App Table 9 Status of tariff bindings: developed countries and agricultural products, 1987 and 2000 252
App Table 10 Accessions and successions to GATT and accessions to the WTO 253
App Table 11 Brazil: Binding coverage by section, 1949 257
App Table 12 Brazil: Binding coverage by section, selected years 258
App Table 13 India: Binding coverage by section, selected years 259
App Table 14 Argentina: Binding coverage by section, selected years 260
App Table 15 Recourse to Article XVIII:B, 1959 to present 260

TECHNICAL NOTES 387

ABBREVIATIONS AND SYMBOLS

AB	Appellate Body
ACP	Africa, Caribbean and Pacific
AD	Antidumping
AoA	Agreement on Agriculture
ASEAN	Association of South East Asian Nations
ASP	American Selling Price
ATC	Agreement on Textiles and Clothing
BIS	Bank for International Settlements
BISD	Basic Instruments and Selected Documents
BOP	Balance of Payment
BTN	Brussels Tariffs Nomenclature
c.i.f.	cost, insurance and freight
CAFTA	Central American Free Trade Agreement
CAP	Common Agriculture Policy
CARICOM	Caribbean Community and Common Market
CCCN	Customs Cooperation Council Nomenclature
CEEC	Central and Eastern European Country
CFF	Compensatory Financing Facility
CIS	Commonwealth of Independent States
CPEs	Centrally Planned Economies
CRTA	Committee on Regional Trade Agreements
CU	Customs Union
CvD	countervailing duty
DISC	Domestic International Sales Corporation
DSB	Dispute Settlement Body
DSM	Dispute Settlement Mechanism
DSU	Dispute Settlement Understanding
EC	European Community
ECSC	European Coal and Steel Community
EEC	European Economic Community
EFTA	European Free Trade Area
EPZs	Export processing zones
EU	European Union
f.o.b.	free on board
FACB	Freedom of Association and Collective Bargaining
FAO	Food and Agricultural Organization
FDI	Foreign Direct Investment
FSC	Foreign Sales Corporation
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariff and Trade
GDP	Gross Domestic Product
GSP	Generalized System of References
GSTP	Global System of Trade Preferences
HS	Harmonized System
ICITO	Interim Commission for the International Trade Organization
ICJ	International Court of Justice
ICSID	International Centre for the Settlement of Investment Disputes
IF	Integrated Framework
ILO	International Labour Organization
IMF	International Monetary Fund

IOs	International Organizations
IP	Intellectual Property
IPC	Integrated Programme on Commodities
IPRs	Intellectual Property Rights
IR	International Relations
IT	Information technology
ITA	Information Technology Agreement
ITC	International Trade Centre
ITO	International Trade Organization
ITS	International Trade Statistics
ITU	International Telecommunications Union
L&E	Law and Economics
LAFTA	Latin American Free Trade Association
LDCs	Least-Developed Countries
LMG	Like-Minded Group
LTA	Long Term Agreement Regarding International Trade in Cotton Textiles
MEAs	Multilateral Environmental Agreements
MERCOSUR	Southern Common Market
MFA	Multi-fibre Arrangement
MFN	Most-Favoured-Nation
MOU	Memorandum of Understanding
NAFTA	North American Free Trade Agreement
NGO	Non-governmental organization
NTBs	Non-tarriff barriers
NTM	Non-tarriff measures
OECD	Organization for Economic Co-operation and Development
OEEC	Organization for European Economic Cooperation
OPEC	Organization of the Petroleum Exporting Countries
OTC	Organization for Trade Cooperation
PECS	Pan-Eureopan cumulation system
PPMs	Process and production methods
PTA	Preferential Trading Arrangement
QRs	Quantitative restrictions
R&D	Research & Development
RoO	Rules of Origin
RTA	Regional trade agreement
S&D	Special and differential treatment
SCM	Subsidies and Countervailing Measures
SME	Small and Medium Enterprises
SPS	Sanitary and Phytosanitary Measures
STA	Short Term Agreement on Cotton and Textiles
STDF	Standards and Trade Development Facility
STEs	State-trading enterprises
SVEs	Small and Vulnerable Economies
TBTs	Technical barriers to trade
TCBDB	Trade Capacity Building Database
TIM	Trade Integration Mechanism
TPR	Trade Policy Review
TPRM	Trade Policy Review Mechanism
TRIMs	Trade-Related Investment Measures
TRIPS	Trade-Related Intellectual Property Rights
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development

UNDP	United Nations Development Programme
UR	Uruguay Round
US	United States of America
USSR	Union of Socialist Soviet Republics
USTC	United States Tariff Commission
VCLT	Vienna Convention on the Law of Treaties
VER	Voluntary export restraint
WIPO	World Intellectual Property Organization

The following symbols are used in this publication:

...	not available
0	figure is zero or became zero due to rounding
-	not applicable
$	United States dollars
€	euro
£	United Kingdom pound
Q1,Q2,Q3,Q4	1st quarter, 2nd quarter, 3rd quarter, 4th quarter

EXECUTIVE SUMMARY

On 1 January 2008 the multilateral trading system will celebrate its sixtieth anniversary. The World Trade Report 2007 marks the occasion with a retrospective look at what we have learned from those six decades of international trade cooperation. In asking this question, the report reviews a rich history of change and institutional adaptation. It attempts to identify both what lessons are to be drawn from past experience and the nature of challenges to come. This is an ambitious undertaking, and we have divided the Chapter into three main sections. The first major Section (Section B) begins with a very brief historical review of what the trade policy world looked like in the century and a half before the birth of the GATT. The rest of this Section takes a step back from events to consider what the theoretical literature might teach us about why nations choose to cooperate with one another in trade matters. This is an eclectic review that draws on perspectives from economics, political economy, political science and international relations literature, as well as legal analysis. We seek to show that despite differences in their methodological approach, these different conceptual frameworks display some interesting features in common. They also offer a variety of different insights about what might drive cooperation.

Building on the rationale for trade cooperation, Section C is concerned with the practical question of how the gains from such cooperation can be secured and safeguarded. The Section starts with an analysis of why governments appear willing to cede authority to international institutions like the GATT/WTO and what they expect to gain from such commitments. We then look more closely at the mechanics and architecture of arrangements designed to promote and protect trade liberalization. Different subsections deal with trade liberalization, how the gains from liberalization are secured, the role of contingency provisions in addressing unanticipated situations, the function of dispute settlement as an enforcement mechanism, and how transparency and surveillance can serve to strengthen the basis for international cooperation.

While the previous two Sections focus mainly on trade agreements in general, Section D examines the multilateral trading system of the GATT/WTO. The Section starts with a historical account of how the GATT emerged, developed and was eventually transformed into the WTO. We then examine the evolution of market access commitments over the years and the development of the dispute settlement system. This is followed by a discussion of the development of the institution in the context of the continuing need to accommodate an expanding and increasingly diverse membership. The emphasis here is on the challenges of addressing developing country needs and interests within the system. The next Section looks at regionalism, both as a complement to multilateral cooperation and as a systemic challenge. We then discuss decision-making in the GATT/WTO, both in relation to internal processes for doing business and the interest in involvement on the part of external non-state actors. The final Section in this Chapter seeks to explain how governments determine the content of the trade agenda under the WTO and considers the challenges of defining policy areas upon which governments choose to negotiate.

THE ECONOMICS AND POLITICAL ECONOMY OF INTERNATIONAL TRADE COOPERATION

The historical context

Many historians regard a part of the last half of the nineteenth century as a golden age of international cooperation in Europe, characterized by fast growing economies and a spontaneous emergence of multilateralism in trade ... but this period was short-lived.

Trade over long distances, contractual trade relations and tariffs can be documented from antiquity, but a new level of more intensive trade relations and cooperation emerged in Europe after the end of the Napoleonic wars. The Vienna Congress contributed to more political stability on the continent and the mercantilist system prevailing in the 18th century was further weakened by new economic thinking pioneered by Adam Smith. Technological advancement and industrialization underpinned economic development in Europe during the second half of the 19th century and spurred trade cooperation through a series of bilateral trade treaties that significantly lowered trade barriers and evolved into a *de facto* multilateral non-discriminatory network of agreements. Not all nations shared in this experience.

The United States and Latin America remained relatively protectionist in this period, while Asian, African and other countries were being forced into a form of cooperation driven in no small part by colonial relations or imperial design. In Europe, however, strong leadership and enthusiasm for free trade from the United Kingdom sustained a period of relative prosperity. But this began to falter towards the latter part of the 19th century, as depressed conditions in agriculture contributed to increased and generalized protectionism in continental Europe.

Crumbling international cooperation and deteriorating economic conditions towards the end of the 19th century provided the backdrop against which Europe was plunged into war in 1914.

By the time more than 50 European trade treaties came up for renewal in the early 1890s, most governments faced an increase in demand for protection from organized interest groups representing agricultural producers and a number of industrialists. Several countries resorted to high trade barriers across a range of sectors and European powers increasingly turned to their colonies and spheres of territorial influence for trade, building a series of preferential trading arrangements along the way. Nationalism was on the increase, German and Italian unification had been consolidated, the United States was growing in power and influence, and the United Kingdom was experiencing relative decline. European nations were competing more fiercely for colonial territory and influence. Territorial disputes within Europe, particularly between France and Germany, contributed to strained foreign relations. A lack of leadership, flagging cooperation, deteriorating economic conditions and escalating tensions created the conditions for war.

The inter-war years were marked by far-reaching government failure, limited international cooperation, acute economic hardship in many countries, and erratic trade policy punctuated by bouts of protectionism, discrimination and policy tension, both in the trade and monetary fields – in short, a set of conditions conducive once again to armed conflict.

The absence of international coordination to dismantle war-time controls and create the conditions for an orderly transition to a post-war economy simply fed uncertainty and mistrust. Although trade protection among some countries was reduced in the years following the war, it took nearly a decade after the cessation of hostilities for trade to attain its pre-World War I level. The period was characterized by instability and unpredictability with respect to trade policy, and as economic conditions deteriorated in the late 1920s, the trade war provoked by the Smoot-Hawley tariff (1930) aggravated the economic crisis that resulted in a shrinkage in trade flows of some 60 per cent between 1929 and 1932. The breakdown in trade further exacerbated deflation and unemployment in many economies. Monetary policy was also in crisis, with the collapse of the gold standard in the early 1930s and a rash of currency devaluations. The reversal of protectionism in the United States and some other countries in the mid-1930s, and efforts to squeeze some of the discrimination and instability out of trade policy came too late to stem the tide towards preferential trading arrangements.

Trade policy largely remained in disorderly limbo until the establishment of post-World War II institutional arrangements and the birth of the modern multilateral trading system. A lesson from the first half of the 20th century is surely that effective and sustainable international cooperation requires a predictable institutional framework that embodies a pre-commitment by governments to a defined policy stance.

The significant degree of international economic integration achieved in the latter part of the 19th and early 20th century might have been sustainable with better institutional foundations. The history of the first half of the 20th century demonstrates how easily the benefits of open trade and sound economic policy more generally can elude nations in the absence of a commitment to international cooperation.

If these are lessons that should be learned, what is their relevance today? Will governments show the necessary foresight and commitment to preserve, strengthen and, if necessary, reform the institutions they deemed necessary in the past to articulate and order international cooperation?

The multilateral trading system is confronted by considerable challenges, of a short-term nature in relation to incomplete negotiations, but more fundamentally in relation to its continuing role as an institution vested with the legitimacy necessary to mediate international trade relations. The balance of economic power and the focus of national interests is shifting among nations. Do governments see viable alternatives to the inclusiveness of the universalist perspective implicit in today's multilateral trading system? If not, careful reflection is needed on how to nurture and manage the multilateral trading system in the interests of shared benefits. The future of the WTO depends on how far governments value the contributions such an institution can make.

What economic theory has to say about motivations for international trade cooperation

Economists traditionally see trade cooperation as a means to escape trade wars that could arise when large countries unilaterally raise tariffs so as to reduce the price of their imports at the expense of their trading partners. A country seeking to improve its terms of trade (relative price of exports in terms of imports) in this way may provoke retaliatory behaviour from other trading partners, making all parties concerned worse off.

The terms-of-trade argument is the most formalized and elaborated of all economic rationales for trade cooperation. It is the only one that formally integrates an explanation of why countries cooperate with an explanation of how they can do this. In other words, it is the only available economic approach that can explain both the GATT/WTO and its architecture. Some of the other economic approaches discussed in the Report certainly lend themselves to more rigorous analysis and empirical investigation, but this work has yet to be undertaken.

The non-cooperative situation posited in the traditional approach is sometimes referred to as a prisoners' dilemma, where rational behaviour without cooperation will leave the parties concerned worse off than they would be if they were to cooperate. But this take on what motivates cooperation has two main weaknesses. First, many economists are sceptical about its practical relevance and the empirical evidence is mixed as to whether the exclusive focus on relative world prices is what really shapes behaviour. Second, the theory only provides a rationale for agreements between countries large enough to impose terms-of-trade costs on their partners. We do not have an explanation here for why countries that are too small to manipulate the world price of their imports would see a reason to cooperate with each other or why large countries would enter into trade negotiations with such countries.

Some political economy analysis has focused on two reasons governments have for imposing taxes on trade – to garner political support from beneficiaries of such taxes and, if large enough, to shift the terms of trade in their favour.

We have already seen how the latter motivation makes international cooperation worthwhile. Adding a political economy dimension to the analysis takes account of realities such as that private interest groups will try and sometimes succeed in changing government policy and that the interests of producers may prevail over those of more numerous consumers because the former are better organized politically than the latter. The interaction of private interest groups and political-support-seeking governments explains why governments would want to eliminate the incentive to manipulate the terms of trade. The reciprocity inherent in an inter-governmental agreement will convert each nation's exporters from bystanders in the tariff debate to opponents of protection within their own nation.

Since governments will factor in the political consequences of a trade policy decision and not look simply for an efficient outcome, as suggested in an economist's traditional view, we have an explanation for two important empirical observations about policy behaviour. First, the process of trade liberalization has been gradual – free trade would be the rational outcome if governments only cared about the terms of trade. Second, mixed motives for government behaviour can also help to account for the fact that most post-war liberalization has taken place in products characterized by two-way trade.

This political economy analysis still does not explain why small countries would be participants in international trade agreements – both from the point of view of their own interests and those of their large trading partners. Attempts have been made to explain small country involvement as a purely political motivation with no terms-of-trade effects, where exporters are induced to lobby for trade liberalization in a reciprocal negotiating framework simply by the prospect of additional market opportunities. The absence of a terms-of-trade dimension under this reasoning has troubled many theorists, some of whom have argued that terms of trade effects may be more common than is generally appreciated, even in supposedly small economies, on account of the myriad factors that may segment markets in practice.

Another approach to explaining why governments cooperate in trade rests on a policy credibility argument. This is the so-called commitment approach.

If governments lack credibility *vis-à-vis* domestic economic agents, they may wish to anchor future policy intentions in international commitments. If, for example, the decision of a government to liberalize trade in a particular sector at a certain future date is not deemed credible by the industry concerned, the latter may fail to undertake the required restructuring during the transition period. Then when the liberalization falls due it will not be an optimal policy because the sector will not be ready for international competition. So an international commitment can solve a time-inconsistency problem. International commitments are rendered more credible by the threat of retaliation in the face of non-compliance.

Reasons for questioning the practical validity of this argument include the observation that trade rules may not be designed to make them enforceable – especially on small and poor countries. Moreover, the commitment argument for cooperation may be undermined somewhat by the reality of existing international trade agreements. For example, the existence of contractual escape provisions such as safeguards in trade agreements cannot be explained by a commitment motivation for cooperating. We lack empirical evidence in regard both to the political economy and commitment approaches to the explanation for international cooperation

A number of other reasons suggest themselves as to why governments may wish to cooperate on trade policy. These include strategic reasons, such as increasing market size and insurance against unfavourable trade policy developments in partner countries. Yet other reasons are specific to preferential arrangements, such as increasing bargaining power and the pursuit of geographically limited market-opening for protectionist motives.

Countries may want to cooperate on trade issues to increase their market size. This is likely to be more true of small countries and would allow domestic firms to exploit economies of scale and reduce costs. Trade cooperation may be motivated by the need to insure countries against the erosion of their market access to other countries. This could be achieved by fostering further MFN liberalization or alternatively by entering into competing regional trade agreements. An interest in engaging in regional trade agreements may be provoked by a desire to secure preferential market access for producers that are not globally competitive but are competitive at the regional level. Such a motivation implies that some of the benefits of a discriminatory trade agreement may come at the expenses of non-participants. Alternatively, regional and bilateral trade alliances may be designed to increase the bargaining power of the countries concerned. The above range of propositions, while all plausible, have not been the subject of rigorous theoretical formulation nor a great deal of empirical verification.

Insights from the international relations literature

The international relations (IR) literature is rich in explanations of what motivates international cooperation, going beyond the proposition that interested parties cooperate simply to maximize collective economic benefits. While IR theories offer varied and interesting ways of looking at the motivations and behaviour underlying decisions to cooperate, as well as the nature of that cooperation, they do not always lend themselves readily to empirical validation. Just as with some economic analyses, this lack of precision is an invitation to continuing research.

A broad conclusion emerging from IR theories is that the rationale and historical evolution of international trade cooperation must also be understood in terms of the changing configuration of power capabilities, distributional conflict, the role of shared ideas and beliefs, and developments in the wider international political and security order. Two broad approaches in IR are referred to as rationalism and constructivism.

Rationalist theories assume that actors take decisions with the strict aim of maximising their utility subject to whatever constraints are present. They do so by weighing up the costs and benefits of cooperation in a world where national interests are already defined. Constructivist approaches see international cooperation as a means of interactive iteration towards mutually beneficial outcomes. Cooperating parties influence one another in shaping their commitments.

The study of international cooperation in IR theory was traditionally dominated by the assumption that the state was a unitary actor. More recently, theories have focused on the links between international cooperation and domestic politics.

Some theories build on the notion that agents – individuals, groups, or states – can actively and consciously shape the consequences of their interaction. The choices made by agents determine outcomes, or in other words, the system. Other theories are more "structuralist" in nature and contend that it is the system that shapes the actors and not vice-versa. The system is more than the sum of its constituent parts, and therefore assumes a life of its own. Systems influence how agents think and act.

Several strands of rationalist analysis explain cooperation in trade.

One strand of rationalist literature – "neoliberal institutionalism" – assumes that states are driven by mutual efficiency concerns. Each party bargains for the solution that maximises the "size of the pie" generated by cooperation. The core objective of cooperation is to increase mutual efficiency.

The school of "liberalism" parts with the notion that states are unitary actors with a steady and defined purpose in mind. In order to explain what motivates countries to cooperate internationally, liberalists base their research on domestic politics. Cooperative agreements are concluded if the decision to collaborate is the equilibrium outflow of some rational deliberation process among relevant domestic groups.

Another strand of rationalism – "neorealism" – assumes that parties try to maximize their relative power position in the international system. International cooperation is akin to a "zero-sum game", where gains to one party come at a loss to another because the size of the pie is fixed. Cooperating parties seek to protect their power ranking within the international system. Cooperation among states occurs in the form of short-term alliances that can temporarily mitigate anarchy, but never overcome it.

A milder form of neorealism – "postclassical" or "defensive realism" – argues that while power is an important dimension of state interaction, it is not an end in itself. Rather it is a means of achieving security and increasing the resource-base of a country. Countries therefore choose cooperation so as to reduce the probability of conflict, help overcome international externalities or spillovers, and increase the welfare.

"Hegemonic stability theory" is another variant of neorealism. A hegemon seeks to fortify its predominant position in the international system through cooperation, while at the same time injecting its own norms and values into the international regime. The hegemon also has the power to address international collective action problems involving spillovers and to underwrite the supply of public goods from which all parties to cooperative arrangements can benefit.

"Constructivist" or non-rationalist approaches to decision-making reject the assumption that agents are driven only by cost-benefit considerations – the power of shared norms and inter-subjective beliefs prevails as a base for actors' decision-making.

Constructivists consider that international cooperation is better explained by reference to fundamental norms, shared ideas, inter-subjective beliefs, traditions, habits, and perception. Norm-based decisions (the "logic of appropriateness") replace rational, self-interested choice (the "logic of consequences"). The system and the agents acting within it are strongly interdependent – the structure shapes agents' perceptions and therefore preferences and behaviour. Collective behaviour can in turn have a feedback impact on the system.

A variation of constructivism is the "English" school of IR, which is concerned with the diffusion of certain norms and values within "international society". The construction of the post-war liberal international economic order is a good example of this thinking, where like-minded countries formed a coalition to inject their open market ideas into the international system. Finally, "weakly cognitivist" approaches examine how guiding norms and principles emerge, become prominent and consequently influence the cooperative choices of governments.

The contribution of legal analysis to understanding international cooperation

Legal theories of trade agreements are theories of constitutionalism.

Legal approaches to trade agreements are based on two central tenets. The first is that the individual citizen is the legitimate principal in all domestic and world affairs. The second is that "government failure" and rent-seeking behaviour on the part of public officials are rampant and need to be overcome by means of an adequate legal framework – namely a constitution.

Four main approaches to trade constitutionalism can be discerned from the legal literature.

The first of these has been referred to as the "internal" constitutional view, which treats trade agreements as the second line of constitutional defence against domestic policy failure. Secondly, the "external" or "transnational" constitutional view perceives trade agreements to be contracts aimed at reciprocally granting countries transnational representation and participation in each others' trade policymaking processes. Third, what can be called the "internal-external" constitutional view claims that elected legislators deliberately delegate trade policy-making to the administrative branch of government in order to lessen the likelihood of political capture and the cooption of trade policy decisions by narrowly focused interest groups. Finally, the "global" constitutional view asserts that citizens in an interdependent world enact an international multilevel trade constitution, since national constitutional approaches and state-centric international law necessarily fail to curb global policy failures.

Legal approaches tend to focus on non-economic issues, such as legitimacy, participation, democracy, and sovereignty. Given the difficulties associated with according precise, consensual meanings to some of these concepts, legal approaches to trade agreements sometimes blur the line between prescription and description.

Diverse actors, diverse motives and diverse agreements: cooperation in a heterogeneous world

Diverse nations are likely to have different motives and priorities when they contemplate participation in trade agreements. The traditional terms-of-trade approach only provides a rationale for trade agreements among countries with market power. Political economy considerations, on the other hand, apply to both large and small countries. The desire to use international agreements as a commitment device, or to increase market size and bargaining power, are more likely to motivate smaller countries and in some case will favour regional over multilateral cooperation.

The four "grand theories" of IR – neorealism, neoliberal institutionalism, liberalism, and constructivism – offer a wide variety of motivations for participating in bilateral, plurilateral, or multilateral trade agreements for diverse countries. Neorealists stress issues of power (balancing, bloc-building, dependency-creation), institutionalists focus on efficiency, liberalists look at domestic political-economy reasons for contracting, and constructivists emphasize the pervasive role of social norms, values, and ideas in motivating behaviour. Similar observations apply in relation to the broad applicability of legal analyses to a diverse range of motivations for shaping different kinds of international cooperation.

Pulling together the strands of theoretical thought on international cooperation

Despite different analytical methods and traditions, commonalities are present among the theoretical approaches to understanding international cooperation that have been identified in this Report. Four distinct clusters of explanation can be identified.

The first cluster focuses on a domestic problem negatively affecting economic efficiency that an international contract can help to overcome. This is the essential focus of the political economy and commitment approaches originating in economics, the IR school of liberalism, and the legal internal constitutionalist approach.

The second cluster views international spillovers or externalities as the key problem that a contract can remedy. Trade agreements can constrain unilateralism, for example, where one country's actions can harm the economic well-being of others. This is the essence of the traditional approach in economics, neoliberalist institutionalism in IR theory, and the external and internal-external constitutionalist legal theories.

The third cluster has been referred to as the "ideational" route, which is the normative approach to understanding international cooperation. Values, age-old traditions, a collective sense of history and humanity, and other such factors inspire influential individuals, pivotal groups, and states as a whole to conclude trade agreements. Non-economic objectives for contracting play a crucial role here. Norms and ideas play some role in certain variants of neoliberal institutionalism and hegemonic stability theory. The power of ideas, however, is a central feature of the English school in IR, as well as the weakly and strongly cognitivist schools of constructivism. This thinking is also present in legal approaches characterized as external and global constitutionalism.

The final cluster can be termed the "realpolitik" argument. Countries conclude trade agreements – or refrain from doing so – for reasons of power (i.e. distributive efficiency). The focus is on power-related benefits and within this framework participation in international agreements could even be involuntary. Alternatively, the driving force could be to create dependency in others, to balance power, or to build power blocs. This concern for power and distribution is most notably at the core of neorealism, and may also be found in postclassical realism and hegemonic stability theory.

Scholarship has a long way to go in enhancing our understanding of the motivations for international cooperation in trade matters.

The fact that there are so many different analytical approaches explaining the same outcome, namely the conclusion of international trade agreements, raises reasonable doubts that there exists one single theory that is able to explain the phenomenon of trade cooperation. It is probably fair to say that most countries are motivated by an array of objectives they want to pursue by contracting to a trade agreement. Moreover, it may be difficult to find two countries with identical "baskets" of cooperative goals. Some states may wish, for example, to promote peace and stability in the region, advance their power-based position internationally, attract foreign investment, mitigate the influence of domestic special interest groups, and so forth. Some of a government's objectives may be partially in conflict with one another. Even when we take a broad multi-disciplinary approach in trying to understand the motives for cooperative international arrangements, it is obvious that our current state of understanding of these complex issues is in need of more research.

Policy conclusions that follow from the theoretical analysis of trade cooperation

Notwithstanding the limited reach of our understanding of what drives international cooperation, we can draw some practical lessons from what we do know. These relate to the sheer heterogeneity of interests at stake and the fragile and incomplete nature of cooperative endeavours in a changing and uncertain world.

Three key points should be made. First, because of the varied nature of motivations, interests and priorities that seem to inform international cooperative endeavours, it will frequently prove difficult – and sometimes impossible – to strike the initial balance in an agreement, a balance that will offer something to all parties.

Second, once an agreement has been struck, it will invariably have to contend with at least three sources of uncertainty. One is the fact that not all eventualities could be foreseen when the contract was struck. This is because the world is too complex and our knowledge of it too imperfect. Another is that circumstances upon which an agreement was predicated can change, testing the willingness of parties to stick with the contract. A final factor that can change is the nature of the underlying interests of the parties to an agreement.

The third key point relating to the complexities of international agreements and the uncertainties surrounding them is that successful cooperation requires negotiating agendas to be encompassing enough to reflect adequately the heterogeneity of interests and priorities among the negotiating parties. Failing this, negotiations may be unending or results may contain a coercive element and therefore impart a destabilizing effect on an agreement.

All the above considerations remind us that successful international cooperation is a continuing, iterative process. Reaching compromise takes time and effort, and lengthy negotiations may be a sign of the system at work – not at fault. International cooperation and the underlying agreements are likely to fail if governments are inattentive to the need for inclusiveness and flexibility in the face of change.

THE DESIGN OF INTERNATIONAL TRADE AGREEMENTS

The role of institutions

Neither economics nor IR literature has invested a great deal of research on the role of institutions. Yet their significance in determining cooperative outcomes has become better understood in recent years. Legal scholarship usually thinks in terms of constitutions as the institutional setting for cooperation.

Much like when at the national level political constituencies entrust an independent central bank with the conduct of monetary policy, signatories to trade agreements may confer some authority to an independent agent (institution) in the belief that a neutral or internationalized body is more effective in governing trade relations than the signatories themselves. Such institutions differ from the kind of *ad hoc* or circumstance-specific cooperative arrangement that might be predicted as the preferred approach by the neorealist literature. In conferring certain authority upon an institution, governments are effectively pre-committing to a set of rules without certainty as to their implications in terms of future outcomes. This is one way of looking at how authority is ceded to the institution – as a constraint on present and future freedom of independent action. Why would governments do this?

Early economic approaches to cooperation built on assumptions that simply assumed away any of the reasons that governments might have for creating institutions – including uncertainty, lack of full information, costly transactions and changing circumstances – but more recent work identifies a series of efficiency-enhancing functions for institutions.

Economic research on the rationale for trade cooperation and on the rationale for trade institutions evolved independently. The latter body of work evolved once market "imperfections" in the form of transaction costs, asymmetrical information, contractual incompleteness and so on were allowed, thus accounting for the efficiency-enhancing nature of an impartial trade institution to underpin trading arrangements. Thus, formal economic models can show that institutions matter, among other reasons, because they can facilitate negotiations, disseminate information, settle disputes, administer agreements, monitor policies and act as an agent for surveillance.

Theories of international relations establish a number of additional roles for trade institutions.

Trade institutions can act as facilitators of cooperation, helping parties to achieve a cooperative equilibrium in the face of heterogeneous preferences. Furthermore, trade organizations like the WTO oversee the implementation and operation of negotiated outcomes. In an effort to centralize operations – that is to

reduce transaction costs and enhance efficiency – signatories create international institutions. Much of this is similar to what theorizing from economics would also conclude. In addition, however, constructivist takes on cooperation see trade institutions as fostering the generation and evolution of common norms and values that reflect the community interest. Issues of autonomy and oversight, such as agency capture by influential parties, and autonomous regime evolution are also addressed in some IR theories.

Trade liberalization as an outcome of international cooperation

The approach through which international trade cooperation allows countries to escape from the terms-of-trade prisoners' dilemma is reciprocal liberalization. Liberalization needs to be non-discriminatory to eliminate terms-of-trade effects. Reciprocity cannot always be precisely defined in practice, although it is possible to model its welfare effects. The binding of liberalization commitments is regarded as vital for contractual stability.

The theoretical literature defines reciprocal liberalization as a coordinated reduction of protection which leaves the terms of trade of the parties to the agreement unchanged. The mutual reduction of protection expands the division of labour and the volume of trade, which increases national income. Leaving the terms of trade unchanged implies that this trade expansion is not accompanied by world price changes that make one of the parties less well off.

If there are more than two parties involved in the negotiation, efficiency requires that liberalization be non-discriminatory. If a country discriminates among its trading partners by applying different tariffs, different terms of trade will apply to each. This creates the possibility of opportunistic gains for subsets of countries from reciprocal liberalization, which would be at the expense of non-participants whose terms of trade deteriorate.

While a number of prominent economists have sought to provide an economically rigorous interpretation of reciprocity in the GATT, long-time observers of the multilateral trading system tend to emphasize the political aspect of reciprocity. Reciprocity in the GATT/WTO involves an outcome that each Member considers advantageous by whatever standard the Member chooses to apply. Precise measurement is not of the essence.

As far as trade in goods are concerned, liberalization in the GATT/WTO context not only means a reduction in tariff rates, but the binding of those rates against future increases. Governments have attached as much importance to the legal commitment not to raise tariffs beyond a certain level and the security in market access that this implies, as they have towards the reduction of duties. In the case of services, commitments are also bound against future increases, although the manner in which this is done is somewhat different on account of the particularities of services transactions.

The most-favoured-nation (MFN) principle is at the centre of the GATT/WTO system of rules, but important exceptions exist and it is difficult to make a strong case for MFN from a pure efficiency perspective.

Some economists have argued that the MFN principle (combined with reciprocity) is necessary in order for governments to engage in mutually beneficial bargaining. On the other hand MFN is likely to lead to free-riding and empirical evidence appears to confirm the relevance of the free-riding problem. Free-riding is less of a problem, however, in situations where trade liberalization is undertaken unilaterally. But where there is free-riding, governments would engage in less trade liberalization with MFN than without it.

One of the strongest economic arguments in favour of MFN is probably an argument developed in the 1930s that emphasises the costs of administering discriminatory tariffs because of the need to keep track of product origin. Formula approaches would allow WTO Members to avoid free-riding problems in negotiations and to take advantage of the lower costs involved with MFN – as opposed to discriminatory – tariffs.

Regionalism as a departure from MFN

Two main arguments have been advanced for regional agreements as an exception to MFN – that they can expand trade and serve as building blocks for further multilateral liberalization, but there are contrary views.

It is the impact of regional trade agreements (RTAs) on economic welfare rather than trade expansion which should be the proper criterion for evaluating such agreements. Economic theory is ambiguous as to whether a country gains or loses from entering into a RTA. This will depend on the balance between the trade creating and trade diverting effects of the agreement. Furthermore, RTAs will come at the expense of non-members who lose out from trade diversion and from the deterioration in their terms of trade.

The idea that preferential trade liberalization ultimately builds support for liberalization at the multilateral level faces significant objections. Once RTA members establish preferential footholds in their partners' markets, incentives are created to try and maintain the preferential advantage. Multilateral liberalization could be seen as a threat to that privileged access. The harmonization of rules and policies, which sometimes accompany regional integration, may lock in members to agreements that are later difficult to generalize. Finally, negotiating regional trade agreements absorb resources and political capital that could be devoted to multilateral negotiations.

Special provisions for developing countries as a departure from MFN

Guided by the idea that economic development requires the (temporary) use of trade-distorting policies, a number of exceptions have been included in GATT/WTO disciplines that allow for departures from key obligations, notably the MFN principle.

Special and differential (S&D) treatment provisions allow countries (often on a best-endeavour basis) to provide more favourable treatment to developing countries than to the remainder of the membership. Other provisions grant beneficiary developing countries rights that are not available to others. S&D is based on the assumption that developing countries are different from advanced economies and that temporary exemptions from the general rules (otherwise considered economically beneficial) constitute an appropriate response to particular development challenges. Developing countries may suffer from market imperfections and distortions not found in more advanced economies that obstruct their diversification into non-traditional activities. Resource constraints make it harder to adjust to the impact of trade liberalization, to take advantage of new trading opportunities and to shoulder the costs associated with reform. While trade measures rarely present a first-best policy response, their use may be appropriate under certain circumstances and for a limited amount of time.

A core challenge for the system is to distinguish between legitimate public policy and protectionism in the design and use of domestic policies

Most disputes concerning the effect of domestic policies on market access have been based on GATT Article III (national treatment) and/or Article XX (general exceptions), or on WTO Agreements concerning specific domestic measures like the Agreement on Subsidies and Countervailing Measures, the Agreement on Technical Barriers to Trade or the Agreement on Sanitary and Phytosanitary Measures. The relevant legal provisions give guidelines on how to distinguish a legitimate domestic policy from one that is not legitimate. In economic terms, first best policies – that is, policies that are the best remedy to correct a domestic market failures and imperfections, are considered legitimate. The question whether existing legal texts allow for an interpretation that corresponds to economic thinking has been debated in the relevant literature and different answers have been given to this question. Another difficulty is to know in practice which policy can be considered to be a first-best-policy in a given situation. It has been pointed out in the literature that this approach can lead to a "war between public orders", given that optimal policies depend on characteristics that may be country-specific, like consumer preferences, moral values or cultural heritage.

Contingency measures and trade liberalization

Contingency measures deal with political demands for protection, not the costs of adjustment. The introduction of contingency measures in a trade agreement may be thought of as anticipating the possibility of difficult adjustments and the political pressure for protection to which they give rise. Contingency measures provide a means to counter this pressure with a temporary reversal of liberalization. The existence of such escape clauses may allow deeper liberalization to be achieved.

How deep the liberalization that can be achieved by a trade agreement *ex-ante* may depend on whether built-in escape clauses exist that recognize uncertainty in the economic environment. While the use of contingent measures may result in ex-post welfare losses during periods when the level of protection is temporarily increased, the deeper liberalization that is allowed *ex-ante* means that these costs are outweighed by the long-term welfare gains.

The GATT/WTO contains a number of contingency provisions. These include those relating to safeguards, antidumping and countervailing duties, restrictions to safeguard the balance of payments, and Article XXVIII on the modification of schedules. Some WTO Members may also use the margin between bound and applied tariff rates as a trade-contingent device.

The enforcement of trade agreements

Trade agreements are contracts and require enforcement. Enforcement gives credibility to mutual commitments made. It may deepen those commitments and deter defection. Parties to a trade agreement may perceive an interest in vesting certain authority in an independent adjudicatory body.

The extent to which parties are willing to cooperate crucially depends on the quality of the enforcement mechanism. In the absence of a supra-national authority, most trade agreements must rely on self-enforcement. Codified rules of enforcement reduce the risk of a breakdown of cooperation by providing agreed mechanisms for the detection, examination and quantification of possible infringements. Rules may also help to improve the enforcement capacity of individual parties and provide for a range of options to settle disputes amicably. This, in turn, may increase mutual trust within the system and stimulate deeper *ex ante* trade liberalization commitments.

The existence of transaction costs, information asymmetries, uncertainty and other contractual imperfections may induce parties to a trade agreement to vest some authority in a neutral dispute settlement body. Such a body can fulfil multiple functions, including those of an honest broker, an arbitrator, an adjudicator and an information disseminator. However, under an international agreement, a dispute settlement body may not have the means to give effect to a verdict. Successful dispute resolution remains in the hands of the parties, depending either on the willingness of the offending party to cooperate or the capacity of the membership to punish the offender.

The transparency and surveillance roles of a trade agreement

Transparency provisions are fundamental to a viable international agreement. The transparency function fills information gaps, facilitates compliance and helps parties to uphold their rights. Surveillance is more than transparency. It involves monitoring and provides a forum for non-litigious exchange.

Transparency features in trade agreements because there are reasons for believing that the problem of imperfect information is acute in the case of trade agreements. Provisions on transparency are spread across the whole range of WTO Agreements. While the transparency provisions in a particular WTO Agreement may be concerned only with the narrow range of measures covered under that agreement, the cumulative effect of these provisions is to diminish the opacity of Members' trade regimes and trade policymaking processes.

Transparency helps achieve two basic objectives. The first is improved compliance by the parties to the commitments they have made under the trade agreement. Second, transparency should help private economic agents better understand the environment in which they operate and enable them to make better decisions.

Surveillance goes beyond transparency. It implies monitoring the compliance of Members with their obligations, but outside a litigation framework. It provides a forum for dialogue to enhance understanding among parties and is almost always an activity vested in an institution (and its bodies) rather than being left to the parties. An appropriate combination of transparency and surveillance can provide incentives for parties to validate their commitments under an agreement and to comply with their obligations.

What are the policy implications of design issues relating to international agreements?

Much depends on the underlying rationale for cooperating in the first place. It is clear that basic contractual ground rules and institutionalization can mitigate the inevitable incompleteness of agreements. However, treaty design is unlikely fully to overcome the pitfalls implied by contractual incompleteness.

The reasons why signatory countries engage in trade cooperation largely determine their preferred choice of treaty design. Intuitively, a trade agreement concluded with the objective of tying the hands of policymakers, for example, requires a substantially different set of rules, and will pose different demands on the institution administering them, than an agreement concluded with the sole aim of promoting global peace. To understand, explain, and reform contractual rules and institutional procedures, a better understanding of the determinants of trade cooperation is therefore helpful.

Contracting parties to a trade agreement can neither foresee every future contingency, nor can they write down in every detail even the foreseeable details. Every trade agreement is necessarily incomplete. Institutions and contractual provisions can mitigate the uncertainties connected with contractual incompleteness, but they can hardly eradicate them. This brings with it two implications. One is that disputes are a natural outflow of contractual incompleteness. The other is that dealing with incompleteness is a delicate balance between flexibility and adaptation on one hand and the preservation of predictability and stability on the other.

SIXTY YEARS OF THE MULTILATERAL TRADING SYSTEM: ACHIEVEMENTS AND CHALLENGES

From the GATT to the WTO: the building of an institution

The multilateral trading system had a rocky beginning, but its focus of purpose proved to be its early strength. The system expanded inexorably over the years, both in terms of membership, issue coverage and institutional purpose, culminating in the establishment of the WTO in 1995.

International trade cooperation had a difficult start. The efforts to establish an International Trade Organization failed, but a by-product was a temporary contract to govern trade relations among 23 nations. In eight successive rounds of multilateral trade negotiations, substantial trade liberalization was achieved and important trade rules were established. These developments culminated in the creation of the WTO in 1995. The WTO has a more comprehensive mandate, a more solid institutional base, and covers additional areas including trade in services and intellectual property rights.

From its inception the GATT brought together a diverse group of countries. The common goal of multilateral trade liberalization in the context of a rules-based system resulted in the continuous accession of new countries to the agreements, adding to the heterogeneity of the membership. Whereas the first five rounds of multilateral trade negotiations took place under the leadership of the United States and several European countries, developing countries assumed an increasingly prominent role in subsequent

rounds of negotiations. The ability of the GATT/WTO system to accommodate the different needs of its Members has been an important factor in its success.

The same range of issues has tended to dominate the multilateral trading agenda over the life of the institution and have become no easier to solve.

Looking back over six decades of multilateral trade negotiations, one observes the recurrence of certain key issues. Already in the 1950s, agriculture, regionalism, and development issues occupied trade negotiators in Geneva. On several occasions, the multilateral trade negotiations were on the brink of collapse because views, particularly on these topics, were far apart. Each time the GATT/WTO Members were able to bridge their differences.

Agriculture, the terms of participation of developing countries in the trading system, and the relationship between regionalism and multilateralism continue to dominate or at least overshadow the agenda, and prevent easy closure of the current Doha Round of negotiations.

Market access negotiations: liberalization and consolidation

Tariffs have been progressively reduced through eight rounds of trade negotiations since the establishment of the GATT in 1948. More progress has been made in the manufacturing sector than in agriculture. Industrial country tariffs on industrial products have come down sharply since the inception of the GATT, from an average of some 20 to 30 per cent to less than 4 per cent.

Tariffs in industrial countries today can only be considered a significant trade barrier in a few product categories. Reductions in tariffs over the years have differed by sector, with less progress in labour-intensive industrial products and agricultural products. Textiles and clothing, leather and footwear, fish and fish products and agriculture typically face higher tariffs and more tariff peaks than other product categories. While much of the observed reduction in developed country tariff levels has occurred through multilateral bargaining, one should not loose sight of the reductions resulting from regional integration and preferential schemes in favour of developing countries.

For several decades, developing countries did not make much use of the multilateral system to reduce or bind their tariffs even though tariffs have come down significantly as a result of unilateral policy reform and regional agreements. In the multilateral context, the situation changed significantly in the Uruguay Round.

Prior to the 1980s, developing countries made limited tariff commitments in accession negotiations. Binding coverage was relatively low and in most cases remained so until the Uruguay Round. A number of developing countries that negotiated their accession during the Uruguay Round consolidated all their tariffs at a ceiling level, which introduced a gap between bound and applied rates. Many developing countries significantly extended their binding coverage in the Uruguay Round. All of them bound the entirety of their agricultural tariff lines and a number of them, in particular in Latin America, extended the coverage of bindings on non-agricultural products. In most cases, however, the bindings were set at a ceiling level well above applied rates. In other words, applied tariffs have continued to be set independently of bound tariffs. The trend towards stronger multilateral commitments continued after the Uruguay Round. A number of Asian developing countries used the Information Technology Agreement (ITA) negotiations to eliminate their tariffs on IT products. Evidence also suggests that accession negotiations under Article XII of the Marrakesh Agreement have been instrumental in reducing the tariffs of new members.

Non-tariff barriers (NTBs) have played an important role in trade policy, but some progress has been made in reducing and eliminating these obstacles to trade. The fact that they remain an issue is testified to by the retention of the NTB issue on the Doha negotiating agenda.

The multilateral trading system has been instrumental in reducing and disciplining non-tariff barriers to trade, such as quantitative restrictions. While developed countries kept quantitative restrictions in place

in agriculture and textiles for many years, some developing countries maintained balance-of-payments related restrictions for several decades. The Uruguay Round made significant inroads on remaining non-tariff barriers. The elimination of voluntary export restraints was a notable achievement in this context.

World trade has grown twenty-seven fold in volume terms since 1950, three times faster than world output growth. The contribution of trade barrier reductions via the multilateral trading system to this impressive record has been significant although uneven. Moreover, the greater stability and certainty imparted by the rules of the system are also likely to have influenced trade growth over the years.

The contribution of the GATT/WTO to world trade growth via reduced tariffs has been uneven, with much stronger impacts on the trade of industrial countries and on a wide range of non-agricultural goods. This unevenness is a reflection of how the multilateral trading system managed to achieve more significant reductions in barriers to trade in industrial products and did not require much liberalization from developing countries. The GATT/WTO may also have been instrumental in the creation of new trade links between countries who had not previously traded before.

The evolution of the multilateral dispute settlement system

The last six decades have witnessed remarkable developments in the GATT/WTO dispute settlement system. Contracting Parties/Members have managed to strengthen the rule of law while preserving the system's intergovernmental character.

The demand for dispute settlement has existed since the early days of the GATT. Over time, somewhat informal "diplomatic" proceedings have given way to more "judicial" approaches. Basic disagreements in certain policy areas have sometimes overshadowed the system, whose limitations have been made evident from time to time by the failure to establish panels or by the non-adoption of rulings dealing with sensitive issues. During the Uruguay Round, dispute settlement procedures were strengthened in an unprecedented manner, notably with the introduction of the quasi-automatic adoption of reports and the establishment of the Appellate Body as a standing organ for legal review. Enforcement procedures have also been streamlined and isolated from possible blockage by the defendant.

Utilization of the dispute settlement mechanism has grown significantly since the establishment of the WTO, not least due to increased activity on the part of developing countries.

Developing countries have brought more than 40 per cent of WTO disputes. Fourty-two per cent of developing country complaints under the WTO were directed against other developing countries, compared to merely 5 per cent under the GATT. Non-tariff barriers are the most frequent targets of complaint, followed closely by a large number of cases dealing with "unfair" trade practices or the measures taken to offset them (subsidies, antidumping/countervailing duties). Under the WTO, by far the largest number of disputes have been in agriculture. Most cases are settled successfully, predominantly in favour of the complaining party. In a majority of cases, compliance is forthcoming. However, a number of high-profile cases have been characterized by implementation problems and protracted proceedings. In a few instances, retaliatory measures were ultimately imposed.

A large measure of agreement exists in the literature that the WTO Dispute Settlement Mechanism has served Members well. Nevertheless, there is a lively discussion on how certain aspects of the new system could be further clarified and improved.

Additional improvements to the WTO Dispute Settlement Mechanism could possibly be made in facilitating its use, in clarifying its procedures, and perhaps even in further strengthening its capacity to resolve disputes in a more timely and effective manner. Overall, these discussions are not about drastic or fundamental changes to existing rules and do not seek to detract from the substantial results already achieved under the current system.

The ability of smaller and poorer countries to bring cases might be strengthened further. Besides the provision of legal aid, the role of improved "surveillance" has been stressed. A number of proposals have been made on procedural and adjudicative issues. These range from questions of transparency – notably to accommodate the increased interest of non-governmental actors in dispute settlement proceedings – to suggestions of a remand procedure by the Appellate Body to allow for further analysis. Some of this discussion touches on the more fundamental question of whether the system has become too "judicialized". In addition, a number of ideas have been put forward to deal with the limited availability and practicality of countermeasures, especially where developing countries are concerned. Economic thinking permeates many of the proposals made, especially those dealing with alternatives to mutually harmful trade sanctions. Some deeper concerns have been raised on the appropriate response to persistent non-compliance and the calculation of equivalent damages.

Developing countries in the multilateral trading system

For many years developing country participation in the multilateral trading system was confined to obtaining exceptions from the rules and more favourable treatment from industrialized nations.

Most of the trade and development-related provisions foreseen in the ITO draft charter did not become part of the GATT. However, with decolonization and increasing numbers of developing countries in GATT, these countries began to revive some of the proposals originally made at the ITO conference. They also gradually extended their interests from securing exceptions for their own policies towards extracting broad market access concessions from developed countries. Among the rule changes secured by developing countries were a revision of GATT Article XVIII to protect infant industries, the inclusion of Part IV on "Trade and Development", which codified the notion of "non-reciprocity", as well as a waiver for non-reciprocal preferences (later made permanent under the 1979 "Enabling Clause"). During the Tokyo Round, developing countries only made limited market access commitments and few signed up to the new "Codes" dealing with a variety of non-tariff barriers. Since they were hardly bound by the outcomes, developing countries did not participate much in GATT activities. The negotiating agenda was largely controlled by the industrialized countries.

Developing countries pursued their offensive interests more actively in the Uruguay Round.

Among the factors that contributed to increasing participation by developing countries were widespread perceptions concerning the limitations of import substitution policies and the success of East Asian countries in international markets. Moreover, a number of developing countries faced the threat of unilateral action against their exports in certain markets. Others, especially smaller developing countries, feared exclusion from emerging regional trading blocs. These and other developments contributed to deeper engagement by developing countries in the multilateral trading system.

At the same time, the Uruguay Round Single Undertaking implied a range of new obligations for developing countries.

While many developing countries had substantial interests in further multilateral trade liberalization and the strengthening of trade rules in a number of areas, for some of them the implementation of certain obligations stretched their resources and was not seen as a development priority. Transition periods were the primary means employed to ease the adjustment process to new obligations, and many developing countries considered the provisions inadequate. Calls intensified for further differentiation in WTO rules to take account of the special needs and capacity limitations of developing countries. These concerns first found concrete expression in the "implementation" debate. Subsequently, all S&D treatment provisions were made subject to review in the Doha negotiations. In parallel, the WTO has stepped up its technical assistance and capacity-building efforts and has increasingly assumed a coordinating role, most notably in the context of the Aid for Trade initiative, to ensure that other relevant agencies understand the trade needs of WTO Members and work together more coherently and effectively to address these needs.

The current negotiations provide an opportunity to reconsider how the special interests of developing countries might be accommodated within the WTO.

Existing approaches to S&D largely reflect early development thinking. It is questionable whether "policy space" in the sense simply of greater policy freedom is a promising approach. Nevertheless, in recent years there has been renewed recognition in many quarters that government interventions may be justified to address particular development challenges. It is also increasingly accepted that the cost-benefit ratio of certain obligations is a function of a country's level of development.

New approaches that seek to make WTO rules more responsive to development needs often involve a more or less explicit recognition of the fact that not all developing countries face the same problems. Despite the difficulties involved, a strong case can be made for an issue-by-issue analysis of needs in relation to the rationale for S&D, the form it takes, the conditions attached to it, and its compatibility with the rules-based character of the organization. More technical and incremental approaches to S&D stand the best chance of meeting the development needs of poorer countries within the multilateral trading system without undermining the integrity of the system. At the same time, it must be recognized that effective assistance and technical support constitute an indispensable complement to better rules.

Regionalism and the multilateral trading system

A major challenge facing the multilateral trading system is the proliferation of regional and bilateral trade agreements over the last decade and half.

As of 15 September 2006, there were 211 notified regional trade agreements (RTAs) in force, some involving several parties and others purely bilateral in nature. With the only exception of Mongolia, all WTO Members are a party to at least one preferential trade agreement. This poses clear risks for the transparency, efficiency and the progress of the multilateral trading system.

It was already apparent in the post-war negotiations of the 1940s to establish the International Trade Organization that while the nations involved favoured multilateral rules that would open up trade, they also had a keen interest in pursuing preferential trade arrangements. Article XXIV of the GATT was the legal expression of this reality. But the weakness of the GATT rules became apparent with the notification of the EEC-Association of Overseas Countries and Territories and the emergence of a second wave of regionalism.

The Uruguay Round sought to clarify the criteria and procedures for the assessment of regional agreements and to improve transparency by requiring that all notified RTAs be examined by a WTO working group. Interpretative questions relating to this decision combined with a certain lack of enthusiasm among Members meant that this initiative bore no fruit.

The recent decision on transparency is a step toward reducing the risk that the proliferation of RTAs will undermine the multilateral trading system.

The new transparency measures announced in July 2006 will increase the level of transparency of RTAs by mandating the WTO Secretariat to prepare reports on notified RTAs. While this report has to be "factual", it may provide a powerful tool to raise awareness and alert the WTO membership to some of the actual or potential negative implications of regional arrangements for third parties.

However, a number of non-procedural issues remain to be settled. Most importantly, this includes the re-examination of the requirements of Article XXIV for RTAs with a view to ensuring that any adverse effects of RTAs are minimized.

The main debate surrounding RTAs in the WTO has focused on the interpretation of the conditions that Article XXIV requires RTAs to satisfy. These concern the depth and the extent of product coverage of preferential liberalization, the transition period for the full establishment of a RTA, and the policy instruments in respect of which preferential rules should apply. These issues remain a challenge for further negotiations.

Article XXIV establishes that barriers to trade should be eliminated on "substantially all trade". The discussions aimed at clarifying this wording have focused on whether a more precise definition should be established in terms of trade volume, tariffs or sectoral coverage. But no consensus has been reached so far. As economic theory shows, whether or not a RTA is complementary to the multilateral trading system is likely to depend on the definition of the required product coverage of RTAs. Similar issues have emerged in trade in services with the establishment of the General Agreement on Trade in Services, GATS (Article V).

Article XXIV also requires that besides duties, RTAs eliminate "other restrictive regulations of commerce". The range of policies covered by RTAs may determine the depth and extent of trade liberalization under an agreement, as well as its impact on third countries. Such policy instruments may include tariff rate quotas, safeguards, anti-dumping measure and rules of origin. Yet there is no clear consensus on the interpretation of rules in these areas.

Finally, Article XXIV requires that RTAs should not result in higher barriers against third parties. However, economic theory suggests that this requirement will not guarantee the absence of negative welfare effects on third parties upon the formation of a RTA.

Arguments go both ways as to whether RTAs are "building blocks" or "stumbling blocks" in relation to the multilateral trading system. An issue related to this is whether provisions in some bilateral trade agreements, particularly involving developed and developing countries, that go beyond the WTO rules will facilitate or complicate progress in a multilateral setting. Recent work suggests that scope exists for multilateralizing the current multiplicity of overlapping regional and bilateral agreements.

The debate over whether RTAs are building blocks or stumbling blocks is characterized by two schools of thought. One provides a pessimistic prognosis of the effects of regionalism on multilateral liberalization, while the other predicts benign effects. Systematic and anecdotal evidence can be found to support both views.

A number of more recent bilateral agreements between developed and developing countries contain provisions in certain policy areas that are either excluded from the purview of the WTO or go beyond WTO provisions. While this tendency has been subject to some criticism in terms of its implications for the trade and development benefits of the developing country party to such an arrangement, another issue is what the implications of this pattern of differentiated content will be for the multilateral trading system.

Recent work has stressed that the network of overlapping RTAs, including trade-diverting RTAs, may act as a positive force for the multilateral trading system by generating a need to rationalize the system. This can be explained by the increasing costs generated by the system of overlapping RTAs and complex and intertwining rules of origin, especially with the increasing importance of production sharing and geographical fragmentation of production. In particular, it has been argued that the WTO could facilitate this process of multilateralization in three ways: (i) undertaking analytical research to provide a deeper understanding of the attractions of multilateralizing regionalism; (ii) providing a forum for the coordination/standardization/harmonization of preferential rules of origin; and (iii) providing a forum for the weak countries in hub-and-spoke regional arrangements to identify ways of dealing with the hegemonic power of the hub.

Doing business in the WTO: decision-making and relations with the outside world

Despite explicit voting provisions in the GATT, the decision-making practice generally has been characterized by consensus. This practice has been carried over into the WTO, but the issue of participation in decision-making processes has come to the fore.

GATT decisions relied on consensus, but in practice this was the product of deliberations among a minority of the membership. Despite growing disquiet with the traditional arrangements, many of the GATT decision-making practices were institutionalized in the WTO, including the consensus principle.

The WTO decision-making process, like the GATT before it, consists of formal and informal processes. The formal WTO meeting track is open to all Members of the organization and the minutes of meetings provide automatic transparency. Yet it is the informal meeting track where such decisions are negotiated and prepared. Because so many more countries are involved in the multilateral trading system than before, there have been growing demands to ensure adequate representation and participation. This issue is covered in WTO parlance under the rubric of "internal transparency". Over the past decade, issues relating to internal transparency and the decision-making processes of the WTO have emerged as a major institutional challenge facing the multilateral trading system. In response to these pressures, promising decision-making arrangements and ways of enhancing wider participation have evolved.

As far as decision-making processes are concerned, the principal challenge will always be to find the right balance between efficiency and inclusiveness.

The legitimacy of the decision-making process requires that there is an adequate degree of open-ended and inclusive activity to balance other more restrictive consultative processes. At the same time, informal and exclusive consultations for practical reasons will continue to play important roles in the overall WTO process. Although there is general recognition of this among the WTO membership, the legitimacy of such consultations hinges on the ability to ensure an adequate degree of transparency and inclusiveness, as well as a guarantee that such mechanisms are understood as coalition-building and not decision-making exercises.

Not all problems related to transparency and inclusiveness have been resolved. Indeed, the informal and non-legal nature of the principles and practices that underpin the current consultative process at the WTO provides no guarantee against the re-emergence of practices considered excluding by some parties.

Coalitions have become more important in WTO decision-making processes, as well as in the formulation of substantive negotiating positions.

One of the most significant developments within the WTO decision-making process over the past few years is the growing role played by different country groups, particularly among developing countries. WTO Ministerial Conferences have played a particularly important part in the emergence and evolution of country groups as well as the wider cooperation that has developed among such groups.

It is difficult to generalize when it comes to the multitude of groups and coalitions which have emerged since the launch of the Doha Round. Most issues on the WTO agenda do not break along the sort of North-South fault line which in the past pre-empted the flexibility that characterizes coalition-building in the WTO today. The Doha Round negotiations have added a new dimension and a certain fluidity to the creation and destruction of coalitions and groups within the WTO.

The past decade has seen important changes in the way in which the WTO deals with non-governmental organizations (NGOs) and other representatives of civil society. Issues surrounding this relationship are referred to as "external transparency".

Although the WTO remains an intergovernmental organization where decisions are taken by consensus among Members, many NGOs have successfully established a role in which they influence the agenda and the negotiating positions of many parties. The original hesitation and suspicion among a majority of Members with respect to the role of NGOs has been replaced by an often symbiotic relationship which is manifested through increased substantive cooperation.

However, the institutional rules that guide WTO interaction with NGOs remain unchanged and largely informal, and as such do not provide these organizations with new rights in the context of the multilateral trading system. But it is probably fair to say that the current practices are now sufficiently well established to render a roll-back improbable. The challenge from an organizational perspective is to ensure that this relationship continues to evolve in a positive direction.

It is also important to recognize that the WTO system is only one part of a much broader set of international rights and obligations that bind WTO Members and that issues related to global economic policymaking go much beyond the WTO's formal and specific cooperation with the Bretton Woods institutions. The WTO maintains extensive institutional relations with several other international organizations, such as UN, FAO, UNEP and UNCTAD, and there are some 140 international organisations that have observer status in WTO bodies. Their close substantive involvement with the WTO and its Members provide an important transparency element to the overall international economic coherence discussion.

Deepening the multilateral agenda

A core issue confronting the multilateral trading system down the years is the extent of its competence. How is the WTO's mandate shaped? The shape of the multilateral trade agenda matters because it affects perceptions about the legitimacy of the system, and therefore its efficiency and viability.

Questions concerning the appropriate reach of the multilateral system and whether particular subjects should be covered – and if so in what institutional context – have been the subject of lively debate among governments. Differences of views on this matter have often influenced the pace of progress in rounds of multilateral trade negotiations. The debate in the late 1970s and 1980s about whether trade in services had a place in GATT has been followed by similar discussions on TRIPS, labour rights, environment, investment, and competition. Additionally, in some areas, the issue has not been so much about introducing new topics, but rather about how far to go in defining international obligations in established areas of GATT/WTO work, such as product standards and sanitary and phytosanitary measures. A distinction between border and internal measures is often made in these discussions, although in reality both border and internal measures will in some degree affect the conditions of competition between domestic and foreign supplies and suppliers, and therefore affect trade.

The scope of the multilateral trading system emerges from a political process. No adequately defined conceptual or theoretical framework exists for analysing the advantages or disadvantages of a given agenda.

The absence of an appropriate analytical frame of reference for identifying the optimal reach of international cooperation rules out normative prescription. We have no means for asserting *ex ante* what should be on or off the multilateral trade agenda. Nor do we have a blueprint for future agenda formation. This agnosticism about the feasibility of prediction or prescription is consistent with much of the relevant literature in this area.

A distinction can be made between internal measures aimed at preserving the value of pre-existing commitments and internal measures that seek to promote additional market opportunities through their impact on the conditions of competition. But internal measures do not always fit neatly into one or other of these categories.

Trade negotiations in the early GATT days were about the reduction of barriers to trade in the form of border measures like tariffs. Internal measures initially figured on the GATT agenda because of concerns that such measures may be used to circumvent concessions made in market access negotiations. Article III (national treatment) and Article XX (general exceptions) were the main provisions in the original GATT text that served this purpose, but as time went on these provisions were considered insufficient to control the circumvention of market access commitments. The Agreement on Technical Barriers to Trade, the Agreement on Sanitary and Phytosanitary Measures and certain elements of the Agreement on Subsidies and Countervailing Measures are examples of Agreements that in part aim to preserve the *acquis* of market access.

Internal measures aimed at preserving acquired market access rights may focus on avoiding explicit discrimination, as would be the case with subsidy or government procurement provisions. Alternatively, they may concern measures that embody elements of *de facto* discrimination, where the underlying putative objective of a measure is not directly to discriminate, but rather to secure a particular public

policy objective. Examples of internal measures falling into this category include standards and the range of objectives covered by Article XX of GATT or Article XIV of GATS.

A second factor explaining a broader and deeper agenda on internal measures relates to the notion that market access is inherently linked to the conditions of competition prevailing in the relevant markets. A focus on measures whose effect is to modify the conditions of competition has increasingly played a role in shaping the multilateral trading system. The motivation here is not to protect existing levels of market access, but rather to promote further market opportunities. Aspects of the General Agreement on Trade in Services are clearly an example of such a focus. The same may be said of the TRIPS Agreement, and would apply, for example, to rules on competition. But this distinction between protecting acquired rights in a market and seeking to advance those rights does not clearly categorize particular sets of rules on internal measures. There can be significant overlap. The reason for this is that any internal measure, whatever its motivation, will affect to some degree the conditions of competition in a market. It will affect the kinds of access and/or operating environment encountered by suppliers and supplies of goods and services.

Some have suggested that notions of "trade-relatedness" or "specificity" may be useful in identifying which internal measures should be subject to negotiation within the WTO. But trade-relatedness is not an efficiency postulate. Nor does the notion of specificity offer clear guidance on this question.

The more an internal measure is able to affect the relative competitive positions of foreign and domestic suppliers and supplies of goods and services, the argument goes, the stronger the case for subjecting that measure to WTO discipline. A problem with this proposition is that it does not indicate in a precise manner what the impact of internal measures might be on the conditions of competition or on welfare. The direct link to trade is but one element that might be considered. It would be for governments to determine that this was a key element in choosing among internal measures that might be negotiated in the WTO.

As far as specificity is concerned, measures that target a particular group of suppliers or consumers may be considered more distorting than measures of general application and therefore more deserving of attention in the WTO. The WTO Agreement on Subsidies and Countervailing Measures, for example, develops subsidy disciplines that rely on a specificity criterion. The idea that specificity should be a criterion for determining an ordering of internal measures as more or less desirable for inclusion on the WTO agenda has not been subject to systematic empirical or theoretical investigation. Nor does economic analysis yield clear guidance.

Governments may seek linkages between issues that are entirely unrelated to market access or competitive considerations. Such linkages can give rise to beneficial bargains, but they do render negotiations more complex and the negotiated results for individual parties harder to assess.

By exchanging concessions across different policy dimensions, two countries may be able to achieve cooperation in situations where scope would not otherwise exist for the attainment of mutual gains. The possibility of cross-issue linkage has, for instance, been raised with respect to global environmental problems and trade. A possible drawback of combining negotiations on border and (unrelated) internal measures is that the calculus of costs and benefits from international cooperation for individual parties becomes more multi-dimensional and less certain. This is the case in part because negotiations on internal measures often go in the direction of harmonizing relevant rules at the international level. Harmonization may facilitate international transactions and understandings, but may also have disadvantages when policy objectives and appropriate measures to pursue them differ across countries. Country-specific factors such as cultural heritage, climate, ideology, regulatory traditions and the level of development will become more relevant in more multi-dimensional exchanges.

International cooperation in some policy areas may involve distributional consequences, such that some countries loose and others gain. This does not provide a reason for eschewing such negotiations if the overall welfare benefits are positive, but it does argue for a need to develop compensatory mechanisms in such circumstances.

If commitments involved in rule-setting carry negative inter-jurisdictional implications for some parties in distributional terms, something else is required in order to ensure the viability of cooperation. Win-win outcomes at the global level that entail win-loss relationships at the level of individual parties may be rendered realizable when the losers are compensated in some fashion. Such compensation could comprise a transfer, elements not related directly to trade, or a balance might be found directly within a package emerging from trade negotiations.

The question whether or not to embrace international negotiations on internal measures is separate from the choice of forum. If international negotiations on related subjects take place in different fora, coherence needs to be guaranteed in order to avoid ambiguities and inefficiencies.

Numerous internal measures are negotiated in different international fora, often – but not always – within a specialized international organization. Food safety standards are negotiated at the Codex Alimentarius Commission, labour standards at the International Labour Organization and environmental standards in the context of multilateral environmental agreements (MEAs). Bringing internal measures into the multilateral trading system therefore also calls for a definition of the relationship between the WTO Agreement and other relevant standard-setting bodies or agreements. Once again, no conceptual framework exists for determining an optimal international architecture or desirable distribution of subject matter among institutions.

I RECENT TRADE DEVELOPMENTS AND SELECTED TRENDS IN TRADE

A RECENT TRENDS IN INTERNATIONAL TRADE

1. INTRODUCTION: THE STATE OF THE WORLD ECONOMY AND TRADE IN 2006

The year 2006 witnessed robust growth in the world economy and vigorous trade expansion. According to data available in April 2007, which has been used in this section, global gross domestic production (GDP) growth accelerated to 3.7 per cent, the second best performance since 2000. All major regions recorded GDP growth in excess of population growth.

Economic growth in the least-developed countries continued to exceed 6 per cent for the third year in a row. A large part of the stronger global economy is attributable to the recovery in Europe, which turned out to be stronger than expected in early 2006. The United States economy maintained its overall expansion as weaker domestic demand was balanced by a reduction in the external deficit, mainly due to a faster export growth. In Japan somewhat faster economic growth was achieved despite weaker domestic demand reflected in a widening of its external surplus. China and India continued to report outstandingly high economic and trade growth.

Strong economic fundamentals in many key economies contributed to stronger investor confidence worldwide. General government deficits decreased in the United States, the European Union and in Japan and inflationary pressures were contained. A high level of global monetary liquidity combined with a low level of real interest rates contributed to a rally on global stock markets. Stock markets in emerging economies again recorded much faster growth than those in developed economies. Increased investor confidence in emerging markets is also reflected in the sharply reduced spread in interest margins between emerging market bonds and those of US government bonds.

The more favourable investment climate is also reflected in a sharp rise in global foreign direct investment (FDI) flows in 2006, which approached the record levels of the past. UNCTAD[1] reports that global FDI inflows surged by one-third to $1.23 trillion, the second highest level ever. The high growth of global FDI flows can be attributed partly to increased mergers and acquisitions activity and higher share prices. A high level of total net private capital flows to emerging markets was reported by the Institute of International Finance.[2]

A further sign of high global liquidity is the rise in global foreign exchange reserves and the advanced re-payment of external public debt by a number of developing countries. Debt levels, measured by the outstanding debt to GDP ratios, decreased in all developing regions partly due to debt forgiveness. For the heavily indebted poor countries the debt levels in 2006 are estimated to have come down to half the level reported five years ago.[3]

The real effective exchange rate of the US dollar continued to depreciate moderately, contributing to the readjustment of the US current account deficit (the trade deficit in goods and services).[4] The exchange rates of the Asian economies with large current account surpluses fared differently in 2006. On an annual average basis, real effective exchange rates appreciated significantly in the case of the Republic of Korea and Singapore and moderately in the case of China. The Japanese yen, however, continued to depreciate in 2006.[5]

---

1 UNCTAD, UNCTAD Investment Brief, No.1, 2007.

2 Institute for International Finance, Capital Flows to Emerging Market Economies, January 18, 2007.

3 IMF, World Economic Outlook, April 2007, Table 40.

4 The ratio of the US current account deficit to US GDP is estimated to have remained unchanged in 2006 and the deficit started to decline in current dollar terms in the fourth quarter of 2006.

5 JPMorgan, Real broad effective exchange rate indices. Direct communication to the WTO Secretariat, March 2007.

High global liquidity and a further steep rise in the price of fuels and nominal interest rates have not so far translated into higher domestic inflation rates. In developed markets consumer price increases averaged between 2 and 3 per cent, and in the developing economies the rate was about 5 per cent. In both developed and developing regions no acceleration in consumer price inflation was observed between 2005 and 2006.[6] However, inflationary pressures can be detected in sectors for which supply is less elastic, such as real estate markets and auction prices for works of art.

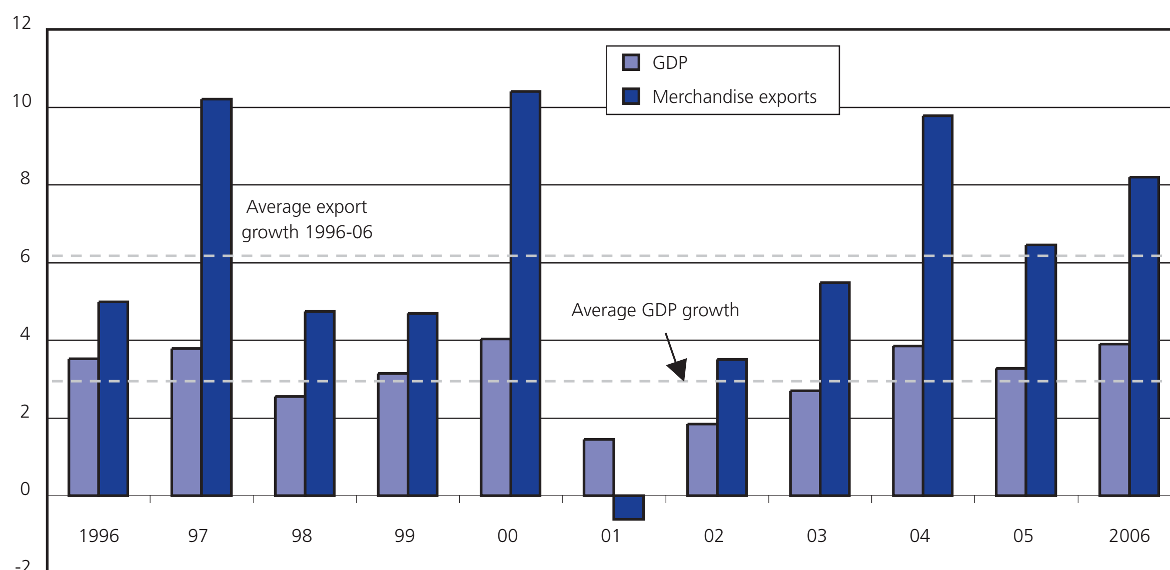
The strong global macroeconomic situation in 2006 provided a favourable framework for the expansion of international trade. In 2006, world merchandise exports grew in real terms (i.e. at constant prices) by 8.0 per cent, compared to 6.5 per cent in the preceding year. A large part of this trade acceleration can be attributed to the marked recovery in Europe's export and import growth. Higher prices of fuels and metals led to a moderate increase in the quantity of mining products traded internationally but the higher export earnings of oil exporters resulted in import growth in excess of the world average. High energy prices also invigorated demand for mining equipment and investment in machinery with high energy efficiency.

China's merchandise trade expansion remained outstandingly strong in 2006. Office and telecom equipment continued to be the mainstay of Chinese export growth but significant gains in world market shares in 2006 could be observed in "traditional" exports such as clothing and "new" products such as iron and steel. Chinese imports again rose faster than global trade but continued to lag behind export growth.

2. REAL MERCHANDISE TRADE DEVELOPMENTS AND OUTPUT IN 2006

The pick up in global economic activity was the major factor in the vigorous expansion of global trade in 2006. Real merchandise export growth is provisionally estimated to have grown by 8.0 per cent in 2006, almost two percentage points faster than in 2005, and well above the average expansion of the last decade (1996-2006). The expansion of real trade exceeded global output growth by more than 4 percentage points (see Chart 1).

Chart 1
Growth in the volume of world merchandise trade and GDP, 1996-2006
(Annual percentage change)



Source: WTO.

[6] IMF, World Economic Outlook, April 2007.

In 2006, the variation in regional real trade growth increased even though economic growth by region differed less than in the preceding year. These divergent developments can be attributed largely to the terms of trade changes in favour of fuel-exporting countries and regions. The North American region comprises two net exporters of fuels and the United States, which is a major net importer of fuels. The real merchandise exports of the United States rose by 10.5 per cent in 2006, which was the highest growth rate since 1997 and almost two times faster than its import growth. Energy related petroleum products decreased by 2.5 per cent in volume terms. Weaker domestic demand in the United States, a lower real effective (i.e. trade weighted) dollar exchange rate, and stronger global demand growth contributed to this favourable development. Canada's merchandise exports slowed down markedly due to the combination of lower US demand and a marked appreciation of the Canadian dollar since 2002. Mexican merchandise trade expanded vigorously with both imports and exports up by double digit rates as its economy recorded its best growth since 2000.

At 13.5 per cent, Asia's real merchandise exports remained the most buoyant of all regions. Asia's imports rose faster than in the preceding year and faster than world trade but continued to lag behind its export growth. Most of the excess of Asia's export over import growth can be attributed to the region's major traders, China and Japan. The expansion of China's exports was somewhat less dynamic in 2006 than in 2005, while Japan, the Republic of Korea and Chinese Taipei recorded a faster growth (between 10 and 15 per cent). Imports into Japan and Chinese Taipei, however, advanced by only 2 to 3 per cent in 2006.

Table 1
GDP and merchandise trade by region, 2004-06
(Annual percentage change, at constant prices)

	GDP			Exports			Imports		
	2004	2005	2006	2004	2005	2006	2004	2005	2006
North America	3.9	3.2	3.4	8.0	6.0	8.5	10.5	6.5	6.5
United States	3.9	3.2	3.4	8.5	8.0	10.5	11.0	6.0	5.5
South and Central America [a]	6.9	5.2	5.2	13.0	8.0	2.0	18.5	14.0	10.5
Europe	2.4	1.8	2.8	7.0	4.0	7.5	7.0	4.0	7.0
European Union (25)	2.3	1.6	2.8	7.0	4.0	7.5	6.5	3.5	6.5
Commonwealth of Independent States (CIS)	8.0	6.7	7.5	12.0	3.5	3.0	16.0	18.0	20.0
Africa and Middle East	6.0	5.5	5.4	8.0	5.0	1.0	14.0	13.0	8.5
Asia	4.8	4.1	4.4	15.5	11.5	13.5	14.5	8.0	8.5
China	10.1	9.9	10.7	24.0	25.0	22.0	21.5	11.5	16.5
Japan [b]	2.7	1.9	2.2	13.5	5.0	10.0	6.5	2.0	2.0
India	8.0	8.5	8.3	15.5	20.5	11.5	16.0	20.5	12.0
World	3.9	3.2	3.7	10.0	6.5	8.0	...	...	...

[a] Includes the Caribbean.

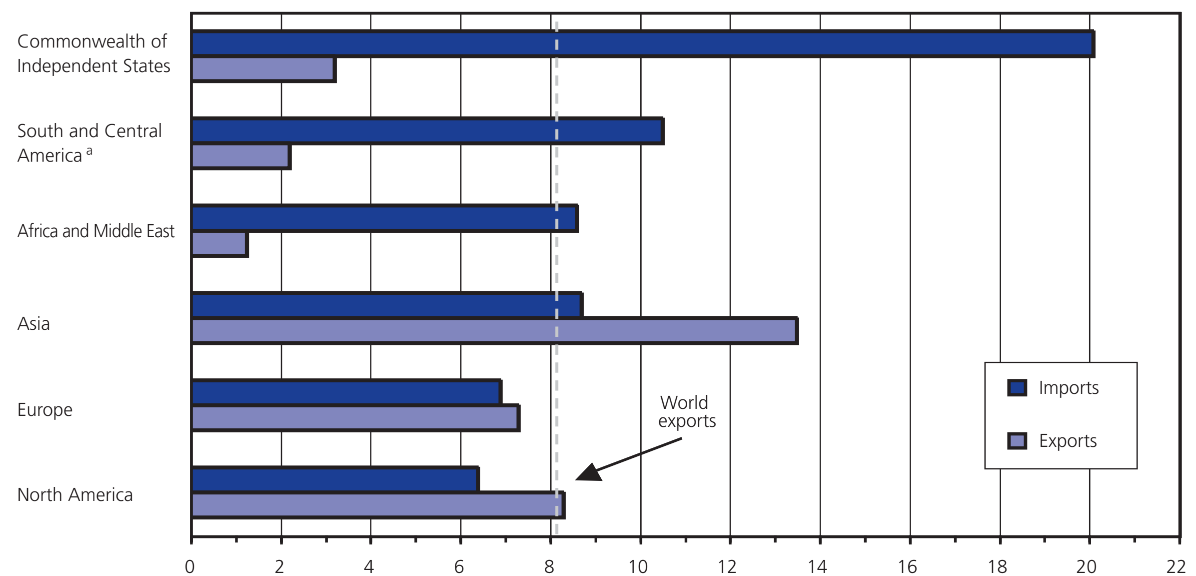
[b] Trade volume data are derived from customs values deflated by standard unit values and an adjusted price index for electronic goods.

Source: WTO.

Europe's real merchandise exports recorded their strongest annual growth since 2000, exceeding import growth (estimated at 7 per cent) but continued to lag behind the global rate of trade expansion. European countries recorded considerable variation in their trade performance. Double-digit export growth can be observed for the countries at its eastern border, ranging from Finland and the Baltic states in the North to Turkey in the South. All these countries benefited from further integration with the EU and the strength of import demand from the Commonwealth of Independent States (CIS) region. Both Germany and the United Kingdom recorded export and import growth well above the European average, while real trade growth was sluggish in Italy and Spain and stagnated in France and Ireland.

The four net fuel exporting regions (CIS, Middle East, Africa and South/Central America and the Caribbean) only recorded a small increase in their export volume (of about 2 percentage points), while their imports rose faster than global trade in 2006 (Chart 2). The most buoyant imports of all regions were observed for the Commonwealth of Independent States, which are estimated to have expanded by 20 per cent, while the region's real exports remained sluggish in 2006. In contrast to these global trade developments, South and Central America's expansion rate of both exports and imports decelerated in 2006. Venezuela recorded a marked contraction of her exports and those of Brazil rose by less than 4 per cent. The combined exports of Africa and the Middle East are estimated to have almost stagnated, while imports, despite their deceleration, continued to expand somewhat faster than the global average. While the slowdown in the exports of these regions can be linked to reduced demand for the more expensive categories of fuels and metals, the increase in imports might be considered modest given the outstanding income growth of these regions over the last three years.[7]

Chart 2
Real merchandise trade growth by region, 2006
(Annual percentage change)



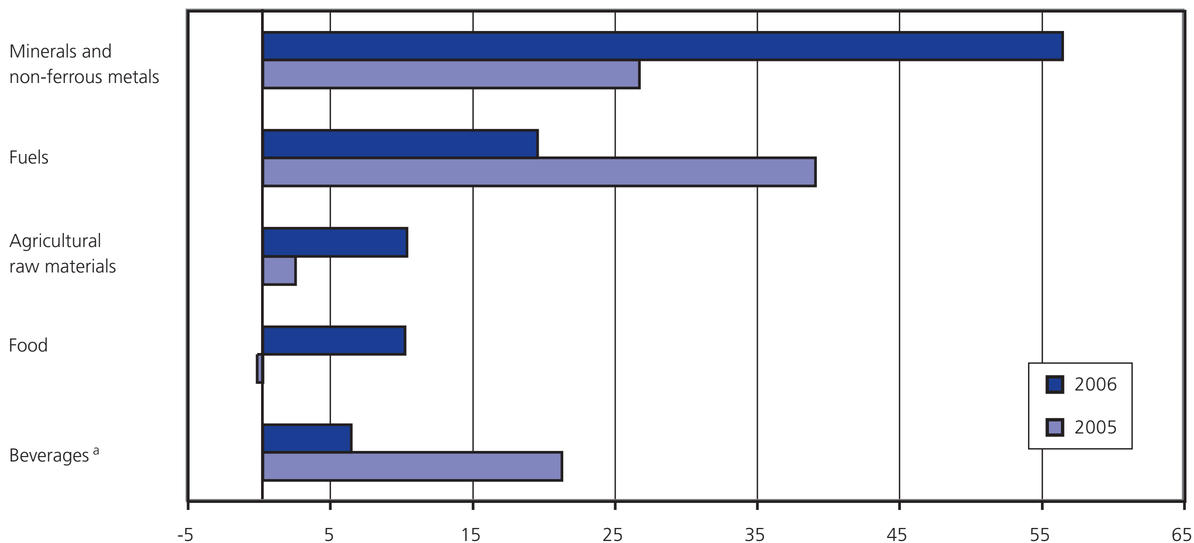
[a] Includes the Caribbean.
Source: WTO.

[7] There are indications that some imports are not fully covered in the regular trade returns which could lead not only to an underreporting of the level of imports but also to an underestimation of their import growth.

3. NOMINAL MERCHANDISE AND COMMERCIAL SERVICES TRADE DEVELOPMENTS IN 2006[8]

World merchandise exports in dollar value terms were strongly affected by price developments in 2006. Price developments differed widely by sector in the course of the year. According to the IMF commodity price indices, the world export prices of minerals and non-ferrous metals increased by 56 per cent, those of fuels by 20 per cent and those of food and agricultural raw materials by 10 per cent (see Chart 3). Export prices of manufactured goods are estimated to have increased by not more than 3 per cent.[9]

Chart 3
Export prices of selected primary products, 2005 and 2006
(Annual percentage change)



[a] Comprising coffee, cocoa beans and tea.
Source: IMF, International Financial Statistics.

Price changes for manufactured goods remained less strong than those for primary products for the third consecutive year. An important element in the moderate price trends for manufactured goods was the continued decline in prices for electronic goods, which accounted for more than one in six dollars of world exports of manufactured goods in 2005. These shifts in relative prices explain largely the different regional export unit values (prices) which ranged from 4 per cent to 5 per cent for Asia and Europe to about 18 per cent to 20 per cent for exports of South and Central America, Africa, the Middle East and the CIS. Information on price trends for world commercial services trade are not available. However, the price deflators for US services exports and imports increased between 3 and 4 per cent in 2006, somewhat less rapidly than in the preceding year.

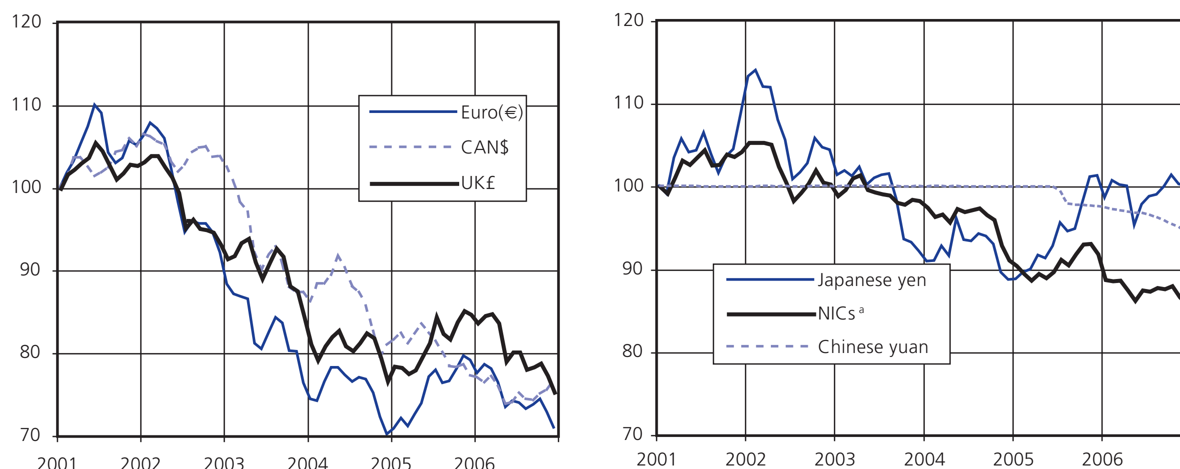
Overall exchange rate developments in 2006 only had a moderate impact on the dollar price level of internationally traded goods. Contrary to developments between 2002 and 2004, the average annual exchange rate change between the US dollar and the euro and the British pound had been rather moderate as divergent developments in the course of 2005 and 2006 balanced each other. While a weaker yen might have contributed to weaker dollar export prices of Japan, the appreciation of the Canadian dollar and the currencies of several Asian traders had the opposite effect (see Chart 4).

---

8 Merchandise trade values for 2006 were estimated on the basis of monthly customs data while commercial services data are derived from Balance of Payments statistics. The latter are typically available later than merchandise trade data, contributing to a greater uncertainty in the estimates for services than for merchandise trade in 2006.

9 Dollar export prices of manufactured goods increased in the United States and Germany by 2.5 per cent and 1.7 per cent respectively while those of Japan decreased by 2.5 per cent in 2006. China's export unit value index for manufactured goods rose by 3.6 per cent in 2006.

Chart 4
Dollar changes vis-à-vis selected major currencies, 2001-06
(Indices, January 2001=100)



[a] Trade weighted currency basket of the Korean won, the Singapore dollar and Chinese Taipei dollar.
Source: IMF, International Financial Statistics.

World merchandise exports in dollar terms rose by 15.4 per cent to $11.76 trillion. About 40 per cent of this value change can be attributed to inflation. Commercial services exports rose by 11 per cent to $2.71 trillion. The increase in commercial services exports in 2006 was about the same as in the preceding year and for the fourth consecutive year less pronounced than that of merchandise trade. It is uncertain to what extent divergent relative price developments have contributed to the differences in the growth of merchandise and commercial services trade values.

Table 2
World exports of merchandise and commercial services, 2006
(Billion dollars and percentage)

	Value	Annual percentage change			
	2006	2000-06	2004	2005	2006
Merchandise	11762	11	22	14	15
Commercial services	2710	10	10	11	11

Source: WTO.

Merchandise exports by region in dollar terms have been strongly affected again by price developments. The four regions with the highest share of fuels and other mining products in their merchandise exports – the Middle East (70 per cent in 2005), Africa (65 per cent), the Commonwealth of Independent States (60 per cent) and South/Central America (37 per cent) again recorded the strongest annual export increases in 2006. However, as prices of fuels increased in 2006 less rapidly than in 2005, the sharp rise in the export values of these regions were in effect smaller than in the preceding year. The opposite development can be observed for the net importers of fuels – North America, Europe and Asia reported a faster export growth in 2006 than in 2005, although the growth in their shipments remained less strong than that of the fuel exporting regions.

Although Europe's merchandise exports recorded the weakest regional growth rate (13 per cent), its share in world merchandise exports, at 42 per cent, remained the largest of all regions. Europe's imports rose by 14 per cent to $5.22 trillion. Intra-EU (25) trade rose by 13 per cent, which was somewhat stronger than export growth to third countries (11 per cent) but slower than imports from third countries (15 per cent). The Baltics and the Balkan states continued to record export and import growth in excess of 20 per cent. The combined exports/imports of the Balkan states exceed those of Turkey, whose exports and imports also expanded faster than those of total Europe.

In North America, Mexico reported stronger export and import growth than its NAFTA partners. The United States reported its best annual export growth performance (14 per cent) in more than a decade, and although US export growth exceeded its import growth (11 per cent), the merchandise trade deficit had grown already so large that it continued to grow in 2006. Only in the fourth quarter, supported by the decline in import volumes and falling import prices for crude oil, did the US merchandise trade deficit started to decrease.

Asia's merchandise exports and imports continued to expand faster than world trade in 2006. Among the six major Asian traders China continued to record the highest export and import growth, and as its export growth continued to exceed its import growth, the merchandise trade surplus rose sharply. In the course of 2006, China's trade surplus widened further as the momentum in the export expansion was maintained while nominal import growth slackened, partly due to weaker oil prices. The dollar value of Japan's merchandise exports grew by nearly 9 per cent but continued to lag behind the expansion of world trade and its own import growth. The fast growing economies of India and Viet Nam reported a vigorous expansion of exports and imports, in the range of 20 per cent to 35 per cent in 2006. Since 1995, the exports and imports of these two countries have expanded faster than Asia's trade and their share in world merchandise exports increased markedly. Among the smaller Asian traders, Bangladesh, Cambodia and Mongolia continued their double-digit export expansion, a feature since 2003, with exports up between 20 per cent and 44 per cent in 2006. The merchandise trade of New Zealand virtually stagnated while that of Chinese Taipei and the Philippines was less dynamic than world trade in 2006.

Africa's merchandise exports rose by 21 per cent, again faster than imports, which are estimated to have increased by nearly 16 per cent. The share of Africa in world merchandise exports reached its highest level since 1990. Although most of Africa's export growth can be attributed to the rise in oil exports, it is a noticeable development that non-oil exporting African countries increased their exports by about 16 per cent. It is estimated that about one in 10 African countries experienced a decline in their exports, while half of them recorded an export expansion which exceeded the global average. South Africa, the region's largest merchandise trader, reported a rise in its imports of 24 per cent while exports advanced by 13 per cent.

Middle Eastern trade has been strongly affected by political and oil market developments. The region's merchandise exports are estimated to have grown by 19 per cent, roughly in line with crude oil prices. Merchandise imports increased by 14 per cent which must be considered a rather moderate increase given the surge in the region's export earnings and foreign exchange reserves in the past years.

Among the seven geographic regions distinguished in this report, the Commonwealth of Independent States (CIS) recorded the most dynamic export and import growth in 2006. Benefiting from strong fuel and metal prices on world markets, the region's exports increased by one-quarter last year to $422 billion, more than twice the level recorded only three years ago. Imports rose by nearly one-third to $278 billion, but the region's merchandise trade surplus continued to expand by about $20 billion in 2006.

South/Central America's merchandise exports and imports continued to expand faster than world trade in 2006 even though their growth was less pronounced than in the preceding year. The deceleration in the region's export growth is attributable largely to the performance of the region's oil exporters and Brazil. Sharply higher prices for metals benefited exports from Chile, Jamaica, Peru and Suriname. The exports of Chile and Peru surged by more than 40 per cent, the highest export growth rates reported in the region in 2006.

Box 1: Textiles and clothing trade developments in 2006

In the second year after the phasing out of the Agreement on Textiles and Clothing, the structural changes in world trade of textiles and clothing continued unabatedly. Exporters from developed countries and those from advanced developing economies in East Asia are losing market share, together with major developing suppliers in Central America and the Mediterranean region, which process textiles originating from developed countries. China's exports continued to gain market share in all major developed import markets despite restrictions introduced in 2005. Some smaller suppliers expanded their textiles and clothing exports even faster than China and the share of least-developed countries in imports of the United States and the European Union increased sharply in 2006.

The annual expansion rate of textiles and clothing imports from China into Canada, the United States and the EU was roughly halved between 2005 and 2006 in each of these three markets. The combined textiles imports of the three economies from China rose by 41 per cent in 2005 and is estimated to have increased by 15 per cent in 2006. Despite the sharp deceleration this rate is still about twice the rate of imports from all sources (with EU intra-trade excluded). These import developments suggest that the introduction of quotas in the United States and the EU in the course of 2005 had a restrictive effect on textiles imports from China. On the other hand, the deceleration in textiles exports from China to Canada was about the same as to the United States in the absence of any new quotas. The new restrictions also had no apparent effect on China's overall exports of textiles and clothing to the world, which increased in 2006 by one-quarter – somewhat faster than in 2005 (21 per cent).

Imports of textiles and clothing of the four major developed markets (incl. Japan) are estimated to have increased by 5.5 per cent, to about $350 billion in 2006. This increase was slightly faster than in the preceding year despite the deceleration in US import growth, to less than 4 per cent. In contrast to the moderate overall import growth, intra-NAFTA textiles (and clothing) trade was declining and that of intra-EU(25) stagnated in 2006. US imports from CAFTA members and the Dominican Republic, and Sub-Saharan Africa, declined by 7 per cent and 10 per cent respectively. The strongest decline in US imports (–14 per cent) was observed for the more advanced economies in Asia (i.e. Hong Kong, China; Chinese Taipei and the Republic of Korea). US imports from the EU (25), which still exceeded those from India in 2005, decreased by 2.5 per cent in 2006.

The import decline from these suppliers was balanced by a double digit increase of imports from six Asian countries. While imports from China increased by 15 per cent and accounted for nearly 30 per cent of total US imports of textiles and clothing, the rise in imports from Indonesia, Viet Nam, Bangladesh and Cambodia exceeded that from China. Imports from India, a major supplier to the United States, rose 12 per cent in 2006, which was less than the rate recorded by China.

The re-shuffling of EU import shares had similarities with those of the US market. Some of the major traditional suppliers (e.g. Turkey, Romania, Morocco, Tunisia) lost market shares while Asian developing countries increased their share. As in the US market, China expanded its role as leading supplier, but imports from smaller Asian suppliers tended to rise faster than those from China. Rather untypical is the sharp rise of EU clothing imports from Hong Kong, China in 2006.

Among the developed markets Japan's textiles and clothing imports are the most concentrated on China due both to geographic proximity and the absence of import quotas in the recent past. More than three-quarters of Japan's textiles and clothing imports originated from China in 2006. The share exceeds 80 per cent for clothing imports.

At nearly 9 per cent, Canada recorded with the strongest rise in textiles and clothing imports of the four major developed markets in 2006. Imports from China rose by more than 20 per cent. The structural shifts among suppliers observed in 2006 were similar to those observed in the US market.

Imports of textiles and clothing into major markets by origin, 2006

(Billion dollars and percentage change)

	United States	EU(25)	Japan	Canada
World (value)	*106.4*	*197.5*	*30.0*	*11.2*
		Annual Growth		
World	4	6	6	9
China	15	13	8	22
India	8	13	12	6
Pakistan	12	12	-7	9
Bangladesh	22	31	4	19
Cambodia	25	17	...	21
Indonesia	25	17	4	18
Philippines	9	20	...	5
Viet Nam	18	48	6	33
Thailand	1	9	-2	0
Sri Lanka	2	21	12	...
East Asia(4)	-14	22	-5	-12
Sub-Saharan Africa	-10	9	...	...
Egypt	32	13	...	...
Morocco	69	4	...	...
Tunisia	...	1	29	...
CAFTA	-7	64	...	...
Mexico	-10	13	6	7
Canada	-7	6	-7	...
United States	...	11	-3	-1
EU(25)	-3	1	-2	2
Romania	15	1	...	...
Bulgaria	-18	13	...	...
Turkey	-17	4	20	-1
Memorandum items:				
Least-developed countries	14	27	27	17
Hong Kong, China	...	44	...	...

Note: East Asia(4) comprises Chinese Taipei; Hong Kong, China; Macao, China and the Republic of Korea. EU(25) imports include intra-trade.

Source: Global Trade Atlas and Eurostat, COMEXT data base.

It is clear from the discussion above that trade expansion in 2006 was very favourable for the developing countries as a group. Their combined merchandise exports rose by 20 per cent, to $4.27 trillion, and imports rose by 17 per cent. The share of developing countries in world merchandise exports reached, with 36 per cent, an all-time record level. The share of developing countries in world merchandise imports was 31 per cent, the largest share in more than a quarter of a century. For the least-developed countries, the expansion of merchandise exports has been even stronger than for the developing countries over the last six years, including 2006. Least-developed countries' exports are estimated to have increased by about 30 per cent, to $108 billion in 2006. Their share in world merchandise exports reached 0.9 per cent, the highest level since 1980 (the first year for which records are kept). Merchandise imports rose by 17 per cent, which was far less rapid than merchandise exports, leading the least-developed countries as

a group to record a trade surplus for the first time. Because of differences in commodity composition, individual country performance, and relative country size, aggregations such as developing countries and least-developed countries are increasingly less meaningful for trade analysis (see Appendix Table 1).

World commercial services exports rose by 11 per cent to $2.7 trillion in 2006[10]. The expansion rate of global services trade was basically unchanged from the preceding year and that of the last six years. Since 2003, commercial services exports expanded less rapidly each year than merchandise trade.

Among the three broad commercial services categories, transportation, travel and "other commercial services", the latter is by far the largest and also the fastest growing category. In 2006, other commercial services categories expanded by 13 per cent while transportation and travel services were up by 9 per cent and 7 per cent respectively. In the 1990s, transportation services expanded less rapidly than travel, but since 2000 the situation has been reversed. The relatively sluggish growth of travel services can be observed in all major exporting regions but is most pronounced in North America's services trade.

Table 3
World exports of commercial services trade by major category, 2006
(Billion dollars and percentage change)

	Value	Annual percentage change			
	2006	2000-06	2004	2005	2006
Commercial services	2710	10	20	11	11
Transport	626	10	25	12	9
Travel	737	7	18	8	7
Other commercial services	1347	12	19	12	13

Source: WTO.

Commercial services trade by region is presented in Appendix Table 2. Europe and North America, recorded – as in the preceding year – export and import growth below the world average. Within the European Union services trade developments by member differed widely: services exports of France and Finland are reported to have declined, while those of Luxembourg and Poland expanded by one-quarter or more.[11] The CIS region reports export and import growth rates of commercial services of about 20 per cent, the fastest growth of all regions.

Asia's commercial services exports continued for the third consecutive year to expand faster than the global average and faster than the region's services imports, thereby reducing the region's deficit in services trade. Japan, the region's largest commercial services trader, increased its commercial services exports by 12 per cent and its imports by 8 per cent. Among the major Asian traders India continues to excel in terms of its services trade expansion. While the dynamic growth of India's commercial – and in particular software services[12] – exports are widely reported, the dynamic expansion of its services imports attracts less attention even though the growth rate in 2006 exceeded that of exports. According to the most recent numbers, India's commercial services imports are only about 5 per cent short of its commercial services exports.

The commercial services trade of Africa and the Middle East are provisionally estimated to have expanded close to the world average in 2006, but limitations in data availability could make these estimates subject to larger revisions than for the estimates provided for other regions.

[10] Commercial services data are derived from Balance of Payments statistics which do not include the sales of majority-owned foreign affiliates abroad (commercial presence).

[11] The decline in services exports of France and Finland are concentrated in the group "other commercial services". Economic explanations for this decrease have yet to be identified. In the case of Luxembourg the marked rise in services exports can be attributed to the strength in financial services.

[12] Comprising computer services, IT enabled services and business process outsourcing.

Appendix Table 1

World merchandise trade by region and selected country, 2006

(Billion dollars and percentage)

	Exports					Imports				
	Value	Annual percentage change				Value	Annual percentage change			
	2006	2000-06	2004	2005	2006	2006	2000-06	2004	2005	2006
World	11762	11	22	14	15	12080	11	22	13	14
North America	1675	5	14	12	13	2546	7	17	14	11
United States	1037	5	13	11	15	1920	7	17	14	11
Canada	388	6	16	14	8	357	7	14	15	11
Mexico	250	7	14	13	17	268	7	16	13	15
South and Central America [a]	426	14	30	25	20	351	9	28	23	18
Brazil	137	16	32	23	16	88	7	31	17	14
Other South and Central America [a]	289	13	29	25	22	262	10	27	25	19
Europe	4957	11	20	9	13	5218	11	20	10	14
European Union (25)	4527	11	19	8	12	4743	11	20	9	14
Germany	1112	12	21	7	15	910	11	18	9	17
United Kingdom	443	8	14	11	15	601	10	20	9	17
France	490	7	15	3	6	533	8	18	7	6
Italy	410	9	18	6	10	436	11	19	8	13
Commonwealth of Independent States (CIS)	422	19	36	28	24	278	23	31	25	29
Russian Federation	305	19	35	33	25	164	24	28	29	31
Africa	361	16	31	30	21	290	14	28	20	16
South Africa	58	12	27	12	13	77	17	35	17	24
Africa less South Africa	303	17	32	34	23	213	14	26	22	13
Oil exporters [b]	212	19	40	46	25	81	18	33	25	18
Non oil exporters	90	13	20	14	17	131	11	23	20	10
Middle East	644	16	33	35	19	373	14	31	19	14
Asia	3276	12	25	16	18	3023	12	27	17	16
China	969	25	35	28	27	792	23	36	18	20
Japan	647	5	20	5	9	578	7	19	13	12
India	120	19	30	30	21	174	23	37	41	25
Four East Asian traders [c]	844	9	25	12	15	787	9	27	13	17
Memorandum items:										
MERCOSUR	190	14	28	21	16	134	7	38	20	17
ASEAN	771	10	20	15	18	683	10	25	17	14
EU (25) extra-trade	1480	11	21	11	11	1697	11	21	15	15
Developing economies	4274	14	27	22	20	3749	13	29	18	17
Least Developed Countries (LDCs)	108	20	32	36	30	101	15	18	21	17

[a] Includes the Caribbean. For composition of groups see the Technical Notes of WTO, International Trade Statistics, 2006.
[b] Algeria, Angola, Cameroon, Chad, Congo, Equatorial Guinea, Gabon, Libya, Nigeria, Sudan.
[c] Chinese Taipei; Hong Kong, China; Republic of Korea and Singapore.

Source: WTO.

Appendix Table 2
World commercial services trade by region and selected country, 2006
(Billion dollars and percentage)

	Exports					Imports				
	Value	Annual percentage change				Value	Annual percentage change			
	2006	2000-06	2004	2005	2006	2006	2000-06	2004	2005	2006
World	2710	10	20	11	11	2620	10	19	11	10
North America	460	6	13	10	9	401	7	15	9	9
United States	387	6	14	10	9	307	7	16	9	9
South and Central America [a]	77	9	16	18	14	80	7	14	21	14
Brazil	18	12	21	28	21	27	9	12	38	20
Europe	1382	11	20	9	9	1223	10	17	8	8
European Union (25)	1247	12	19	9	9	1132	10	16	8	8
United Kingdom	223	11	25	5	9	169	10	18	10	6
Germany	164	13	17	10	11	214	8	13	4	7
France	112	6	11	6	-2	108	10	19	8	3
Italy	100	10	18	7	13	101	11	12	9	14
Spain	100	12	16	9	8	77	15	24	11	18
Commonwealth of Independent States (CIS)	51	20	29	20	21	74	21	28	19	19
Russian Federation	30	21	26	21	22	45	18	23	18	17
Africa	64	13	21	12	12	80	13	23	21	12
Egypt	16	9	30	3	10	10	6	24	27	9
South Africa	12	16	16	15	8	14	16	28	18	17
Middle East	63	11	16	14	9	96	12	23	19	10
Israel	19	4	21	10	9	15	4	15	7	8
Asia	614	12	27	14	15	666	10	24	12	14
Japan	121	9	25	14	12	143	4	21	2	8
China	87	...	34	19	...	100	...	31	16	...
India	73	...	...	...	34	70	...	...	...	40
Four East Asian traders [b]	208	10	22	9	14	197	10	23	10	12

[a] Includes the Caribbean. For composition of groups see the Technical Notes of WTO, International Trade Statistics, 2006.

[b] Chinese Taipei; Hong Kong, China; Republic of Korea and Singapore.

Note: While provisional full year data were available in early March for 33 countries accounting for more than 60 per cent of world commercial services trade, estimates for most other countries are based on data for the first three quarters (the first six months in the case of China).

Source: WTO.

B SELECTED TRADE DEVELOPMENTS AND ISSUES

1. TEN YEARS OF THE INFORMATION TECHNOLOGY AGREEMENT, 1996-2006

(a) Introduction

In December 1996, at the first WTO Ministerial Conference held in Singapore, 23 economies signed the Information Technology Agreement (ITA). The objective of the ITA was to "encourage the continued technological development of the information technology industry on a world-wide basis" and to "achieve maximum freedom of world trade in IT products" by eliminating all duties on trade in these products. Lower barriers to trade should help to spread "the positive contribution of IT to global economic growth and welfare".[1] The ITA went into force in 1997, when the trade value of the participants exceeded 90 per cent of world trade in the covered products – the benchmark stipulated in the Agreement. Ten years on, the information and communication industry is seen as a major engine of the globalisation process, transforming both the developed and developing economies. The rapid development of the internet (1 billion users in 2005) and the global spread of cellular mobile telephony (2.1 billion subscribers in 2005) are two prominent examples of the increased role of IT in today's global economy.[2] The spread of IT technologies has created many new business opportunities, transformed many services sectors and challenged many old patterns of production and distribution.

The elimination of tariffs on IT products[3] contributed to this rapid development of the IT sector. While bound and applied tariffs for IT products were already moderate in the major developed markets (most of them between 2 and 4 per cent) a large variation in tariff levels could be observed among developing economies. While some developing economies also had low bound and applied tariffs on IT products, others had tariff rates ranging above 10 per cent and a low level of bindings. For the latter group, the elimination of tariffs due to the ITA was a major step in market opening, attenuated to a degree by a staged implementation which lasted up to eight years in many cases (e.g. India, Malaysia and Thailand). Between 1997 and the end of April 2007, 33 more economies joined the ITA, bringing total membership of the agreement to seventy.[4] The share of ITA members in global exports and imports of IT products exceeded 97 per cent in 2005.

In what follows we provide an overview of tariff reductions that have taken place through the ITA, as well as a summary of trade flows in IT products by region, trader, and IT product category. Unfortunately, it is not possible to make an accurate estimate of the overall impact of the ITA on global trade in IT products. Such an estimate would have to take into account the absence of a precise starting point when all the commitments were fully implemented. Secondly, the impact of ITA tariff elimination is limited to imports subject to MFN tariff treatment and not to the trade flows subject to duty free preferential tariff treatment. Third, the period under review is characterized by strong variations in the business cycle with large swings among major exchange rates. Nominal trade flows in dollar terms are also affected by a marked downward trend in prices. Information on real trade flows (i.e. adjusted for price changes) is generally not available.

1 Ministerial Declaration on Trade in Information Technology Products, Singapore,13 December 1996, WTO document WT/MTN/(96)/16.

2 According to the International Telecommunication Union (ITU), the number of internet users increased 13 times (from 74 million to 1 billion) and users of cellular mobile phones multiplied fifteen-fold times (from 145 million to 2.1 billion) between 1996 and 2005.

3 In this review IT products are defined as those products covered by the Information Technology Agreement.

4 Counting the EU(27) members separately.

(b) Overview of ITA tariff cuts

In order to situate the tariff cuts made through the ITA in a wider framework one has to recall that these cuts were made on top of the reductions of bound rates agreed in the Uruguay Round (UR). The tariff commitments of ITA participants are laid down in specific ITA tariff schedules which indicate the initial (bound) tariff rate (thereafter called the "base rate") and the intermediate tariff rates for each year of the implementation period. The ITA base rate of a given tariff line corresponds – in general – to final bound tariff rates agreed in the UR. For an assessment of the actual tariff reductions recorded by traders, a distinction has to be made between bound and applied tariff rates. In many countries, in particular developing economies, one can observe that the final most-favoured-nation (MFN) bound rates of the UR are significantly higher than the MFN applied rates. In order to assess tariff cuts under the ITA it is therefore important to also look at the MFN applied rates prevailing at the time the ITA was concluded. Consideration must also be given to preferential rates applicable to major segments of international trade in IT products. The two most important categories of preferential trade flows are intra-RTA flows (such as the EU and NAFTA) and imports for processing in special economic zones, for which duty draw backs are granted.[5]

An overview of the tariff changes resulting from the ITA is provided by Table 1 below. This table shows that the tariffs on IT products (covered by the ITA) were somewhat lower on average than the average for all industrial products in 1996, in respect of both final bound and applied rates. As could be expected, applied rates on IT products were lower than the corresponding bound rates. For six major developed traders, the applied rates were more than 2 percentage points lower than the bound rates. As the result of the ITA, the arithmetic average bound rate of the six major developed importers declined from 4.9 per cent (and those of applied rates from 2.7 per cent) to zero. Looking only at the average rates conceals the fact that for some countries (including some developed countries) the highest tariffs for IT products were several times higher than the average applied rate.

As already noted, bound and applied tariffs for ITA products among developing country participants were in general considerably higher than in the industrial countries. The major exceptions were Hong Kong, China and Macao, China which already had duty free trade in ITA products before the agreement went into force. Singapore had final bound rates of 13 per cent for IT products, but the average applied rate was zero. From the data available it seems that the largest reductions of pre-ITA applied rates were implemented by India, China, Jordan and the Republic of Korea.

Table 1 also shows the number of duty free rates in existence before and after the ITA. In the developed countries, about two-thirds of IT products which still carried duties after the UR were made duty free thanks to the ITA. The increase of duty free tariff lines differed considerably among the developing countries – from no increase in the case of Hong Kong, China to more than 200 new duty free tariff lines in the case of China, India, Malaysia and Chinese Taipei.

The impact of the ITA on the partipants' tariff schedules as a whole is indicated by the share of ITA tariff lines in all duty free tariff lines for industrial products. While for the developed participants this share is in a range of 5 per cent to 17 per cent, the corresponding shares for developing participants are much higher. For six out of 17 developing country participants reported in Table 1 the share is 100 per cent or very close to that share.

[5] In 2005, the intra-trade of the EU(25) and of NAFTA combined accounted for 37 per cent of world exports of manufacturers. More than one-half of China's imports of manufactures are destined for processing in special zones and re-export, and are exempt from duties.

Table 1
Information Technology Agreement (ITA) tariffs of selected economies

	Year ITA start	Year ITA final impl.	No of duty free ITA tariff lines		Average tariff rates [a]			Share of ITA prod. in duty free final bound tariffs of non-agric.	Average non-agric. prod.	
			Final bound UR	ITA base rates (1996)	ITA base rate (TL)	Pre- ITA rate appl.r. [b]	ITA final bound rates		Final bound	Appl. rates [b]
Developed participants										
Australia	1997	2000	9	190	12.1	3.3	0	19.7	11.0	3.9
Canada	1997	2000	69	345	4.3	3.4	0	12.0	5.3	3.7
EU(15)	1997	2000	69	358	4.0	3.9	0	14.2	3.9	3.9
Japan	1997	2000	145	332	1.0	0.1	0	10.1	2.8	2.8
Norway	1997	2000	15	226	5.2	2.4	0	8.6	3.2	0.6
United States	1997	2000	81	327	2.8	2.8	0	7.4	3.3	3.3
Developed participants(6)			*65*	*296*	*4.9*	*2.7*	*0*	...	*4.9*	*3.0*
Developing participants										
China	2001	2005	14	317	6.5	12.7	0	55.9	9.1	9.2
Costa Rica	1997	2005	...	270	6.0	5.0	0	100.0	42.9	4.9
Egypt	2003	2007	...	190	13.0	12.1	0	99.0	27.7	12.5
El Salvador	1997	2005	213	192	1.2	3.2	0	100.0	35.7	5.0
Hong Kong, China	1997	1997	168	168	0.0	0.0	0	11.1	0.0	0.0
India	1997	2005	...	217	66.4	36.3	0	99.5	36.7	16.4
Indonesia	1997	2005	99	216	5.9	4.7	0	100.0	35.6	6.8
Israel	1997	2005	150	358	5.1	4.2	0	50.8	11.3	4.9
Jordan	2000	2005	-	248	19.5	9.4	0	51.5	15.2	10.4
Korea, Rep. of	1997	2004	...	386	14.4	7.9	0	27.5	10.2	6.7
Macao, China	1997	1997	255	255	0.0	0.0	0	31.6	0.0	0.0
Malaysia	1997	2005	2	237	12.4	4.1	0	66.4	14.9	7.9
Morocco	2004	2010	...	210	12.8	11.9	0	98.6	39.2	21.2
Saudi Arabia	2005	2008	...	199	5.8	...	0	28.0	10.5	4.8
Singapore	1997	2000	58	253	13.2	0.0	0	28.5	6.3	0.0
Taipei, Chinese	1997	2002	29	253	4.7	4.8	0	12.4	4.8	4.7
Thailand	1997	2005	...	194	30.9	...	0	99.5	26.9	8.3
Turkey	1997	2000	...	365	24.9	4.2	0	86.5	17.1	4.7
Developing non participant							appl. rates			
Brazil	-	-	-	-	31.7	17.2	10.1	-	30.8	12.6
Mexico	-	-	-	-	34.8	11.8	9.7	-	34.9	13.3
South Africa	-	-	-	-	11.5	2.2		-	15.8	7.9

[a] Averages of base rates are calculated on tariff line level while those of applied rates are based on HS 6 digit subheadings. Pre-ITA applied rates refer in general to the year prior to the ITA participation (for initial participants the year 1996). For non-participants the applied rate for ITA products refer to the following years: Brazil 1997 and 2006, Mexico 1998 and 2004 and South Africa 2000.

[b] Refers to year 2006 or 2005, except for Indonesia (2003).

Source: WTO, IDB database.

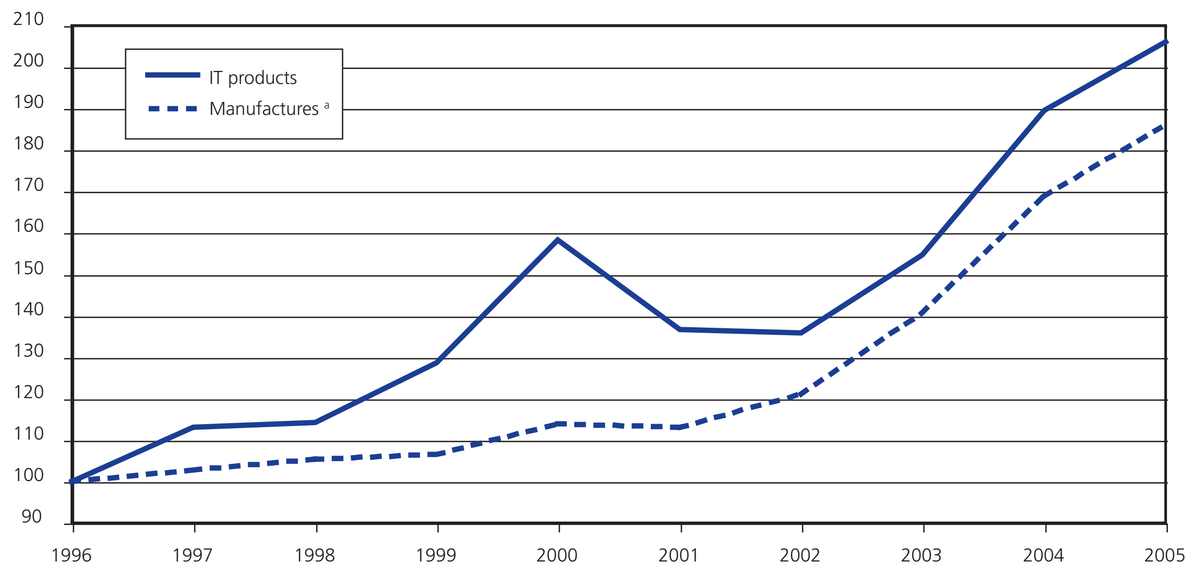
(c) World trade developments in IT products[6], 1996-2005

IT trade at the global level

World exports of ITA products have more than doubled in dollar terms between 1996 and 2005 (Chart 1). The annual average growth rate was 8.5 per cent over this nine year period and the value reached $1450 billion in 2005. In that year, IT products accounted for 14 per cent of world merchandise exports, thereby exceeding the combined global exports of agricultural products, and textiles and clothing.[7]

The expansion of IT trade over the nine year period was uneven. From 1996 to 2000 a strong annual rise of 12 per cent was recorded for global IT exports. Thereafter, the burst of the internet bubble caused trade in IT products to shrink sharply in both 2001 and 2002, followed by a recovery in the subsequent three years. Comparing trade in IT products with that of other manufactured goods, it appears that growth in IT product trade exceeded other manufactured goods trade in the 1996-2000 period, but lagged somewhat in the 2000-05 period.

Chart 1
The expansion of world exports of IT products and other manufactures, 1996-2005
(Indexes, 1996=100)



a Excluding IT products.
Source: UN, Comtrade database.

Nominal dollar values, however, understate the absolute and relative strength of trade growth in IT products. Prices for computers, semi-conductors and telecom equipment have recorded a general downward trend, while those of other manufactured goods increased moderately. The price developments of US imports illustrate this. Between 1996 and 2005 the prices of IT products decreased on average by 6 per cent annually while those of all other manufactured goods increased by nearly 1 per cent annually.

---

6 As defined by the Information Technology Agreement. There are some difficulties in precisely measuring trade in IT products as the definition provided in the Agreement cannot always be clearly matched with national tariff schedules. For example, some IT products are grouped together with other non-IT products in tariff and trade classifications. Including all tariff lines embodying IT products and other products overstates the "true" product coverage and excluding them understates the trade flows. The world total of IT trade based on the broader definition expands somewhat less rapidly and is about 10 per cent larger than the trade based on the narrow definition. In this review we opted for the somewhat overstated coverage which principally affects semiconductor equipment.

7 In this review of global IT trade the standard regional definitions used in the WTO International Trade Statistics are applied. This implies that intra-EU trade is included and that the re-exports of Hong Kong, China are excluded from the world total.

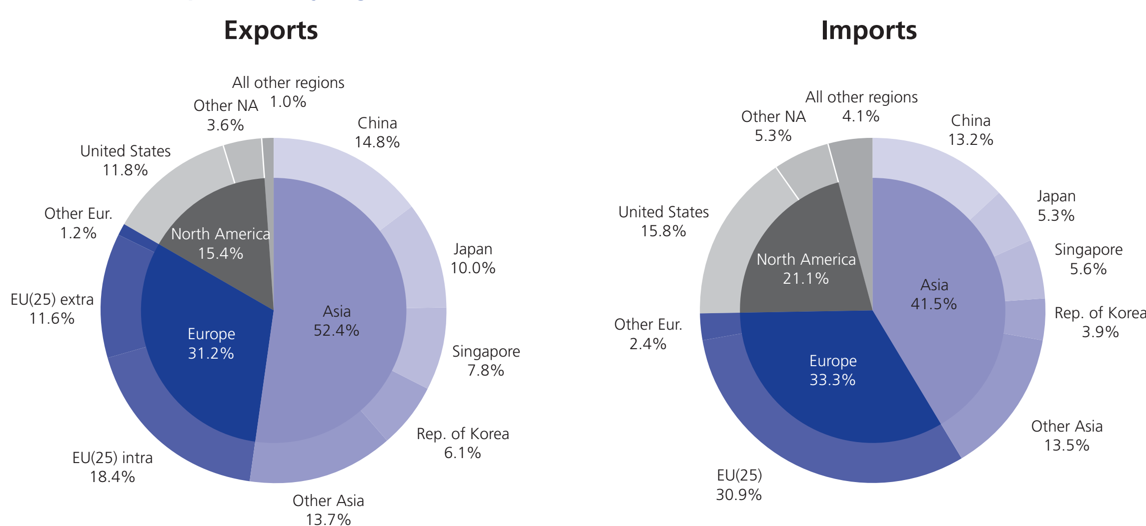
Given these relative price movements it is most likely that the real trade expansion of IT products was still more dynamic than that of other manufactured goods, not only in the 1996-2000 but also during the 2000-05 period.

Intra-NAFTA imports of the United States and Canada as well as intra-EU trade expanded over the entire nine years somewhat less dynamically than imports from traders outside the respective regional configurations. Excluding from the world total these trade flows, which did not benefit from the ITA because they were already duty-free, or might indeed have even been adversely affected by the ITA, one would observe an even stronger overall increase in IT exports between 1996 and 2005. While we have no precise way of measuring the contribution of the ITA to trade expansion during the first nine years of its operation, the existence of the agreement is unlikely have been incidental to this outcome.

IT trade by region and leading traders

An outstanding feature of world trade in IT products is the prominent role played by Asia, which became more accentuated after the ITA entered into force in 1997 (Chart 2). Asian economies accounted for more than a half of world exports and more than 40 per cent of world imports of IT products in 2005. Intra-regional trade is substantial and competition among these economies for foreign investment and export markets is strong. The region and (most of) its leading traders are net-exporters of IT products. Europe's exports and imports of IT products are second only to those of Asia. Intra-EU(25) exports alone accounted for 60 per cent of Europe's total exports in 2005. Within Europe, the most dynamic traders are those which acceded to the EU in 2004 and which expanded their IT trade much faster than Ireland, the most dynamic trader among the EU(15) in the 1990s. The share of Europe in world IT exports and imports decreased moderately between 1996 and 2005. Imports of IT products of the region continue to exceed exports. North America's share in world trade of IT products decreased between 1996 and 2005, partly due to a shrinkage in intra-NAFTA trade after 2000. Intra-NAFTA trade in IT products accounted for somewhat more than 40 per cent of total North American IT exports. North America is a large net importer of IT products. IT exports of South/Central America, Africa, the Middle East and the CIS continue to have only a small share in world exports of IT products. These regions are net importers of IT products and although their imports were very strong in 2005 they still accounted for about 4.1 per cent of world IT imports.

Chart 2
World trade of IT products by region, 2005



Source: UN, Comtrade database and WTO.

Major shifts can be observed in the shares of the leading traders of ITA products over the 1996-2005 period. The United States and Japan were the principal exporters of ITA products in 1996, but their exports expanded less rapidly than world exports before and after the burst of the internet bubble in 2001. These setbacks were sufficiently severe that in 2005 US IT exports were still below their peak level in 2000, while those of Japan only matched the level reached five years previously[8] (see Appendix Table 1).

Exports of the European Union (15) rose somewhat less rapidly than global IT trade over the 1996-2005 period. The deceleration after 2000 was less pronounced than on the global level, partly due to the strength of European exchange rates *vis-à-vis* the US dollar. An outstanding feature of IT trade in Europe was the divergent developments within the region. The Czech Republic, Hungary, Poland and other countries in the process of acceding to the EU benefited from the relocation to them of parts of the European IT production. As a consequence, these countries became dynamic exporters and importers of IT products and EU(15) intra-trade expanded far less rapidly than EU(15) trade with third countries (including the future members). The vigorous expansion of IT trade in new EU members was largely driven by the European integration process. The most evident case illustrating the benefits of integration is Hungary, which was not a participant in the ITA until 2004 and which had by far the strongest IT export growth in Europe over the 1996-2005 period (41 per cent annual average growth).

Among the leading traders, China has been by far the most dynamic exporter of IT products over the last decade. During the 1996-2000 period China's exports rose by 29 per cent annually, nearly three times faster than those of all other traders. Moreover, while global IT export growth slowed in the 2000-05 period, China's export of the products in question accelerated to nearly 40 per cent annually, more than 7 times faster than the rest of the world. China's share in world exports rose from 2.1 per cent in 1996 to 14.8 percent in 2005. China ranked as the seventh largest exporter in 1996 and became the largest in 2005, if EU(25) intra-trade is not taken into account. If EU(25) intra-trade is taken into account, the EU(25) was the largest exporter of IT products in 2005.

The outstanding growth of China's exports of ITA products is closely linked to FDI inflows into China. Many globally operating firms, encouraged by low operating costs and attractive investment conditions, have increasingly added new production capacity in China. Investments originated not only from developed countries such as the United States and Japan, but prominently also from rapidly growing economies in East Asia such as Singapore, Chinese Taipei and the Republic of Korea. This shift in the location of the global information and communication industry in Asia contributed to the deceleration of export growth of some of the major developing exporters in Asia after 2000 (excluding China). Asian traders, such as Chinese Taipei, Malaysia, the Philippines and Indonesia recorded a loss in their share of world exports between 2000 and 2005. In contrast, the Republic of Korea succeeded in expanding its share and Thailand successfully maintained its share over this five year period.

Among the developing countries that do not participate in the ITA, Mexico is the most important trader. Its exports of IT products are largely destined for the US market (88 per cent in 2005), where Mexico enjoys duty free access owing to its NAFTA membership. Canada, a participant in the ITA and Member of NAFTA, somewhat reduced its dependence on the US market between 1996 and 2005. The trade performance of both countries is largely shaped by developments in the US market. They recorded export growth above the global average between 1996 and 2000, when the US market expanded very fast, and an export decrease between 2000 and 2005,[9] when US imports of IT products stagnated in value terms. For the entire 1996-2005 period, the two countries recorded an annual average increase in export value of IT products of 10 per cent and 2 per cent respectively.

[8] Japan's exports had recovered up to $148 billion in 2004, but decreased in 2005.

[9] The rise of the US dollar against other major currencies up to 2000 and its subsequent decrease affected the shift in trade values.

In summing up the major shift in world exports of ITA products by trader over the 1996-2005 period, an outstanding feature was the rise of China. The increase in China's share in global IT trade was at the expense of the market shares of the United States and Japan. Among other leading exporters, only the Republic of Korea recorded an increase in its export share in the four years before the burst of the internet bubble (1996-2000) and in the five following years. In Europe, Hungary, the Czech Republic, Poland and the Slovak Republic all reported dynamic export growth throughout the 1996-2005 period.

Import developments by country between 1996 and 2005 show many similarities with those of exports. Among the major developed countries the United States, Japan, the EU(15) and Canada recorded an import increase below the global average over this nine-year period. China's imports expanded at an annual rate of nearly 30 per cent and became the third largest importer of the world behind the EU(15) and the United States.

Among the leading ITA product traders are seven East Asian developing economies which as a group slightly increased their share in world imports between 1996 and 2005. However, excluding Hong Kong, China and Singapore which both largely import for re-export, the share of the remaining five economies – Chinese Taipei, the Republic of Korea, Malaysia, Thailand and the Philippines – remained roughly unchanged over the 1996-2005 period.

An outstanding development occurred in respect of Indian IT imports. Indian import growth nearly matched that of China over the 1996-2005 period and in contrast to global developments accelerated after 2000. Most of India's IT imports consist of finished IT products such as telecoms and computers. Obviously, the fourfold increase in IT imports between FY2000/01 and FY2005/06, to $14.1 billion, is associated with the surge in India's software exports after 2000. The Indian example illustrates well that the opportunities created by the availability of IT technology and products are not limited to the IT hardware sector itself but have beneficial repercussions on many sectors of the economy. Important gains in services exports, output and employment could be obtained in India by effectively employing information technology.[10]

The importance of IT products (measured by the share of IT products in merchandise exports) differs widely across countries and regions. In East Asia five developing economies reported a share of IT trade in excess of 30 per cent in 2005 (or double the share in world exports). These economies comprise the Philippines (66 per cent), Singapore (49 per cent), Malaysia (42 per cent), Chinese Taipei (38 per cent) and the Republic of Korea (31 per cent). The importance of IT products in these economies' export basket rose sharply between 1996 and 2000 but decreased markedly thereafter. A similar development could be observed in Japan, where ITA products accounted for shares in total merchandise exports of 26 per cent in 1996, 30 per cent in 2000 and 24.5 per cent in 2005. However, only in Japan was the relative decline strong enough to lower the share of IT products below the level reached in 1996. In contrast to all these Asian economies, the importance of IT products increased steadily in the merchandise exports of China from less than 10 per cent in 1996, to 16.3 per cent in 2000 and to 28.2 per cent in 2005.[11]

Outside Asia the share of IT products in total exports is generally much lower. In the United States the share of ITA products ranged between 21 and 26 per cent in the 1996-2000 period but decreased to less than 20 per cent in 2005. A similar decrease in the share of IT products could also be observed in Mexico and Costa Rica, where the shares stood at 16 per cent and 24 per cent respectively in 2005. In Europe the share of IT products in total merchandise exports remained rather stable at slightly above 10 percent, while for some of the countries joining the EU in 2004 the share increased sharply (e.g. in Hungary to 22 per cent in 2005).

[10] The number of mobile telephone subscribers in India rose from 0.3 million in 1996 to 90 million in 2005 and internet users are estimated to have risen from 0.4 million in 1996 to 60 million in 2005.

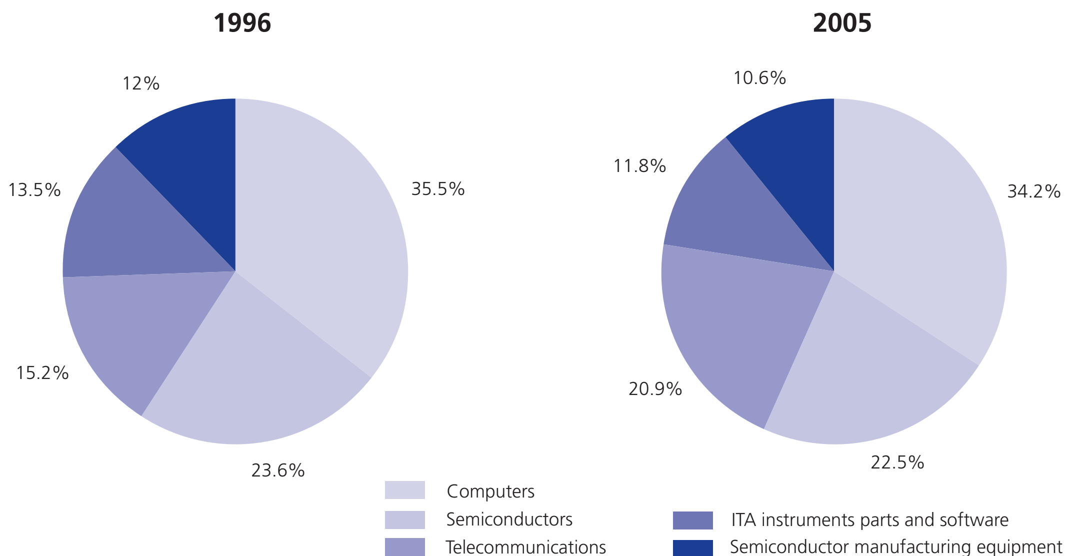
[11] Most likely there is some double counting in China's IT trade which overstates the absolute size and the relative importance of IT products in China's merchandise trade. In 2005, according to Chinese customs statistics about $33 billion of China's $200 billion imports of IT products originated from China and these re-imports have expanded faster than total Chinese merchandise imports (and exports) over the last five years.

IT trade by ITA product category

Trade developments by major product category are reported in Chart 3 below and in Appendix Table 2. In 2005, the three major categories in world exports of ITA products are computers (34 per cent), semi-conductors (23 per cent) and telecom equipment (21 per cent). Semi-conductor manufacturing equipment accounts for slightly more than 10 per cent, or roughly as much as the three residual groups, ITA instruments, parts and ITA software together.

The share of the computer category in total ITA product trade remained roughly unchanged between 1996 and 2005, while that of semi-conductors decreased markedly and that of the telecom category increased significantly. In respect to semi-conductors one notices that their export shipments had risen much faster than other ITA products in 1990-2000 but thereafter expanded less rapidly than other ITA product categories. Telecommunication products increased their share in total ITA product trade before and after the recession in 2000/01 and approached the share of semi-conductors.

Chart 3
World exports of ITA products by category, 1996 and 2005
(Percentage shares)



Source: UN, Comtrade database and WTO.

(d) Conclusion

The Information Technology Agreement has facilitated the expansion of world trade in IT products by eliminating tariff duties on imports, both among all participants and with the rest of the world. The average applied MFN tariff reduction for the IT products was between two and three percentage points for the developed countries. This cut of two to three percentage points was implemented within three years and at first sight might not look very impressive if compared with the annual variations in exchange rates and the steady fall in prices for most IT products. However, this view neglects to take into account that tariffs on individual tariff lines had sometimes been three times larger than the average rate in developed countries. Moreover, average applied rates in many developing countries were quite significant before the ITA (e.g. India and the Republic of Korea). Even low duty levels can be more than a "nuisance tariff," and far from being negligible if the product is a component in a global production process that has to cross customs borders several times before reaching the final consumer as a part of a finished product. In addition, the predictability and stability achieved through the binding of IT tariffs has assured investors that tariff costs will not hamper its future import requirements or access to foreign markets.

The number of countries joining the ITA continues to increase and in early 2007 Viet Nam and the United Arab Emirates became new participants. While the country coverage of the ITA is still increasing, its product coverage is at risk of decreasing if no action is taken by the participants. Given rapid technological change in the industry, many new products emerge and old products converge into multi-functional products not clearly covered by the definitions of the ITA established a decade ago. It is therefore important that ITA participants co-operate in a constructive manner in the IT Committee of the WTO to solve these classification problems. A successful conclusion of market access negotiations in the Doha Round would facilitate the work in the IT Committee, as this would tend to reduce the difference between IT tariffs and those of other manufactured goods on the verge of being covered by the ITA.

Appendix Table 1
The thirty leading exporters and importers of IT products in 2005

Exporters

	Value (Mill$)	Share	Average Annual Growth		
	2005	2005	1996-05	1996-00	2000-05
EU(15)	400328	27.7	7	9	5
Extra-EU15 exports	185682	12.9	8	9	7
Intra-EU15 exports	214646	14.9	6	9	3
China	213637	14.8	35	29	40
United States	170121	11.8	3	11	-3
Japan	144759	10.0	4	8	0
Hong Kong, China	115768	...	16	13	18
Re-exports	111124	...	18	16	19
Domestic Exports	4644	0.3	-2	-5	0
Singapore	111969	7.8	7	6	7
Korea, Republic of	87947	6.1	13	18	10
Taipei, Chinese	71891	5.0	17	40	2
Malaysia	59370	4.1	9	15	4
Mexico [a]	33904	2.3	10	25	-1
Philippines	26940	1.9	12	28	0
Thailand	24464	1.7	8	9	6
Canada	19045	1.3	2	13	-6
Hungary	14011	1.0	41	82	16
Switzerland	10956	0.8	4	4	4
Czech Rep.	9919	0.7	25	18	30
Indonesia	6193	0.4	14	29	3
Brazil [a]	4073	0.3	22	32	14
Israel	3758	0.3	1	22	-14
Poland	3169	0.2	22	13	29
Australia	2544	0.2	-1	-2	0
Norway	2486	0.2	6	3	8
Slovakia	2076	0.1	34	31	36
India	2112	0.1	12	8	15
Costa Rica	1744	0.1	70	240	-2
Estonia	1530	0.1	30	63	8
Malta	1208	0.1	3	14	-5
Morocco	1065	0.1	34	75	8
Romania	1046	0.1	37	80	11
Tunisia [a]	972	0.1	13	-56	141
World [b]	1443963	100.0	8	12	6
Memorandum items:					
EU(25)	433842	30.0	7	10	6
Extra-EU25 exports	167596	11.6	8	8	7
Intra-EU25 exports	266245	18.4	7	10	5

a Non-participant of ITA.
b Excluding Hong Kong,China re-exports and including EU(15) intra-trade.

Appendix Table 1
The thirty leading exporters and importers of IT products in 2005 (cont'd)

Importers

	Value (Mill$)	Share	Average Annual Growth		
	2005	2005	1996-05	1996-00	2000-05
United States	237429	14.9	5	12	0
EU(15)	419779	27.9	7	10	4
Extra-EU15 imports	205133	13.6	8	11	6
China	199006	12.5	29	27	30
Hong Kong, China					
Retained imports	9223	0.6	-3	4	-8
Singapore	84914	5.3	6	6	6
Japan	79797	5.0	6	10	2
Taipei, Chinese	60965	3.8	20	44	4
Korea, Republic of	59217	3.7	9	12	6
Malaysia	48992	3.1	7	10	5
Mexico [a]	47923	3.0	13	24	5
Canada	32213	2.0	3	11	-3
Thailand	24799	1.6	6	3	9
Philippines	21970	1.4	9	6	10
Australia	15142	1.0	5	5	5
Hungary	14593	0.9	28	47	14
India	14097	0.9	27	22	31
Switzerland	12224	0.8	4	7	2
Brazil [a]	10995	0.7	6	11	2
Czech Rep.	10895	0.7	15	9	19
Poland	10060	0.6	13	13	14
Turkey	8999	0.6	15	23	8
Russian Federation [a]	8268	0.5	15	-7	36
South Africa [a]	6906	0.4	7	-1	13
Norway	5973	0.4	6	3	8
Israel	6022	0.4	4	13	-3
Saudi Arabia	4311	0.3	14	1	26
Romania	3925	0.2	21	23	19
Argentina [a]	3644	0.2	3	9	-1
Slovakia	3518	0.2	24	19	28
Colombia [a]	2822	0.2	6	-6	18
World [b]	1503582	100.0	9	12	6
Memorandum items:					
EU(25)	465399	31.0	8	11	5
Extra-EU25 imports	199154	13.2	8	11	5

a Non-participant of ITA.
b Excluding Hong Kong,China re-exports and including EU(15) intra-trade.
Source: UN Comtrade and WTO.

Appendix Table 2
World exports of IT products by category, 1996-2005
(Billion dollars and percentage)

	Value							Average Annual Growth		
	1996	2000	2001	2002	2003	2004	2005	1996-05	1996-00	2000-05
IT products	697	1106	955	951	1083	1328	1444	8	12	5
I. Computers	247	375	342	340	387	460	494	8	11	6
II. ITA Instruments and Apparatus	21	26	27	25	28	34	37	6	5	8
III. Parts and Accessories	50	82	64	64	72	87	92	7	13	2
IV. ITA Software	24	26	26	26	31	36	41	6	2	9
V. Semiconductors	164	280	212	224	258	308	325	8	14	3
VI. Semiconductor Manufacturing Equipment	84	118	98	94	112	149	153	7	9	5
VII. Telecommunications	106	200	186	178	195	255	302	12	17	9

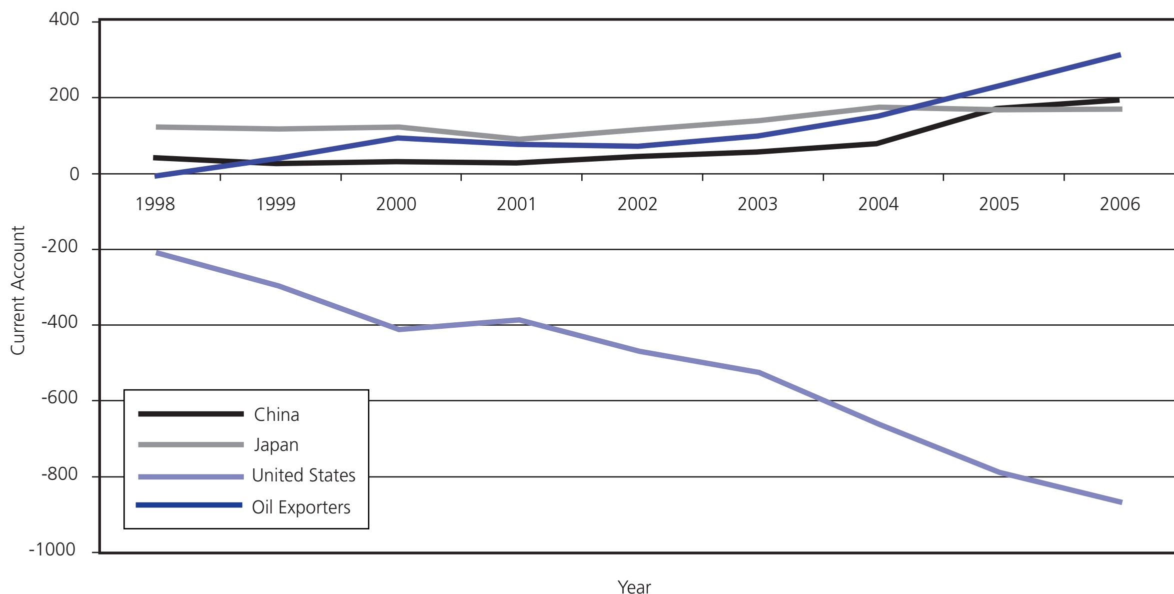
Note: Excluding Hong Kong, China re-exports and including EU intra-trade. Definition of IT products according to the ITA.
Source: UN Comtrade database and WTO.

2. GLOBAL IMBALANCES AND WORLD TRADE

(a) Introduction

A great deal of attention and concern has been focused on rising global imbalances. These current account imbalances have been most pronounced between the East Asian economies and oil exporters on the one hand and the United States on the other. Some idea of the increase in global imbalances and the pattern they have taken can be discerned in Chart 4, which traces the current account balances of four major economies: the United States, Japan, China, and three major oil exporters (Saudi Arabia, Russia and Norway). The US current account deficit rose to $870 billion (6.6 per cent of GDP) in 2006 from $214 billion (2.4 per cent of GDP) in 1998. By way of contrast, China's current account surplus in 2006 is estimated at $184.2 billion (7.2 per cent of GDP), having risen from about $32 billion (3.3 per cent of GDP) in 1998. And among the oil exporters, Saudi Arabia's current account surplus reached $120 billion (32.9 per cent of GDP) in 2006.

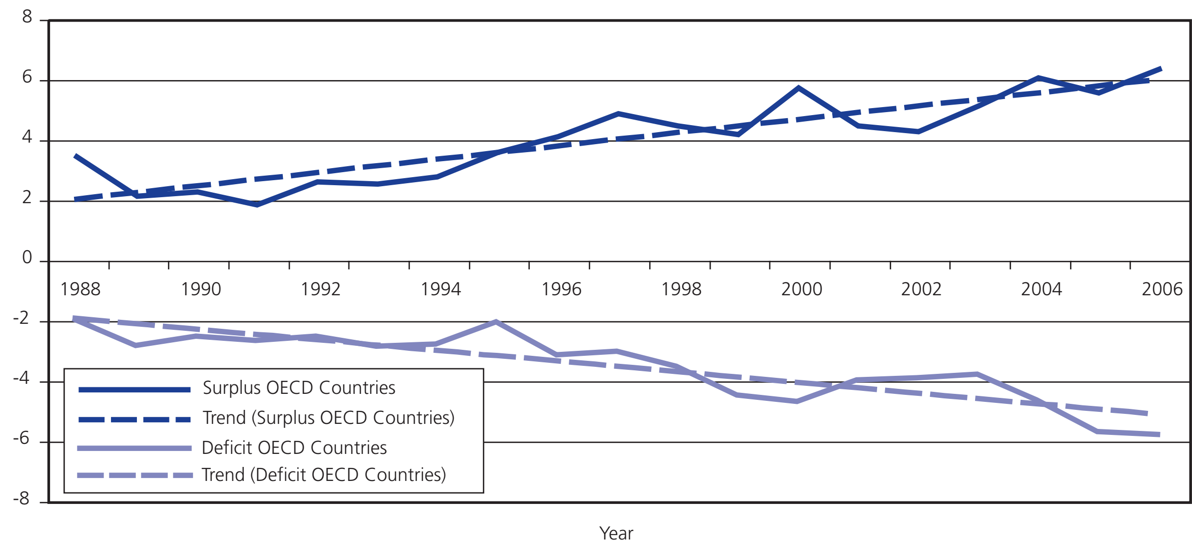
Chart 4
Current account balances of selected economies, 1998-2006
(Billion dollars)



Source: IMF, World Economic Outlook Database, September 2006.

However, the widening of current account imbalances appears to be a much wider and longer-term phenomenon. Among the OECD countries, there is a discernible trend towards larger imbalances. Chart 5 shows the average size of the current account surpluses/deficits as a share of GDP for OECD countries since 1988. For each year, OECD countries are classified according to the state of their current accounts. Surplus (deficit) countries are grouped together and the average surplus (deficit) as a share of GDP is calculated. The dashed lines show the widening trend around which the average surpluses and deficits have grown. In 1988, for OECD countries running deficits, the average size was around 2 per cent of GDP. By 2006, estimates place this average at around 5.8 per cent of GDP. Similarly, in 1988 for OECD countries with surpluses, the average surplus was around 3.4 per cent of GDP. By 2006, this had risen to 6.3 per cent of GDP. So by 2006, the current account imbalances, whether surplus or deficit, of OECD countries were about twice as large as in 1988.

Chart 5
Average current account surpluses/deficits of OECD countries, 1988-2006
(Percent of GDP)



Source: OECD Economic Outlook 79 Database.

The trend towards large imbalances is not confined to the OECD countries. Many emerging economies now show larger surpluses in their current accounts, although it may be necessary to distinguish between those who are enjoying a temporary surplus due to a favourable movement in the prices of their exports (as in the recent run-up in commodity prices) and those whose surpluses are the result of the pursuit of a particular development strategy (see the discussion in the next section).

(b) Explaining the imbalances

In part, larger current account imbalances reflect the impact of greater capital and financial market integration. A current account deficit reflects dissaving by domestic residents, an excess of absorption over income. The fact that it is occurring reflects a willingness by foreigners to finance that excess absorption by accumulating future claims on the earnings of domestic residents. It is important to emphasize that sustained imbalances are primarily a macroeconomic phenomenon and they have little to do with trade policy. Trade measures that restrict imports hurt exports as much (a proposition known as the Lerner symmetry theorem).[12]

One implication of bigger deficits and surpluses is that capital markets are capable of affecting ever larger transfers of savings across national boundaries. Greater integration of capital markets makes it easier to accommodate big differences in savings propensities and profitable investment opportunities among countries. Feldstein and Horioka (1980) developed a well-known test of international capital market integration. Although their original estimate of capital market integration in the OECD countries proved somewhat of a disappointment, more recent estimates appear to offer greater support for the idea of capital market integration. A discussion of the evidence for this appears in Box 1.

12 See Lerner (1936).

Box 1: Defining openness in capital markets – revisiting the Feldstein-Horioka test

Over the last few decades, the world has experienced progressive financial market deregulation and global market integration. This is often cited as one of the major factors contributing to the growing size of current account surpluses and deficits relative to GDP among countries.

In a completely closed economy, the total amount of resources available for capital formation is generated internally from domestic savers – whether by households, the corporate sector or government. Since the current account is also the difference between domestic savings and domestic investment, it is always in balance in autarky.

Global financial market integration, however, erodes this home bias, that is, the inclination of investors to invest incremental savings domestically. Any country which opens its capital market, is then able to draw on foreign savings to finance investment, thereby allowing larger current account imbalances to be financed than would have previously been possible.

Feldstein and Horioka (1980) famously tested for this effect of capital market integration by assessing the correlation between domestic savings and investment rates with the following cross-sectional regression:

(1) $(I/Y)_i = \alpha + \beta(S/Y)_i + u_i$

where $(S/Y)_i$ = average Net Saving/Gross Domestic Product of country i,
$(I/Y)_i$ = average Gross Fixed Capital Formation/Gross Domestic Product of country I,
u_i = is a random disturbance term,

and α and β are the relevant parameters to be estimated.

The basis for their reasoning is that in a world of perfect capital mobility, there would be no correlation between domestic saving and investment rates (β=0) as domestic savings would flow to countries offering the highest returns, while domestic investment would be financed from global capital markets. This is compared to a situation of autarky whereby all incremental savings are invested domestically (β=1).

Feldstein and Horioka ran the regression on a sample of 16 OECD countries over the period 1960-74 and found that, contrary to expectations of greater capital market openness within the OECD and the evidence of large capital flows among countries, the estimated correlation between savings and investment equalled 0.89 and was not significantly differently from unity. They interpreted this high correlation as implying segmented capital markets or low international capital mobility.

This surprising result led Obstfeld and Rogoff (2001) to identify the Feldstein and Horioka result as one of the six major puzzles of international macroeconomics. Their own re-estimation of the regression for the period 1982-91 on a sample of 22 OECD countries resulted in a correlation coefficient of 0.62. Thus, they concluded that the high correlation between savings and investment had not weakened over time. Furthermore, they add a number of non-OECD countries (for a total of 56) to the regression sample and find that this unexpectedly lowers β to 0.41.

The literature investigating the Feldstein-Horioka puzzle has been extensive, with various extensions of the original test and greater refinement in the econometric methods. More recently, Blanchard and Giavazzi (2002) re-estimated the original Feldstein-Horioka regression for OECD countries. They also looked specifically at the single European market, which has been subject to considerable product and financial market integration and to the countries of the European Monetary Union which adopted

the euro in 1999. Although they conclude that there is no evidence of a decline in the correlation between savings and investment in the OECD countries, their estimate of the coefficient β is lower than that found by Feldstein and Horioka and Obstfeld and Rogoff. Importantly, they find that in the case of the EU and the Euro Area, the Feldstein-Horioka puzzle seems to have largely disappeared. The estimate of β is very low, a finding consistent with the conclusion that incremental savings are increasingly being used to finance investment in other countries.

Testing for Global Financial Integration - Results of Feldstein-Horioka test

Studies	Countries	Period	Estimate of β
Feldstein and Horioka	OECD [a]	1960-1974	0.89*
Obstfeld and Rogoff	OECD [b]	1982-1991	0.62*
		1990-1997	0.60*
Blanchard and Giavazzi	OECD	1991-2001	0.57
	European Union		0.36
	Euro Area		0.14

Notes:

* Significant at the 1 per cent level. Blanchard and Giavazzi do not provide information on the level of significance.

[a] : Australia, Austria, Belgium, Canada, Denmark, Finland, Germany, Greece, Ireland, Italy, Japan, Netherlands, New Zealand, Sweden, United Kingdom and the United States.

[b] : Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Mexico, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom and the United States.

In line with this idea of greater capital market integration, one leading explanation for rising global imbalances traces it to an excess of savings in emerging markets (specifically East Asia) and the attractiveness of the United States as an investment destination, the depth and sophistication of US financial markets and the role of the dollar as leading international reserve currency (Bernanke, 2005).

The savings glut in emerging East Asia is traced to the lessons drawn by governments there from the financial crisis of 1997-98, the type of development strategy pursued in the region and the underdeveloped nature of the region's financial and capital markets. The Asian financial crisis led the emerging market economies to self-insure against future financial crises. They have done so by accumulating foreign exchange reserves, primarily in US dollars. A number of indicators that have traditionally been used to assess whether foreign reserves are sufficient seem inadequate to explain the build-up of reserves. One such rule is to maintain reserves enough for three to four months worth of imports. A second rule-of-thumb suggests keeping enough reserves equal to a country's short-term external debt (short-term is usually defined as having a maturity of up to one year). A third rule-of-thumb is to keep the ratio of foreign exchange reserves to broad money, which reflects the potential for resident-based capital flight from the domestic currency, significantly above zero. By these traditional indicators of reserve adequacy, the stock of international reserves held by central banks in Asian countries is substantially in excess of what is needed.

Emerging East Asia has followed an export-led development strategy which was supported by exchange rate policies that anchored domestic currencies to the US dollar. It has been a successful development strategy resulting in the rapid mobilization and employment of tens of millions of workers. The means to bring this about is the cross-border transfer of goods and services to the centre country in exchange for financing its deficits (Dooley et al., 2006).

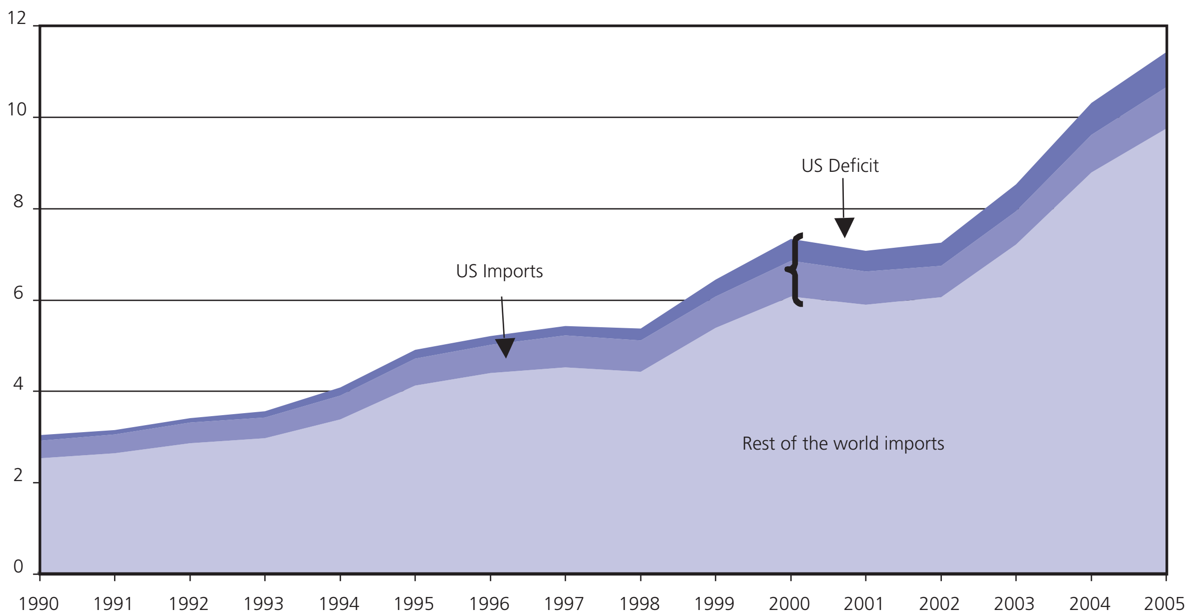
The flow of savings to developed countries has also been encouraged by the lack of financial and capital market development in emerging Asian economies. The underdeveloped nature of the domestic financial or capital markets has become a bottleneck preventing the effective channelling of domestic savings into worthwhile investment projects at home.

But the size of the imbalances has raised the key question of their sustainability and the nature of the adjustment process. The weight of expert opinion suggests that these imbalances will ultimately decline although there is no consensus on when or on the manner, whether smoothly or abruptly, in which it would occur (Clarida, 2006). But there seems to be broad agreement that some combination of exchange rate and asset price changes would play a role during the process of adjustment. Studies of past adjustments in industrial countries point to the challenges ahead. Larger deficits take longer to adjust and are associated with significantly slower income growth during the current account recovery (Freund and Warnock, 2006). Consumption-driven current account deficits involve significantly larger depreciations than deficits financing investment. Obstfeld and Rogoff (2006) suggest that a large depreciation of the US dollar, something in the order of 30 per cent, could accompany the process.

(c) Implications for world trade

One side effect of the large current account imbalances of the last few years has been a higher growth rate in world merchandize trade. Many countries were willing to produce and ship more merchandise goods to the United States than could be paid for by the sale (export) of US products to them, thus helping fuel the global economy. Since the year 2000, the US trade deficit has averaged between 7 and 8 per cent of world trade. This is nearly double its average size of 3.8 per cent during the 1990s. The US trade deficit has thus represented a hefty source of demand growth to the world economy. Given that the US has run large trade deficits with nearly all of its major trading partners, that demand has also been spread more evenly than is sometimes thought, although China gets the lion's share (see Table 2).

Chart 6
US merchandise trade deficit as share of global trade, 1990-2005
(Trillion dollars)



Source: UN Comtrade database.

But if the US current account imbalance were to narrow as would seem inevitable, would the world be facing the prospect of slower merchandize trade growth? Not necessarily so. It would depend on the nature of the adjustment. If the adjustment occurs through an acceleration of the growth of US merchandise exports, with only some modest adjustment on the import side, then the unwinding of the US deficits need not represent an adverse shock to world trade. And there is some historical evidence to support this "soft-landing" scenario.

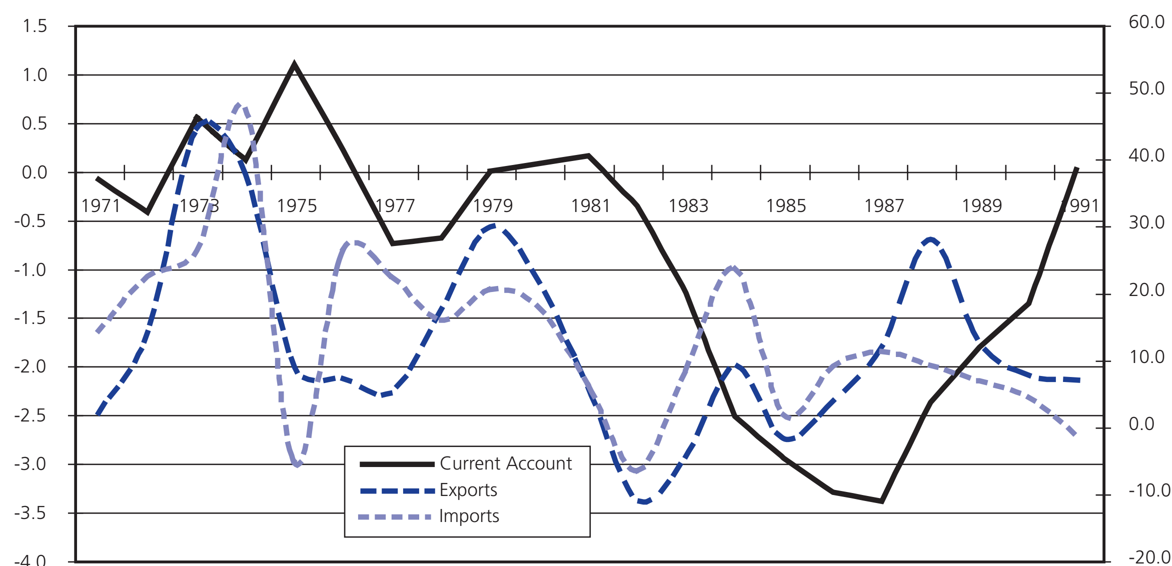
Table 2
US trade deficits with major trading partners, 2006
(Billions)

Region/Country	US trade deficit
North America	
Canada	75.6
Mexico	66.5
Europe	
EU (25)	120.0
Eastern Europe	11.2
Asia	
China	232.7
Japan	90.6
India	11.8
Rep. of Korea	14.4
Chinese Taipei	15.6
South and Central America	
Brazil	7.3
Venezuela	28.2
Middle East	35.5
Africa	
South Africa	3.1
TOTAL	836.0

Source: US Bureau of Economic Analysis.

Chart 7 shows the pattern of previous adjustments in the US current account deficit during the two decades after 1970. Three figures are shown: the current account as a share of GDP, the annual growth rate of nominal exports and the annual growth rate of nominal imports. There were small imbalances in the early 1970s, just after the Smithsonian Agreement ended the fixed exchange rate system of Bretton Woods, and in the mid-70s, partly because of the oil price shock. A longer and more pronounced period of imbalances took place in the mid-1980s, as a rebounding US economy was coming off its deepest recession of the post-war era and the dollar appreciated strongly against the major currencies. In all these episodes, exports played an important role in facilitating the adjustment towards current account balance. US nominal exports grew strongly in each episode -above 40 per cent in 1973, and close to 30 per cent in 1979 and in 1988. US import growth slackened during each of those periods, although it did not fall off precipitously until in the last episode of adjustment. Beyond the US example, Freund's (2000) study of 25 episodes of turnarounds in the current account imbalances of industrialized countries between 1980 and 1997 found that real export growth was generally part of the adjustment process.

Chart 7
Pattern of previous US current account adjustments, 1970-91
(Percentage)



Source: IMF, World Economic Outlook Database, September 2006.

Now, adjustments to large current account imbalances are complex processes. The speed and economic effects depend on many factors. How much of the adjustment takes place in changes in asset valuation? How much in a reduction in absorption? How much in expenditure switching? It will also matter how much international coordination among finance and central bank authorities takes place to ensure a supportive policy environment. Thus, the discussion above should not be seen as simplifying the challenges that are involved. If one can take a specific example, the soft-landing scenario requires that the acceleration of US export growth be matched by increased demand for US goods from the rest of the world. This would need to be triggered by just the right kinds of movements in exchange rates, asset and goods prices. A more liberal trading system would also facilitate this adjustment. Some comfort should be drawn from the fact that smooth adjustments have occurred in the past, but by the same token, history offers no guarantees for the future.

Beyond the implication for future world trade growth, the more immediate threat to trade from global imbalances is the ammunition it has provided for trade protectionism. There is a temptation to explain the source of the imbalance to unfair trade practices rather than to differences in savings and investment behaviour between countries. Thus, proposed solutions typically invoke protectionist measures. But they are addressing the symptoms rather than the causes of the imbalances. This type of policy debate poisons public perception about the desirability of more trade liberalization, such as that being discussed in the Doha round of multilateral trade negotiations. As was emphasized earlier, sustained current account imbalances are primarily a macroeconomic phenomenon. The adjustment, when it comes, needs a supportive international policy environment, and a successful conclusion to the current multilateral trade negotiations would go a long way towards providing just that.

BIBLIOGRAPHY

Bernanke, B. S. (2005) 'The global saving glut and the U.S. current account deficit', Remarks given at the Sandridge Lecture, Virginia Association of Economics, Richmond, Virginia, 10 March.

Blanchard, O. and Giavazzi, F. (2002) 'Current account deficits in the Euro area: the end of the Feldstein-Horioka puzzle?', *Brookings Papers on Economic Activity 2002 2:* 147-209.

Clarida, R. H. (2006) *G7 Current Account Imbalances: Sustainability and Adjustment,* Chicago: University of Chicago Press.

Dooley, M. P., Folkerts-Landau, D. and Garber, P. (2006) 'Direct investment, rising real wages and the absorption of excess labor in the periphery' in Clarida, Richard H. (ed.) *G7 Current Account Imbalances: Sustainability and Adjustment,* Chicago: University of Chicago Press.

Feldstein, M. and Horioka, C. (1980) 'Domestic savings and capital flows', *Economic Journal* 90: 314-329.

Freund, C. (2000) 'Current account adjustment in industrialized countries', *International Finance Discussion Papers* No. 692, New York: Board of Governors of the Federal Reserve System.

Freund, C. and Warnock, F. (2006) 'Current account deficits in industrial countries: the bigger they are, the harder they fall?', in Clarida, Richard H. (ed.) *G7 Current Account Imbalances: Sustainability and Adjustment,* Chicago: University of Chicago Press.

Lerner, A. P. (1936) 'The symmetry between import and export taxes', *Economica* 3, 11: 306-313.

Obstfeld, M. and Rogoff, K. (1996) *Foundations of International Macroeconomics,* Cambridge: MIT Press.

— (2001) 'Six major puzzles of international macroeconomics', in Bernanke and Rogoff (eds) *NBER Macroeconomics Annual 2000,* Cambridge : MIT Press.

— (2006) 'The unsustainable U.S. current account position revisited', in Clarida, Richard H. (ed.) *G7 Current Account Imbalances: Sustainability and Adjustment,* Chicago: University of Chicago Press.

II SIX DECADES OF MULTILATERAL TRADE COOPERATION: WHAT HAVE WE LEARNT?

A INTRODUCTION

On 1 January 2008 the multilateral trading system will celebrate its sixtieth anniversary. The World Trade Report 2007 marks the occasion with a retrospective look at what has been learned from those six decades of international trade cooperation. It attempts to identify both what lessons are to be drawn from past experience and the nature of challenges to come. To address these issues, the report adopts an eclectic approach, drawing from the economic literature as well as from economic history, international relations or legal approaches. The objective of the report is to explore the lessons to be learned from the rich history of change and institutional adaptation of the multilateral system.

This is an ambitious undertaking, which is one of the reasons why the report does not pretend to be exhaustive. While the selection of topics, in particular in the fourth Section, reflects an attempt to cover the most important achievements of the multilateral trading system and the challenges the system faces, a number of core areas – particularly services and intellectual property – have clearly not received the attention they deserve. It should also be noted that this report takes a long term perspective on achievements and challenges to the system and does not attempt to analyse or debate the ongoing Doha negotiations.

The first major Section (Section B) begins with a brief historical review of international trade cooperation in the late 19th century and in the first half of the 20th century. The rest of this Section takes a step back from events to consider what the theoretical literature might teach us about why nations choose to cooperate with one another in trade matters. The review of the literature starts with a discussion of the economic theory of trade agreements. This is followed by an examination of international relations and legal approaches to cooperation. The question of how the theories analyse cooperation amongst diverse nations is treated separately. The review seeks to show that despite differences in their methodological approach, these different conceptual frameworks display some interesting features in common. They also bring a variety of different insights about what might drive cooperation.

Building on the rationale for trade cooperation, Section C is concerned with the question of how the gains from such cooperation can be secured and safeguarded. The Section starts with an analysis of why governments appear willing to cede authority to international institutions like the GATT/WTO and what role such institutions play with regard to trade cooperation. Again, both economic and non-economic approaches to formal institutions are taken into consideration. The Section then looks more closely at the mechanics and architecture of arrangements designed to promote and protect trade liberalization. Different subsections deal with reciprocity and non-discrimination, anti-circumvention and how to secure the gains from liberalization, the role of contingency provisions in addressing unanticipated situations, enforcement mechanisms and the function of dispute settlement, and how transparency and surveillance can serve to strengthen the basis for international cooperation.

While the previous two Sections analyse trade agreements in general without focusing specifically on the GATT/WTO, Section D examines the multilateral trading system of the GATT/WTO. This Section starts with an historical account of how the GATT emerged, developed and was eventually transformed into the WTO. This is followed by six subsections that examine a variety of issues of particular importance. Subsection 2 reassesses the magnitude of tariff reductions in the early years of the GATT for both developed and developing countries. Subsection 3 examines the development of the dispute settlement system. This is followed by a discussion of the development of the institution in the context of the continuing need to accommodate an expanding and increasingly diverse membership. The emphasis here is on special and differential treatment and the challenges of addressing developing country needs and interests within the system. Subsection 5 then looks at regionalism, both as a complement to multilateral cooperation and as a systemic challenge. The evolution of the decision-making process in the GATT and the WTO is the subject of subsection 6. Both internal processes for doing business and the involvement of external non-state actors are covered in the discussion. Finally subsection 7 explores how governments determine the content of the trade agenda under the WTO and considers the challenges of defining policy areas upon which governments choose to negotiate. Section H contains the conclusions, highlighting some of the challenges facing the multilateral trading system and noting a number of likely future challenges.

B THE ECONOMICS AND POLITICAL ECONOMY OF INTERNATIONAL TRADE COOPERATION

1. THE HISTORICAL CONTEXT FOR THE FAILURE OF INTER-WAR TRADE COOPERATION

(a) Trade policy before World War I, 1860-1914

The rise and decline of free trade in the 19th century and the attendant economic and political consequences of these trends have always intrigued historians and economists. In the difficult times following World War I, when international trade relations had to be rebuilt, the free trade episode among European countries in the second half of the 19th century was perceived as a golden age. During that latter period, widespread economic development, driven by industrialization and technological change, went together with trade expansion supported by a network of bilateral trade treaties. This network started with the Anglo-French (Cobden-Chevalier) treaty of 1860 and triggered a series of other treaties among European countries. Bilaterally agreed reciprocal tariff reductions, together with the application of the unconditional most-favoured-nation (MFN) clause contained in the treaties, led to historically low tariff levels, in particular for agricultural products. This period of largely unfettered trade across Europe lasted for nearly two decades up to 1879, faltering gradually thereafter and collapsing with World War I.[1]

(i) The emergence of a multilateral trading system with low tariffs in Europe

In light of subsequent developments in international trade relations, it is interesting to note that no multilateral conference or international institution underpinned the de facto network of multilateral, non-discriminatory trade arrangements that emerged from the bilateral treaties among the leading trading nations in the late nineteenth century. These arrangements did not, however, constitute a global trading system with low protection levels – the United States and Latin American countries maintained a high tariff policy throughout this period. Moreover, trade between the colonial powers and the territories they controlled was largely bilateral and driven mainly by political factors which often led to a certain level of discrimination in trade and navigation policies. China and Japan, which had been closed economies in the first half of the 19th century were pressured into opening their markets to international trade between 1840 and 1860.[2]

The second half of the 19th century witnessed the spread of the Industrial Revolution to the European continent, the United States and Japan. A steady flow of innovations brought new and cheaper industrial goods to the market and sharply reduced communication and transportation costs. The impact of the telegraph, the railway networks and the steamship made international transportation not only cheaper but also more secure and faster. Markets for bulk commodities which had been separated in the past by insurmountable transport costs came increasingly into the reach of traders and stimulated production in regions of recent European settlements. These new opportunities attracted foreign investments and immigrants which accelerated the integration of markets on a global scale. The agricultural sector in the United Kingdom and on the European continent had to take the first brunt of market integration but with the spread of industrialization competition also increased among the industrial sectors of the European countries.

Throughout the 19th century a vivid theoretical and political debate flourished on the benefits of free trade. While the mercantilist's trade policies became largely discredited, the prescriptions of the classical

[1] For a detailed account of trade policy developments of the 1850-1913 period see Bairoch (1976), Bairoch (1989), Baumont (1952), Frieden (2006), Kindleberger (1975), Lal (2006), O'Rourke (2007), O'Rourke and Williamson (1999), Thorn (1970) and Woodruff (1971).

[2] China was forced to sign the treaties of Nanjing (1848), Tianjing (1848) and the Convention of Beijing (1860), which left its tariff regime under the control of foreign powers. Japan also faced pressure to conclude a series of trade treaties with the United States and major European powers from 1854 onwards (with Russia, the United Kingdom and the United States, in 1854, and with France, Holland and Prussia in 1861).

economists such as Adam Smith and David Ricardo in favour of unrestricted trade were opposed by other authors such as the American, Alexander Hamilton and the German, Friedrich List which recommended government intervention and a trade policy which should protect emerging domestic industry. The intellectual respectability of infant industry protection reached its zenith when John Stuart Mill, the pre-eminent mid-nineteenth-century economist, endorsed it in his major work "The Principals of Political Economy". Neither Friedrich List nor John Stuart Mill, however, recommended protection for the agricultural sector in any nation, nor did they argue for protection for Britain, the leading industrial nation of the time. Robert Torrens developed ideas akin to the optimal tariff argument, a notion that under certain conditions protection could improve national welfare. The strongest counter argument to these ideas is that of likely government failure. A government has not the foresight or the information to identify the industries worth supporting and is often not strong and independent enough to restrict protection only to those industries for which protection could lead to an increase in national welfare.

The United Kingdom played a crucial leadership role in the European experience. The Corn Laws were repealed in 1846, and other measures were taken to open up to trade, including the conclusion of bilateral trade treaties.[3] In the mid-nineteenth century, the United Kingdom was the undisputed technological leader in the industrialization process, most prominently with its textiles industry. It was the largest exporter and importer in the world, and possessed the largest commercial fleet.[4] The UK pound was the most widely used and accepted currency in the world and the United Kingdom had the largest stock of investment outside its home economy. The British currency and London's financial markets were the lynchpin of the gold standard to which adherence had been growing rapidly since 1872.[5] Since the end of the Napoleonic wars and the Congress of Vienna, the United Kingdom had entered a period of unprecedented political stability at home and in its relations with its European neighbours. With its competitive industry, the United Kingdom looked for export markets and in return was willing to accept agricultural products and raw materials on a large scale. The development of overseas sources of supply was supported in large measure by capital exports and immigration.

Why did other European countries follow the United Kingdom's lead to substantially lower their trade barriers? First, trade policy in Europe was a feature of more liberal, market-oriented domestic economic policy regimes.[6] Second, the United Kingdom offered the largest import market and even although trade barriers were low, the prospect of reducing them further and binding them through a treaty proved a worthwhile objective. Under the Cobden-Chevalier treaty, France benefited from guaranteed free entry for a specified list of manufactured goods, an 80 per cent duty reduction for wine and an exemption from the British export tax on coal. The United Kingdom secured the elimination of import prohibitions in France and their replacement by tariffs (with an upper limit of 30 per cent *ad valorem*).[7] Once France and the United Kingdom had agreed, a flurry of agreements followed across Europe. The United Kingdom had already applied its (low and mainly fiscal) tariffs on an unconditional MFN basis before 1860 and this clause was retained in the Cobden-Chevalier treaty.[8] According to Kindleberger (1989), the example provided by the Cobden-Chevalier treaty helped to win over the protectionist forces in Prussia, leading to a trade treaty between the Zollverein and France in 1865. Besides the economic considerations the Prussian government hoped to improve relations with France and garner support for its foreign policy

3 The repeal of the Navigation Act in 1849 was a further major step in the liberalization of Britain's trade.

4 The United Kingdom alone accounted for about one-fifth of world trade (see Appendix Tables 1 and 2).

5 Between 1872 and 1879, nine countries started to apply and guarantee a gold parity for their exchange rate (Germany (1872); Denmark, Norway and Sweden (1873); Netherlands (1875); Belgium, France and Switzerland (1876) and the United States(1879); Frieden (2006: 6).

6 Bairoch (1976: 57) reproduces a letter from Napoleon III to his Minister of State dated 5 January, 1860 in which he exposes his broad economic program including support to industry by lowering tariffs on imported raw materials and the stimulation of competition in the industrial sector by lifting various domestic restrictions.

7 See Bairoch (1989). In 1860, the United Kingdom recorded a large bilateral trade deficit with France, which at that time imported few manufactured goods. The share of manufactured goods in French merchandise imports was a mere 3 per cent in 1860.

8 Before the repeal of the Corn Laws, the United Kingdom tariff of 1842 contained preferential tariff rates for its colonies on one-fifth of its 1825 tariff positions (Nolde, 1932: 101).

over the Danish question and in isolating Austria.[9] In the case of Italy, agricultural export interests in the Piedmont region were a major factor in the adoption of a free-trade policy. Smaller European economies concluded trade agreements with France, thereby improving market access for their producers to the French market (which still had significant tariff barriers) and contributing to the creation of a low tariff area in Europe.

(ii) European free trade in decline, 1879-1914

The European trade treaty network started to falter when the initial trade treaties came due for renewal in a changed political and economic environment. During the Great (European) Depression between 1873 and 1896, prices of internationally traded goods decreased steadily, falling by one-third over the period.[10] While the United Kingdom remained strongly committed to its free trade principles and low tariff policy up to World War I, countries in continental Europe which had large agricultural sectors and less developed industrial sectors started to increase tariffs.

The shift towards more protection was motivated by different factors, although a major one was the depression caused by the agricultural crisis in continental Europe. Following the end of the United States' civil war (1861-65), grain production recovered in the United States and exports rose sharply. Benefiting from falling transportation costs, other areas of European settlement overseas also expanded their production. The influx of overseas grain into Europe caused a widespread price decline.[11] Continental wheat farmers who had supplied the British market during the United States' civil war quickly lost this market to United States suppliers when the war ended. Woodruff (1971) estimates that "with the great increase in the world production of grain from the 1870s until the end of the century, the price of wheat dropped from about $1.50 a bushel in 1871 to 86 cents in 1885; a decade later in 1894 the figure was about 70 cents.".[12] According to Bairoch (1989), this inflow contributed to a slowdown in the growth of agricultural production in continental Europe and a fall in farmers' income. Farming still employed more than one-half of the active population in these countries (compared to 22 per cent in Great Britain when it abolished the Corn Laws in 1846).

The fall in farmers' income depressed demand for consumer and investment goods, which had adverse effects on other industries. Reduced domestic demand was not fully compensated by offsetting favourable developments such as a real rise in the incomes of industrial workers (due to a fall in living costs) or higher manufactured exports. Monetary factors, in the form of lower growth in international liquidity, may have also played a significant role after the gold rushes in California and Australia had run their course.[13]

Demands by agricultural lobby groups for stronger protection against highly competitive overseas supplies also encouraged others such as the iron and steel and textile industries to seek higher protection. The most prominent shift to a more protectionist trade policy in Europe was the rise of German tariffs in a customs law introduced in 1879.[14] The shift to a more protectionist German trade policy cannot be attributed solely to domestic producers as government interests also played a role. In the case of Germany, Chancellor Bismarck (previously a supporter of free trade) joined and united the protectionist forces in the hope that higher tariffs would increase central government revenues.

---

9 It should be recalled that trade liberalization among countries had an important parallel within some countries. Within the German borders of 1871, more than 20 trade entities existed after the Congress of Vienna in 1815. These were gradually integrated through the formation and eventual merger of the Norddeutsche and Süddeutsche Zollverein. In Italy, national unification also resulted in the disappearances of independent autonomous trade entities.

10 See Lewis (1981) Tables 3 and 4.

11 After the spread of refrigeration techniques, a similar decrease in meat prices was observed.

12 See Woodruff (1971: 662).

13 See Baumont (1952).

14 Bairoch (1989) reports that Russia, Austria and Spain were ahead of Germany in the move to a more restrictive trade policy, with various measures introduced in the course of 1877.

Continental European trade policy turned even more protectionist during the 1890 to 1913 period. The starting point might be fixed at 1892, when more than half of the 53 trade treaties of European countries had expired and nationalist sentiments had become stronger. The introduction of the so-called Méline tariff[15] in France provided additional protection to the country's agricultural sector and strengthened protectionist forces all over the continent. In addition to the rise in tariff rates, more detailed and complex tariff schedules emerged. The introduction of schedules with maximum and minimum rates increased the uncertainty to traders. The French minimum tariffs were reserved for countries that had agreed to a bilateral treaty but they remained subject to changes decided by the French parliament. In contrast to the conventional tariffs applied in previous commercial treaties, therefore, no stability in tariff rates could be assured for the duration of the treaty. While the increased detail of tariff schedules was partly driven by the emergence of a larger variety of traded goods, in particular manufactured goods, this increased detail in specifications was sometimes used as a protectionist device to discriminate against competing foreign goods.

As trade barriers in Europe increased, the direction of trade flows changed. The colonial European powers strengthened their trade ties with the territories they controlled. Colonial territories had become more valuable markets and sources of supply due to falling transport costs, rapid population growth through migration, and increased foreign investment.

Once protectionist forces took hold across many countries, governments could blame the behaviour of others to justify their own trade restrictions. The shift in German trade policy in 1879 had been justified on the grounds that the United States retained high tariffs on manufactured goods (Bairoch, 1976:59). Over this period there was also a shift in the relative size of various national economies, which on balance eroded the leading position of the United Kingdom. First, the rise of the United States was increasingly felt in international trade relations.[16] Second, national sentiments were strengthening, above all in newly-unified Germany (1871) and Italy (1870). These countries were trying to catch up with the United Kingdom not only industrially, but also in international policy by competing for colonies. Growing rivalry among the major trading nations was only partly contained, for example through the Berlin Conference on colonies. Strong animosity prevailed in France towards Germany due to the loss of territory (Alsace, Lorraine) following the war of 1870/71. In the two decades prior to World War I, a number of tariff wars broke out, usually provoked by the establishment of a new, more protectionist tariff, or in the course of renegotiation of bilateral treaties.[17] After the expiry of a treaty, tariffs were often raised temporarily as a means of improving negotiating leverage.

Other important trade policy developments should be flagged. New policy instruments were introduced in the form of anti-dumping and export bounties (subsidies). Following a series of international conferences, the first international commodity agreement – the Brussels convention on sugar – was signed in 1902. This convention sought to regulate global production and trade in this product.

The increasing departure from the MFN principle could also be observed in the emergence of preferential trading arrangements, such as those among some members of the British Commonwealth.[18] Despite the widespread increase of protectionist measures before World War I in continental Europe, the United

[15] Méline was the French agricultural minister and major promoter of the tariff.

[16] The share of the United States in world exports rose from 7.9 per cent in 1870 to 14.1 per cent in 1900 (see Appendix Table 1).

[17] France had severe tariff conflicts with Italy (1987-1910) and Switzerland (1893-95). Germany experienced the same with Russia (1893), Spain (1894-96) and Canada (1894-1910), and Austria with several Balkan states (e.g. Romania).

[18] Imperial preferences were introduced by Canada in 1897, by New Zealand and South Africa in 1903 and by Australia in 1907 (Nolde,1932: 103).

States[19], Argentina and other countries, world trade continued to expand rapidly.[20] Among the factors which balanced the adverse impact of these protectionist measures was broad adherence to the gold standard in the latter part of the period, rapid technological progress, which continued to reduce transportation costs and a marked rise in migration flows and foreign investment. Finally, the recovery in prices of internationally traded goods from 1896 onward attenuated the *ad valorem* incidence of specific duties.

(b) Trade policy turmoil in the inter-war period, 1918-39

During World War I, international trade relations based on private commercial transactions were replaced by extensive government controls, as output was dedicated to support national war efforts. Sea blockades and submarines curtailed overseas trade. High tariff levels, quantitative restrictions and prohibitions on both exports and imports, combined with foreign exchange controls, increasingly dominated the policy scene. At the Allied Economic Conference in 1916, Britain, France and Italy indicated that after the war they would no longer be prepared to grant MFN treatment to their German enemy, but would give trade preferences to each other. On the other hand, United States' President Wilson declared in his Fourteen Points Programme for the post-war period that all economic barriers should be removed (as far as possible) and that equality of trade conditions among all nations (which consent to the peace) should be established. [21]

Territorial changes in continental Europe resulted in nine new states and trading entities (in general, largely agricultural economies), which aimed to consolidate their newly-found independence and used tariff policy to foster their nascent industrial sectors. The division of Habsburg Austria into six independent states[22] led to the disintegration of one single market into six separate customs territories and a breakdown of the pre-war production pattern. Germany had lost provinces in the East, which previously supplied a large part of its grain output, and had been markets for its industrial goods. On its western border, Alsace and Lorraine, two important coal and steel producing regions, returned to France. Following civil war and revolution, Russia lost territory in the West and the Soviet Union became an inward-looking centrally-planned economy with a much reduced role for external trade in its economy. The territorial changes also provoked large displacements of people across Europe.

Despite the creation of the League of Nations in 1920, and the various international conferences sponsored by the League of Nations, the political willingness to cooperate internationally remained limited.[23] This was partly because the economic consequences of the war (in particular reparations, inter-allied war debts and unrealistic exchange rates) were not addressed properly. The United States, which had become the largest creditor and the strongest economy in the world, was reluctant to play an international role commensurate with its economic power, and was unwilling to join the League of Nations, whose creation it had sponsored. Domestically, the role of governments in economic affairs was greater after World War I than before it. This was partly due to the spread of more representative parliaments and a shift in public opinion, which expected governments to provide improved social protection and full employment.

However, the biggest and largely underestimated challenge was how to cope with the massive dislocation of production and trade patterns caused by the war. Before the outbreak of war, the major European countries traded extensively among themselves, and their overseas trade consisted largely of exporting manufactured

[19] The McKinley tariff of 1890 was partly reversed by the Wilson-Gorman Tariff Act of 1894. But the Dingley Act of 1897 'had the distinction of imposing the highest average rate of customs duties overall written into any US tariff law up to that time' (Dobson, 1976). The Payne Aldrich Tariff of 1909 changed little, while the Underwood Tariff Act of 1913 markedly reduced tariff rates (although these still remained high by European standards).

[20] According to Lewis (1981) nominal (and real) world merchandise trade growth was only marginally stronger in the 1860-80 period than in the subsequent 1880-1913 period.

[21] For a more detailed account of inter-war trade policy developments see Committee on Trade and Industry (1925), Frieden (2006), Kindleberger (1989), Irwin (1993), O'Rourke (2007), League of Nations (1942) and (1945), Liepmann (1938) and Rappard (1938).

[22] Austria, Czechoslovakia, Hungary, Poland, Romania and Yugoslavia.

[23] The major conferences were the 1922 Brussels International Financial Conference, the 1922 Genoa Conference, the 1927 Geneva World Economic Conference, and the 1933 London Monetary and Economic Conference.

goods and importing agricultural produce and other primary products. Trade among the European countries in manufactured goods had been increasing as the late-comers to industrialization caught up with the United Kingdom and started to overtake it in new fields (such as the chemical and electro-technical industry).

The war absorbed most of the domestic resources in the European countries involved in hostilities. This reduced exports, which were further curtailed by trade and transport restrictions, culminating in outright blockades enforced by military means. The breakdown of traditional trade flows reduced and reversed prevailing specialization in the world economy. For national security reasons, autarchy took hold in critical agricultural and raw materials sectors.

The self-destruction of Europe in World War I provided a massive stimulus for the economies outside Europe. Not only did export demand for raw materials and agricultural produce increase, but the decline in imports of manufactures from Europe also led to an expansion of manufacturing industry in regions outside Europe. Once the hostilities were over, a simple return to international pre-war production and trade patterns was not possible, given the existence of recently added capacity in agricultural output on a global level, which contributed to an abrupt price decline from the peak level reached in the period immediately after the war.

European governments and their people had great difficulty in accepting the wealth and income loss associated with the war, and had unrealistic expectations on how war reparations could offset their inter-allied debts and contribute to the reconstruction of their economies. The determination of realistic exchange rates remained extremely difficult as long as there was no certainty as to how the war debt should be paid, and how suppressed domestic inflation could be contained once numerous price controls were lifted. As these monetary issues were not properly addressed, hyperinflation and massive exchange rate adjustments occurred frequently in the two decades following World War I.[24]

(i) Tariff policies in the inter-war period

The absence of any master plan after World War I and the lack of a coordinated international approach to dismantling war-time controls and facilitating the transition to an orderly post-war world economy created uncertainty and mistrust among nations, leading to political instability. The dire economic situation in most European countries and the fragile domestic political situation in many of them (especially in Germany, the major economy in Central Europe) combined with monetary instability made it very difficult for governments to accept lower trade barriers. On the contrary, given the shortages experienced during the war, many industries were considered strategically important and granted special protection after the war. Examples of this were parts of the chemical industry and electrical machinery industry in the United States and the United Kingdom (through the Fordney-McCumber Tariff in 1922 and the Safeguard of Industries Act in 1921, respectively).[25]

According to League of Nations calculations, tariffs on manufactured goods in 1925 were higher than before World War I in a majority of countries (Table 1). It may be noted that countries which had become creditor nations, in particular the United States (but also Argentina, Australia, Canada and India), increased or kept tariffs very high by international standards.[26] Another aspect of trade policy was the significant rise in preferential tariff margins in the Commonwealth countries.[27] In certain cases, the shift towards higher tariffs in the early 1920s compensated to some extent the lifting of various non-tariff barriers introduced during the war. The dismantling of war-time prohibitions, quantitative restrictions and exchange controls

24 See Williams (1947) and Horowitz (2004).

25 The United Kingdom prohibited the imports of dyes as dependence on German supplies of this product had been problematic during the war.

26 According to a League of Nations estimate, the United States (together with Spain) had one of the highest overall tariff levels in 1925.

27 Committee on Industry and Trade (1925: 24): 'The amounts of these preferences are in general substantial and they have increased materially since the war.. ... At the present time this preferential advantage has on average increased to 9 percent *ad valorem*.'.

was almost completely achieved by 1920 in North America, Belgium, Great Britain, the Netherlands, and the Scandinavian countries, but it took more time in other parts of Europe. In order to patch up the old trade and production linkages, Central Europe's trade was largely based on intergovernmental barter trade which was gradually replaced by a mixture of prohibitions and licensing systems.

Table 1
Applied tariff rates of major traders in 1913 and 1925
(Percentage)

	Manufactured goods		All products	
	1913	1925	1913	1925
Argentina	28	29	26	26
Australia	16	27	17	25
Austria-Hungary	18	-	18	-
Austria	(18)	16	(18)	12
Czechoslovakia	(18)	27	(18)	19
Hungary	(18)	27	(18)	23
Poland [a]	(13-18)	32	(12-18)	23
Belgium	9	15	6	8
Canada	26	23	18	16
Denmark	14	10	9	6
France	20	21	18	12
Germany [b]	13	20	12	12
India	4	16	4	14
Italy	18	22	17	17
Netherlands	4	6	3	4
Spain	41	41	33	44
Sweden	20	16	16	13
Switzerland	9	14	7	11
United Kingdom	-	5	-	4
United States	{ 44 25[c]	37	{ 33 16[c]	29

[a] Germany and Austria for 1913.
[b] Average of old and new tariff (from October 1925) for 1925.
[c] Referring to Underwood Tariff applied in 1914.
Note: Unweighted arithmetic average.
Source: League of Nations (1927) p.15.

By 1925-27, nearly a decade after the end of the hostilities, exchange rates had become more stable and world trade started to exceed the pre-war level of 1913, while the tendency to revise tariffs upwards almost came to a halt. However, it was not only high tariff levels but also the instability of tariffs that restricted international trade. In order to react quickly to currency changes, governments remained empowered to introduce surtaxes or apply "coefficients of increase". The number of bilateral trade treaties remained small up to 1925, and even when they started to increase, their duration remained short-term.[28] Rebuilding a more stable trading system would have implied a return to the MFN principle. Acceptance of a MFN clause in its unconditional form occurred in 1922 in the United States, but Europe, France and Spain resisted the application of the unconditional MFN clause until 1927/28. The generalization of the MFN clause over the course of the 1920s did not, however, extend to national treatment of foreign traders or firms. This meant that additional domestic charges or regulations could undermine the value of the tariff commitment, and do so in a discriminatory manner. In addition, non-

28 According to Irwin (1993), the number of countries linked by commercial treaties rose from 30 in 1927 to 42 in 1928.

discrimination at the border was in many cases obstructed by means of very detailed tariff specifications which limited the applicability of bilaterally-agreed tariff reductions for third parties.

The temporary tariff truce of 1927-28 and the build-up of a network of commercial treaties based on an unconditional MFN clause started to fail when a sharp fall in agricultural prices occurred in 1928-29. France, Germany and Italy reacted quickly by raising their agricultural tariffs (Kindleberger, 1989:168). Tariff reform discussions in the United States Congress in 1929 focused first on higher agricultural protection but soon encompassed industrial products. In the end, Congress passed the Smoot–Hawley Tariff Act, which was signed by President Hoover and enacted in June 1930. During the debate over this tariff reform, 1,000 American economists and numerous countries protested against the tariff reform, but to no avail. Even before its implementation, this legislative act provoked widespread retaliation, contributing to a general increase in tariffs. The targeted increase of individual tariffs on goods of interest to the United States broke down any vestigial resistance to demands for protection.[29]

The passage of the Smoot-Hawley Act and the retaliatory response it engendered are considered a classic example of the disastrous repercussions of unilateral protectionist actions on international trade relations and the volume of trade flows. The protectionist measures introduced unilaterally by the strongest economy at that time, which was also the largest international creditor with a large trade surplus, did not produce the intended results. Domestic agricultural prices continued to decline and exports of agricultural produce and manufactures decreased. More importantly, Smoot-Hawley shattered the limited trust remaining in the trading system and wrought havoc on global trade flows.

Monetary policies played a more prominent role in the outbreak of the 1929 crisis, by accelerating the reversal of capital flows from Europe to the United States, and aggravated the deflation in Europe. Trade restrictions introduced in Europe in 1930 to limit the trade deficits and maintain debt payments contributed to the financial panic and bank failures in 1931, eventually leading the United Kingdom (on 21 September, 1931) and later the United States (on 20 April, 1933) to abandon the gold standard. Sixteen countries devalued or left the gold standard in the course of 1931.[30] The breakdown in international trade relations based on non-discriminatory bilateral trade treaties postponed economic recovery and had broader repercussions on international relations. Countries started looking for cooperation partners with whom they had or intended to develop special stable and preferential ties going beyond trade policy. Openly discriminatory trade relations evolved. This new direction of policy and the severity of the crisis led to the introduction of very blunt trade measures, including prohibitions, quantitative restrictions, exchange controls and clearing systems. Germany did not officially abandon the gold parity but introduced exchange controls (July 1931) and developed a multiple exchange-rate system. The autarkic reconstruction of the German economy under Hjalmar Schacht was accompanied by an elaborate system of preferential trade agreements with East European countries. Japan left the gold standard in September 1931 and strongly devalued the yen. Only a few months later its troops went to Manchuria to assure raw materials and energy supplies.

Having departed the gold standard in 1931, Britain participated in 1932 in the Ottawa Agreement, establishing the Imperial Preference System through a combination of a broad increase of general duties and substantial tariff preferences. Almost a century-old tradition of free, MFN-based trade policy ended when the United Kingdom surrendered its role as a stalwart of multilateral trade and the gold standard.[31] Discriminatory policies were widespread in other leading nations in favour of their colonies or of countries under their political influence. Much of this discrimination was caused by exchange allocation, clearing agreements and the administration of import quotas.

---

29 Irwin (1998) provides estimates indicating that the Smoot-Hawley Act increased US tariffs on average by about 20 per cent and that the deflation up to 1932 increased the effective tariff rate by about 30 per cent. Liepmann (1938) provides estimates for the sharp increases in tariffs for 15 European countries between 1927 and 1931. According to one data set (Table 5) the average increase in applied European tariff amounted to 50 per cent between 1927 and 1931.

30 Frieden (2006: 187); League of Nations, Statistical Yearbook of the League of Nations, 1939/40, Table 101 provides the dates when countries left the gold standard in the 1929-40 period.

31 More precisely it was a period of 86 years (1846-1932) only interrupted by the World War I period.

The years 1932-33 witnessed perhaps the darkest period for trade policy in the twentieth century. In 1932, trade was at its lowest level in dollar terms since 1921. Between 1929 and 1932, trade measured in dollar terms contracted by 60 per cent and shrank in real terms by nearly one third (see Appendix Charts 1-4). Following the abandonment by the United States of the gold standard in early 1933, eight European countries forming the so-called "gold block" insisted at the London Monetary and Economic Conference (June 1933) on some dollar exchange-rate stabilization before considering a tariff agreement. However, United States President Roosevelt was unwilling to take any commitments in that direction "which rendered impossible any agreement on currency and thereby also on trade policy".[32]

Once it became apparent that the Smoot-Hawley Act had failed to stem the agricultural crisis and did not lift prices of agricultural goods on world markets, nor improve domestic employment levels, United States' policies began to take a new direction. The New Deal was introduced and on the trade policy front the Reciprocal Trade Agreements Act of 1934 was introduced. Given the domestic and international situation, the only feasible approach was to engage in bilateral trade negotiations. With the new trade act, Congress granted the President the authority to conclude reciprocal and mutually-beneficial trade agreements in which prevailing duties could be lowered by up to 50 per cent. Between 1934 and the end of 1939, 21 agreements with 19 countries were concluded, accounting for two-thirds of United States' trade in the 1931-35 period (exports plus imports). The most important agreements were those with Canada (1936 and 1938) and the United Kingdom (1938). These countries had been by far the largest trading partners of the United States. Although the bilateral agreements took some time to put in place, they contributed significantly to the reduction of high protection levels prevailing in the mid-thirties.

The Reciprocal Trade Agreements Act of 1934 contained other important features. First, treaties were based on the MFN principle, so that all traders signing a treaty with the United States benefited from the tariff reductions agreed in all other agreements based on the Act. Second, detailed tariff setting was moved from Congress to the executive branch, thus diminishing the influence of narrowly-focused interest groups. The changed direction in United States' trade policy in the 1930s came too late, however, to reverse the trend towards preferential trade areas.

As access to crucial raw materials from traditional overseas sources became less secure for a number of countries, national security concerns favoured tendencies towards regional bloc-building. This trend was ultimately wound up with the use of military force to secure access to critical sources of supply. Assured access to critical supplies were openly-declared war objectives of both Germany and Japan.

(c) Conclusions

This brief historical summary emphasizes how easily the benefits of open trade can elude nations in the absence of a shared commitment to international cooperation. If countries submit to the temptations of protectionism, autarchy and narrowly-drawn nationalism, and these forces take hold, the trends are not easy to reverse before costly errors and attendant hardships have taken their toll.

A lesson from trade policy in the first half of the twentieth century is surely that effective and sustainable international cooperation must build on a predictable institutional framework that embodies a pre-commitment by governments to a certain policy stance. Nor should we forget that international economic policy is not only about trade protection – the treatment of international capital flows and exchange-rate policies also exert a strong influence on outcomes. Large shifts in international capital flows in a fixed exchange rate system (like the gold standard at the end of the 1920s) and uncoordinated (autonomous) large exchange-rate adjustments can undermine efforts to develop a predictable trade policy based solely on tariffs.

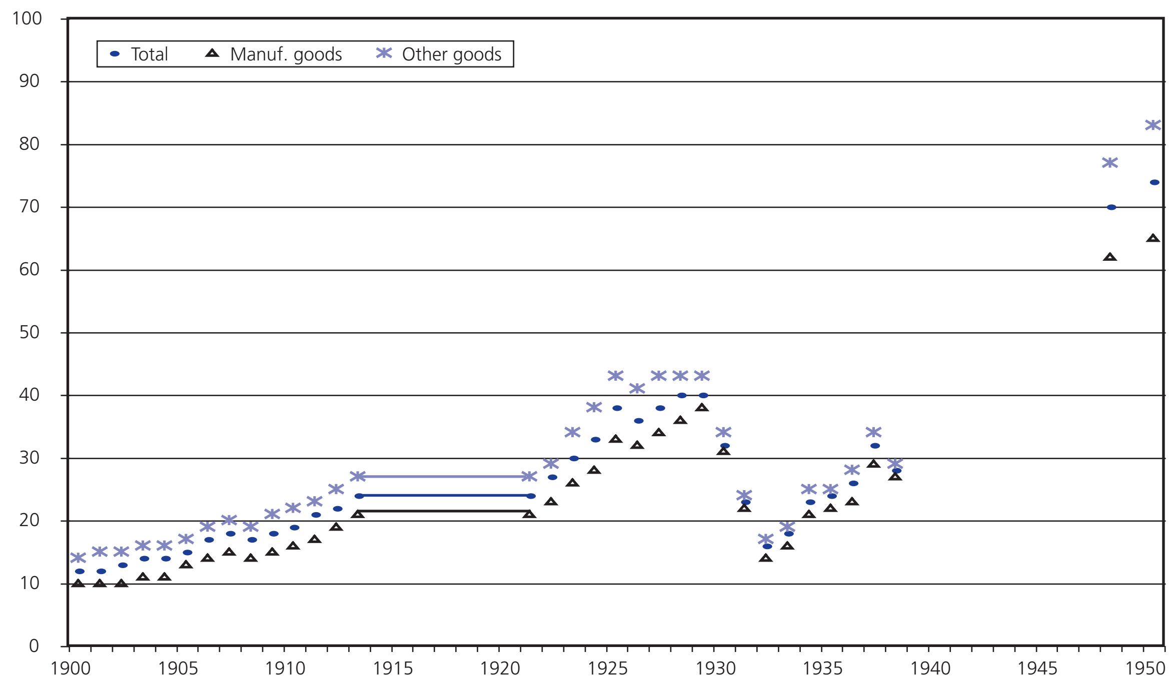
Leadership by a strong power can inspire engagement in building international cooperation, provided the exercise of such power is regarded as legitimate and enlightened by other nations – a role the United

[32] See Rappard (1938: 42).

Kingdom fulfilled to a degree in the nineteenth century. But strong leadership by large nations may not be sufficient for effective trade cooperation – smaller economies are often more open[33] and have a keener interest in this kind of cooperation than large economies. It is noteworthy that the smaller European countries (Benelux and Scandinavia) had much lower tariffs than the large continental countries in the first half of the twentieth century. Large economies less dependent on foreign trade might also be tempted to use trade policy as a foreign policy instrument in order to achieve non-economic objectives.

The high degree of world-wide economic integration achieved before World War I might have been more sustainable with better institutional foundations. The relative decline of the United Kingdom and the absence of a guiding institution created something of a void. This void was not filled by the United States prior to the Second World War, and the League of Nations proved too weak and unsupported to do the job. It may be argued that this was one of the lessons that the post-war institutional architects had learned, thus leading to the establishment of the Bretton Woods institutions and eventually, the multilateral trading system. If this is true, then what of the present situation with respect to international cooperation in the trade field? We are witnessing shifts in economic power among nations, and the multilateral trading system faces considerable uncertainty. In these circumstances, it is well to recall the lessons of the past, even if we accept that history does not repeat itself. What we have learned from six decades of international trade cooperation under the auspices of the multilateral trading system embodied in the GATT, and subsequently the WTO, and what challenges await the international community in the trade sphere, constitute the subject matter of the rest of this Report.

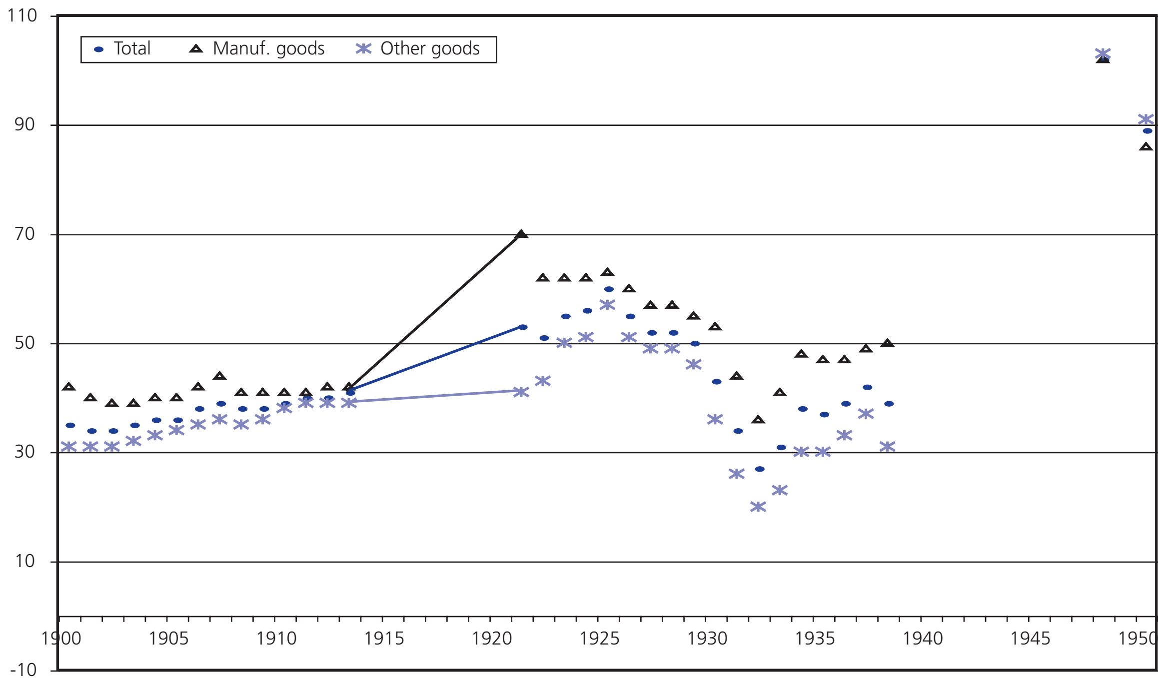
Appendix Chart 1
World merchandise exports, 1900-1950
(Indices, 1953=100)



Source: United Nations (1970) and Norbohm (1962).

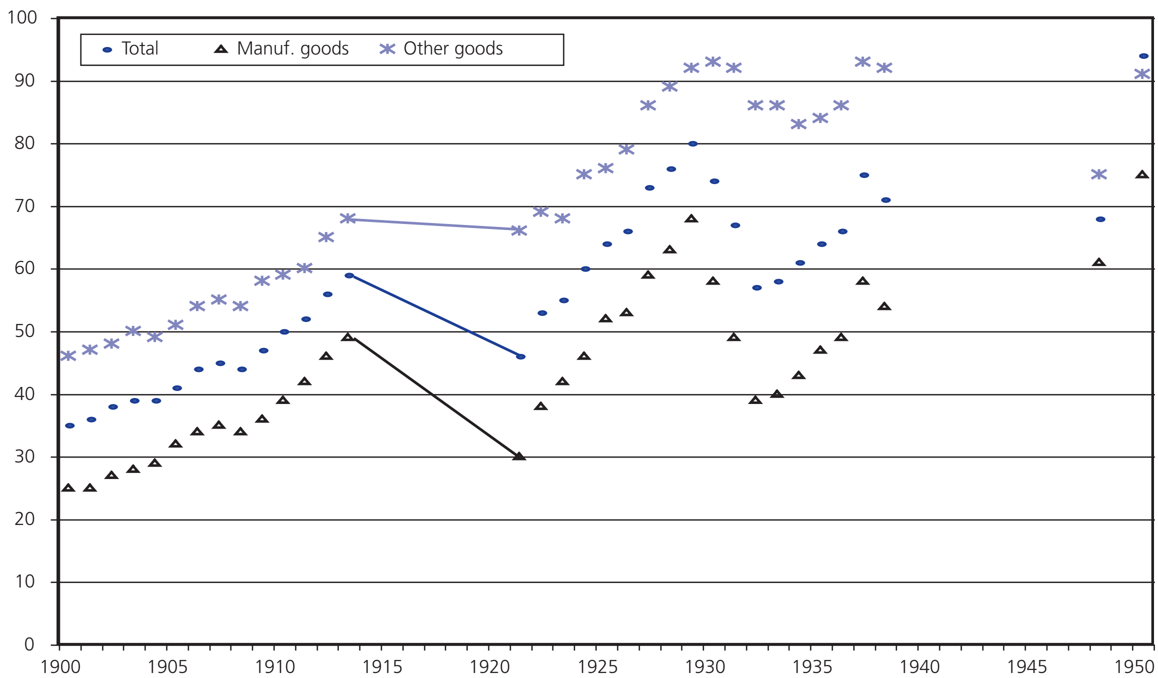
[33] This means 'open' in the technical sense of relying more heavily on trade as a component of overall economic activity.

Appendix Chart 2
World merchandise export prices, 1900-1950
(Indices, 1953=100)



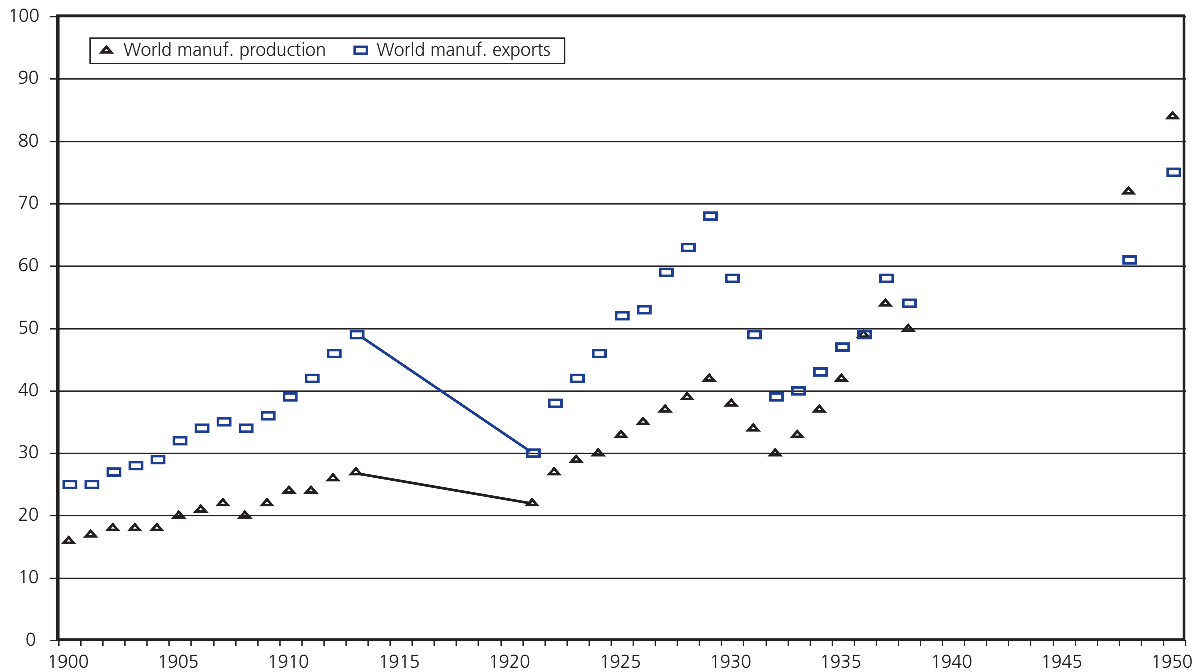
Source: United Nations (1970) and Norbohm (1962).

Appendix Chart 3
Volume growth of world merchandise exports, 1900-1950
(Indices, 1953=100)



Source: United Nations (1970) and Norbohm (1962).

Appendix Chart 4
Volume growth of world exports of manufactures and of manufacturing output, 1900-1950
(Indices, 1953=100)



Source: United Nations (1970) and Norbohm (1962).

Appendix Table 1
World merchandise exports by selected economy, 1870-1938
(Million dollars and percentage)

	1870	1900	1913	1921	1929	1932	1938
				Value			
World	5130	10100	19500	19700	33000	12700	22700
				Share			
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0
North America							
Canada	1.1	1.7	1.9	3.5	3.6	3.5	3.7
United States	7.9	14.1	12.8	22.4	15.8	12.5	13.5
South America							
Argentina	0.6	1.5	2.4	2.5	2.7	2.6	1.9
Brazil	1.5	1.8	1.6	1.1	1.4	1.4	1.3
Europe							
Austria	3.1	4.2	2.9	0.9	0.9	0.8	0.6
Belgium-Luxembourg	2.6	3.7	3.6	2.6	2.7	3.3	3.2
France	10.5	7.9	6.8	7.5	6.0	6.1	3.9
Germany	8.3	10.9	12.4	3.8	9.7	10.8	9.3
Italy	4.1	2.6	2.5	1.8	2.4	2.7	2.4
Sweden	0.8	1.0	1.1	1.3	1.5	1.4	2.0
Switzerland	...	1.6	1.4	1.6	1.2	1.2	1.3
United Kingdom	18.9	14.6	13.5	14.0	10.9	10.2	10.8
Russia/USSR [a]	4.2	3.7	4.0	...	1.3	1.7	1.1
Africa-Middle East							
South Africa	0.3	...	0.7	0.5	0.7	0.7	0.6
Asia-Oceania							
Australia-New Zealand	2.1	2.1	2.4	3.3	2.9	3.2	3.5
Australia	1.9	1.6	1.9	2.4	2.1	2.3	2.5
New Zealand	0.2	0.6	0.5	0.9	0.8	0.9	1.0
China [a]	2.0	1.2	1.5	...	2.2	1.6	1.9
India	5.0	3.4	4.1	3.1	3.5	2.8	2.6
Japan	0.3	1.0	1.6	3.1	2.9	2.9	3.3

[a] 1928 instead of 1929 and 1935 instead of 1932.

Note: Major breaks in time series affect continuity especially between 1913 and 1921 (e.g Habsburg Austria, Germany and Russia).

Source: Norbohm (1962) and Maddison (2001) Table F1 for year 1870.

Appendix Table 2
World merchandise imports by selected economy, 1870-1938
(Percentage)

	1870	1900	1913	1921	1929	1932	1938
				Share			
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0
North America							
Canada	1.5	1.7	3.2	3.2	3.6	2.8	2.2
United States	8.9	8.2	9.1	11.9	12.3	9.5	8.7
South America							
Argentina	...	1.0	2.4	2.5	2.3	1.5	1.8
Brazil	...	0.8	1.6	1.0	1.2	0.8	1.2
Europe							
Austria	3.1	3.3	3.4	1.6	1.3	1.3	1.1
Belgium-Luxembourg	3.1	4.0	4.4	3.5	2.7	3.2	3.1
France	9.7	8.5	8.0	7.8	6.3	8.2	5.7
Germany	...	12.8	12.7	5.7	8.8	7.9	8.7
Italy	3.3	3.1	3.5	3.4	3.1	3.0	2.4
Sweden	1.9	1.3	1.1	1.3	1.3	1.5	2.1
Switzerland	...	1.9	1.8	1.8	1.4	2.3	1.5
United Kingdom	22.1	21.4	16.1	17.5	15.0	16.2	17.1
Russia/USSR [a]	...	2.2	2.8	...	1.2	0.8	1.1
Africa-Middle East							
South Africa	...	...	1.0	1.0	1.1	1.1	2.0
Asia-Oceania							
Australia-New Zealand	...	2.1	2.2	3.4	2.4	1.7	2.9
Australia	...	1.7	1.7	0.7	0.6	1.1	2.0
New Zealand	...	0.5	0.5	0.7	0.6	0.6	0.9
China [a]	...	1.8	2.0	...	2.5	2.4	2.7
India	...	2.8	3.3	3.6	2.6	2.5	2.3
Japan	...	1.3	1.8	3.6	2.8	2.9	3.0

[a] 1928 instead of 1929 and 1935 instead of 1932 and for two years derived from partner statistics.

Note: Major breaks in time series affect continuity especially between 1913 and 1921(e.g Habsburg Austria, Germany and Russia).

Source: Norbohm (1962), Maddison (1962) and Maddison (2001) Table F1 for year 1870.

Appendix Table 3

Ratio of merchandise exports to GDP, 1870-2005

(Percentage, real trade and GDP at 1990 prices and exchange rates)

	1870	1913	1929	1950	1973	1998	2000	2005
Canada	11.3	11.6	22.4	12.3	19.3	39.0	42.4	39.7
United States	2.5	3.7	5.9	3.0	4.9	10.1	10.6	10.2
Brazil	12.2	9.8	6.9	3.9	2.5	5.4	5.5	8.9
Mexico	3.9	9.1	14.3	3.0	1.9	10.7	12.3	12.3
Austria	5.5	8.6	7.4	5.2	16.3	45.5	52.7	64.8
Belgium	9.0	22.6	24.3	17.3	52.1	88.5	97.0	112.6
Denmark	8.3	12.8	23.2	12.1	23.7	41.9	45.5	49.4
Finland	15.5	25.0	40.4	18.7	30.2	51.6	54.6	51.9
France	4.9	7.8	11.5	7.6	15.2	28.7	29.9	27.6
Germany	9.5	16.1	14.8	5.0	20.6	38.9	42.1	51.1
Italy	4.3	4.8	5.9	3.5	12.5	26.1	28.7	28.8
Netherlands	17.4	17.3	29.7	12.2	40.7	61.2	62.9	77.7
Norway	9.0	14.0	23.3	12.9	26.2	55.4	56.7	55.6
Sweden	10.3	15.3	23.9	15.6	31.4	62.5	63.3	64.5
Switzerland	18.9	34.8	35.0	15.3	33.2	51.8	56.0	59.3
United Kingdom	12.2	17.5	14.2	11.3	14.0	25.0	23.1	19.3
Australia	7.1	12.3	13.2	8.8	11.0	18.1	19.8	18.6
China	0.7	1.7	2.6	2.6	1.6	4.9	5.9	10.7
India	2.6	4.6	4.0	2.5	2.0	2.4	2.9	3.7
Japan	0.2	2.4	6.1	2.2	7.7	13.4	14.6	15.7
World	4.6	7.9	9.0	5.5	10.5	17.2	18.5	20.5

Note: Territorial changes affect comparibility in time for a number of countries especially between 1913 and 1929 and 1929 and 1950 (e.g. Austria, France, Germany, Great Britain, China, India and Japan).

Sources: Maddison (2001), L'économie mondiale: une perspective millenaire. Table F5 and WTO estimates for years 2000 and 2005.

2. THE ECONOMICS OF TRADE POLICY COOPERATION AMONG NATIONS

Economists traditionally distinguish three major approaches to the study of trade agreements, none of which is based on the familiar economic arguments for free trade. It would seem natural to attribute the impressive reduction in trade barriers achieved through multilateral or regional negotiations since World War II to the desire of governments to reap the benefits of free trade for consumers. There are, however, two problems with this reasoning. First, the economic case for free trade is a case for unilateral liberalization which does not leave any role for a trade agreement. Second, neither multilateral, nor regional liberalization have been driven by consumers. As pointed out by Bagwell and Staiger (2002), virtually every tariff that has been lowered by a government as a result of a GATT/WTO negotiation has been lowered because exporters somewhere in the world valued market access, and their governments were willing to offer access to their own market in exchange. This means that other ingredients than the economic arguments for free trade are needed to explain trade agreements.

The most elaborate economic approach to trade agreements, sometimes termed the "received theory", addresses the possibility that countries with market power can manipulate the terms-of-trade[34] in their favour and at the expense of their trading partners. The second approach stresses the political economy of trade policies and the fact that governments care about the distributional effects of their interventions. The third approach stresses governments' credibility problems *vis-à-vis* their domestic stakeholders. Each of the three approaches offers an explanation for the existence of international trade agreements. In the received theory, the agreement addresses an inefficiency that arises in a government's relationship with other governments. In the commitment approach, agreements address inefficiencies that arise in the government's relation with its private sector. With the political economy approaches the situation is less clear-cut, as a number of different perspectives may be embodied in the analysis. In some instances, agreements serve a similar purpose as in the terms-of-trade approach while in others they address inefficiencies that arise in a government's relation with its private sector.

These approaches provide fairly general reasons why governments may enter into trade agreements with one other. Economists have identified more specific reasons why governments may cooperate in this manner and these will also be discussed below. The terms-of-trade argument is formalized in the literature and so are some political economy aspects. Other arguments are less formalized, but this does not necessarily mean they are any less relevant. None of the motivations analysed here should be regarded as mutually exclusive. On the contrary, efforts have been made to integrate various approaches within the same conceptual framework. As subsections 3 and 4 below will show, some overlap also exists between economic approaches, international relations approaches, and legal approaches to explaining the rationale of trade agreements.

(a) Exchanging market access

(i) The traditional approach

The core logic of the terms-of-trade approach, often termed the traditional approach, can be summarized as follows. When nations set tariffs in an uncoordinated fashion, each government realises that its tariffs cause some damage to its domestic economy, but when part of the cost of the tariff is borne by foreigners, nations have an incentive to charge tariffs. When all nations do so, however, potential gains from trade are not realized. In such a setting, the switch from an uncoordinated tariff setting to coordinated tariff reduction can increase the size of the pie, so all nations can gain.

Participation in international trade agreements is not compulsory and within this framework of analysis, governments are assumed to enter into such agreements voluntarily. This means that agreements must allow all participants to reap some of the gains from trade. Note that with preferential agreements, such

34 The terms-of-trade is a measure of the relative prices of a country's imports and exports. If a country is able to lower the price of its imports relative to its exports, or raise the price of its exports relative to its imports, then it has secured an improvement in its terms of trade, or equivalently, an increase in national income.

benefits can at least in part be transferred from non-participants, a possibility that is discussed below. In the case of multilateral agreements, however, the participants' gains should not come at the expense of non-participants.[35] The multilateral trade agreement should generate mutual gains from trade that add to the size of the overall pie.

The traditional economic approach relates the inefficiency to terms-of-trade externalities between governments or, in other words, the fact that a country can improve its welfare as compared with free trade by imposing a trade barrier. This approach can be traced back to the mid-nineteenth century and the writings of Torrens (1844) and Mill (1844) on optimal tariffs and the role of terms-of-trade in their determination.[36] A seminal contribution is Johnson's paper (1953-1954) which formally shows how a national welfare maximizing government can use tariffs to manipulate its terms-of-trade – that is, the prices at which it trades, thereby generating inefficiencies that a trade agreement can correct. The traditional approach has been further developed in a number of contributions including the influential work of Bagwell and Staiger (1999, 2002).

The traditional approach has been developed both in game-theoretic terms and using a standard general equilibrium model of trade.[37] Here the argument is presented using a simple game-theoretic example that can be seen as an illustration of the Smoot-Hawley tariff war of the 1930s. Consider two large trading partners, A and B, facing two policy options. Each of them can either choose a free trade policy or impose a tariff that raises its own real income but reduces its trading partner's income. Assume also that governments can assign numerical values to the satisfaction they will derive from each policy outcome. Table 2 below shows the corresponding payoff matrix depending on whether or not the trading partners choose to cooperate. The first figure in each square is the payoff for country A, while the second is the payoff for country B.

Table 2
Trade war or trade cooperation?

		B	
		Free trade	Protection
A	Free trade	10 \ 10	-10 \ 20
	Protection	20 \ -10	-5 \ -5

The payoffs in the matrix reflect the idea that each of the two countries can raise its welfare compared to the free trade position at the expense of its partner. This is an application of what economists call the terms-of-trade argument for a tariff. This argument, which plays a crucial role in the received theory, goes as follows. A country may apply a tariff to lower the price of its imports and thereby generate a terms-of-trade benefit. To do this, the country needs to be large enough to affect the prices of foreign exporters. When a large country imposes a tariff on imports of product X, it reduces world demand for this product sufficiently to depress its price on the world market. The large country thus obtains its imports of product X at a lower price. By analogy with a domestic tax that is partly paid by domestic producers, the tariff can be thought of as a tax on imported goods which is partly paid by foreign producers who cannot fully pass it on to domestic consumers and so end up bearing part of the burden.[38] Obviously, this "terms-of-trade" benefit must be set against the costs of the tariff, which arises because

35 Multilateral does not mean universal, which means that there may be transfers from non-Members but that these transfers are not a prominent feature of multilateral agreements.

36 See Irwin (1996).

37 For an explanation of the terms-of-trade argument in formal game-theoretic terms, see Dixit (1987). For a formal presentation using a standard trade model, see Bagwell and Staiger (2002).

38 This analogy also makes it clear why the terms-of-trade argument does not work for most NTBs. If there is no tariff revenue or equivalent rent accruing to a domestic agent, the optimal trade barrier is zero and the terms-of-trade argument cannot explain why nations agree to the liberalisation of NTBs.

of the distortion that the tariff introduces. It can be shown, however, that large countries can be better off with a tariff than with free trade. In short, the terms-of-trade case is an argument for using a strong market position to extract gains at a partner's expense.

Given those payoffs, each country is better off choosing to protect if it takes its partner's strategy as given. This captures the idea that countries, if they act unilaterally, end up in a trade war.[39] Predatory behaviour by one of the trading partners induces retaliation by the other. A "trade war" is a stable equilibrium (Nash equilibrium) as once protection is in place neither one nor the other country would have an incentive to reduce its tariff unilaterally. This is because it has no reason to expect the other to reciprocate and if the other does not reciprocate, the country that liberalizes is worse off. At the same time, however, both countries would be better off if they both chose free trade. This reflects the fact that one country's net terms-of-trade gain is less than the cost it imposes on its partner. Eliminating the tariffs on both sides thus yields a net gain for both countries.[40] All this means that if the two countries do not cooperate, they end up in the lower right corner of the matrix, whereas they would both be better off in the upper left corner. This situation is known as a prisoners' dilemma. Cooperation, in the form of a trade agreement, offers an escape from the prisoners' dilemma.

A trade agreement does not eliminate the beggar-thy-neighbour temptations of its signatories. This means that enforcement is a key issue. In order for the signatories' tariff reduction commitments to be credible, the agreement must be effectively enforceable. In the absence of other forms of punishment, this means that the short term gain of deviating from the commitment must be balanced by the long term loss from retaliation. Applying game theory, enforcement issues have been analysed using a repeated game setting with an infinite number of periods. A number of interesting insights can be drawn from this approach. First, the "most-cooperative" tariffs that can be achieved will depend on the enforcement constraint. The more they differ from the Nash equilibrium, the larger the incentive to cheat. Second, this perspective sheds an interesting light on the GATT/WTO dispute settlement procedures. They can be seen as an attempt to move from a non-cooperative equilibrium to a cooperative equilibrium by limiting the use of retaliation along the equilibrium path and repositioning it as a threat that serves to enforce the cooperative equilibrium. Dispute settlement and enforcement issues will be examined in more detail in Section C below.

The literature distinguishes between two approaches to trade negotiations. These approaches explain how governments can escape the prisoners' dilemma and move from the inefficient non-cooperative equilibrium to the political optimum. A power-based approach is one where governments bargain over tariffs without having previously agreed upon principles of negotiation. Under a rules-based approach, on the other hand, governments identify and agree upon certain principles by which subsequent negotiations must abide. The negotiations approach embodied in the GATT/WTO is of the latter type. Section C examines the specific rules by which Members must abide.

Under the traditional economic approach, the reason why governments can gain from trade policy cooperation is that they have the possibility of shifting costs onto each other, which leads them to pursue inefficient unilateral policies. The means through which the shifting of costs can occur is the terms-of-trade externality. Yet many economists are sceptical of the practical relevance of the terms-of-trade argument for trade agreements. The main reasons for this scepticism relate to: (a) the consistency of the main predictions of the terms-of-trade model with observed tariff patterns; (b) the consistency of the predictions of the model with the observed instruments of protection; (c) the consistency of the model's prediction with the characteristics of trade agreements; (d) the empirical relevance of the terms-of-trade theory; and, (e) the failure to explain both why small countries with no influence on world prices seek to form a trade agreement with one another, and why large countries may want to have a trade agreement with small countries.

[39] Technically, the outcome resulting from non-cooperative behaviour is known as a Nash equilibrium.

[40] A reduction in tariffs from the Nash equilibrium level is not sufficient to ensure mutual welfare gains. If there is sufficient asymmetry between the two countries, the largest country may be better off at the Nash equilibrium.

Bagwell and Staiger (2002) make considerable efforts in their book to convince their readers of the practical relevance of terms-of-trade considerations. First of all, they argue that presentation and interpretation matter. The traditional interpretation where the governments of large countries use a tariff to improve their terms-of-trade is too abstract and does not convince practitioners. They therefore present other interpretations which, in principle, should have more practical relevance in the eyes of policy makers. One such interpretation is in terms of market access and can be summarized as follows.

The inefficiency reflected in excess protection and too little market access – which trade agreements address – arises because foreign exporters' interests are not taken into account in domestic trade policy decisions. When country A imposes a tariff on imports from country B, it inflicts a cost on country B exporters in terms of lower prices. The inefficiency arises because A's government does not take this cost into account when setting its tariff. The role of cooperation is to provide a mechanism through which foreign exporters' interests are taken into account in governments' trade policy decisions so as to ensure that efficient levels of protection are chosen. Trade agreements then take the form of exchanges of market access for market access. If the agreement allows both countries to improve their welfare by offering new market access to their exporters without hurting any third party, then it can be said to be Pareto improving[41] from a global point of view. As pointed out by Staiger (2004), this interpretation of the purpose of trade agreements has two important implications. First, it explains why WTO Members are driven by exporters' interests in the negotiations without having to assume irrational mercantilist behaviour on their part. Second, with this interpretation, the argument in support of the WTO is far more general than the argument in favour of free trade.

Bagwell and Staiger (2002) also respond to various objections regarding the consistency of the main predictions of the terms-of-trade model with observed tariff patterns and other instruments of protection. The fact that some large countries do not set their tariffs at optimal levels is consistent with the terms-of-trade argument. These countries may simply form trade agreements to avoid being stuck with high optimal tariffs. Small countries that would be expected to have zero tariffs according to the terms-of-trade argument may have high tariffs on account of other (including political and strategic) motivations for setting tariffs. Other observed patterns can be explained only when certain refinements are added to the traditional model. For instance, the static version of the traditional approach does not account for the fact that liberalization is often introduced gradually. Bagwell and Staiger suggest, however, that when enforcement is modelled using a repeated game setting, and learning-by-doing (infant industry) effects are assumed to exist, an initial liberalization induces changes in the economy that enhance the value of cooperation and thus create the conditions for further liberalization. The basic model can also be extended to account for observed export subsidization programs and the use of voluntary export restraints (VERs).

The question of the empirical relevance of the terms-of-trade theory is probably the main objection to the approach. In effect, the evidence is mixed. The idea that countries set tariffs in response to their market power in international markets can be seen as the single most controversial result in international trade policy.[42] The trade war that resulted from the adoption of the Smoot-Hawley tariffs in the 1930s can be seen as an example of a non-cooperative Nash equilibrium. In fact, Whalley (1985) showed that the tariff rates that prevailed among major powers after the Smoot-Hawley Tariff Act were close to those that would be predicted in the Nash non-cooperative equilibrium for a computable general equilibrium model.[43] Bagwell and Staiger (2002) survey the limited amount of empirical work that is available and conclude that a "strong affirmative presumption" that governments are able to improve their terms-of-trade in a quantitatively significant fashion with their trade policy choices can be drawn from this work.[44] Interesting recent work tends to confirm this presumption. Broda et al. (2006) find evidence

41 A 'Pareto improvement' refers to a change that yields a more efficient outcome than the status quo ante. More precisely a Pareto improvement occurs when at least one individual is made better off without making anyone worse off.

42 See Broda et al. (2006).

43 See Whalley (1985).

44 See the survey in Chapter 11 of Bagwell and Staiger (2002) and the more recent studies by Bown (2004a, 2004b, and 2004c), Limão (2006) and Shirono (2003).

that countries that are not members of the World Trade Organization systematically set higher tariffs on goods with inelastic supply.[45] From this observation, they infer that countries are motivated by optimum tariff considerations. This result is robust to the inclusion of a political economy control variable.

Apart from this indirect evidence, there is very little direct evidence supporting the terms-of-trade interpretation of the role of the WTO. Along the same lines as the interpretation of the Smoot-Hawley tariffs, the multilateral trading system under GATT can be seen as representing an effort to move towards a cooperative equilibrium. Beyond this largely anecdotal evidence, only a recent paper by Bagwell and Staiger (2006) investigates empirically the idea that governments use trade agreements to escape from a terms-of-trade driven prisoners' dilemma. In this paper, a simple prediction is derived from the model and submitted to empirical tests. This prediction is that the difference between the non-cooperative tariff and negotiated tariff increases with the level of its non-cooperative import volume. The empirical strategy consists in regressing the difference between pre-accession and bound tariffs on pre-accession import levels for a sample of 16 Members that have acceded to the WTO under Article XII. The estimation results support the prediction and thereby the terms-of-trade theory.[46] However, in light of the limitations of their study, the authors conclude that it offers "a first, albeit promising, glimpse at the empirical content of the terms-of-trade theory of trade agreements.".

The idea that a strong affirmative presumption in favour of the terms-of-trade approach can be drawn from existing work is challenged by Regan (2006). His interpretation of the Smoot-Hawley tariffs is that the story behind them is one of protectionism pure and simple. Based on detailed studies by political scientists of the politics and the legislative process that produced the tariffs, he argues that these tariffs, and more generally United States' tariffs in the last century, were not designed to maximise national income by collecting tariff revenue from foreign producers. Similarly, Regan argues that the Broda et al. (2006) correlations give no reason to think that there must be terms-of-trade manipulation in addition to a protectionist motivation. He also doubts that any result obtained using their sample of 15 countries that were not members of the WTO could be generalized. Regan also considers evidence from the rhetoric of trade policy, the general pattern of countries' trade policy behaviour, and the provisions of the WTO. His conclusion is that terms-of-trade manipulation is of very limited significance in the real world.

Regan (2006) argues that trade agreements are primarily about restraining protectionism, and he suggests that this is the view of most trade lawyers and economists. He acknowledges that there is no formal model of this theory and that it poses a number of puzzles. In particular, how can the same political forces first generate protectionism and then an agreement to restrain it? Regan suggests that the answer must be partly "framing effects" – people perceive their interests differently in different decisional contexts. He also argues that the reason behind the lack of a formal model of the anti-protectionism theory may be the difficulty of modelling framing effects.

Finally, an important limitation of the received theory concerns the relevance of the terms-of-trade argument in explaining the participation of small countries in trade agreements. This question is addressed in more detail in subsection 4 below, but a number of points are worth mentioning at this stage. The terms-of-trade approach provides a rationale for agreements between countries with market power, but for the most part fails to explain negotiations involving countries without market power. A crucial question is the extent to which developing countries are large enough in relevant markets to alter international prices with their policy choices. Based on theoretical work which suggests that even very small countries have the power to alter their terms of trade, Staiger (2006) argues that casual empiricism can be very misleading. It should be noted that systematic empirical evidence on this point is not yet available. To date, the evidence presented by Broda et al. (2006) probably represents the most important contribution in this area.[47] The traditional approach, however, is not the only possible explanation for the

[45] That is, goods whose supply is relatively unresponsive to price changes.

[46] The results also provide some support for the commitment approach (see below).

[47] Evidence presented in this paper suggests that a group of 15 developing countries which were not Members of the WTO were motivated by optimum tariff considerations when they set their tariffs.

participation of small countries in trade agreements. As discussed below, political economy approaches provide further explanations.

(ii) The political economy approach: triggering the support of exporters

The terms-of-trade driven prisoners' dilemma discussed above offers a powerful explanation of the role that international trade agreements can play. But, traditional models assume that governments are immune from political pressure and act as benevolent servants of the public interest. What is the role of international cooperation when governments are not only concerned with improving the standard of living of their electorate, but also with collecting campaign contributions from special interests groups? This question is addressed by political economy models of trade.

Political economy models of trade view individuals and firms as *demandeurs* of particular trade policies, such as import protection, and governments as the suppliers of these policies. Governments care about the political as well as the efficiency consequences of trade policies. In particular, in this set-up governments are seen as aiming to maximize national welfare subject to the political constraints under which governments operate, which is that of being re-elected. Therefore, governments respond to the demand of individuals and firms who provide the votes and the funds for their election. In other words, governments choose trade policies so as to maximize a weighted sum of the contributions offered by individuals and firms and their likelihood of being re-elected. The former will depend on how much of the private benefits from the political process special interest groups will be able to capture. The latter will depend on whether the income of the median voter will increase. According to these models, tariffs are chosen to balance the demand and supply of protection in the political market, much as prices balance demand and supply in the goods markets.

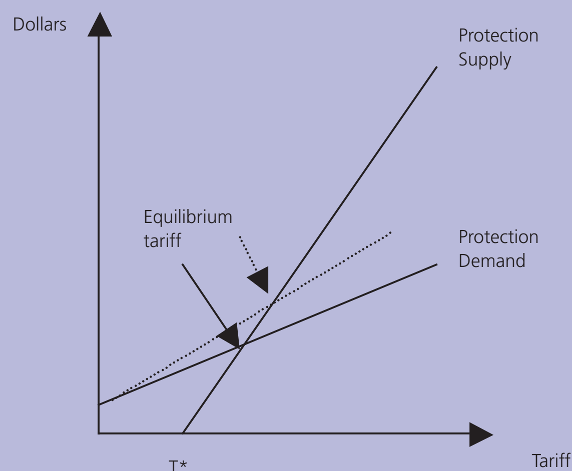
When governments chose their trade policy unilaterally, an equilibrium will emerge where there are two reasons why a government will wish to tax international trade: the political support and the terms-of-trade motive (see Box 1 for a more analytical treatment of how tariffs are set in a political economy model).

Box 1: Unilateral tariff setting in a political economy model

The distinguishing feature of political economy models is that governments shape their trade policy not only in pursuit of economic efficiency, but they also care about the political consequences (i.e. distributional effects) of their tariff selection. Two main approaches may be distinguished in the political economy literature. One stresses the competition between opposing parties during the election (see Magee et al., 1989; and Hillman and Ursprung, 1988). In this setting, candidates commit to different policies before the elections. Lobby groups contribute to the election campaign of the candidate that commits to the policy that makes them better off. Then, candidates use these contributions to shift votes in their favour. Political contributions are clearly motivated by a willingness to influence the elections, and the value of the contributions will depend on the benefits that lobby groups will derive from the election of their favourite candidate.

The second approach focuses on the policy choices of an incumbent government that attempts to maximize its likelihood of being re-elected, but in this set-up, unlike in the previous one, the election process is not explicitly modelled. Two classes of models use this approach: (i) median voter models, which assume that policies are established by majority vote (Mayer, 1984); and (ii) lobby models, where policies are determined not only on the basis of consumers' welfare but are also influenced by contributions by lobbying groups (see Baldwin, 1987; and Grossman and Helpman, 1994).

According to a basic lobbying model of tariff choice, governments set tariffs such that the supply of protection equals the demand for protection in the political market. Graphically, the supply of protection will be defined by how much a government will be willing to supply if it receives a contribution equal to *y*. This curve will be positively sloped, and, for a large country, will be equal to the optimal tariff for a contribution equal to zero (in the chart below this is the positively-sloped curve denoted "protection supply", that intersects the horizontal axis at the level of the optimal tariff T*). The demand for protection can be represented by a positively sloped curve that defines how much a firm is willing to offer for a marginal increase in tariff (in the chart this is the line called "protection demand"). The curve is positively sloped because a marginal increase in tariff will increase the firm's operating profits. The chart below represents the equilibrium in the political market. This is defined by the point where the demand curve crosses the protection curve. The chart shows that the equilibrium tariff will be higher than the optimal tariff. The optimal tariff will respond to the terms-of-trade motivation for setting a tariff and the rest is the politically motivated tariff.



Source: Baldwin (2006)

The political optimum tariff will depend on the size of the import-competing sector. If this is large, the equilibrium tariff will be higher. This is because the higher the number of firms in the import-competing sector, the stronger the impact of a hike of protection on the import-competing profits will be for any given level of tariff. Graphically, the demand for protection will rotate inwards (the dashed line in the chart). Therefore, the equilibrium tariff will increase.

Some empirical evidence supports the assumptions of the political economy models.[48] For example, legislators tend to vote in a protectionist manner the higher the proportion of voters in their district who are employed in import-sensitive sectors (Baldwin, 1996). Furthermore, certain empirical evidence supports some of the conclusions of the political economy models.[49] For example, several studies provide evidence of a positive relationship between levels of protection and the extent to which an industry is politically organized.

As may be expected, in these circumstances the economic incentive for governments to manipulate the terms-of-trade creates an inefficiency that a trade agreement can solve – just as in the case when governments are only concerned with national welfare and are not affected by lobby pressures. As Bagwell and Staiger (2002) point out, political economy models do not provide a new reason for trade

48 For evidence on the political economy approach see Magelby and Nelson (1990), Snyder (1990), Baldwin (1985), Tosini and Tower (1987), Riedel (1977), Lavergne (1983), Trefler (1993).

49 See Goldberg and Maggi (1999); Gawande and Bandyopadhyay (2000); Mitra et al. (2002); and MacCallum (2004).

agreements to exist – even politically-motivated governments engage in trade agreements only to correct for terms-of-trade externalities. The contribution of political economy models to the understanding of the existence of a trade agreement is that they explain the motivation for governments to eliminate the incentive to manipulate terms-of-trade by the interaction of private interest groups and political-support-seeking governments. In this set up, the terms-of-trade motive for taxing international trade imposes a cost in terms of median voter welfare, since tariffs imply higher prices for consumers. Governments know that freer trade would be better for their nation, but they also know that an attempt to reduce tariffs unilaterally will encounter opposition from the import-competing sector.[50] In other words, the unilateral reduction of tariffs is not politically viable because even if it would benefit a large number of consumers and only hurt a small number of producers, the latter are much better organized to press their case than the former. Yet governments realize that they may spare each other political costs by cooperating. This is because by entering a trade agreement, whereby tariffs are reduced reciprocally, they may help each other foster the political support needed to implement a freer trade policy .[51]

In the political economy approach, as in the traditional approach, the principle of reciprocity provides a way to eliminate the incentive to manipulate the terms-of-trade. Reciprocity is the key because it will convert each nation's exporters from bystanders in the tariff debate to opponents of protection within their own nation.[52] When liberalization is reciprocal, exporters can gain from better access to foreign markets only if tariffs in their own country are lowered. This will trigger the support of domestic exporters in favour of trade liberalization policies. Since foreign tariffs are a function of domestic tariffs under reciprocity, contributions by lobbies will depend on both domestic and foreign tariffs. Therefore, all countries find it optimal to cut tariffs (Grossman and Helpman,1994 and 1995a, and Baldwin and Robert-Nicoud, 2006). In particular, tariffs that reflect both terms-of-trade and political economy motivations will be reduced by the amount that is attributable to the terms-of-trade motive. The politically optimal tariff will remain in place.

Political economy models can provide an explanation for a number of empirical observations. These include the observations that: (i) the process of liberalization has been gradual;[53] (ii) much liberalization has taken place in products where two-way trade is prevalent (Baldwin, 2006); and; (iii) trade agreements generally do not prohibit terms-of-trade manipulation through export-taxes. It is important, however, to underline that political economy considerations are neither the only possible explanation for these facts, nor do they solve all puzzles.

As mentioned above, a dynamic version of the traditional model could explain why the liberalization process has been gradual.[54] However gradualism can also be explained with political economy models. Lobbying pressures will depend on the size of the import and export sector. The larger the number of firms in a sector the stronger the pressure. When a government announces reciprocal liberalization, the domestic tariff will decrease. This, in turn, will reduce the number of firms in the import-competing sector and increase the number of exporting firms. Therefore, this initial liberalization will trigger pressure for further liberalization by the export sector. The process will gradually lead to free trade. This process is known as the "juggernaut effect" (Baldwin, 1994; Baldwin and Baldwin, 1996; for a formal treatment, see Baldwin and Robert-Nicoud, 2005).

[50] Notice that free trade is not domestically optimal in political economy models because of the political support motive for a tariff. Yet a reduction of tariffs to eliminate the terms-of-trade motivated part of the tariff is optimal.

[51] Bagwell and Staiger (2002) stress that benefits occurring to exporters are also important to governments that maximise national welfare under the traditional approach. That is, the standard political economy interpretation of reciprocity – that reciprocity mobilizes political support which serves as a counterweight against protests by import-competing firms – is in fact already embedded in the terms-of-trade model.

[52] See Baldwin (2006).

[53] By gradual we do not mean there is a phase-in implementation period, but rather that multilateral liberalization has been achieved through a series of successive rounds of liberalization.

[54] See Bagwell and Staiger (2002, Chapter 6) for a review.

The juggernaut effect, as formulated above, explains the process of gradual liberalization in situations where the import-competing firms and exporting firms produce different goods. Therefore, it explains trade liberalization in import-competing sectors. But most post-war liberalization has taken place in sectors characterized by intra-industry trade. When applied to new trade theories built around the existence of heterogeneous firms within and among industries (Melitz, 2003; and Eaton and Kortum, 2002), political economy models of trade can also explain trade liberalization in industries characterized by two-way trade. In these models, countries trade different varieties of the same good (i.e. trade is intra-industry in nature). Furthermore, firms differ in size and efficiency, and there are fixed costs of entry in a foreign market. Because of these so-called beachhead costs, only the largest, most efficient firms export in each sector, while smaller firms only sell domestically. When countries enter a trade agreement, reciprocal trade liberalization will raise the profits of big export firms while lowering the profits of small firms in the same industry that sell only in the local market (Falvey et al., 2004, Baldwin and Forslid, 2004).[55] In terms of political economy pressures, this implies that intra-sectoral special-interest groups will emerge – large firms will lobby in favour of liberalization, while small firms will lobby against. But big firms will be better organized politically than small firms in the same sectors. Overall, sectors characterized by intra-industry trade will be pro-liberalization. Over time, liberalization will beget further liberalization, as small firms will become smaller and perhaps exit the industry, resulting in relatively more support for further liberalization (Baldwin, 2006).

Regarding the third point above, the political economy approach to trade agreements, it has been claimed, solves the so-called terms-of-trade puzzle in the traditional theory (Ethier, 2006). The puzzle is reflected in two observations: (i) actual trade agreements do not prevent countries from manipulating their terms-of-trade with export taxes;[56] and (ii) industrial countries nevertheless do not by and large implement such taxes. Indeed, political economy models of trade predict that if the interests of owners of factors specific to export sectors are sufficiently important, governments will not wish to tax exports.

However, as has been argued by Bagwell and Staiger in a number of their works (Bagwell and Staiger, 2002, Chapter 10; Bagwell and Staiger, 2001 and Bagwell, 2007) the argument above has two weaknesses. First, Ethier's criticism applies with less force in a world of many goods than in a simple two-good model. Second, the political economy approach to the terms-of-trade argument for a trade agreement opens up another puzzle: that of the restrictions on export subsidies. The argument is the following. A politically motivated government, while it may not be tempted by export taxes, would under-supply export subsidies. This is because export subsidies generate terms-of-trade gains to the importing country that the exporting country would not take into account when setting trade policy unilaterally. The question then arises as to why the WTO Agreement, for example, has restrictive rules on the use of export subsidies.

(b) Capturing credit for the benefits of trade liberalization

Economists have also explored the idea that inter-governmental political externalities give rise to trade agreements. This alternative approach, however, remains highly controversial, in part because of the limitations and weaknesses of the theoretical models developed so far.[57]

In Ethier (2004), the government does not obtain all the political credit from the benefits of unilateral trade liberalization because exporters are imperfectly informed. Special interests are subject to "bounded rationality" – that is, their political support is more sensitive to the "direct effects" of government actions than to the "indirect consequences". For example, if country A reduces textile import tariffs and

[55] The intuition is simple. Reciprocal liberalization harms small firms that sell only locally since it raises the degree of competition they face; they have no exports to benefit from the expanded foreign market access. For the big firms, by contrast, the extra competition at home is offset by better market access abroad. On net they gain since their sales benefit from the downsizing and exit of small firms in both markets.

[56] For example, nothing in the GATT/WTO prevents a country from introducing export taxes.

[57] Ethier (2004 and 2006) present models of political externality driven trade agreements. For a discussion of this approach see Bagwell and Staiger (2002).

subsequently textile imports rise, the import-competing textile industries will realize that the government is responsible for this and will oppose liberalization. In contrast, although more textile imports might boost exports of textile machinery to the foreign supplying country enjoying additional textile exports, domestic exporters in the textile machinery industry will most likely give only partial credit for this to the government. Therefore, they will only provide minor support to the liberalization policy. Because of this imperfect information, a free trade policy, although optimal, cannot be implemented because it is not politically viable.

Entering a trade agreement may help governments to foster the political support needed to implement a freer trade policy. This is because each government will enable its partners to capture a larger share of the credit for the benefits of the agreement by furnishing signals (in the form of "concessions") that the agreement has indeed generated those benefits. Continuing with the example above, if country A negotiates better market access for textiles machinery in country B, it will get the credit for the increased exports of this sector. Greater support from exporters will allow the government to proceed with trade liberalization.

In conclusion, reciprocal liberalization triggers the support of exporters in both the international political externality theory for a trade agreement (discussed here) and the political economy variant of the terms-of-trade argument (discussed in the previous subsection). The crucial difference between these two approaches is that while exporters in the former case do not give due credits to the government for the benefits from unilateral liberalization, in the latter case exporters gain more from reciprocal liberalization than from unilateral liberalization. The difference is crucial, as it may potentially provide an explanation of trade agreements among countries without market power.

(c) Increasing credibility

Another reason for countries to join an international trade agreement is to solve time-inconsistency problems. In this case, the source of the problem is a domestic inefficiency, resulting from the interaction between a government and its own private sector. Time-inconsistency problems can arise when the decision of the government to implement a certain policy at some future time is not optimal when the future period arrives.[58] Therefore, the announcement that a certain policy will be implemented at a later time is not credible. The inconsistency is primarily about commitment and credible threats. One example of time inconsistency for trade policy is provided by Matsuyama (1990).[59] Suppose that country A has developed a certain large and inefficient industrial sector behind high tariff barriers. Suppose as well that the government of country A realizes that at present the costs of maintaining such a large and inefficient sector are too high and, therefore, announces that at a future date it will open up the sector to international competition. If the announcement is credible, the industry will decide to restructure and invest in cost-saving technologies. At the pre-announced date, the government will liberalize the sector. A problem of time inconsistency may arise if the industry foresees that the government will not liberalize if the sector is not ready for international competition. In this case, following the announcement of trade liberalization, the industry will not undertake the required restructuring. At the stage of policy implementation, the government will not liberalize because if it did, it would have to face the costs of a crisis in the sector. The government is trapped in a situation in which it cannot credibly liberalize.

By "tying the hands" of a government, an international trade agreement may help to make credible policy commitments affecting the private sector that it would not be able to maintain without the agreement. The commitment to an international agreement will signal to domestic actors that if the

[58] The problem of time inconsistency was first highlighted with regard to monetary policy. In their seminal paper, Kydland and Prescott (1977) show that the discretion of the central bank to revisit a certain policy after its announcement can create a time inconsistency problem that makes the economy worse off.

[59] Other papers focusing on credibility issues in trade policy and not discussed in this section include: Carmichael (1987), Staiger and Tabellini (1987, 1989, 1999), Gruenspecht (1988), Lapan (1988), Maskin and Newberry (1990), Tornell (1991), Brainard (1994), Mayer (1994), McLaren (1997, 2002), Grossman and Maggi (1998), Krishna and Mitra (2005) and Mitra (1999).

government reneges on its commitment it will face additional external costs, such as retaliation from a trading partner. This external threat makes the policy announcement credible, and solves the time-inconsistency problem, thus making trade liberalization viable.

Typically, the time-inconsistency problem is purely economic in nature. But time inconsistency is also a reason for international cooperation in the context of political economy models. In this context, trade agreements provide a way for the government to foreclose the political pressure of domestic special interest groups that may be lobbying for protection.[60] At first sight, this argument may appear in contradiction with political economy models that stress the role of lobbies in influencing the policy of a government. Why would a government want to commit to a trade agreement and distance itself from lobby groups if it receives electoral contributions from them?

Maggi and Rodriguez-Clare (1998) describe three situations in which this can be the case. In all three situations a government seeks to minimize distortions in the present that may arise in the future. One case is when a government may be subject to lobbying pressures by a politically organized import-competing sector. If the country does not have (nor may develop over time) comparative advantage in the sector, the protection will distort investment and lead to an oversized sector. This may be better than free trade for the government in the short-run (as contributions may compensate social welfare losses), but in the long-run the costs of distortions will be too large. The government may therefore seek to enter into a predefined trade agreement to minimize these distortions from the beginning.

An example of a second situation in which a government may prefer to commit to a trade agreement is when the adjustment process is slowed down because a declining sector relying on government protection is hit by a terms-of-trade shock. Again, the costs of the distortion due to the misallocation of resources may be too high in the long run. Therefore, the government may seek a commitment through a trade agreement to avoid delay in the adjustment process in the declining sector.

Finally, a third situation is one where an inefficient firm with the potential to develop strong lobbying power may over-invest in order to seek future protection from the government. By committing to an existing agreement, a government will seek to avoid such long-term distortionary investments.

The commitment argument is closely linked to two popular propositions that are often used in discussions of the benefits of accession to the WTO or in relation to the enlargement of the European Union. The first argument is the idea that accession to the WTO or to the EU can play the role of an "external anchor".[61] This notion, which originates from the macroeconomics literature, captures the idea that by establishing a substantial number of policy goals and conditions on which consensus might be difficult to reach, "external anchors" such as the WTO or the EU help focus policy, thereby functioning as an arbitration mechanism in case of differing internal political opinions. The second argument corresponds to the idea that signing a trade agreement can be used as a signalling device. It has been argued, for instance, that WTO membership has provided a potent symbol of China's continuing "opening up" to the rest of the world. Because, to the best of our knowledge, these arguments have not been formalized, it is difficult to assess exactly how they operate.

A number of arguments have been raised by economists that point to the irrelevance of the commitment interpretation for joining a trade agreement. One argument is that the commitment approach relies on enforceability, but this may not be effective. For example, the incentive to enforce WTO rules in small and poor developing countries may be too weak for such countries to benefit in domestic political terms from international commitments. An essential element for a trade agreement to play a commitment role is that its rules are enforceable and that there is a credible threat associated with non-compliance with those rules. In the WTO this is accomplished with the threat of retaliatory actions and enforcement is provided

60 The case of "political" time inconsistency is different. In this case, the government does not lack credibility and there is not a time inconsistency problem. Nevertheless, a government may wish to lock in its policy to diminish the likelihood that a future government may reverse the policy.

61 See IMF (2000) World Economic Outlook, October 2000, Chapter III, Transition: Experience and policy issues.

through the dispute settlement system.[62] However, there is a limited incentive to engage in a dispute with a small low-income country if the costs of the procedure offset the gains of a positive outcome. In the absence of a credible threat, there is little scope for the WTO to serve as a commitment device for small and poor countries.

Secondly, some design features of trade agreements cannot be explained on the basis of the commitment approach. For example, the WTO safeguard (escape clause) provisions "work against the role of WTO in serving as commitment mechanism to constrain the actions of governments against their private sector" (Staiger, 2004).

A third argument is that governments, at least governments with a high reputation, can in principle find solutions other than an international trade agreement to solve a potential commitment problem. They could, for example, establish an independent institution to deal with trade policy.

Very little empirical evidence exists on the possible commitment role played by international trade agreements. But available evidence provides some support for the commitment theory. A paper by Staiger and Tabellini (1999) supports the view that the GATT has worked as a commitment device. In particular, they investigate whether GATT rules allowed the United States government to make credible commitments to its private sector. To test this, they compare the decisions of the United States government on whether or not to give protection to an industry in two different circumstances: (i) during the Tokyo Round negotiations, when each country could choose to exclude certain product categories from the general tariff-cutting rule and specify an alternative tariff change for these products; and (ii) following the completion of the Tokyo Round, when each country could temporarily increase tariffs on a unilateral basis if the conditions for escape clause action were satisfied. The crucial difference between these two environments is that only in the former do GATT rules serve as a potential commitment device. In contrast, once the injury condition that activates the escape clause is established, a government is free to adjust its tariffs. A government that cannot credibly commit to a trade policy would not take production distortions into account when selecting an exclusion from the tariff-cutting formula. But if the GATT works as a commitment device it should help a government to make decisions that would minimize production distortions. Consistent with expectations, Staiger and Tabellini (1999) find that the United States government granted fewer departures from the tariff-cutting formula in sectors where an exclusion induced higher production distortions, whilst they find a positive association between escape clause protection and induced production distortions. This is what should be expected if the escape clause offers a government that lacks credibility in the absence of international rules an opportunity to undo what the rules have accomplished.

More recently, Bagwell and Staiger (2006) attempted to investigate empirically the purpose served by market access commitments in the WTO. Although their findings mainly support the view that trade agreements are useful to governments to escape the terms-of-trade prisoners' dilemma, they seem to suggest a possible commitment role of the WTO as well.

Finally, Eschenbach and Hoekman (2006) investigated the role that GATS and EU commitments have played in affecting the service sector reforms in 16 transition economies. Their findings appear to suggest that the WTO played a weak commitment role, although the EU itself may have worked as an effective commitment device. Results differ across countries – for most EU-acceding countries GATS commitments have not been relevant, as their policy reforms can be explained by requirements linked to their accession to the EU. For the non-acceding transition economies, GATS commitments appear to have contributed little to policy reform in services. Furthermore, no case has been brought to the WTO against any of these countries.

To conclude, it is worth highlighting that the terms-of-trade approach and the commitment approach are not mutually exclusive. In a recent paper, Maggi and Rodriguez-Clare (2007) combine these two approaches into one framework. In this setting, if governments do not cooperate two types of inefficiency

[62] See subsection 4 below.

emerge – a domestic time-inconsistency problem and a prisoners' dilemma arising from the terms-of-trade externality. The model presents a number of interesting implications. Most importantly, it explains why trade agreements typically specify tariff ceilings rather than exact tariff levels. The intuition for this result is that the commitment to a tariff ceiling keeps the lobbying game alive. Lobbies will be obliged to pay contributions ex-post, and this will reduce returns to capital and in turn help to reduce the distortions caused by lobbying itself.

(d) Other motives for cooperation among nations

The arguments we have examined in the previous sections (relating to the terms-of-trade externality, the politics of trade liberalization, and policy credibility) explain why countries may set higher tariffs in the absence of cooperation and why there is a case for reducing these tariffs through international cooperation. The economic rationale for cooperation relates to an economic inefficiency that a trade agreement can solve. Furthermore, it is important to note that all these arguments are valid for multilateral trade agreements as well as bilateral or regional trade agreements.

Several other economic reasons exist why countries may want to cooperate on trade policy. These include increasing market size, ensuring against preference erosion, enhancing protection, or increasing bargaining power. Most of these arguments are relevant in the context of preferential arrangements, implying that some of the benefits from the trade agreement may come at the expenses of non-participants. But some of the arguments also motivate the case for participating in the multilateral trading system.

(i) Increasing market size

Countries may want to cooperate on trade issues in order to increase their market size. The argument is especially valid for small countries. Smallness will be a disadvantage if markets are not large enough to generate the sales volume necessary to cover costs. Access to foreign markets would allow domestic firms to exploit economies of scale and produce at lower costs.

Increasing market size can be a motivation for multilateral or regional cooperation. In the case of a regional arrangement, the opportunity to exploit economies of scale may provide firms with a competitive edge relative to firms producing the same or a similar good located in other small countries outside the regional trade agreement. In addition, preferential access to a large market may prove particularly advantageous in increasing a country's attractiveness to foreign direct investment.

Since access to the market of a small country is unlikely to be an essential motive for trade cooperation from the point of view of a large country, the latter will be motivated to cooperate only if issues other than tariffs are on the negotiating agenda. This helps to explain why small countries might make concessions on issues such as standards, government procurement or intellectual property rights, which they may otherwise regard as uninteresting from a national welfare perspective..

(ii) Insurance motive

Countries may also cooperate on trade policy to insure themselves against the erosion of market access in a large market. The insurance motive may best be explained against a backdrop where many small (developing countries) are establishing free-trade agreements (FTAs) with larger (developed) country partners.[63] These hub-and-spoke arrangements are a prominent feature of the current Regional Trade Agreement (RTA) landscape. In this environment, forming a RTA with a large country partner is an insurance policy against the erosion of market access to the large market. This may also help explain

63 Empirical support for this third-party terms-of-trade externalities is offered in Chang and Winters (2001), Bown and Crowley (2006 and 2007).

why small countries are willing to give significant concessions to enter such RTAs. One can think of those concessions as a form of insurance premium that is paid to guarantee or preserve access.[64]

However, the insurance motive can also be seen as a reason for cooperation at the multilateral level. Those developing countries that are excluded from a RTA with a developed country – or face less favourable market access conditions – may choose to push toward multilateral liberalization in order to re-create a level playing field among developing countries in terms of their access to the markets of developed countries.

(iii) Protectionism

A trade agreement can also serve a protectionist rationale. This can be a motive for a bilateral or a regional trade agreement, but not for a multilateral agreement where concessions have to be extended on a MFN basis. The theoretical argument for this is made in the political economy literature. As explained above, the central idea in this literature is that trade policy is only partly about the maximization of social welfare. Of fundamental importance is the political pressure that comes from various lobby groups including those who provide campaign financing to elected officials. Under these conditions, those who stand to gain the most, and who will therefore be the strongest backers of a RTA, are the producers who are not efficient internationally (i.e. who will find it difficult to compete in the world market), but who are nevertheless more efficient than the producers in the partner countries.

Consider the case of two governments that negotiate an FTA. Since policies are influenced by national welfare and special interests, there are two cases when the FTA is feasible – when it increases consumer welfare and producers are not organized to lobby against it, or when it enhances the profits of well-organized producers that will lobby in favour of the FTA. Grossman and Helpman (1995b) show that the more trade diverting a FTA, the stronger is the support from lobby groups benefiting from it. Therefore, they claim, a FTA is more likely to come about when it is trade diverting. In each country, those producers that are regionally efficient but are not globally efficient will lobby to obtain preferential access to the regional market. If two governments can swap trade-diverting concessions, trade diversion is good politics even if it is bad economics and the governments will form the FTA.

In a free trade area, external tariffs of the members are not identical and rules of origin are used to determine whether a good is eligible for preferential treatment. Following the example above, suppose that the least efficient producer of a certain good is located in the FTA member country with the highest external tariff, while the regionally efficient producer is located in the FTA member country with the lowest external tariff. Creating the FTA integrates the markets of the members, and as a result, the regionally efficient (but globally inefficient) producer gains privileged access to its partner's market while at the same time benefiting from the protective effect of the highest external tariff. Thus the use of the term "enhanced protection".

(iv) Increasing bargaining power

Another argument for trade cooperation is that countries may want to form a RTA to increase their bargaining power in the context of multilateral negotiations (Mansfield and Reinhardt, 2003). This argument is likely to be most important for small developing countries. A World Bank study (Andriamananjara and Schiff, 1999) argued that increased bargaining power at the international level provides an explanation for why a regional grouping like CARICOM, which is made up primarily of very small states, might arise. Given the small size of the countries concerned, trade integration provides limited economic benefits. The creation of a regional grouping will bring benefits through savings on international negotiation costs and giving the countries concerned a larger voice in the international arena.

---

[64] The insurance motive is closely linked to the domino theory of regionalism proposed by Baldwin (1996). See Section C for a discussion of this theory.

However, the creation of a regional bloc does not necessarily work to increase the bargaining power of its member countries. For example, if member countries are characterized by very different economic interests, it will be relatively easy for opposing negotiators to undermine the deal by making offers that suit the interests of some countries to the point of inducing their defection. This explains why historically the most successful negotiating blocs have been those formed on product-based alliances, such as OPEC or the Cairns Group. Both blocs had a common interest in achieving liberalization on a common export sector – oil and agriculture, respectively.

Furthermore, there are circumstances where the creation of a RTA may even weaken the bargaining power of its member countries. This may occur, for example, in the context of negotiations with a multinational that is considering investing in a certain country, say A. Suppose that, in order to invest in country A, the multinational demands tax concessions. In the absence of a FTA, the government of country A can bargain these concessions against market access (if the multinational does not invest in country A, its product will have to face trade barriers to be commercialised in country A). But, if country A is member of a FTA, the multinational can locate in any country of the region – choosing the one that offers the best tax conditions – and benefit from duty free access in the whole region, including country A. The bargaining power of the government in country A is undermined. The FTA member countries will compete with each other to attract the multinational company in their own country by offering the best deal. This will trigger a race to the bottom that can only be avoided if countries delegate decisions over tax matters to the region.

3. INSIGHTS FROM INTERNATIONAL RELATIONS THEORIES ON INTERNATIONAL COOPERATION

So far, we have examined economic and political-economy approaches to trade cooperation. International cooperation and the factors that promote or inhibit such cooperation have also been analysed from a range of different theoretical perspectives in the International Relations (IR) literature.[65] The aim of this section is to discuss the similarities between economic and IR approaches to trade cooperation, and, more importantly, to highlight the additional insights the IR literature can offer over and above the purely economic and political-economy explanations analysed so far.

(a) Efficiency, power, norms and ideas: a brief introduction to IR theories of cooperation

IR approaches to the study of international cooperation and institutionalization can significantly contribute to the analysis of cooperation in the field of international trade. Various theories allow for an understanding of how international cooperation in trade matters is shaped by efficiency considerations, power and distributional conflict, and shared norms and ideas. Box 2 gives a schematic overview and short characterization of the most important IR theories of cooperation. For reasons of parsimony, however, the main text of this section will focus on the "grand theories" of IR, and how they explain rationales for international trade cooperation.[66]

A useful starting point is to distinguish between rationalist approaches, on the one hand and more sociological approaches on the other. Two prominent theories of international cooperation – neoliberal institutionalism and neorealism – are rationalist in the sense that they regard states "as self-interested, goal-seeking actors whose behaviour can be accounted for in terms of the maximisation of individual

[65] Many IR theorists have adopted the definition of "cooperation" originally advanced by Robert Keohane according to which cooperation occurs when 'actors adjust their behaviour to the actual or anticipated preferences of others, through a process of policy coordination'. Keohane (1984: 51); Grieco (1990: 22); Milner (1998: 7). For overviews of IR theories on international cooperation and institutionalization see, for example, Simmons and Martin (2002)., Hasenclever et al. (1997, 2000), Krasner (1999: 43-72), Martin and Simmons (1998), Snidal (1997), Haggard and Simmons (1987) and Kratochwil and Ruggie (1986).

[66] The IR theories of neorealism, neoliberal institutionalism, liberalism, and constructivism, which will be explained in detail below, are often called the 'grand theories' of IR.

utility" (Hasenclever et al., 1997: 23).[67] As will be shown below, both neoliberal institutionalism and neorealist approaches have been widely used in the study of the post-war trade regime. Whereas neoliberal institutionalists focus on the efficiency-enhancing qualities of trade agreements, neorealist theories tend to stress the importance of power capabilities and distributional conflict as key factors determining the prospects of international cooperation in the area of trade.

In contrast to the rationalist orientation of neoliberal institutionalism and neorealism, theories commonly referred to as "social constructivist" adopt a more sociological view of the international system. Social constructivist theories emphasize the normative and inter-subjective dimension of international cooperation and reject the view that cooperation and institutionalization can be adequately explained by strategic interaction between utility-maximising states.[68] An early example of the use of social constructivist theory in the analysis of the international trade regime is Ruggie's seminal article on "embedded liberalism", which analyses the multilateral trading system as an "inter-subjective framework of meaning".[69] Constructivism has been applied less frequently to the study of the trade regime than neoliberalism and neorealism,[70] but as will be shown below, it opens new and impressive perspectives on trade cooperation.

Some IR theories reject the "statist" assumption that nations are unitary actors with a fixed utility or set of norms and values. These approaches are concerned with investigating how domestic interaction shapes preferences and norms of trade policymakers in charge of formulating national trade policy and negotiating international trade agreements. Assessing trade policy on the sub-state level, these theories stress the role of various domestic government entities and non-state actors, such as lobby groups or non-governmental organizations (NGOs). They analyse how these groups interact in an effort to shape trade policy. Rationalist approaches to domestic trade policy generation are called "liberalist", and examine the role of individuals and interest groups as the fundamental actors in world politics. Liberalists claim that the rational rent-seeking behaviour of special interest groups and elites influences or even determines the actions of elected officials and bureaucrats. "Weakly cognitivist" theories of preference generation, on the other hand, advance the constructivist contention that domestically generated norms, values, customs and traditions have critical effects on public officials and trade decision-makers.

Box 2: A schematic overview over IR theories of cooperation

The Chart below presents a stylised and simplified overview of influential IR theories of international cooperation. The various strands of IR theory can be sketched along two dimensions: the vertical axis distinguishes between different underlying assumptions of decision-making. Rationalist theories assume that actors – the presence of informational constraints and environmental imperfections notwithstanding – take decisions with the strict aim of maximising some utility function. They do so by rationally weighing up costs and benefits of cooperation. One rationalist strand of literature thereby assumes that all negotiating parties are driven by mutual efficiency concerns. Each cooperating party is believed to bargain for that solution which maximises the "size of the pie" that cooperation generates.[71] Another theme of the rationalist conception assumes that players try to maximise their relative power position. To proponents of this view, international cooperation is akin to a zero-sum game, where gains to one party necessarily come at a loss to another one (the

67 On the use of rational choice-based theories in IR theory see, for example, Snidal (2002).

68 On constructivism in IR theory, see, Adler (2002); Guzzini (2002); Wendt (1999), Checkel (1998); Ruggie (1998); Reus-Smit (1997); Finnemore (1996); Kratochwil (1989).

69 See Ruggie (1983).

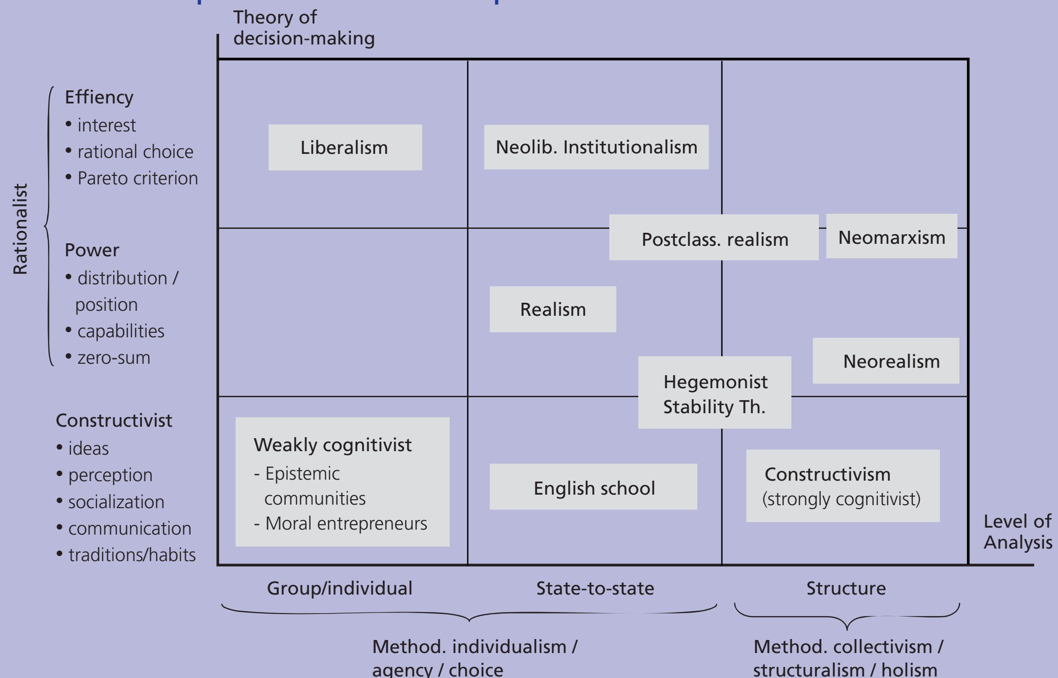
70 See Lang (2006: 83).

71 In other words, these theories believe that signatories to a contract strive for "Pareto efficiency", which maximises the absolute gains of interaction. Pareto efficiency is an equilibrium outcome reached when no negotiating party can be put into a better position without making any other agent worse off.

"size of the pie" hence is thought to be fixed). Therefore, cooperating parties anxiously watch over their power rank within the international system.[72] Non-rationalist approaches to decision-making reject the assumption that agents are only driven by rigid cost-benefit considerations. To them, decision-making is much better explained by resort to fundamental norms, shared ideas, inter-subjective beliefs, traditions, and habits. Perception, interpersonal communication, learning and socialization to a large degree shape these norms and ideas.

The horizontal axis can be labelled "level of analysis". The distinguishing criterion is the object of examination. Theories pertaining to methodological individualism or agency believe that agents – individuals, groups, or states – can actively and consciously shape the consequences of their interaction. Agents' choice is thought to determine the outcome (the system). In contrast to this, theories adhering to the school of methodological collectivism, structuralism, or holism, contend that it is the system that shapes the actors and not vice-versa. The system, according to structuralists, is more than the sum of its constituent parts, and therefore assumes "a life of its own". Systems shape how agents think and act. Along those two dimensions the various schools of IR can be plotted:[73]

IR theories of cooperation in a schematic representation



Source: Based on Wendt (1999); compilation by the authors.

The school of neoliberal institutionalism is a rational statist approach to international cooperation.[74] According to institutionalists, countries cooperate with the substantive aim of increasing mutual efficiency.[75]

[72] Distributive concerns are sometimes referred to as "Kaldor-Hicks efficiency". Under this conception of efficiency parties worry about relative gains, and largely ignore (or take for granted) absolute gains.

[73] Ikenberry et al. (1989) classify IR approaches in a similar fashion along the following two dimensions: level of analysis (system-centred, society-centred, state-centred) and driving forces (power, interest, norms/ideas).

[74] The school of neoliberal institutionalism is also referred to as "rational functionalism".

[75] Efficiency gains may be achieved by reducing uncertainty, increasing mutual information levels, producing collective goods (such as forums for bargaining and dispute settlement), centralizing certain tasks so as to reduce transaction costs, raising the costs of opportunistic actions (e.g. through repetition of the game or through pooling of enforcement capabilities), and so forth.

Scholars of liberalism part with the somewhat arbitrary idea that states are unitary actors with a steady utility function. In order to explain what motivates countries to cooperate in the international realm, liberalists firmly base their research on domestic politics. Cooperative agreements are concluded if the decision to collaborate is the equilibrium outflow of some rational deliberation process among salient domestic groups.

Neomarxist or "world systems" analysis is a structural approach to international cooperation giving primacy to economic power relations. World systems analysis is usually grounded in the Marxist conception of social reality. The central argument is that the world economy contains two sorts of countries: a dominant core and a dependant periphery. Core and periphery interact and function as an integrated whole. In a unified global capitalist system the hierarchy of states is held together by economic dependency. The periphery is the source of the wealth of the core; the latter extracts and siphons off the resources of the former. This produces underdevelopment throughout the dependent periphery.[76] Hence, countries at the core (industrialized countries) create alliances with each other to choreograph the "development of underdevelopment" (Frank, 1969: 9). Trade cooperation agreements between core and periphery are more akin to adhesion or dependency contracts than to contracts of mutual consent and benefit.[77]

Realism is a state-centric, power-oriented approach to international relations. It is the longest-standing paradigm in IR, and was dominant from at least the 1930s to the 1970s (Simmons and Martin, 2002).[78] Realists contend that states strive for power maximization. Countries candidly act in ways that satisfy their power interests. Realist scholars have shown interest in issues of military security and less in international trade. Hence, international trade cooperation does not feature prominently in realist thought, and where it does, its proponents see the hand of power exerting the true influence behind the façade of international agreements (Morgenthau, 1948). Generally, treaties and international law are "epiphenomenal" to state power and interests (Carr, 1939).

The neorealist school is usually seen as the successor of realist thought. However, neorealism is a systemic power-oriented approach to international affairs. The international system is characterized by anarchy. In a state of anarchy, any nation is exclusively occupied with its own survival (Waltz, 1954). To that end, each nation must watch its power position in the international system. Countries predominantly care about military capabilities and the distribution of coercive power within the system. Interaction among rational countries is assumed to be a zero-sum game. To maintain (or improve) their power rank, countries utilize their own resources, or form (spontaneous) short-term international alliances or blocs. Alliances can temporarily mitigate anarchy, but never overcome it.

A milder form of realism is called postclassical realism or defensive realism. The view of the world here is somewhat less pessimistic. Postclassical realists argue that power, while an important dimension of state interaction, is not an end in itself. Rather it is but a means of achieving security and increasing the resource-base of a country. For proponents of this view, countries choose cooperation so as to reduce the probability of conflict, help overcome international externalities, and increase the welfare of a country.

---

76 According to world systems theorists, there exists an inherently unfair international division of labour, where modern high-profit industries are located in the core and traditional labour-intensive industries and natural resource extraction originates in the periphery. This division of labour produces capital accumulation and development in the core, and yields economic and political underdevelopment in the periphery. The more the world economy progresses, the more difficult it is for the periphery to develop, and the greater is the revolutionary effort required to escape global market forces.

77 Early formulations of world system analysis include Wallerstein (1974), Baran (1967), and Frank (1969). For more contemporary approaches, see e.g. Chase-Dunn (1998).

78 The earliest available works of realism – Thucydides and Sun Tzu – date back further than 400 B.C.

Hegemonic stability theory is another variant of realism. It takes a more nuanced stance on international cooperation: an incumbent hegemon (such as the United States after World War II) aims at fortifying its predominance in the international system through cooperation. At the same time, the hegemon wants to forge a global community of values, and aims to inject some of its cherished norms and ideals into the system. In addition, only the hegemon as the most powerful state in the system is in a position to address international collective action problems so as efficiently to fight global externalities, such as environmental pollution or opportunistic beggar-thy-neighbour trade policies.

Constructivist approaches to the discipline of IR reject the method of rational choice and agent-centred methodological individualism that all of the above perspectives maintain. Strongly cognitivist constructivists claim that rationalist theories of choice fail on two accounts. Firstly, they neglect the formative influence of ideas, norms and values on behaviour. They therefore propose to replace the "logic of consequences" with a "logic of appropriateness", so that norm-based decisions substitute rational, self-interested choice. Secondly, rational choice theories fail to acknowledge the influence that the system has on the actors. The power of inter-subjective beliefs, shared understanding, culture and socialisation, according to constructivists, is completely overlooked by agent-centric theories of choice. Hence, for proponents of the strongly constructivist stance, the dictum "actors" preferences shape the outcome is false. Instead, system and agents are strongly interdependent; the structure shapes actors' perceptions, perception shapes agents' preferences and consequently their behaviour. Collective behaviour then can have a feedback impact on the system.

A variation of structural constructivism (and arguably its forerunner) is the English school of IR. This theory is less concerned with how the system shapes states' norms, but rather with the transnational diffusion of certain international norms and values. Its proponents have emphasized the importance of international society in maintaining global order. The concept of "collective security" is a good example, showing how like-minded countries form a coalition to inject their defensive aims into the international system.

Weakly cognitivist approaches, finally, examine how guiding norms and principles emerge, become prominent and consequently influence the cooperative choice of domestic decision-makers. The roles of eminent individuals (moral entrepreneurs), elites, and epistemic communities are paramount in this process.

Some caveats to this schematic representation of IR theories are in order: first, the selection of approaches is necessarily eclectic. It is illustrative rather than exhaustive. Second, it is always a challenge to allocate IR scholars to a particular school of thought. Naturally, authors do not religiously adhere to a particular IR theory. Scholars draw selectively from those approaches they feel best explain social behaviour and human interaction. Third, the classification of theories is not as clear-cut and rigid as it may appear. Theoretical and dogmatic debates have evolved over time. Cross-fertilization between views has produced hybrid approaches that embrace aspects of various schools of thought. Finally, historic paradigm shifts (such as the end of the Cold War or the decline of US hegemony) and technical innovations within IR (such as advances in game theory and the increased use of econometric tools) have influenced the popularity and prominence of different schools.

(b) "Statist" approaches to trade cooperation: states as actors

Various schools of IR take a statist perspective on international trade cooperation. Their subjects of examination are sovereign nation states that are assumed to be unitary actors in the international system.

(i) Rationalist approaches to the study of international cooperation: market failure, power and distribution

Focus on efficiency: neoliberal institutionalism

Neoliberal institutionalism argues that cooperation between states can be explained in terms of calculations of self-interest. The fundamental insight of this theory is that collective action dilemmas, transaction costs and information asymmetries and deficits may create situations in which behaviour that is rational from the perspective of individual states prevents them from realising mutual benefits, as illustrated by the prisoners' dilemma metaphor. In such situations, international regimes, or institutions,[79] enable states to cooperate by providing information, reducing uncertainty and lowering transaction costs, i.e. the costs of shaping, monitoring and enforcing rules.[80] Regimes facilitate cooperation in that they influence cost-benefit calculations of alternative courses of action by states. In its original formulation by Keohane (1984) a central feature of neoliberal institutionalism was that cooperation between states does not require a formal international organisation with centralised enforcement capacity. Rather, regimes are self-enforcing agreements, and compliance with a regime's rules can be explained by reciprocity and the role of reputation.[81] Thus, neoliberal institutionalism stresses the bilateral and decentralised nature of international cooperation regimes.[82]

Applying this logic more concretely to the field of trade cooperation, it becomes clear that neoliberal institutionalism and prominent economic theories of trade agreements share many properties. Externality-based theories in trade, especially the terms-of-trade approach, are agent-centred, statist, and efficiency-minded approaches to trade cooperation. Those market imperfections, externalities and inefficiencies that international trade cooperation can overcome according to neoliberal institutionalism, can also be understood as world-price externalities that feature so prominently in the terms-of-trade theory. Moreover, from a neoliberal institutionalism perspective trade agreements can be viewed as mitigating collective action problems which arise from economic considerations. If no two countries want to shoulder the costs of drafting, launching, and maintaining a trade agreement from which everybody benefits, the conclusion of a multilateral regime will solve this problem by providing a public good to the benefit of the international trading system.[83]

---

79 There is no consensus definition of the term "international regime" in the IR literature. One influential characterization of "international regime" is a set of 'principles, norms, rules and decision making procedures around which actors' expectations converge in a given area of international relations.' (Krasner, 1983: 2). For a discussion of the different definitions of "international regime" used in IR theory, see for example, Hasenclever et al. (1997: 8-22). Although some theorists prefer the term "institution" over "regime" (Simmons and Martin, 2002:194), the former term has also been used in widely different ways in IR theory (see, for example, Buzan, 2004; Holsti, 2004). However, for the present purposes of explaining rationales for trade cooperation, it is inconsequential whether trade agreements are regimes or institutions. Yet one thing is evident – trade agreements as regimes or institutions are more than just contracts, which is the way economists tend to conceptualise trade cooperation.

80 See Keohane (1984). See also Keohane (2005: xi): "International regime – clusters of principles, norms, rules, and decision-making procedures reduce transaction costs for states – alleviate problems of asymmetrical information, and limit the degree of uncertainty that members of the regime face in evaluating each others' policies. Like other political institutions, international regimes can be explained in terms of self-interest. Furthermore, they exert an impact on state policies largely by changing the costs and benefits of various alternatives. They do not override self-interest but rather affect calculations of self-interest." Although neoliberal institutionalism is the term generally used in the IR literature to refer to Keohane's work, the author himself has rejected the label "neoliberal" (Keohane, 2002: 3).

81 Later versions of neoliberal institutionalism have departed from Keohane's functionalist approach, and attached more weight to the importance and influence of formal international organizations as cooperation facilitators, see section C.1.(c) below.

82 See Abbott and Snidal (1998). The theory was significantly influenced by the experience of the GATT trade regime in the 1970s and 1980s. Keohane (2005: xi) observes that 'indeed, it could be argued that my theory generalizes the experience of GATT'.

83 On the public-good nature of trade agreements, see section C.1.(d) below.

Although neoliberal institutionalism usually focuses on the prisoners' dilemma as representing the typical collective action dilemma in international relations, its logic has also been applied to other patterns of strategic interaction between states. Several authors have attempted to explain the likelihood of the formation of an international regime (and the formal characteristics of different regimes) by referring to different "strategic structures" of the underlying collective action problems (e.g. Aggarwal and Dupont, 1999 and 2004; Ostrom, 2003; Sandler, 1992). A common distinction in this context is that between collaboration problems and coordination problems.[84] It is often argued that collaboration regimes are typically more formalized and institutionalized with regard to surveillance and enforcement than coordination regimes. Unfortunately, it is understudied in the institutionalist literature, in what respects trade agreements can be conceptualised as coordination games, and what impact this would have on the design of trade agreements.[85]

Focus on distribution: the school of neorealism

Whereas neoliberal institutionalism highlights the role of international cooperation in enabling states to solve market failure and other efficiency problems, and thereby to achieve joint efficiency gains, neorealist approaches to the study of international cooperation reject the proposition that market failure in this sense is a fundamental problem in international relations. Neorealists emphasize the role of "power and distribution rather than information and joint gains. The basic issue is where states will end up on the Pareto frontier, not how to reach the frontier in the first place.".[86] Consequently, proponents of this theory question the relevance of the prisoners' dilemma metaphor and posit that a more pertinent game-theoretic model is that of the "battle of the sexes", a coordination game with two possible negotiation equilibria. Players have conflicting preferences regarding the two optima.[87]

In this respect, several authors have rejected the view that the prisoners' dilemma metaphor adequately represents the configuration of interests of states in the field of international trade.[88] According to neorealist theory, countries thus do not cooperate to reap primarily welfare-enhancing mutual efficiencies. Instead, states try to "squeeze out" as many concessions from other players in order to be propelled onto a higher power rank.

Neorealist theory contends that it is exactly questions of distribution that make cooperation difficult to achieve in the first place. It is argued that as a consequence of the anarchic nature of the international system, states will often refrain from participating in efficiency-enhancing international cooperation regimes when they suspect that other states will realise greater gains.[89] This concern about "relative gains" is due to the fact that economic profits can eventually be transferred into military capability.

[84] See Stein (1983); Martin (1993). In a nutshell, in collaboration games – such as the prisoners' dilemma – parties have partially conflicting interests, namely those of acting opportunistically by cheating the other party. Opportunism is not a problem in coordination games (such as the "battle of sexes" game). There, no party gains from defecting. Cooperating parties join forces so as to reap mutual transaction efficiencies or synergies. However, coordination games are nevertheless not free from disagreement: typically, there exist more than one Pareto-efficient equilibrium outcome. States then collectively must choose one of various welfare superior equilibria. Different equilibria thereby are preferred by different players. This creates tensions and disagreement among the cooperating parties.

[85] Trade agreements based on "minimum standard" or "positive integration", such as the WTO Agreement on Trade-Related Intellectual Property Rights (TRIPS), or the Agreement on Trade-Related Investment Measures (TRIMs) of the WTO may be properly conceptualised as collaboration games, where all parties know that conceding to some level of regulation is mutually efficiency-enhancing. However, disagreement may arise among the signatories over the question what the optimal level of cooperation really is.

[86] See Krasner (1991: 140).

[87] Applied to the less clinical setting of a 2-by-2 matrix, theories of distribution contend that cooperation over complex issues usually yields a vast amount of self-enforcing equilibria that two or more parties prefer to no agreement. However, parties are in vivid disagreement in their subjective rankings of the mutually preferable agreement candidates. Adding realism by considering dynamism, uncertainty, and asymmetrical information about other parties' "bottom line" makes clear that virtually all contexts of international cooperation involve distributional conflict over the terms of cooperation (Fearon, 1998).

[88] See, for example, Goldstein (1993). Gowa and Mansfield argue that the prisoners' dilemma metaphor fails to reflect the most critical aspect of free trade agreements in an anarchical system – the existence of security externalities. Gowa and Mansfield (1993), Gowa (1989).

[89] See Grieco and Ikenberry (2003: 103-105), Mearsheimer 1995), Grieco (1988), (1990).

"Driven by an interest in survival and independence, states are acutely sensitive to any erosion of their relative capabilities".[90] Thus states are not seen as rational egoists but as "defensive positionalists.".[91]

At face value, the neorealist relative gains hypothesis thus seems unhelpful in explaining why countries enter into trade agreements – it rather gives reasons for why countries refrain from cooperating. However, the relative-versus-absolute gains issue has spawned a lively debate about the extent and boundaries of trade cooperation. It has focused attention on whether security-related relative gains decrease the prospect for international cooperation, and whether – as an empirical matter – states are concerned about such relative gains at all.[92] Joseph Grieco has argued that an analysis of the implementation of some of the Tokyo Round Agreements on non-tariff barriers supports his theory on the importance of security-related relative gains.[93] This analysis, however, has been subject to widespread criticism in the literature.[94] The prevailing view seems to be that the significance of the relative gains problem depends upon various factors, including the number of states involved. Relative gains seem to matter less in a multilateral than in a bilateral context.[95]

Lloyd Gruber stresses the importance of global power-divides with respect to trade agreements. The author challenges the contention that trade cooperation is mutually welfare-enhancing. He argues that the fact that states enter into cooperative arrangements on a voluntary basis does not mean that such arrangements are necessarily welfare-improving for all participants. If powerful countries, through the exercise of "go it alone power" can alter the status quo and thus remove the original status quo from the choice set of weaker states, weaker players must either accept an agreement that is worse than the status quo ante or accept to be left behind in conditions that are even more disadvantageous.[96] Therefore, entering into cooperative arrangements can leave nations in a worse position relative to the status quo ante. The concept of "go it alone power" and the concomitant idea that states are forced to enter into international agreements that leave them worse off compared to the status quo ante have recently also been used by some authors in the analysis of GATT/WTO negotiations.[97] Trade agreements thus may not be concluded because countries want them, but because they are coerced to do so by powerful countries whose aim is to create dependency, or to exploit weaker countries. For this post-colonial perception of trade cooperation, see e.g. Jawara and Kwa (2004).[98]

The idea that international cooperation should be understood either in terms of the efficiency considerations emphasized by neoliberal institutionalists, or in terms of the distribution concerns stressed by neorealists has recently been criticized. James Fearon argues that the collaboration-coordination dichotomy is misleading, because all problems of international cooperation have a common strategic structure. The author contends that international cooperation always first involves a problem of bargaining about the distribution of future cooperation gains. This bargaining is akin to a coordination game. Secondly, cooperation games involve a problem of enforcement and monitoring, which is akin to

90 See Grieco (1990: 39).

91 As was mentioned in Box 2 above, the relative gains concern of neorealists stands in contrast to absolute gains concerns of neoliberal institutionalists who claim that countries strive for welfare maximisation, and are largely agnostic about gains that other countries carry away from the mutual cooperation. Interestingly, Grieco (1990: 234) does not argue that concerns about relative gains mean that international institutions do not matter. To the contrary, a focus on relative gains helps explain certain functions of international institutions such as the provision of formalised side-payments by which strong members can compensate weaker members.

92 See Baldwin (1993).

93 See Grieco (1990: 168-215).

94 See, for example, Gruber (2000: 22-27), Fearon (1998: 288), Morrow (1997), Keohane (1993), Powell (1991) and Snidal (1991).

95 See also Grieco and Ikenberry (2003: 104-105).

96 See Gruber (2000).

97 See Steinberg (2002: 341, 349), Barton et al. (2006:206).

98 Notice the substantial similarity between this coercion argument and the economic insurance model of trade cooperation discussed in subsection 2.(d) above. Only the rhetoric is different.

a prisoners' dilemma game of collaboration.[99] Whereas an approach that treats a prisoners' dilemma as the key problem in international cooperation leads to the expectation that states will have little difficulty in cooperating once countries possess enough deterring enforcement and monitoring capacity, different and more nuanced predictions result when a distinction is made between the bargaining phase and the enforcement phase of international cooperation. According to Fearon, bargaining problems are often more important obstacles to international cooperation than monitoring and enforcement.[100] The author thus argues that "regimes deserve greater attention as forums for bargaining rather than primarily as institutions that aid monitoring and enforcement" (*ibid.*: 298).[101]

Applying Fearon's analysis to the field of trade agreements does not tells us why countries cooperate in trade. Yet the author directs attention to the inherent obstacles in the run-up to a successful conclusion of a trade deal.[102] Moreover, his approach can also be seen as helpful in understanding the structure of negotiations. In order to overcome the problem of distributional conflicts over the expected gains from trade cooperation, and to reach agreement at all, countries make efforts to structure the negotiation process. All these strategies are aimed at reaching a speedy agreement, to mitigate long-winded distributional conflicts, and to prevent a breakdown of negotiations. Side payments and issue linkage, for example, are ways of cutting short the bargaining process.[103] Gradualism (the concept of trade rounds) is apt to decrease the "shadow of the future". A shorter shadow of the future reduces the size of anticipated gains from trade and thereby the incentive to renegotiate endlessly. A structured bargaining process of offers and counter-offers reduces negotiation frictions. Regular high-level meetings and artificially high political costs of failure (e.g. the "single undertaking" scheme applied in the Uruguay Round of the GATT) are strategies aimed at "upping the stakes" in case of a negotiation meltdown, and at reducing parties' incentives to hold out on each other in the negotiation process.

Focus on the dominant power in the international system: hegemonic stability theory

The theory of hegemonic stability asserts that the creation and maintenance of an open international order requires the presence of the one state that is endowed with a preponderance of power resources relevant to the particular issue area, and that a more equal distribution of power capabilities will lead to a decline of the regime.[104] Only the hegemon can overcome international market failure and provide global public goods.

Although hegemonic stability theory is seen as flawed by many theorists,[105] it remains an important concept in studies of international cooperation. For example, it has been argued that a hegemonic power faces the problem of how to assure other states that it will not act opportunistically. In this regard, it has been suggested that the United States encouraged the formation of the post-war international

99 See Fearon (1998: 270, 275-276).

100 While 'a long shadow of the future may make enforcing an international agreement easier, it can also give states an incentive to bargain harder, delaying agreement in hopes of getting a better deal.' (*ibid.*: 270).

101 Fearon's contribution underlines a point made by Snidal that "almost all international cooperation problems mix efficiency and distribution concerns" (Snidal, 1997: 485; see also Morrow, 1994).

102 "...the major obstacles to the conclusion of each of the last three GATT rounds were not intractable problems of monitoring, commitment, enforcement, or information flows to make enforcement possible. Instead negotiations have regularly stalemated on questions of who would make the concessions necessary to conclude an agreement" Fearon (1998: 289).

103 The inclusion of TRIPS serves as an example of issue linkage and side-payments geared towards reaching consent in the Uruguay Round.

104 See Kindleberger (1973); Krasner (1976); Gilpin (1987).

105 See e.g. Strange (1982), Conybeare (1984), or Snidal (1985). Empirical studies have found little support for hegemonic stability theory in its crude form. Hegemonic stability theory has also been criticised on theoretical grounds. One major theoretical argument advanced against the theory is that it incorrectly assumes that an international regime is a public good. Thus, for example, many analysts take the view that free trade and the GATT regime are not public goods (cf. the discussion in section C.1.(d) below). Another argument is that, even assuming that international regimes are public goods, such goods can also be provided by groups of states sufficiently small for each state to notice whether or not other states in the group are contributing to the provision of the collective good ("k-group"; Milner, 2002; Hasenclever et al., 1997; Lake, 1993; Keohane, 1984).

trade regime partly to make its commitment to free trade credible.[106] This may explain the interest of the United States in multilateralism in the 1990's: while the Cold War resulted in a commitment to a stable and prosperous Western Europe and thus decreased "the need for a trade-specific signal of the United States' willingness to adhere to free trade", the end of the Cold War again confronted the United States with the problem of how to assure other states as to the credibility of its commitment to free trade, given its reputation for unilateralism.

(ii) Focus on ideas, knowledge and values: constructivist theories of the system

When trying to answer the question of why countries cooperate in trade affairs, sociological or social constructivist theories can be very helpful in revealing the general conditions conducive to international cooperation in trade affairs. Constructivists show that not only norms and values play an important role, but also that history matters. Whereas rationalist theories usually only look at utility, interest, and choice, constructivists contend that lessons learned from the past shape the way governments think about trade cooperation and consequently the decisions they take.

Constructivist theories argue that interest-based, rational choice theories reviewed above fail to account for the role of ideas and knowledge in shaping the identities of states. Structural, or strongly cognitivist theories maintain that the behaviour of states is rule-driven and that international cooperation and institutionalisation cannot be understood without reference to generally accepted normative structures that shape the identities of states.[107] For example, Reus-Smit argues that neither neorealism nor neoliberal institutionalism can explain the historical development of multilateralism. As a fundamental institution of modern international society, multilateralism reflects the constitutional structure of international society consisting of dominant beliefs about the moral purpose of the state, a norm of procedural justice and an organising principle of sovereignty.[108]

As noted above, Ruggie's analysis of "embedded liberalism" is a prominent example of the use of a social constructivist approach to the study of the multilateral trade regime. Ruggie argues that international regimes are social institutions and as such constitute "inter-subjective frameworks of meaning".[109] The formation of international regimes is a manifestation of "the internationalization of political authority". Since political authority "represents a fusion of power with legitimate social purpose", interpretations that exclusively focus only on power, and ignore the dimension of social purpose, are necessarily incomplete.[110] They may manage to explain the form of a regime but not its content. With respect to this dimension of legitimate social purposes, Ruggie emphasizes the fundamental differences between the post-World War II international economic order with the "Bretton Woods Institutions" (World Bank and IMF) and the GATT as its centrepiece, and the liberal economic order prevailing in the 19th century (cf. subsection 1.(a) above). According to Ruggie, attempts to reconstruct a liberal international economic regime in the interwar period failed not because of the absence of a hegemonic power but because "even had there been a hegemon, they stood in contradiction to the transformation in the mediating role of the state between market and society, which altered fundamentally the social purpose of domestic and international authority.".[111] A fundamental change in social purpose, however, did occur after World War II. It manifested itself in what Ruggie terms "the compromise of embedded liberalism", i.e. the vision shared by leading states that international commitments needed to be compatible with the pursuit of domestic economic policy objectives. "This was the essence of the embedded liberalism compromise: unlike the economic nationalism of the thirties, it would be multilateral in character; unlike

106 See Goldstein and Gowa (2002: 154).

107 See Hasenclever et al. (1997: 167-168).

108 See e.g. Reus-Smit (1997) and Ruggie (1993). But see Martin (1993) for a critical view.

109 See Ruggie (1983: 196).

110 See Ruggie (1983: 198).

111 See Ruggie (1983: 208).

the liberalism of the gold standard and free trade, its multilateralism would be predicated upon domestic interventionism.".[112]

Strongly cognitivist theories assume that it is largely norms and ideas permeating the international system which motivate and shape state-to-state cooperation in trade affairs. However, these theories ultimately remain unclear about the way shared norms, values and beliefs diffuse into the system. An older strand of IR theory, the English school, is occupied with exactly this question. Scholars of the English school emphasize the importance of "international society" in global cooperation. International society is thereby seen as a group of states that share common ideas and coherent goals.[113] A central concern is to explain how shared purposes spread internationally and contribute to order (Bull, 1977). With respect to trade cooperation, special attention is thereby given to a belief in the peace-promoting quality of trade (see Box 3). The idea that multilateral, non-discriminatory trade would contribute significantly to global peace was a central theme in the thinking of English and American policymakers about the design of the post-World War II trading system.[114] Theories of norm diffusion (which draw heavily on historical data) try to show how the vision of peace-through-trade emerged,[115] but more importantly, how some influential states – such as the United Kingdom, the United States, Canada and Australia – went about persuading other countries to join in multifaceted international cooperation.

Box 3: The peace-promoting quality of trade

The genuine belief that trade "dovetailed with peace" (Hull, 1948: 81) seemed to have been a principal belief among Western Allies in the post-World War II era.[116] In the wake of the Cold War, the Allies entertained the hope that an open international economic order would reduce power balancing and strategic rivalry among the great powers.[117] Post-war European integration is another important example of a trade agreement for which national security was a primary driving motivation.[118]

112 See Ruggie (1983: 209). Andrew Lang (2006: 83) has recently argued that 'while the narrative of embedded liberalism itself has been relatively well reproduced, the theoretical framework on which it is based has been neglected.'. In particular, trade lawyers have relied heavily on rationalist approaches in their understanding of the nature of the trading regime and have insufficiently taken account of Ruggie's characterisation of the trade regime as an 'inter-subjective framework of meaning'. Lang argues that constructivist insights have the potential to significantly enrich and expand the understanding of the trade regime and of trade law.

113 English school proponents see international society either as a group of states that have 'established by dialogue and consent common rules and institutions for the conduct of their relations, and recognize their common interest in maintaining these arrangements'. (Bull and Watson 1984: 1). Alternatively, international society exists because those who speak and act in the name of states assume that it does. (Evans and Wilson, 1992: 32).

114 See Penrose (1953). The historical record clearly shows that the ITO/GATT was envisioned by the Allied powers to be part of a bigger cooperation scheme that included the establishment of the United Nations, the World Bank, and the International Monetary Fund (see e.g. Jackson, 1969; Dam, 1970; Gardner, 1980).

115 Economic nationalism and the spread of regional blocs in the 1930s were seen as a major source of conflict and as one of the causes of the war.

116 The term "commercial liberalism" has been used to describe the view that the mutual dependence generated by international trade promotes international peace.

117 This hope proved to be in vain. Instead, trade cooperation deepened the trenches between the Socialist Bloc and the West: it has been argued in this respect that in view of the close linkages between economic and security considerations that 'the opening of the world economy after World War II was given critical support by the system of security cooperation triggered by the Cold War'. (Grieco and Ikenberry, 2003: 157).

118 European economic integration was seen as a way of ensuring a lasting peace on the continent. The first step taken in this process was the establishment of the European Coal and Steel Community (ECSC). While the stated objective of the ECSC was "to contribute ... to economic expansion, growth of employment and a rising standard of living ...", the Treaty had a militarily strategic value in putting coal and steel – industries essential to war-making – under a common authority. It had the effect of making sure that "any war between France and Germany becomes, not merely unthinkable, but materially impossible". (Pomfret, 1997: 89).

Even though the contention that trade and peace dovetail is still very present today,[119] it is not uncontested on theoretical and empirical grounds. A number of IR scholars and political economists stress the importance of increased economic dependency and improved transnational relationships. Economic integration may help to reduce the risk of conflicts for two main reasons. First, negotiations on trade issues help gradually to build trust among governments, thus fostering peace. Second, by advancing specialization, trade liberalization increases dependency among countries, thus rendering conflict more costly and less probable.[120] Critics of this view support a pessimistic prognosis, and stress that asymmetric trade and asymmetric gains from trade may lead to conflicts.[121] Empirical evidence appears to generally support the idea that increasing bilateral trade reduces the risk of bilateral conflicts.[122] But studies can be found that support either side of the argument, predicting both a negative and positive relationship between trade and war.[123]

Influenced by theoretical advances in constructivism, other grand theories of IR have subsequently attempted to integrate the importance of "ideational" motives in a rational choice framework. One influential contribution of neoliberal institutionalism argues that ideas can be understood as "principled beliefs" or as "causal beliefs". Such ideas can serve as "road maps" that help actors select a course of action that best fits with their normative and analytic understandings. Common beliefs can also serve as focal points that enable states to solve collective action dilemmas where there exists more than one equilibrium outcome.[124] Finally, ideas can influence states when they are embodied in institutional frameworks.[125] In the latter regard, Judith Goldstein has applied the insight that international institutions legitimate and disseminate ideas and norms to the GATT/WTO. The author argues that "free trade ideas are embedded in an extant group of international institutions" including the GATT/WTO and the IMF. (Goldstein , 1998: 146-147).[126]

Proponents of hegemonic stability theory also have integrated constructivist ideas into their theorizing. Ikenberry has pushed for a liberal version of hegemonic stability theory (also called leadership theory). Leadership theory discusses the nature of an incumbent hegemon. The author questions the understanding of hegemonic order built simply around the exercise of material capabilities (military power, control over raw materials, markets, and capital; or competitive economic and technological advantages) and argues

[119] Keohane argues that 'commerce on a non-discriminatory basis within an orderly political framework promotes cooperation on the basis of enlightened national conceptions of self-interest that emphasize production over war'. (Keohane, 2002: 49).

[120] Both these arguments apply equally to multilateral and regional trade agreements. Yet, it is countries that are geographically close to one another or who share a common border that have a strong stake securing a peaceful neighbourhood. Regional economic integration is then one vehicle through which past or potential antagonisms can be managed and eventually erased.

[121] See Barbieri and Schneider, 1999 and Kapstein, 2003 for recent surveys.

[122] There is too little evidence to evaluate the impact of trade on extra-regional conflicts.

[123] For the contention that trade has a negative impact on international peace, see for example, Polachek (1992; 1997). For the opposite view, see Barbieri (1996; 2002). In general, these studies do not test the robustness of their results against the possibility that the relationship is determined by the feedback effect of war on trade. A recent study (Martin et al. 2005), based on data on military conflicts in the period 1948-2001, shows that when this feedback is taken into account, increasing bilateral trade between two countries reduces the probability of conflicts between them.

[124] Ideas as focal points arguably gain special prominence when actors' preferences are not particularly strong on a certain issue, or interests are mutually 'balanced'. Agents then look for roadmaps or focal points to guide them to an equilibrium outcome.

[125] See Goldstein and Keohane (1993); Keohane (2002: 5-6); Hasenclever et al. (1997: 143-144). On the importance of formal international institutions, see section C.1 below.

[126] Goldstein (1998: 146-147) emphasizes that the free trade norms institutionalized in the WTO are not 'akin to the free trade models found in an economic textbook. The ideological foundations of the trade regime are a hybrid, coupling trade openness with domestic stability – the liberalization of trade among nations was never a goal in itself but rather a means to domestic economic growth.'.

that the hegemon aims to inject some of its cherished norms and values into the system.[127] By focusing on prestige and moral leadership the hegemon wishes to maintain its hegemonic position (e.g. Ikenberry and Kupchan, 1990).

(c) "Non-statist" theories of trade cooperation

A key weakness of all statist theories is that they treat states' preferences and/or norms as exogenous.[128] An important development in IR theory over the last two decades has thus been the revival of interest in domestic agents. Recent theories have abandoned the concept of the state as a unitary actor and replaced it by a "sub-state" level of analysis. Central to this IR literature is the question how international cooperation is affected by domestic politics and norms.[129] Non-statist theories of trade cooperation opened the black box of states' utility functions and norm bundles. Domestic approaches to cooperation can be seen as falling into two categories: the rationalist school of thought ("liberalism"), and the "weakly cognitivist" school of thought that closely follows a constructivist methodology.

(i) Focus on domestic politics: the theory of liberalism

Andrew Moravcsik has formulated a "liberal theory of international relations" that stresses the role of individuals and private groups as the pivotal actors in world politics, and which he claims to be analytically superior to realism and neoliberal institutionalism.[130] The government represents a subset of domestic society. Self-interested government officials define state preferences according to influences of various domestic non-state agents, and act purposively in world politics. Representative institutions and domestic processes translate the preferences of pivotal individuals and social groups into state policy. As a consequence, the country is not an independent actor but merely an agent of multiple principals, who have interdependent, and partially conflicting, preferences. Nations pursue their endogenous preferences under constraints imposed by the preferences of other states.[131]

Whereas neorealist and neoliberal institutionalist theories explain the rationale for an international regime in terms of distribution of power capabilities or of reducing transaction costs, liberal IR theory emphasises the importance of the "social embeddedness" of a regime; international regimes are created if individuals and social groups do not suffer excessively high adjustment costs that would threaten the domestic social cohesion.[132]

Influential liberalist scholars argue that trade cooperation is a so-called two-level game, in which trade negotiators have to accommodate domestic constituents when cooperating internationally (Putnam, 1988). In the first level of the game, domestic special interest groups lobby for policymakers' support and thereby significantly shape the second-level game outcome, in which policymakers carve out the details of international trade agreements (e.g. Grossman and Helpman, 1995a; Milner, 1998; Milner and Rosendorff, 1997; Ruggie, 1982). Helen Milner develops a model of interaction between domestic and international politics based on the assumption that states are not unitary actors but are "polyarchic" i.e. "composed of actors with varying

[127] Ikenberry analyses United States foreign policy after World War II in terms of an "institutional bargain" between unequal states after a war whereby "the leading state agrees to restrain its own potential for domination and abandonment in exchange for greater compliance by subordinate states" (Ikenberry, 2001: 258-259).

[128] This is to say, governments are assumed to be monolithic entities, endowed with a given set of preferences or values.

[129] See Gourevitch (2002); Milner (2002); Moravcsik (1997, 1998); Milner (1998); Downs and Rocke (1995); Evans et al. (1993).

[130] See Moravcsik (1997).

[131] On the level of methodology and research design, liberalists often use the same modelling techniques as contemporary economics, such as game theory, principal-agent models, or utility maximization concepts. Liberalist approaches to trade cooperation thereby share many properties with the political-economy approach to domestic trade policy formulation (also called 'endogenous trade theories'; see e.g. Baldwin, 1987; Grossman and Helpman, 1994 and 2001; Rodrik 1995).

[132] See, for example, Corden (1997).

preferences who share power over decision making".[133] Milner finds that relaxing the assumption that states are unitary actors shows that even neorealists are too optimistic with regard to the possibilities of international cooperation. Domestic politics makes international cooperation always more difficult.[134]

When it comes to explaining the determinants of domestic trade policy preferences and the role of domestic political institutions there exists a rich body of liberalist literature.[135] Liberalist theories to trade agreements posit that the tug-of-war between those domestic groups that benefit from international trade cooperation (consumers, domestic and foreign exporters, using industries, importers), and those that lose from liberal trade (e.g. import-competing industries, low-skill labour, trade unions) is a highly complex, non-linear matter. The internal factors that explain which domestic group will prevail critically depends on the structure of domestic preferences, the nature and procedures of domestic political institutions, and the distribution of information internally.

A view of trade agreements as an outcome of domestic interests and politics may lead to novel insights compared to statist theories. Most importantly, new rationales for trade agreements emerge: an international trade contract may be concluded simply because one or a number of eminent special interest groups, such as domestic exporters, pressure their government into doing so (Milner, 1988).[136] Alternatively, a free-trade oriented government may conclude a trade agreement in order to stand up to protectionist pressure of influential domestic lobby groups. Also, a trade agreement may be a useful insurance device for voters in a democratic country who aim to control protectionist behavior of their own government (Mansfield et al., 2002; see also subsection 4 below).[137]

Novel rationales for trade agreements become apparent, once foreign exporters' lobby efforts are taken into consideration. They, too, may try to influence the national trade-policymaking process. Also, new motivations arise if the government is not seen as a unitary principal, but (more realistically), as different, partially competing, entities.[138] The picture that liberalist scholars are then describing is a trade policymaking game involving multiple agents and multiple principals:[139] self-interested private firms or lobby groups, who may form coalitions across countries, negotiate with self-interested public entities in affected countries over the formation of an international trade agreement. Some authors argue that this is exactly the dynamics that led to the conclusion of the GATS and TRIPS Agreements (e.g. Harms et al., 2003; Odell and Sell, 2006).

(ii) Focus on domestic norm generation: weakly cognitivist theories

Theories that have been described as weakly cognitivist seek to explain how norms, values, knowledge and beliefs emerge and transcend into state decisions (Hasenclever et al., 1997: 140).[140] Without

133 See Milner (1998: 11).

134 According to the author, "cooperation among nations is less plagued by fears of other countries' relative gains or likelihood of cheating than it is by the domestic distributional consequences of cooperative endeavours". (Milner, 1998: 234).

135 See, for example, Goldstein (1998). For surveys see Gourevitch (2002); Milner (2002).

136 Notice the similarity between this liberalist theory and the political externality approach to trade cooperation introduced in subsection 2.(b) above.

137 This rationale is reminiscent, indeed exactly congruent, to the "commitment" approach brought forth by political economists (as discussed in subsection 2.(c)).

138 Clearly, different public agencies and entities pursue different interests in the national trade-making process. Legislators, ministries, government agencies, cabinet members, and heads of state may very well have conflicting interests, constraints and agendas when it comes to national trade policy-formulation. See Ethier (2001a) for an attempt to formalize domestic strategic games along those lines.

139 While the idea of trade agreements as an equilibrium outcome of a game of multiple agents and multiple principals is quite intuitive, it is difficult to operationalise so as to produce testable hypothesis and predictions. Currently, the adequate methods and technical tools are wanting (see Grossman and Helpman, 2001).

140 When analysing the emergence, diffusion and change of ideas, weakly cognitivist scholars have developed the concept of the "norm life cycle" (Finnemore and Sikkink, 1998). This cycle comprises of the following stages: emergence (generation of norms), cascade (domestic diffusion through socialization), and internationalisation (global diffusion through peer pressure, international organizations and/or norm entrepreneurs).

challenging the assumption of instrumental rationality *per se,* weakly cognitivist theories are compatible with the conception of states as rational utility maximisers, because they focus on the impact of ideas and knowledge on the manner in which states define their interests. However, they are also compatible with systemic theories of constructivism (the strongly cognitivist stance), since norms and values that permeate the system must accrue somewhere.

The role of ideas and knowledge in international cooperation has recently been highlighted by weakly cognitivist IR theories when discussing "epistemic communities" in the formation and evolution of international regimes. The term epistemic community has been defined in this context as "a network of professionals with recognized expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge within that domain or issue-area" (Haas,1992: 3). One example of the application of this concept to the GATT/WTO is a study on the emergence of a "trade-in-services epistemic community" by Drake and Nicolaïdis (1992: 95) during the Uruguay Round negotiations on the GATS. The authors argue that "by framing the issues and establishing the policy options, the community provided governments with the bases on which to define or redefine their national interests and pursue multilateral cooperation".[141]

Another theme in weakly cognitivist IR literature concerns the process of learning in the context of international institutions, especially learning that entails a change in a government's perception of its interests, as opposed to simply a change in its perception of how best to realise its objectives.[142] There are relatively few studies that analyse GATT/WTO in terms of learning and the development of consensual knowledge.[143]

A final weakly cognitivist approach to international cooperation is the role of moral entrepreneurs, or eminent individuals, who influence important norms and values needed for international cooperation, and/or who crucially shape the content and structure of treaties (e.g. Finnemore, 1996; Checkel, 1998). For the case of the GATT, the salience of certain spearhead figures of liberal trade is well-documented. Various authors (Penrose, 1953; Jackson, 1969; Dam, 1970; Gardner, 1980; Irwin, 1996; Miller, 2000) have emphasized the prominent role that individuals such as John Maynard Keynes, James Meade, Lionel Robbins, and Cordell Hull have played in establishing common ground for trade cooperation and for formulating the treaty text.[144]

(d) How IR theories of trade cooperation relate to economic approaches

As was shown in this section, trade cooperation features prominently in the discipline of IR. Some IR theories are thereby very much akin to economic theories. Agent-centred, rationalist approaches to trade cooperation (i.e., the schools of neoliberalist institutionalism and liberalism) share the same methodology as economics and so their explanations for why countries conclude trade agreements are quite similar.[145]

---

141 See also Lang (2006: 109). More generally Goldstein (1998: 146) argues that: "...there exists an epistemic community of economists, policy-makers, and lawyers who share a common vision about economic growth (...) This community acts as a transnational interest group, advocating trade liberalization and villainizing protectionism in their home countries. There are multiple reasons why members of a free trade epistemic community advocate trade openness (...) Whatever the origin of their beliefs, these advocates monitor government action and provide authoritative advice on the workings of the economy."

142 See Haas (1990).

143 Robert Wolfe (2006) defines the development of new consensual knowledge as one of the three principal roles of the WTO and analyses the interaction between institutional design, coalitions, negotiation process and learning in the context of the Doha Round negotiations. Thus "negotiation" cannot be reduced to "bargaining" but also encompasses learning. Dupont et al. (2006) provide an important empirical analysis of learning behaviour in the context of WTO trade negotiations.

144 Social cognitivists might even go farther back in history when selecting the moral entrepreneurs that shaped those beliefs of liberal trade shared among societies today: modern trade theorists arguably stand on the shoulders of such eminent figures as René Descartes, David Ricardo, John Stuart Mill, and Robert Torrens, and others. They all shaped how modern trade practitioners and scholars think about international trade.

145 To recapitulate, both schools focus on achieving Pareto efficiency. This is exactly the same method applied by economics. Therefore, the divide between the disciplines of economics and IR is not always clear-cut. Many arguments listed in subsection 2 above are equally applicable to some IR approaches.

However, other strands of IR can complement economic research on trade cooperation in substantial ways. IR scholars have looked at international trade cooperation from angles that are usually ignored by economists, or which are even completely out of the current explanatory ambit of economic research. IR approaches extend economic approaches to trade agreements by linking the issue of trade with other important themes of international affairs. Issues like power and the promotion of peace and democracy widen the economic horizon. Moreover, factoring in the role of ideas, norms and values in trade cooperation sheds light on important qualitative dimensions, such as justice, fairness, legitimacy and participation. The discipline of IR shows that economic values are not the only concerns that sovereign states maintain when evaluating the merits of trade agreements.[146]

The discipline of international relations provides further insight into certain aspects of trade cooperation. For example, economic theories of trade agreements provide a treatment of the sub-state level that is less developed than those of international relations. Economic theory could thus be significantly augmented by incorporating perspectives from IR theory on: i) the prominent role of individuals, elites and epistemic communities; ii) the complexities of domestic competition between special interest groups; and iii) the interaction between special-interest groups and the legislative, executive and jurisdictional branch of the government. Furthermore, various IR concepts stress the impact that the system has on the individual actors. While neorealists posit that the power rank in the international system shapes countries' cooperative behaviour, constructivists claim that pervasive inter-subjective beliefs condition the choices that states make.

Finally, novel themes and additional perspectives raise various questions in connection with trade cooperation. For example: who exactly is the "state"? How does it generate its preferences and, more importantly, what changes its preferences?[147] Why does history matter in trade cooperation and how do actors evolve over time?[148] What is the pattern of bargaining and how do domestic institutions, habits, culture and religion influence actors' perceptions, learning and decision-making? In short, an approach that goes beyond analyses based exclusively on efficiency considerations suggests that when cooperating on trade matters countries are influenced by non-economic motivations, such as history, their political and social environment, and a multitude of stakeholders that act on a variety of motives.

4. THE RATIONALE FOR TRADE POLICY COOPERATION FROM A LEGAL POINT OF VIEW: CONSTITUTIONAL FUNCTIONS OF INTERNATIONAL TRADE AGREEMENTS

"Legal" theories of trade agreements are based on two central insights, namely that the individual citizen is the legitimate principal in all domestic and world affairs (including trade policy), and that "government failure" and rent-seeking behaviour of public officials are rampant and need to be overcome by means of an adequate legal framework – namely a "constitution". Based on these central tenets, four legal rationales for trade agreements can be distinguished: (i) the internal constitutional view, which takes trade agreements to be the "second line" of constitutional defence against domestic policy failure; (ii) the external, or transnational, constitutional view, which perceives trade agreements to be contracts aimed at reciprocally granting countries transnational representation and participation; (iii) the internal-external constitutional view that claims that elected legislators deliberately delegate trade policy-making to the Administration; and (iv) the global constitutional view which establishes that citizens in an interdependent world enact an international multilevel trade constitution, since national constitutional approaches and state-centric international law necessarily fail to curb global policy failures.

[146] Reasons for not cooperating in trade affairs are thereby as significant as reasons to do so, since countries' reluctance to join needs to be anticipated, factored in, and overcome by trade negotiators.

[147] An example here would be the question, why Viet Nam chose to join the WTO after nearly 60 years of multilateral trading order.

[148] An interesting question is for example, why the GATT morphed into the much more complex treaty arrangement of the WTO over the years (on this topic, see section D.1 below).

Legal scholarship rarely examines the rationale for concluding international agreements and establishing international organizations, such as the WTO. As Schermers and Blokker (1995: 8) argue, "in the land of legal science there is no strongly established tradition of developing theories on [treaty regimes]". Rather, legal science offers descriptive accounts of the history and institutional architecture of treaties, as well as doctrinal analysis of norms and texts, especially the normative output of organizations such as GATT/WTO panel decisions (Abbott and Snidal 1998). Not surprisingly, with one or two exceptions, international lawyers have given little attention to the question why trade agreements exist (Regan 2006, Gerhart 2003). This Section will review "legal" theories of trade agreements,[149] or rather, which additional insights legal scholars can bring to the discussion of the rationale of trade agreements.[150]

(a) Constitutions as a corrective against policy failure

The point of departure and core of all legal theories of trade agreements discussed below is a strong focus on the individual citizen as legitimate (and oftentimes actual) political principal on the one hand, and the fallibility of political agents on the other. Lawyers maintain the perspective of "normative individualism", in which citizens eligible to cast their vote (the *demos* or polity) – at least in democracies – are the *de jure principal* in domestic affairs. The legislative, executive and judicial branches of government are merely agents entrusted with the task of bringing policy, laws, and conduct into conformity with the desires of the majority of citizens.

Legal scholars, however, are aware of the fundamental public choice insight that rent-seeking behaviour of both elected officials ("the government") and certain elites (special interest groups), coupled with limited oversight by parliaments, may frequently lead to government failure. De facto*,* government decisions on domestic policies – if unchecked – oftentimes are not so much guided by national interest as by a desire to maximize political support and to minimize political opposition. And just as domestic market failure in the domain of competition policy is contained by rules prohibiting price fixing, quantitative restrictions, market sharing and other discriminatory restraints on competition, government failure equally needs to be addressed by society. Societies customarily do this through constitutions – that is, long-term institutional arrangements of a higher legal rank that allocate lawmaking and decision-making among individuals and institutions. The basic objective of constitutions is to limit government powers, to institute a system of checks and balances, and to protect equal rights of citizens against "political expropriation" by self-interested government officials. Constitutions are thereby seen as an important means of reinforcing and maintaining basic values of democracy, individual freedom, and participation. Democracy in this framework is regarded as the best regime structure conducive to the pursuit of individual goals and as the mechanism needed for diffusing governmental power throughout society.[151]

Economic policy and international trade are important areas of societal activity and are especially prone to both market and government failure. Although liberal trade is considered to be in the interest of the majority of citizens (hence in the national interest), concentrated special interest groups can command disproportionate leverage over the trade policy-making process.[152] Legal scholars have argued that in most

[149] The term "legal theory" is not quite correct, since the theories described in this subchapter are not particularly legalistic. Their argumentation is not unique to the science of law. Rather, the introduced theories are lawyer's interpretations of social interaction. Legal scholars have drawn on material from those disciplines whose research focus is the explanation of human interaction, such as economics, political science, sociology, or philosophy.

[150] This is of course not at all to say that international trade lawyers adhere to legal theories of trade agreements.

[151] In democracies, constitutionalism is "crucial to reinforcing the power of the diffuse citizenry and to restrain special interests that are "adverse to the permanent and aggregate interests of the community". (McGinnis and Movsesian 2000: 526, quoting the Founding Father of the U.S. Constitution, James Madison).

[152] Owners and workers in industries that are habitually injured by freer trade tend to overcome collective action problems more easily, and manage to form coherent lobbies (e.g. Brainard and Verdier, 1994). Special interest groups are often homogenous, geographically concentrated, and can exploit nationalist sentiments against foreign import surges. Their protectionist efforts tend to overshadow the more diffuse majority concerns that favour freer trade. Consumer interests are too dispersed, their direct losses relatively small, and their information level usually relatively poor. Exporters have little representation in the polity. Importers are usually few in number, and downstream industries using imported inputs depend significantly on domestic markets and national sentiment (Milner, 1998).

societies there exists something like an "economic" constitution. The rationale for this constitution comes in two flavours that slightly differ in perspective but can actually be seen as mutually reinforcing.

Scholars from the European legal tradition – the "Grotian" or "Kantian" perspective of "European absolutism" (Pauwelyn, 2006) – take the view that every economic actor is born with a set of inalienable rights that permit him/her to be free from discriminatory competition, arbitrary taxation, redistribution and expropriation, as well as free to engage in unhampered economic exchange and enter into contracts. From this perspective, an economic constitution encroaching on governmental discretion in economic affairs is a natural way to protect basic economic rights.[153]

Lawyers from the Anglo-Saxon legal tradition ("Lockean" perspective of "American voluntarism") tend to have a more utilitarian (i.e. majoritarian) approach. According to them, it is in the rational, utility-maximizing, long-term interest of the majority of market agents (and every citizen is a market agent in his capacity as consumer, producer, or trader) to limit the rent-seeking capacity of elected officials. Trade protectionism is generally domestically irrational.[154] To this end, citizens write a societal "contract" – a constitution – that sketches government responsibilities and devises supervisory mechanisms in the form of checks and balances between the legislative, executive and judicial branches of government.[155] Government agents need to feel these constitutional constraints and institutional checks and balances in order to make decisions in the "national interest".

Whatever the rationale for a domestic trade constitution – contractarian or rights-based – freedom from protectionism, undistorted competition, and non-discriminatory economic activity is considered in the best interest of citizens. Therefore, a liberal trade policy and a clear hierarchy of domestic (trade) policy instruments emerge endogenously.

(i) How to overcome "government failure": constitutionalist theories of trade agreements

If liberal trade, non-discrimination between domestic and international economic actors, and freedom from arbitrary government protectionism are in the national interest of economic actors, why then does a system of liberal trade and free markets not emerge endogenously and spontaneously within countries? And since citizens have proven to be able to overcome collective action problems by writing national constitutions that protect their basic human and political rights – why is there any need for an international trade constitution? Four distinct rationales for international trade agreements can be detected in legal literature.

The internal rationale – trade agreements solve a domestic problem

The internal, or inward-looking constitutional approach to trade agreements focuses predominantly on *domestic* problems within the country that undertakes protectionist measures. In the presence of overwhelming special interest group pressure for protectionism, a trade agreement acts as an additional constitutional constraint, a "second line of constitutional entrenchment of personal rights" (Tumlir 1985: 87). The conclusion of a trade agreement can be seen as a logical extension of the national constitution to safeguard the latter's functioning. It operates as an international peg (or anchor) against government misdemeanour and lobby influence.

153 Petersmann (2006: 56) explains the Kantian perspective on normative individualism as "values derive[d] from respect for individual self-development and from the constitutional protection of liberty and citizen-driven markets – in the economy no less than in the polity."

154 More precisely, protectionism is domestically irrational in developed countries that possess the means and institutions to address domestic problems (e.g. boost infant industries, address redistribution problems) in more efficient ways than through trade protection (see Regan, 2006, and Bhagwati, 2002).

155 Proponents of the "constitutionalist" school of economics (such as James Buchanan, Gordon Tullock, Anthony Downs, Mancur Olsen) have shown how citizens overcome collective action problems, tie down policymakers' discretion and curb the influence of government and private actors on basic freedoms.

Hence, the internal rationale of constitutionalism essentially takes a national constitution and trade agreements to be complements, whereby the international treaty fortifies a country's economic constitution.[156] Under this approach, a trade agreement is perceived as an international constitutional reinforcement of the national trade constitution.

But why is a national constitution not enough to curb protectionism? Why do citizens opt for an external anchor to constrain the behaviour of policymakers? A number of "domestic policy functions" of international trade rules can be found in the literature (see Regan, 2006; McGinnis and Movsesian, 2000; Petersmann, 1986):

- Trade agreements contain a rich set of rules and often feature strong sanction mechanisms against defection. Granting protectionism will therefore be more "costly" to policymakers in terms of international reputation loss, and in terms of withdrawal of support by those industries harmed by the sanctions. Rules of transparency requested in trade agreements (such as Article X GATT) make the erection of trade barriers more obvious to domestic citizens. This increases domestic "audience costs" of protection.

- External "hand-tying" is easier to monitor. For various reasons, trade policy is customarily delegated to the executive branch. However, legislative assemblies are not capable of exercising complete and permanent oversight with respect to all trade policy measures employed by the executive. An international trade agreement helps the legislative branch to exercise supervision as foreign producers and governments are constantly scrutinizing the home government's actions.

- International trade agreements trigger a domestic "pull-effect". A central feature of any trade agreement is reciprocity.[157] Reciprocal trade liberalization commitments create collective pressure for freer trade in each country, since the prospect of additional access to foreign markets creates incentives for domestic exporters to lobby for lower tariffs.[158] This adds weight to the less organized domestic free-trade camp of consumers and importers, helping to counterbalance the disproportionate impact of protectionist groups.

- In some legal systems, legislative procedures for the conclusion of a trade agreement are likely to be easier than a constitutional amendment. Therefore, citizens and free-trade-minded policymakers may prefer the "external" to the "internal" peg.

- For psychological reasons, a trade agreement based on the *do ut des* principle of reciprocity ("I give so that you give back") is simply easier to sell to domestic audiences than unilateral trade liberalization. As Regan (2006) argues, this may be irrational, but nonetheless true.[159]

According to Hudec (1993) and McGinnis and Movsesian (2000) an important feature of international trade agreements is that they foster democratic values and help preserve important economic freedoms without jeopardizing domestic sovereignty or legitimacy. Trade agreements like the WTO constrain harmful acts of protectionism. This not only promotes freer trade and protects opportunities for private exchange, but also strengthens accountable democratic governance by supporting the will of the majority in the face of protectionist lobbies who would otherwise capture the mechanisms of public policy. As long as trade agreements are framed in such a way that they honour the diversity of Members (in terms

[156] Petersmann (1986: 277) states: "The various layers of private commercial law and public national, regional and worldwide international trade law can be conceived of as a "stratified order", whose "component orders", layers and rules mutually reinforce and strengthen each other following the 'plywood principle".

[157] Cf. section C.2.(a) below for an economic introduction into the nature of reciprocity in trade agreements.

[158] See Baldwin (1994), or Baldwin and Robert-Nicaud (2005); see also subsection 1.(a).(ii) above.

[159] "Even if people understand that their own protectionism hurts themselves, people are often willing to hurt themselves in order to hurt others, out of envy or a desire to punish. Or people may just fail to understand how their country's protectionism hurts themselves. The proposition that protectionism is domestically irrational is old hat to economists, but familiarity should not blind us to the fact that it is a sophisticated insight.". (Regan 2006: 967.).

of nations' development level, social system, and cultural idiosyncrasies, etc.), and as long as they respect the diversity of domestic legislation, and do not interfere with efficient regulatory competition among countries, trade agreements will not harm the sovereignty of its Membership.[160]

In sum, proponents of the internal constitutional approach contend that citizens manage to better tie the hands of domestic trade policymakers to the mast of liberal trade by forcing their national authorities to conclude international trade agreements. That way, both protectionist endeavours on the part of special interest groups and opportunistic rent-seeking behaviour by trade officials can be curbed successfully – without risking domestic democratic values or a loss of sovereignty.[161]

The external rationale – trade agreements solve a transnational problem

An alternative perspective to the internal vision of constitutionalism is the external, outward-looking, or transnational rationale for trade agreements. The external view of constitutionalism takes issue with the internal school of thought, alleging serious conceptual shortcomings in the latter's argumentation. The critics question whether any society would ever conclude an international trade agreement for the reasons proposed by the internal constitutionalist view.

Obvious practical questions arise, such as why independent domestic institutions (like a constitutional court) are not enough to enforce the national economic constitution. Or, how multilateralism can be explained by internal constitutionalists. After all, hand-tying to a single economic super-power should suffice.

Moreover, it is argued that the internal constitutional view cannot account for the following puzzle: on the one hand, the benefits of trade liberalization are not well understood by the polity in general (Irwin, 1996; Hudec, 1993; Gerhart, 2003; Ethier, 2004). Average citizens do not seem to mind trade protection too much, partly because they often fail to grasp the (indirect) gains of trade liberalization, and partly because individual losses from trade protection are minor. On the other hand, individuals fear the (direct) costs of trade liberalization, such as sectoral unemployment, adjustment costs and social frictions. Given this reality, how can a trade agreement whose central premise is neither understood nor appreciated be chosen by the polity as a means of constitutionalism? Mavroidis (2007) also points to a circularity problem – in the face of an uninformed citizenry, why would governments ever negotiate a trade agreement if their true aim were not to maximize welfare in the first place?

Finally, a striking criticism of the domestic constitutionalist perspective is the theory's exclusive focus on economic efficiency as an explanatory variable for the conclusion of a trade agreement. As shown above, the internal view is guided by the idea that citizens wish to forestall economic free-riding by special interest groups, and therefore wish to eliminate all protectionist (discriminatory) trade policy formulation. This is achieved by pegging domestic trade policy decisions to an international agreement. Yet, the perception that protectionist trade policies exclusively result from government failure may be false. As Gerhart (2003) points out, domestic public policy is full of examples where protectionist policies are in the explicit public interest and trump considerations of short-term economic efficiency. In their pursuit of non-economic objectives or long-term interests, societies have regularly shown a preference for unequal

[160] McGinnis and Movsesian (2000: 549) strongly argue in favour of an "anti-discriminatory" model of trade agreements. The organization is only to act as an "adjudicative system with limited authority to resolve claims concerning discriminatory trade measures" (*ibid.* 517). The alternative "regulatory model" authorizes the organization to formulate global labour, environment, health or safety standards and other substantial trade-related areas. According to the authors, this model would be a bad form of constitutionalism, undermining national regulatory sovereignty, and exposing the organization to exactly the same lobby influence that the agreement was designed to overcome in the first place.

[161] Notice the similarity of the internal constitutionalist vision with that of the economic commitment approach (discussed in subsection 2.(c) above). Both schools of thought allege that trade agreements are motivated by a domestic dilemma that is solved by curbing decision-makers' protectionist discretion through international commitments. However, while the economic literature seems to assume a liberal trade stance of policymakers, legal explanations give a more thorough rationale for the hand-tying motivation: Citizens (through an unspecified mechanism) coerce policymakers to contract with other countries, because it is in the majority's interest to do so.

treatment of citizens.[162] For reasons of social justice, environmental or health concerns, altruism, or domestic redistribution societies may prefer protectionist trade measures. However, pegging domestic trade policy to a trade agreement, means that citizens largely give up the possibility of constitutionalizing non-economic values. This may easily clash with society's understanding of democracy.[163] Closely connected to this democratic deficit there may be a sizeable sovereignty deficit implicit in the internal, purely economic constitutionalist view. According to Gerhart (2003: 49) it is wrong to assume that sovereignty is designed to provide one particular outcome, such as that of maximizing efficiency or wealth. In fact, this may undercut the very notion of sovereignty, which is to preserve the right of a people to choose the outcomes that they think are best, including the desire to forego wealth in order to achieve other values. The "argument that the WTO helps bind the hands of the people so that they avoid unwise policy is, in fact, an attack on sovereignty" (*ibid.*). As the author points out, trade agreements that conflict with popular notions of participation, democracy and sovereignty must also fail on account of legitimacy. Hence, due to its exclusive focus on economic efficiency, the internal view is unlikely to explain why citizens may acquiesce to an international trade agreement.

The external legal theory of trade agreements claims to overcome the deficits in democracy, sovereignty and legitimacy that plague the internal rationale. This rationale shifts the perspective from a domestic to a transnational (cross-border) problem. Whereas the internal view is concerned with the harm a country inflicts upon itself by taking protectionist measures, the external view on constitutionalism focuses on the harmful actions of other nations that directly affect the home country.

At the core of the external view is the argument that the risk of government failure and rent-seeking are not a purely domestic problem. Thus, although undistorted competition and non-discriminatory trade policymaking remain prime objectives of trade agreements, the effects of protectionist trade barriers abroad are an issue. By raising protectionist barriers, foreign countries can strip domestic exporters of basic economic contracting rights and market freedoms.[164] While citizens are able to contain their own rent-seeking officials by means of a home-grown economic constitution, they have no leverage over policymakers abroad.

This reciprocal "taxation without representation" problem (Gerhart 2003: 22) can successfully be overcome if citizens authorize their governments to conclude an international treaty. Thus, proponents of the external perspective claim that trade agreements are concluded so that citizens can participate in the making of foreign countries' trade policies.[165] Trade agreements provide an adequate forum to address the reciprocal "problem of unrepresentative decision-making in national forums by allowing countries to represent their interests, and the interests of their people to the governments of other countries in a way that can bring about policy changes and reduce harms" (*ibid.*: 24).[166]

The significance of these negotiations is political as well as economic: trade agreements give rights and voice to previously disenfranchised groups of economic actors. With an agreement in place, all those citizens that are adversely affected by foreign trade policy can comment on, and influence, the policies of other countries (via their home governments). In the age of globalization and transnational exchange, trade agreements are thus a new form of democratic representation across borders. In an interconnected

[162] Non-economic public policy objectives may stem from important societal values such as equity, community and social cohesion, avoiding health risks, maintaining domestic peace, avoiding the infliction of pain to small numbers of people over policies that provide small benefits to everybody (Corden 1997), and so forth. Long-term economic reasons for protection include the well-known infant-industry and technology-cluster arguments.

[163] "The problem with the internal economic vision is that for many people, the economic or efficiency values on which it is based are only a subset of the values that make social arrangements valuable... [The] vision espouses the very caricature of the WTO that the WTO critics find so objectionable – the idea that the functions of the WTO is to freeze public policy into efficiency values, and to retard public policy that would be based on non-efficiency values." (Gerhart, 2003: 33, 70).

[164] This goes not only for deliberate opportunistic foreign government actions, but also for accidental spillovers. As Ethier (2001), for example, points out, many domestic policies produce unintended trade externalities.

[165] "The external, participatory vision of the WTO therefore sees the WTO as a complex, multiparty forum for barter between nations that allows each nation to represent the interests of its constituents to other nations, and facilitates agreements that reduce the harmful external effects of national policy." Gerhart (2003: 25).

[166] Note that transnational representation across borders offers protection from rent-seeking behaviour by domestic special interest groups as a side-effect – but not as a motivation – for concluding an agreement.

world, citizens can participate in shaping all those policies that concern them. Consequently, this cross-border participation promotes freedom – economic agents are granted the freedom to produce and sell where and what they want, knowing that this freedom cannot be taken away from them without their voices being heard. These fundamental constitutional values of freedom, voice, and participation are of great importance, since they foster the important concepts of federalism, sovereignty and democracy.

In sum, the external perspective not only highlights the economic inefficiency in the country imposing the tariff, but the representational, participatory deficiency resulting from protectionist policies abroad. Foreign countries' protectionism is prone to distort the competitive opportunities of citizens at home – unless the latter are given a voice in determining whether a tariff will be imposed.[167]

Internal-external rationale – self-restraint of pivotal groups

As we have seen, the internal perspective reflects solely on domestic problems of protectionism, while the transnational, or external theory focuses primarily on participation and representation issues across borders. The internal-external rationale seeks to strike a balance between those two perspectives.

Hudec (1993) reminds us of the history of the United States Tariff Act of 1930 (better known as the Smoot-Hawley Tariff Act). As was explained in subsection 1.(b) above, this legislation originated as an effort to raise tariffs on certain agricultural imports as a way of protecting United States farmers from low world commodity prices. In order to secure the necessary votes, the Act's sponsors (Senator R. Smoot and Representative W. Hawley) engaged in a process called "log-rolling" or "horse trading" by offering to support tariff increases for other legislators' local industries in return for the latter's support for their own proposals. As is well known, the overall increases in tariffs were massive. Consequently, imports to the United States were sharply reduced. The rest of the world responded by imposing equivalent (or even more restrictive) trade barriers, causing United States exports to fall dramatically. The ensuing trade war dynamics set off a sharp contraction of world trade and contributed to the length and depth of the Great Depression of the 1930s. After the experience with the Smoot-Hawley Tariff Act, the United States Congress passed legislation that authorized the Administration to negotiate tariff reductions with other governments. The logic behind removing Congress from the decision and entrusting the Administration with formulating trade policy apparently was the following. Members of Congress were persuaded of their own ineptitude on tariff matters (Hudec, 1993: 314). They realized their inability to counter domestic interests, and feared the international repercussions that excessive protectionism may provoke. Therefore, they delegated trade policy to the Executive, which they thought was further removed from special interest group pressures.

The experience of excessive protectionism in the 1930s motivates a third rationale for trade agreements. As a matter of self-restraint, a peer-group of decision-makers (a political elite) delegates authority to a third party – namely to the Executive – in the hope that the third party will make better and more balanced decisions. The Administration, whose interests are presumably more aligned to overall national welfare, sensibly concludes an international contract.[168] A trade agreement is thus the natural outflow of the legislators' decision to remove themselves from the trade-policy making process.

In essence, this view combines a clear internal orientation (overcoming domestic policy failure) with an external motivation (fear of retaliation and welfare-depreciating dynamics). Legislators trade off their short-term domestic gain from protection followed by a long-term loss caused by international spillovers for the (presumably higher) long-term gain generated by the trade agreement. A "constitutionalization" of sorts (legislators' hand-tying efforts) then effectively takes place between the legislature and the executive, not between the general polity and the government.

---

[167] Notice the similarity in argumentation between this external constitutionalist approach and externality-based economic theories discussed in subsections 2.(a) and (b) above. In addition, the focus on overcoming external effects is also at the core of various IR models (see section C.3). Common to all views is the contention that international spillovers (of some nature) are what motivates the conclusion of trade agreements.

[168] Judith Goldstein's (1996) analysis of the US-Canada Free Trade Agreement indeed suggests that actors who have the most to gain from a pursuit of general welfare – such as executives elected by a national constituency – tend to show the most interest in turning to international agreements (see also Simmons and Martin 2002: 202).

The advantage of this view is that it can explain why trade agreements are concluded despite the obvious indifference of citizens *vis-à-vis* trade liberalization: it is not the electorate that calls for an economic constitution and a trade agreement. Rather, it is the enlightened self-interest of a political elite that motivates it to detach itself from trade policy-making and to delegate its authority to an outsider in the domestic lobbying game.[169] The outsider (the Administration) then concludes trade agreements not because it is forced to do so (as in the internal constitutionalist rationale), but because it is in line with its own interests that happen to be more congruent with general welfare and therefore the desires of the polity.[170]

Global rationale – trade agreements as international multilevel constitutions

The fourth rationale for trade agreements is yet another logical extension of the idea that societies give themselves constitutions in order to maintain fundamental freedoms and to safeguard the interest of the majority of citizens. Like the external view of constitutionalism, the global rationale searches for new forms of democratic representation in an interconnected world. But whereas the previous three rationales are fundamentally state-centric, the global rationale does away with states as necessary intermediaries between the dealings of economic agents of different nations.

This "citizen-oriented constitutional view of international law" (Petersmann 1995) applies the same constitutional logic, but just assumes the world to be like one big nation of "world citizens" that gives itself a multilevel trade constitution – with the same goals of non-discriminatory competition and prevention of protectionism. The term "multilevel" means that non-state actors have legal access to domestic and international courts so as to keep governments in check, and to defend their constitutional guarantees of freedom, non-discrimination, the rule of law and social safeguard measures in case of rampant government failure (Petersmann, 2006: 6). Trade conflicts thus become depoliticized, decentralized, and replaced by constitutional rules of a higher legal rank, which can be directly applied and enforced in domestic courts.

The global view is harshly critical of both the internal and external constitutional view on trade agreements, especially because of their emphasis on state sovereignty. Proponents of the global view argue that the "Westphalian" notion of international law is outdated. State-centric "Member-driven-ness" is hostile to the vital interests of citizens.[171] To globalists, national trade laws on the one hand are necessarily "partial constitutions" – and of dubious quality at that. They cannot tackle global problems involving transnational spillovers, and they have frequently failed to control domestic protectionism.[172] On the other hand, international trade agreements between governments fail to eradicate the risk of (inter-)national government failure, for the simple reason that self-interested, rent-seeking governments negotiate the deal. In short, having governments interconnected as brokers among citizens of different countries often produces unwanted outcomes.[173]

[169] Note that the internal-external approach to trade agreements does not treat "the government" as a monolithic bloc. Executive, legislative, and judicial functions are three different, heterogeneous, and often conflicting constituents of public officials.

[170] Thus the Administration concludes a trade agreement of its own volition to address the problem of international spillovers caused by trade protectionism.

[171] "The one-sided focus of traditional public international law doctrine on external state sovereignty and no less one-sided focus of constitutional ... theories on internal abuses of power and rights of citizens within states, need to be overcome by transnational constitutional theories on how to protect ... democracy and rule of law more effectively across frontiers." (Petersmann, 1998: 177).

[172] "All national constitutions remain confronted with the Lockean dilemma that, in an interdependent world with some 200 sovereign states, most constitutions provide for only few procedural constraints on discretionary foreign policy powers to tax, restrict, and regulate the transnational relations of citizens across frontiers. Thus, national constitutions turn out to be incomplete partial solutions. They don't constrain discretionary foreign policy powers and fail to provide the collective supply of "global public goods'" (Petersmann, 2006: 8).

[173] Petersmann (2005) speaks of a "jurisdictional gap" (the jurisdiction of a trade agreement is too limited in addressing real problems if the focus is uniquely on eradicating externalities, thus preventing the provision of true collective goods); a "democratic participation gap" (when governments negotiate the terms of an agreement, it is doubtful that the agreement grows out of representative, participatory, and deliberative democratic processes in each Member state); and an "incentive gap" (citizens as true economic actors are treated as mere objects of authoritarian trade protectionism rather than as legal subjects of a liberal world trading system).

Hence as argued by Petersmann, states are gradually losing their organizational advantage in the provision of public goods, Individual nations cannot satisfy the needs for democratic participation, legitimacy, and respect for inalienable individual rights any longer. Since trade takes place among private actors (producers, traders, and consumers) and not among governments, international law needs to guarantee private rights – which are not necessarily uppermost in the minds of governments.[174] Realizing this, the reasoning continues, global citizens are striving to give themselves global multilevel constitutions that manage to produce truly global public goods (the EU being a prominent example). Allegedly, this paradigm shift from the historically state-centred, power-oriented Westphalian system to a modern system of international law has finally reached the realm of world trade.[175] In conclusion, the global rationale for trade agreements argues that the global public bypasses national governments and manages to establish a worldwide, multilevel economic constitution.

The idea of trade agreements as international multilevel constitutions has come under criticism from international legal scholars. First, there is the seeming obliteration of a meaningful distinction between description and prescription. The global view is more about how the WTO should be, rather than what it is today. After all, in most countries, WTO law has no direct effect in the national legal system. States – even if they may be a nuisance to citizens – do exist, and in the absence of a better alternative, governments do represent nations in international trade negotiations.[176] Citizens, even in the most educated corners of the world, do not attach enough importance to international trade issues. Also, even concerned and enlightened private actors lack means and legitimacy to engage into global dialogues on trade constitution-making.[177] Second, according to critics (e.g. Howse and Nicolaidis, 2001; Cass, 2005), the global perspective dodges key conceptual questions. For example, how can the multilateral trading system be constitutionalized in absence of a *world demos*? How are global collective action problems overcome if not via national governments? And even then, how can this global constitution be changed, altered, or made to fit special circumstances and special country needs?

(b) Comparison of different rationales

Discussion has increased in recent years on whether there is a need for legal, institutional, and political reform of the global trading system. The Director-General of the WTO, Pascal Lamy, once criticized the rule-making and decision-making processes of the WTO as "medieval", and has called for new forms of "cosmopolitics" and "cosmopolitical constituencies" in support of global public goods.[178] Some legal experts see this emerging attitude towards cosmopolitics as a sign in favour of a constitutionalization of world trade affairs. All four legal rationales for trade agreements discussed above are variations and extensions of the same theme of constitutionalization. Citizens overcome collective action problems and

174 "Modern international economic law is citizen-oriented and aims at limiting the traditional Hobbesian insistence on sovereign rights of governments, border controls, mercantilist protection of domestic industries and national discrimination against foreigners, which ... hinder mutually beneficial cooperation among citizens across frontiers. It is not the nation state and its national economy, but their global integration and deregulation for the benefit of individual producers, traders, and consumers that are the objective of modern international economic law". (Petersmann, 1998: 179).

175 Petersmann (2006: 33) argues "that WTO law can usefully be conceived as part of a multilevel 'constitutional framework' for limiting multilevel trade governance for the benefit of producers, traders, consumers and other citizens.".

176 "For Petersmann, states are a nuisance. He is welcome to think so, but he cannot ignore them. If WTO obligations were to be enforceable directly through members' judiciaries, free traders might initially rejoice. But they would soon have to reconsider, as the dynamic effects of such a legal change took hold. For the state officials who negotiate the rules in the first place would almost surely restrict the breadth of trade agreement rules..." (Tarullo, 2002).

177 Even if concerned citizens had the resources to draft a worldwide trade constitution, they would lack the legitimacy to do so unless they would represented the majority of the global electorate.

178 In a lecture in 2001, Lamy, then European Commissioner for Trade, suggested that better global governance requires a system which provides for inter-connections between governments, markets and civil society. Reflecting on the globalization debate, Lamy opined that the term "governance" connotes too much control, and instead offered the term "cosmopolitics." (Lamy, 2001; and Charnovitz, 2004).

shape rules and regulations that curb excessive rent-seeking behaviour by special interest groups and policymakers by changing the incentive structure in the political market for protection.[179, 180]

The four constitutional approaches to trade agreements – the domestic, transnational, internal-external and global rationale – are not necessarily in as much conflict as their respective proponents may like to claim. They contain complementary elements. However, the significance that each perspective assigns to international trade agreements as a means of constitutionalism varies in important ways. For the global view, which most directly puts the individual on centre stage, the trade agreement is the constitution. Trade agreements are a constitutional substitute for a national arrangement.[181] For advocates of the external perspective, a trade agreement is a constitutional supplement – it secures the international flank of economic activity.[182] For proponents of the internal view, the agreement is only a constitutional complement – a tool of constitutional entrenchment or a constitutional facilitator. Finally, the internal-external theory sees trade agreements as a natural outflow of a domestic constitution, in which a subset of citizens (the legislature) delegates some authority entrusted to it by the electorate to the Executive.

On a more critical note, all approaches remain unclear about how and by way of precisely which processes citizens can overcome collective action problems, thus allowing them to write a domestic trade constitution.[183] Given the lukewarm interest of the general citizenry to trade affairs, strong reliance on constitutional approaches to trade agreements seem a bit far-fetched. The internal-external explanation that takes trade policy-making to be a problem of elites seems more credible than the other three approaches in this respect. Next, constitutionalist theories of trade agreements seem to work only in democratic countries. Yet not all signatories of trade agreements have democratic regimes. Further, all theories except for the internal-external perspective fail to explain why governments should obey the majority will and negotiate international trade agreements that are essentially against their own interests. How can the gradual decline of trade barriers in the last 60 years of multilateral trading be explained, if trade agreements continue to be antagonistic to policymakers' preferences? In reality, state officials must have an interest in trade liberalization; otherwise they would block the progress of international liberalization rounds. Finally, common to all the legal approaches reviewed above is a certain predominance of normative overtones in relation to less than fully specified notions of democracy, sovereignty and protectionism. They tend to blur the lines between what is and what should be – that is, between analysis and prescription.[184]

[179] The internal-external view, however, has a two-level twist to this story: Citizens vote for legislators, who then constitutionalize trade policy by delegating it to the executive.

[180] Note that the above discussion on legal theories to trade agreements neglected contract-theoretical approaches to trade agreements originating from the discipline of law & economics (L&E). Although influential L&E scholars have suggested that there is potential for a rich research agenda in approaching the trade agreements from a contract-theoretical perspective (Bhandari and Sykes, 1998; Dunoff and Trachtman, 1999; Posner, 1988), little work on the rationale of trade agreements has originated L&E. To this day, there does not exist a thorough and systematic contractarian exploration of the world trading system. Sykes (1999: 1127) remarks: "Much like other subject areas under the rubric of international law, law and economics has only begun to make a dent in the set of potential topics in the trade area.".

[181] It is important to point out that a trade agreement does not replace a national constitution. According to Petersmann, constitutionalism must apply on multiple levels in order to be effective. (Petersmann, 2006).

[182] For outward advocates, trade agreements are a *sine qua non*. Thereby, national and international constitutions are not connected in series, as two lines of constitutional defence, but in parallel. National and international constitutions protect citizens from different sides. The domestic constitution has a wide variety of objectives (including non-efficiency goals), while trade agreements constitutionalize transnational trade policy.

[183] As Regan (2006) aptly points out, there is no reason to believe that special interest groups which have the power to influence trade policy outcomes may not also have the power to prevent a national economic constitution or a trade agreement from being written in the first place.

[184] Dunoff and Trachtman (1999: 3): "International legal scholarship too often combines careful doctrinal description – here is what the law is – with unfounded prescription – here is what the law should be. This scholarship often lacks any persuasively articulated connection between description and prescription, undermining the prescription. International legal scholarship lacks a progressive research program.".

5. DIVERSE NATIONS, DIVERSE MOTIVES, DIVERSE AGREEMENTS

Does a small, autocratic nation with weak institutions have the same motivation to engage into trade cooperation as a large, powerful, democratic country with a credible government? Subsections 2, 3 and 4 have discussed a number of economic, political, and legal approaches to international trade agreements. This subsection examines the contribution of all the reviewed theories to a better understanding of international cooperation among diverse nations. The issues tackled are whether different countries have varying reasons for entering into trade agreements, as well as how cooperation will be affected if countries have diverse motivations.

The fundamental points made here are the following. Firstly, a given explanation for entering into trade agreements does not necessarily apply equally to all countries alike, but only to a subset of countries. The decisive cooperation criteria, which differ among the various approaches, include economic size, military power, regime type, or quality of institutions. Secondly, differing motivations for entering into trade agreements are not necessarily mutually exclusive. By being large, democratic and militarily powerful at the same time, for example, a given country may be motivated by more than one reason to be part of an agreement. Moreover, owing to their diversity, countries also may conclude various types of agreements. That is, different nations have different motivations about whether to conclude bilateral, regional, or multilateral trading agreements (see also subsection 2.(d) above).

(a) Economic perspective

Economic theory offers two coherent approaches to trade negotiations: the terms-of-trade approach and the commitment approach. These approaches are not mutually exclusive and available evidence does not shed much light on their relevance. Most other economic approaches explain exclusively preferential agreements. With regard to cooperation among diverse countries, size plays a crucial role in economic approaches, though in the commitment approach it is more the credibility of governments that is important. There are reasons to expect countries that differ on the basis of these two criteria to have different motivations to participate in trade agreements. Another important aspect of economic approaches is that, unlike other approaches, they all assume that agreements are mutually beneficial for the countries that participate.

(i) The terms of trade motive

The terms-of-trade approach provides a rationale for agreements among large countries, but for the most part fails to explain why large countries would enter into negotiations with small countries or why small countries would wish to negotiate amongst each other. A crucial assumption of the terms-of-trade approach is that countries can impose terms-of-trade externalities on their trading partners with their market access choices. Countries that are too small to influence the price of foreign exports are expected unilaterally to make trade policy choices that are internationally efficient, since they are not motivated by international cost-shifting. Such countries are less likely to end up in terms-of-trade prisoners' dilemma situations where they can benefit from trade agreements.

The nub of the issue, then, is whether a country has or does not have market power. As discussed in subsection 2 above, theoretical work by Gros (1987) suggests that with differentiated products, even small countries may have some market power. Empirical evidence on this particular issue is clearly needed. The recent study by Broda et al. (2006) is an interesting start.[185]

While the terms-of-trade theory has difficulties explaining trade negotiations involving small countries, it provides a rationale for their participation in the GATT/WTO. Membership in the GATT/WTO entails MFN treatment from other Members. Without MFN, a small country may be hurt by GATT negotiations

[185] See subsection 2 above.

if it ends up on the receiving end of discrimination. For small countries who are not granted MFN status, accession to the WTO would thus be a way to avoid discrimination.

In theory, large countries should not restrict MFN treatment exclusively to GATT/WTO Members. As explained in Section C below, if two large countries do not extend the benefit of their bilateral deal to any third country through some form of most-favoured-nation treatment, they run the risk of seeing the benefits of their agreement eroded by "bilateral opportunism". One of the signatories can enter into another agreement with a third party that reduces the value of the initial reciprocal commitment made to the other signatory. Large countries would thus be expected to grant MFN treatment to all other countries. Available evidence, however, suggests that Members do sometimes discriminate against non-Members.[186] Also, even if Members extend MFN treatment to non-Members, they have the possibility of raising their tariffs above MFN levels at any time. Moreover, Members could in principle – and in some cases do – discriminate against non-Members by using instruments such as quantitative restrictions that they would not be allowed to use against other Members.[187] A practical question here is how pervasive such behaviour is likely to be. A theoretical question is whether large countries would see any reason to discriminate against smaller ones if the latter cannot affect world prices.[188] Even if economic logic dictates non-discriminatory behaviour in such instances, perhaps politics plays differently.

The terms-of-trade theory suggests that while small countries may lose if they do not participate in the system, they may not derive benefits from trade negotiations between large countries – that is, reciprocal liberalization among larger countries may not entail positive spillover effects for smaller countries. The terms-of-trade model suggests that the GATT provides a negotiating environment where large countries can internalize most of the benefits from their agreements. More precisely, if two large countries A and B reduce their tariffs on a reciprocal and non-discriminatory basis, there are no, or very limited, spillovers for third countries. The reasoning is as follows. When A and B negotiate non-discriminatory tariff reductions on a reciprocal basis they do two things. First, A and B open up their domestic markets to new imports from each other or any other country. Second, through tariff reductions A and B improve the competitiveness of their exports, which are therefore better placed to exploit the additional market access offered by each other. If the tariffs are reduced on an MFN basis, trade deviation is avoided. If a third country C does not reduce its tariffs, which could be the case for a small country, it should neither be affected negatively nor positively by A and B's reductions.[189] Also, if C is a small non-Member country that receives MFN treatment, this suggests that it may not have a strong incentive to join.

To conclude, according to the terms-of-trade theory, the motivation for entering into trade agreements depends on whether a country can or cannot influence the price of its imports through its trade policy. How many countries are small according to this definition, however, is not clear. Large countries with market power can derive benefits from a trade agreement. This agreement should be multilateral rather than preferential, but because Members sometimes discriminate against non-Members, small countries have an incentive to join the agreement.

(ii) The commitment motive

The commitment approach does not segment countries along the market power criterion, but along the quality of domestic institutions. The theory clearly bears some relevance for countries with weak governments. Governments with credibility problems may use international trade agreements to push through trade reforms. The trade agreements could be bilateral, regional or multilateral as long as they

[186] See recent WTO Trade Policy Reviews of Canada, the EU, Japan and the United States, for examples of discriminatory treatment of non-WTO Members.

[187] The EU has historically imposed import restrictions on footwear, tableware and kitchenware from China, and several countries impose quantitative restrictions on non-WTO Members for foreign policy reasons.

[188] See Staiger (2006).

[189] Bagwell and Staiger (2002, 2005) show that for an interesting class of trade patterns across countries, if countries A and B negotiate lower tariffs according to the principles of reciprocity and non-discrimination, then country C experiences no changes in its terms of trade.

provide a credible threat that other participants will retaliate if a participant violates its commitment. The commitment approach, however, does not explain why a country without a credibility problem may wish to enter into an agreement with a country that faces a credibility problem. Neither does it explain reciprocal negotiations to reduce tariffs. For instance, it may explain why a country joins the GATT/WTO, but not why it would need reciprocal negotiations to reduce its tariffs. Once a Member, a country could unilaterally commit to reduce its tariff.

(iii) Other motives for cooperation

As seen in subsection 2, countries may want to cooperate on trade issues because they need to increase their market size. This argument, which for obvious reasons mainly applies to small countries, explains both their cooperation with large countries and cooperation among a certain number of small countries. Smallness, defined here in terms of market size rather than in terms of market power, can be a disadvantage because the domestic market may not be sufficiently large to generate the sales necessary to cover costs. Acquiring access to a large market can provide firms in the small country with the opportunity to exploit economies of scale, thus reducing their production costs and allowing profitable production.

Since, for a large country, market access to a small country is not a crucial motive for trade cooperation, the argument above does not explain why a large country would accept to cooperate with a small country. A plausible motivation for this may be the interest of the large country in cooperating on issues other than tariffs, such as environmental standards or intellectual property rights.

Related to the market size argument is the idea that a trade agreement can help attract foreign direct investment (FDI). This argument mainly applies to small and developing countries. Small countries may have an incentive to have access – especially preferential access – to the market of a large country to increase their attractiveness to foreign investors. Alternatively, they may create a free trade area among small countries for the same reason.

Another rationale for trade cooperation that has been discussed in subsection 2 above is the insurance motive. This argument mainly applies to smaller countries. And it may best explain the emergence of a number of regional trade agreements where a large country is the hub and the small countries are the spokes. This is because when a preferential arrangement is formed between a large and a small country, small countries outside the agreement will be interested in preserving their access to the market of the large country. Therefore, they will have an incentive to form a competitive preferential arrangement with the same or another large country. Alternatively, they may choose to push toward multilateral liberalization in order to recreate a level playing field among small countries in terms of their access to the markets of large countries.

Furthermore, trade cooperation among countries can be explained by the need to increase their bargaining power in the context of negotiating agreements with large (especially developed) countries. This argument mainly applies to cooperation among small countries, rather than between a small and a large country or between large countries, as large market size *per se* provides significant bargaining power. But it can also explain cooperation between a large developing country and small developing countries.

Finally, there is no specific reason to believe that protectionist motives apply differently to small and large countries. On the contrary, the role that these motives play as factors for trade cooperation are likely to depend on whether countries are neighbours, and whether their governments are sensitive to lobby pressures of organized groups.

(b) International relations perspective

This subsection examines how the four "grand theories" of IR discussed in subsection 3– namely neorealism, neoliberal institutionalism, liberalism, and constructivism – help in understanding international cooperation among diverse nations. How can national differences in power position, size, development level, and regime type account for differences in state preferences and expected cooperative behaviour?[190]

(i) The neorealist school

In the neoliberal conception, countries predominantly care about national security, military capabilities and the distribution of power within the international system. International cooperation is believed to occur in the form of short-term alliances or blocs. For neorealists, cooperation in trade mainly pursues two goals (Hirschman, 1980): a domestic supply effect (trade inputs and efficiency gains can be converted into military power), and a foreign policy influence effect, by which powerful countries try to create dependence. They attempt to force smaller countries into trade "cooperation". Small countries either decide to "bandwagon", that is, to take sides with a hegemonic state in the hope of slipping under the latter's security umbrella and to flourish economically. Alternatively, small powers choose the strategy of "counterbalancing" by forming a power block with other rivals. Thus, neorealists would expect military and economic bloc-building to go together. Preferential trade agreements among military allies would generally be the rule.[191] Within this framework, the early GATT can perhaps be seen as a strategic complement to NATO by the United States and the United Kingdom in an attempt to bind parts of Europe and Latin America into the Western Bloc (Grieco and Ikenberry, 2003). The depth and breadth of a trade agreement would thus seem to depend on the dynamics of the contemporary global balance of power.[192]

Post-classical realists (authors like Stephen Krasner, Robert Gilpin, or Charles Glaser – see Brooks, 1997) have a more nuanced view on the power dimension. They argue that power is not an end in itself but a means of achieving security and increasing the resource-base of a country. Also, post-classical realists point to the different facets of the concept of power.[193] For proponents of this view, trade cooperation can reduce the probability of conflict, help overcome international externalities, foster national security, and increase the welfare base of a country.[194] Therefore, trade agreements should be in the interest of small and big, developing and developed, democratic and autocratic countries alike. However, since economic gains can eventually be transformed into military gains, every nation should closely watch ascendant powers. Established (regional or global) powers should exclude rising nations from a trade

[190] The discussion of these four traditional schools of IR is intended to be illustrative rather than exhaustive. The treatment is inevitably somewhat stereotypical and at times simplifying. The schools identified are general clusters of theoretical IR reasoning and a number of IR scholars freely straddle or draw selectively from more than one approach.

[191] Gowa (1989) and Gowa and Mansfield (1993) argue that because of security externalities, free trade agreements are more likely to occur within than between military alliances and that alliances are more likely to evolve into free trade coalitions in a bipolar than in a multipolar system. Gowa and Mansfield (2004) argue that alliances promote trade between states and that this effect is stronger in the case of trade subject to increasing returns to scale than in the case of trade subject to constant returns to scale.

[192] The depth of a trade agreement refers to the size of *ex ante* trade liberalization commitments, whereas the breadth reflects the number of sectors and issue areas covered by the agreement.

[193] The contemporary concept of power in IR is not to be equated to military capability or market size. Although economic market size is often seen as one of the principal sources of power in the context of international trade (see for example Barton et al., 2006:10-11), IR theory has drawn attention to the multifaceted nature of power. In their book Michael Barnett and Raymond Duvall analyse different dimensions of the concept of power as used in contemporary IR. The authors distinguish between compulsory and institutional power, on the one hand, and structural and productive power, on the other. Compulsory and institutional power work through "interaction of specific actors", while structural and productive power work through "social relations of constitution." This typology encompasses both power involving material resources, and power involving "ideational" resources (Barnett and Duvall, 2005). Gregory Shaffer has analysed the operation of two of these forms of power – compulsory and institutional power – in the context of the WTO (Shaffer, 2005). On different approaches to power in IR theory see, for example, Baldwin (2002).

[194] Post-classical realists interpret the notion of the term "security" more broadly than neorealists. For them, security encompasses an array of "new security issues", such as conflicts due to scarce resources (e.g. water), refugees, migration, or pollution. Thus, trade agreements touching on those issue areas, especially RTAs, may gain special importance in international cooperation. (Ravenhill, 2005).

agreement, or strive to bind the latter into the trading system tightly enough for military confrontation to be perceived as too costly for all parties involved. Consequently, countries can either be expected to form trade-and-security alliances (blocs), or follow the (more risky) route of tight-knit multilateralism.[195]

How does hegemonic stability literature deal with trade cooperation among diverse nations? By default, this theory assumes two types of countries – a hegemon and the rest of the world. To bind other countries, but also to prevent free-riding, the hegemon is keen on creating a global trade institution that commits as many countries as possible. The bulk of small countries – independently of development level or regime type – are willing to join if the hegemon can credibly ensure that it will not opportunistically exploit the trade regime, and that the small players can actually reap the promised gains from trade cooperation.[196] The breadth and depth of trade commitments would thus seem to depend on the hegemon's level of ambition, as well as credibility regarding its willingness to act in the global long-term interest.

(ii) The school of neoliberal institutionalism

As discussed in subsection 3.(b), neoliberal institutionalists assume that interests shape power and not vice-versa, as neorealists seem to contend. Their theories focus on actors' interests in utility maximization and efficiency rather than the power dimension. Nations' concerns regarding absolute gains among cooperating parties outweigh mercantilist concerns about relative gains.

Cooperation in trade among diverse nations, therefore, will take place irrespective of size, economic power, development level, or political regime type. As long as the expected efficiency gains from cooperation outweigh the estimated costs of establishing and maintaining the cooperation regime, nations will engage in trade agreements. Consequently, whether countries prefer bilateral, plurilateral, or multilateral trade cooperation depends very much on the initial context (for example, which market imperfections need to be resolved), the negotiating environment (how many parties are involved, and what are signatories' information levels), the costs of writing the respective "trade contract", and the expected gains of continued cooperation.[197]

(iii) Liberalist approaches to trade cooperation

Scholars of liberalism open up the black box of domestic politics. Trade agreements are concluded if the decision to cooperate is the equilibrium outflow of some rational domestic deliberation process involving various non-state stakeholders and government entities. It is important for proponents of liberalism to stress that every country is unique due to its idiosyncratic domestic set-up. In an attempt to explain countries' rationale for entering into a trade agreement, it is therefore considered inadequate to lump countries together and to label them "developing", "small", "democratic", etc., precisely because the risk of overlooking striking differences is too large.

For liberalists, the economic size of a country does not *a priori* predetermine its trade stance. Neither does income distribution or average income level, the industry structure, the number of citizens, the level of education, the political processes, or the political regime type. Those factors are all part of the domestic context – that is, the present set-up of constraints and restrictions that have to be taken into account by those groups of society who have a liberal trade stance. If free traders want to prevail in the national trade-making process, they need to hold sway over protectionist factions in the national

---

195 On the general relationship between military alliances and global trade patterns, see for example Gowa and Mansfield (2004) and Mansfield and Bronson (1997).

196 Although the question does not feature prominently in the literature, the same concept may apply to regional hegemons. Applying the logic of hegemonic stability theory, those regional powers are likely to opt for regional trade integration. However, within its orbit of influence, the local hegemon will strive to bind all countries.

197 It seems that with growing complexity in trading relations, multilateral trade deals may be superior to a decentralized web of bilateralism because of transaction cost efficiencies (Abbott and Snidal, 1998). Yet increased contractual complexity also means higher costs of pre-contractual bargaining (Fearon, 1998). Rational states hence must trade off the expected costs and benefits of choosing bilateral, plurilateral, or multilateral options for trade cooperation.

decision-making process, whatever the obstacles and stumbling blocks may be. Thus, factors making up the domestic context like regime type, the level of corruption, and political processes do matter in the sense that they positively or negatively affect the bargaining position of national pro-trade influences (e.g. Odell, 1990).

(iv) Constructivist approaches to trade cooperation

According to constructivist thinking, states cooperate and create institutions that shape and constrain state interests and behaviour. To constructivists, however, more important than the question why states cooperate is the question why states want to cooperate in the first place. Here, the roles of moral entrepreneurs and epistemic communities are salient from the actor side ("local effects"). Some charismatic individuals or influential elites may change public perception around the globe (Karl Marx or the Club of Rome may come to mind). However, systemic stimuli ("global effects") impart social meaning and help construct international norms. Examples here are norms of international security, the promotion of peace, the rejection of piracy, genocide, or slavery, and the creation of a fair and liberal international trading order.

Applied to the realm of international trade cooperation among diverse nations, this means that countries (or rather: polities) that cherish the concept of freer and less regulated international trade will want to team up with like-minded societies in order to form a trade agreement.[198] Within this analytical framework, country size, population size, economic power, regime style, geography and other factors take a back seat. What counts is the degree of a society's commitment to a more liberal international economic order.

(c) Legal perspective

Subsection 4 reviewed "legal" approaches to trade agreements. The four approaches – termed the internal, external, internal-external and global constitutional views – are all variants of the same theme of constitutionalism. It is polities, or societies, who are cognizant of the global phenomenon of rent-seeking behaviour among self-interested trade-policymakers. In an attempt to overcome rampant policy failure in the realm of trade policy, societies conclude international trade constitutions.

What role does diversity among nations now play for legal theories of trade agreements? From a legal vantage point the precondition for concluding any sort of trade agreement seems to be the presence of a democratic regime. All legal theories reviewed above crucially depend on the assumption that citizens have the legal means to congregate, discuss, and eventually coerce their policymakers into concluding a trade agreement (e.g. by voting recalcitrant politicians out of office). Without a handful of basic principles usually connected to a democratic regime, constitutionalism is not possible: rule of the people, the provision of basic political rights to citizens (freedom of assembly, freedom of speech, freedom to vote), and a functioning rule-of-law (separation of powers, low level of corruption, functioning and impartial court system) are the bare necessities for constitutionalism to work. Other domestic factors, such as a certain level of subsistence and education, as well as sufficient access to information seem to be crucial.

Hence, it seems that legal perspectives to trade agreements would predict that it is mainly democratic, informed, well-to-do societies who have the means to conclude trade agreements among each other. Autocratic regimes can only be expected to join if they are big enough to cause externalities to those democratic countries that have the means to coerce the former into acceding (this of course only goes for the external and the internal-external constitutionalist views).

[198] Societies may appreciate trade liberalization for a number of reasons: the promotion of peace, religious reasons, economic stability and growth, increases in welfare, reasons of fairness or justice, and so on.

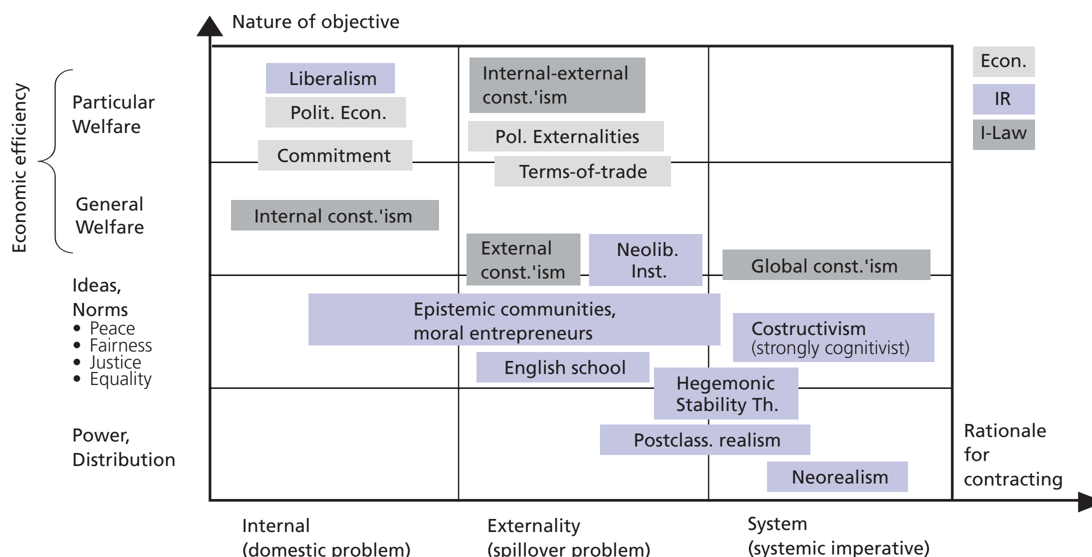
6. CONCLUSION: HOW TO MAKE SENSE OF THE VARIOUS RATIONALES FOR TRADE COOPERATION

This Section has reviewed economic, international relations, and legal approaches to trade agreements. The overarching objective was to explain what motivates sovereign countries to engage in bilateral, plurilateral, or multilateral trade agreements. This final Section provides a number of conclusions by synthesizing elements from all three approaches.

Before proceeding to compare similarities and differences between the various explanations for trade cooperation offered by the three disciplines, it is pertinent to stress the relevance of this analysis in the first place. Why should we care about explaining the underlying rationale of trade agreements? Three important reasons justify this endeavour. First, the motivating factors of a contract such as an international trade agreement crucially determine its nature. Treaty design – the design of contractual rules, provisions, procedures, and organizational features – is shaped fundamentally by the underlying goal(s) pursued by the contracting parties (Section C below will broach the issue of treaty design). Second, possessing a coherent understanding of the nature of an agreement is a prerequisite for engaging in any argument about the quality of outcomes engendered by that agreement. The rationale of a trade agreement is the logical yardstick against which to measure its success.[199] Third, dispute settlement panellists or Appellate Body Members are obliged to consider, together with the ordinary meaning of the terms used, in their context, the purpose of a trade agreement when interpreting the treaty. This is so because, by virtue of Article 31 of the Vienna Convention on the Law of Treaties (VCLT), a treaty interpreter must take into account the object and purpose of the agreement.[200]

How can one make sense of the various trade cooperation rationales that this Section has provided? How do the various approaches to trade agreements originating from the disciplines of economics, IR and international law differ? In what respects do they reveal similarities? Chart 1 graphically represents likeness and differences of the rationales for trade cooperation discussed above along two dimensions.

Chart 1
Comparing rationales for trade agreements



Note: The abbreviation "const.'ism" stands for "constitutionalism", "Neolib. Inst." for "neoliberal institutionalism". "Polit.Econ." is the abbreviation for political economy approaches to domestic trade-policymaking (see section B.2.(b) and (c), and C.3.(c)).

Source: Compilation by the authors.

[199] Any scholar criticizing efficiency or effectiveness of a trade agreement, and/or laying out an agenda for reform should reveal his or her understanding of the treaty's central objectives. Failure to do so may mean that the agreement is discussed in a logical vacuum.

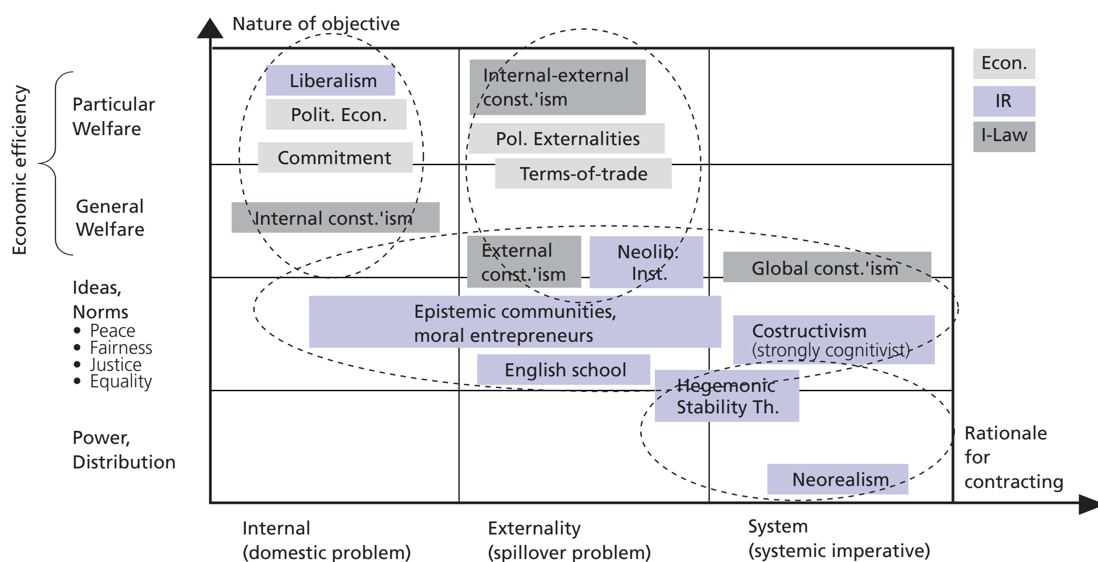
[200] According to Art. 31 VCLT, together with the context, any subsequent practice or agreement relating to the same subject matter, as well as any other relevant rule of public international law applicable between the parties should also be taken into account.

The vertical axis represents the "nature of objective" that is pursued by the trade contract. The horizontal axis represents the "rationale for contracting".[201] It is along the horizontal "rationale for contracting" dimension where the similarity between economics, IR and international law is most striking. Approaches from all three disciplines either postulate some kind of domestic (internal), or externality-based (spillover) problem that an international trade contract can help to overcome. In addition to that, a number of IR and legal schools of thought allege some form of systemic imperative for contracting. There, the international context, or the nature of the system impels states to act cooperatively in trade affairs.

However, the different approaches in economics, IR and law vary strikingly in their explanation of why countries may wish to cooperate in the first place. Whereas (political-) economic theories assume that actors are motivated by economic efficiency concerns of a particular sub-set of society (lobbies, policymakers, consumers), or of society at large (general welfare), other approaches to international cooperation put objectives other than economic efficiency centre stage. Some IR schools allege that actors are motivated by the pursuit of military power, or a country's power rank in the international system. Alternatively, some legal and IR explanations claim that non-economic idea-based or ideal-based factors, such as the pursuit of equality, fairness, or peace motivate countries to enter into cooperation in trade affairs.

Hence, the picture that emerges (and that Chart 2 presents visually) is the following:

Chart 2
Clustering rationales for trade agreements



Note: The abbreviation "const.'ism" stands for "constitutionalism", "Neolib. Inst." for "neoliberal institutionalism". "Polit.Econ." is the abbreviation for political economy approaches to domestic trade-policymaking.

Source: Compilation by the authors.

One way to group the various explanations for trade agreements is illustrated by the dashed-line sets in Chart 2. We distinguish four – partially overlapping – clusters of explanations for why countries may wish to cooperate in trade affairs. Moving from top left to bottom right, the first cluster posits a purely domestic problem that negatively affects economic efficiency considerations within a country, and that an international contract can help to overcome. The IR school of liberalism, the legal internal constitutionalist view, and political economy and commitment approaches originating in economics are all variations of this theme.

[201] It is important to realize that the "rationale for contracting" and the "nature of objective pursued" are two distinct issues. The former is about the contractual intent in answer to the question: "what problem can a contract solve?" or "what situation can the conclusion of a contract improve upon?". The latter is about the objective that guides actors' decisions. It answers the question: "what do we want to achieve by cooperating?".

The second cluster of explanations views some kind of international economic spillovers as the key problem that a contract can remedy. Trade agreements are thus concluded in order to constrain unilateralism, since one country's actions can harm the economic well-being of other countries. An international contract can successfully mitigate these beggar-thy-neighbour problems. This basic insight is at the core (with some variations and extensions) of the external and internal-external constitutionalist legal approaches, the IR school of neoliberalist institutionalism, and the terms-of-trade and political externalities theories in the field of economics.

The third cluster of trade agreement motivations can be called the "ideational route". According to scholars in this cluster, it is non-economic, normative objectives that guide the actions of trade policy decision-makers. In so far as economic or power rationales cannot satisfactorily explain why child, slave and prison labour, human trafficking, or dealing with drugs are repugnant concepts, economic thinking cannot fully explain why trade agreements are concluded. Basic civilizing norms and values, age-old traditions, a collective sense of history and humanity, and other ideational factors inspire influential individuals, pivotal groups, and states as a whole to conclude trade agreements. As was pointed out in subsection 5 above, ideational factors motivate countries to welcome even small and economically insignificant countries into the circle of participants. Non-economic objectives for contracting parties play a crucial role in the legal approaches termed external and global constitutionalism. In the realm of IR literature, ideational elements can be found in neoliberal institutionalism, hegemonic stability theory, and idealism, but especially in weakly and strongly cognitivist schools of constructivism.

The final cluster can be termed the "realpolitik" argument. Countries conclude trade agreements – or refrain from doing so – for reasons of power and subsistence (i.e. distributive efficiency). To paraphrase Clausewitz, for proponents of the power rationale of trade agreements, trade cooperation is a continuation of politics by other means.[202] Hence, states enter into trade cooperation, because they are coerced into doing so, or in order to seize a distinct power-related benefit from doing so (creation of dependency, balancing, bloc-building, etc.). This concern for power and distribution is most notably at the core of the IR school of neorealism, but also of postclassical realism, and hegemonic stability theory.

The fact that there are so many different theories explaining the same outcome, namely the conclusion of international trade agreements, raises the reasonable doubt that there is one single theory that is able to explain the phenomenon of trade cooperation. The discussion in subsection 5 concerning the impact of diversity among nations on their likelihood of concluding different trade agreements further strengthens the contention that the formation of trade agreements is a mixed-motive game.[203] A mixed-motive game has an internal and an external dimension to it. First, any country is probably motivated by an array of (partially conflicting) economic and non-economic objectives that it wants to pursue by contracting to a trade agreement. It may wish to promote peace and stability in its region, to propel its power rank in the international system, to attract FDI, to mitigate the influence of special interest groups, or to stop trade partners from engaging in excessive beggar-thy-neighbour policies, and so forth. Second, signatory countries can be expected to be quite heterogeneous in their contracting goals. Different countries are likely to possess idiosyncratic sets, or bundles, of trade cooperation objectives.

Among the conclusion that can be drawn from the above discussion are, first, that scholarship has a long way to go before a holistic explanation for trade agreements is established. Whilst current economic, political, and legal explanations seem to be able to elucidate facets of the cooperation game, they are

202 Carl v. Clausewitz's original dictum of course reads: "War is a continuation of politics by other means.". (See Clausewitz, 1993).

203 Conceiving of trade agreements as a mixed motive game among sovereign countries, however, is not a conclusion, but a theory. Nothing in the previous analysis of this Section can disprove possible contentions that there is one single dominant rationale for concluding international trade contracts.

far from capturing the whole picture. Cross-disciplinary work seems a fruitful and promising avenue for future research.[204]

Secondly, given that every signatory country is likely to possess a uniquely weighted set of cooperation motives, the initial balance of the trade deal (the common consent indispensable for the conclusion of any contract) can be expected to be difficult to identify and specify comprehensively. In addition, unforeseen environmental changes, dynamism, future shocks, and all other factors having an impact on the original contractual balance evidently increase the inherent complexity. Thus, the initial trade agreement must be seen as a necessarily incomplete contract (see Section C) for further discussion of this point). Two consequences immediately follow from contractual incompleteness. On the one hand, trade agreements are far from perfect contracts and thus dependant on the continuing goodwill of all signatories. A common sense of direction and conduct must be present at all times.[205] On the other hand, disputes in trade affairs are an inevitable result. Incompleteness leaves ample room for ambiguity, controversial interpretations, misunderstandings, and opportunism. In order to make an agreement better and fitter for the future, signatories should embrace disputes as mechanisms to clarify ambiguous treaty language and trade policies. As long as they do not threaten the contract itself, disagreements may be seen as a sign of a system at work, not of a system at fault.

Thirdly and finally, the observation that states have heterogeneous reasons for cooperating via trade agreements should be reflected in the ongoing design of trade negotiations and the conduct of trade relations. Trade negotiators should be aware of the fact that different countries enter trade deals for different and perhaps unique reasons. Moreover, mindfulness of the diversity of motivations for trade cooperation facilitates better understanding of each country's stance with respect to trade policy and trade policy negotiations.

204 An example of potentially fruitful interdisciplinary work arises from the possibility of adding further clarity to the objective functions of economic agents as surmised by economists. Economic approaches to trade agreements hypothesize that agents rationally maximize their utility. For simplicity's sake, standard theory assumes that economic efficiency (usually a maximization of income) is the best proxy for utility. Legal and IR approaches could help expand that view and integrate non-economic preferences (such as peace, fairness, equality, legitimacy, etc.) into the economist's utility function.

205 The common intention of all parties is usually reflected in the preamble of a treaty, albeit at a level of generality that makes it difficult to consult the preamble when interpreting various instruments or provisions. Still, preambular language oftentimes can be seen as the smallest common denominator – i.e. the hard core of contractual intent.

BIBLIOGRAPHY

Abbott, K. and Snidal, D. (1998) 'Why States Act through Formal International Organizations', *The Journal of Conflict Resolution* 42, 1: 3-32.

Adler, E. (2002) 'Constructivism in International Relations', in Carlsnaes, W., Simmons, B. and Risse, T. (eds) *Handbook of International Relations*, London, Thousand Oaks, New Delhi: Sage. pp. 95-118.

Aggarwal, V. K. and Dupont, C. (1999) 'Goods, Games and Institutions', *International Political Science Review* 20, 4: 393-409.

— (2004) 'Collaboration and Coordination in the Global Political Economy', in Ravenhill, J. (ed.) *Global Political Economy,* Oxford: Oxford University Press. pp. 28-49.

Andriamananjara, S. and Schiff, M. (1999) 'Regional Groupings Among Microstates', *World Bank Policy Research Working Paper Series* No. 1922, Washington, D.C.: The World Bank.

Bagwell, K. (2007) 'Remedies in the WTO: An Economic Perspective', mimeo.

Bagwell, K. and Staiger, R. W. (1999) 'An Economic Theory of GATT', *American Economic Review* 89, 1: 215-248.

— (2001) 'Strategic Trade, Competitive Industries and Agricultural Trade Disputes' *Economics and Politics* 13, 2:113-28.

— (2002) *The economics of the world trading system*, Cambridge: MIT Press.

— (2005) 'Multilateral negotiations, bilateral opportunism and the rules of GATT', *Journal of International Economics* 67: 268-294.

— (2006) 'What Do Trade Negotiators Negotiate About? Empirical Evidence from the World Trade Organization', *NBER Working Paper* N. 12727.

Bairoch, P. (1976) *Commerce extérieur et développement économique de l'Europe au XIX siècle,* Mouton, Paris La Haye: Écoles des Hautes Études en Sciences Sociales.

— (1989) 'European Trade Policy, 1815-1914', in Mathias P. and Pollard S. (eds), *The Cambridge Economic History of Europe*, Volume VIII, The Industrial Economies: The Development of Economic and Social Policies, New York: Cambridge University Press. pp. 1-160.

Baldwin, D. A. (2002) 'Power and International Relations', in Carlsnaes, W., Simmons, B. and Risse, T. (eds) *Handbook of International Relations*, London, Thousand Oaks, New Delhi: Sage. pp. 177-191.

Baldwin, D. A. (ed) (1993) *Neorealism and Neoliberalism: The Contemporary Debate*, New York: Columbia University Press.

Baldwin, R. E. (1985) *The Political Economy of US Import Policy*, Cambridge, Massachusetts: MIT Press.

— (1987) 'Politically Realistic Objective Functions and Trade Policy', *Economic Letters* 24: 287-90.

— (1994) 'Towards an Integrated Europe', London: CEPR.

— (1996) 'The Political Economy of Trade Policy: Integrating the Perspective of Economists and Political Scientists', in Feenstra R. C., Grossman, G. M. and Irwin, D.A. (eds) *The Political Economy of Trade Policy*, Cambridge: The MIT Press.

— (2006) 'Multilateralising Regionalism: Spaghetti bowls as building bloc on the oath to global free trade', *The World Economy* 29, 11: 1451-1518.

Baldwin, R. E. and Forslid, R. (2004) 'Trade Liberalization with Heterogenous Firms', *CEPR Discussion Papers* 4635.

Baldwin, R. E. and Robert-Nicoud, F. (2005) 'Juggernaut Model – The Lego Version', mimeo, GIIS.

— (2006) 'Protection for Sale Made Easy', *CEPR Discussion Paper* 5452.

Baldwin, Richard. E. and Baldwin, Robert. E. (1996) 'Alternative approaches to the political economy of endogenous trade liberalization', *European Economic Review* 40: 775-782.

Baran, P. A. (1967) *The Political Economy of Growth,* New York, NY: Monthly Review Press.

Barbieri, K. (1996) 'Economic Interdependence: A Path to Peace or a Source of Interstate Conflict?' *Journal of Peace Research* 33, 1: 29-49.

— (2002) *The Liberal Illusion, Does Trade Promote Peace?*, The University of Michigan Press.

Barbieri, K. and Schneider, G. (1999) 'Globalization and Peace: Assessing New Directions in the Study of Trade and Conflict', *Journal of Peace Research* 36(4), Special Issue on Trade and Conflict. 387-404.

Barnett, M. and Duvall, R. (2005) 'Power in Global Governance', in Barnett, M. and Duvall, R. (eds) *Power in Global Governance*, Cambridge: Cambridge University Press. pp. 1-33.

Barton, J. H., Goldstein, J. L., Josling, T. E. and Steinberg, R. H. (2006*) The Evolution of the Trade Regime: Politics, Law, and Economics of the GATT and the WTO*, Princeton and Oxford: Princeton University Press.

Baumont, M. (1952) 'Le Commerce depuis le Milieu du XIX Siècle. Livre I et II', in J. Lacour-Gayet (ed.), *Histoire du Commerce, Tome V*, Paris: Editions Spid.

Bhagwati, J. (2002) *Free Trade Today,* Princeton, NJ. Princeton: Princeton University Press.

Bhandari, J. S. and Sykes, A. O. (1998) *Economic Dimensions in International Law: Comparative and Empirical Perspectives*, Cambridge: Cambridge University Press.

Bown, C. P. (2004a) 'Trade policy under the GATT/WTO: empirical evidence of the equal treatment rule', *Canadian Journal of Economics* 37, 3: 678-720.

— (2004b) 'Trade disputes and the implementation of protection under GATT: an empirical assessment', *Journal of International Economics* 62, 2: 263-294.

— (2004c) 'On the economic success of GATT/WTO dispute settlement', *The Review of Economics and Statistics* 86, 3: 811-823.

Bown, C. P. and Crowley, M. (2006) 'Policy Externalities: How U.S. Antidumping Affects Japanese Exports to the EU', *European Journal of Political Economy* 22, 3: 696-714.

— (2007) 'Trade Deflection and Trade Depression', *Journal of International Economics*, forthcoming.

Brainard, L. (1994) 'Last One Out Wins: Trade Policy in an International Exit Game', *International Economic Review* 35: 151-72.

Brainard, L. S. and Verdier, T. (1994) 'Lobbying and Adjustment in Declining Industries', *European Economic Review 38*, 3-4: 586.

Broda, C., Limao, N. and Weinstein, D. (2006) 'Optimal tariffs: the evidence', *NBER Working Paper* No 12033, Washington DC: National Bureau of Economic Research.

Brooks, S. G. (1997) 'Dueling Realisms' *International Organization* 51, 3: 445-477.

Bull, H. (1977) *The Anarchical Society.* London, UK: Macmillan.

Bull, H. and Watson, A. (eds) (1984) *The Expansion of International Society,* Oxford, UK: Oxford University Press.

Buzan, B. (2004) *From International to World Society? English School Theory and the Social Structure of Globalisation*, Cambridge: Cambridge University Press.

Carmichael, C. (1987) 'The Control of Export Credit Subsidies and its Welfare Consequences', *Journal of International Economics* 23: 1-19.

Carr, E. H. (1939) *The Twenty Years' Crisis, 1919-1939,* New York, NY: Harper and Row.

Cass, D. Z. (2005) *The Constitutionalization of the WTO,* Oxford, UK: Oxford University Press.

Chang, W. and Winters, A. L. (2001) 'How Regional Blocs Affect Excluded Countries: The Price Effects of MERCOSUR', *American Economic Review* 92, 4: 889-904.

Charnovitz, S. (2004) 'The WTO and Cosmopolitics', *Journal of International Economic Law* 7, 3: 675-682.

Chase-Dunn, C. (1998) *Global Formation: Structures of the World-Economy,* 2nd ed. Lanham, MD: Rowman and Littlefield.

Checkel, J. T. (1998) 'The Constructivist Turn in International Relations Theory', *World Politics* 50, 2: 324-348.

Clausewitz, C. von (1993) *On War*, Howard, M.E. and Paret, P. (eds). Princeton: Princeton University Press.

Committee on Industry and Trade (1925) *Survey of Overseas Markets* (Balfour Report), London.

Conybeare, J. A. C. (1984) Public Goods, Prisoners' Dilemma and the International Political Economy, *International Studies Quarterly* 28, 1: 5-22.

Corden, M. (1997) *Trade Policy and Economic Welfare*, Oxford: Oxford University Press.

Dam, K. W. (1970) *The GATT: Law and International Economic Organization*, Chicago: The University of Chicago Press.

Dixit, A. (1987) 'Strategic aspects of trade policy', in T.F. Bewley (ed) *Advances in economic theory: fifth world congress*, New York: Cambridge University Press.

Dobson, J (1976) *Two Centuries of Tariffs. The Background and Emergence of the United States Tariff Commission*, Washington, DC: US International Trade Commission.

Downs, G. W. and Rocke, D. M. (1995) *Optimal Imperfection? Domestic Uncertainty and Institutions in International Relation*s, Princeton: Princeton University Press.

Drake, W. J and Nicolaïdis,K. (1992) 'Ideas, Interests and Institutionalization: 'Trade in Services' and the Uruguay Round' in Haas, P.M. (ed) *Knowledge, Power, and International Policy Coordination*, Columbia: University of South Carolina Press pp. 37-100.

Dunoff, J. L. and Trachtman, J. P. (1999) 'Economic Analysis of International Law', *Yale Journal of International Law* 24, 1: 1-59.

Dupont, C., Beverelli, C. and Pézard, S. (2006) 'Learning in Multilateral Trade Negotiations: Some Results from Simulation from Developing Countries', in Odell, J.S (ed) *Negotiating Trade: Developing Countries in the WTO and NAFTA*, Cambridge: Cambridge University Press. pp. 145-174.

Eaton, J. and Kortum, S. (2002) 'Technology, Geography and Trade', *Econometrica* 70, 5: 1741-1780.

Eschenbach, F. and Hoekman, B. (2006) 'Services Policies in Transition Economies: on the EU and WTO as commitment mechanisms', *World Trade Review* 5, 3: 415-443.

Ethier, W. J. (2001) 'Punishments and Dispute Settlement in Trade Agreements', *PIER Working Paper* 01-21.

— (2001a) 'Theoretical problems in negotiating trade liberalization', *European Journal of Political Economy* 17: 209–232.

— (2004) 'Political externalities, Non-discrimination, and a Multilateral World', *Review of International Economics* 12, 3: 303-320.

— (2006) 'The theory of trade policy and trade agreements: a critique', *PIER Working Paper* No 06-013, Philadelphia: Penn Institute for Economic Research.

Evans, P. B., Jacobson, H. K. and Putnam, R. D. (1993) *Double-Edged Diplomacy: International Bargaining and Domestic Politics*, Berkeley, Los Angeles, London: University of California Press.

Evans, T. and Wilson, P. (1992) 'Regime Theory and the English School of International Relations: A Comparison', *Millenium: Journal of International Studies* 21, 3: 330.

Falvey, R., Greenway, D. and Yu, Z. (2004) 'Intra-industry Trade Between Asymmetric Countries with Heterogeneous Firms', *Leverhulme Centre for Research on Globalization Economic Policy Working Paper* N. 2004/5.

Fearon, J. D. (1998) 'Bargaining, Enforcement, and International Cooperation', *International Organization* 52, 2: 269-305.

Finnemore, M. (1996) *National Interests in International Society*, Ithaca and London: Cornell University Press.

Finnemore, M. and Sikkink, K. (1998) 'International Norm Dynamics and Political Change', *International Organization* 52, 4: 887-918.

Frank, A. G. (1969) *Capitalism and Underdevelopment in Latin America: Historical Studies of Chile and Brazil,* New York, NY: Monthly Review Press.

Frieden, J. (2006) *Global Capitalism. It Fall and Rise in the Twentieth Century,* New York: W.W. Norton.

Gardner, R. N. (1980) *Sterling-Dollar Diplomacy in Current Perspective: The Origins and the Prospects of our International Economic Order*, New York: Columbia University Press.

Gawande K. and Bandyopadhyay, U. (2000) 'Is Protection for Sale? Evidence of the Grossman-Helpman Theory of Endogenous protection', *Review of Economics and Statistics* 82, 1: 139-152.

Gerhart, P. (2003) 'The Two Constitutional visions of the World Trade Organization', *Pennsylvania Journal of International Economic Law* 24, 1: 1-74.

Gilpin, R. (1987) *The Political Economy of International Relations*, Princeton: Princeton University Press.

Goldberg, P. K. and Maggi, G. (1999) 'Protection for Sale and Empirical Investigation', *American Economic Review* 84, 4: 1135-1155.

Goldstein, J (1993) 'Creating the GATT Rules: Politics, Institutions, and American Policy', in Ruggie, J.G. (ed) *Multilateralism Matters: The Theory and Praxis of an Institutional Form,* New York: Columbia University Press. pp. 201-232.

— (1996) 'International Law and Domestic Institutions: Reconciling North American Unfair Trade Laws', *International Organization* 50: 541-64.

— (1998) 'International Institutions and Domestic Politics: GATT, WTO, and the Liberalization of International Trade', in Krueger, A.O. (ed) *The WTO As An International Organization*, Chicago and London: The University of Chicago Press. pp. 133-152.

Goldstein, J. and Gowa, J. (2002) 'US National Power and the Postwar Trading Regime', *World Trade Review* 1, 2: 153-170.

Goldstein, J. and Keohane, R. O. (eds) (1993) *Ideas and Foreign Policy*, Ithaca: Cornell University Press.

Gourevitch, P. (2002) 'Domestic Politics and International Relations', in Carlsnaes, W., Simmons, B. and Risse, T. (eds) *Handbook of International Relations*, London, Thousand Oaks, New Delhi: Sage. pp. 309-328.

Gowa, J. (1989) 'Bipolarity, Multipolarity, and Free Trade', *American Political Science Review* 83, 4: 1245-1256.

Gowa, J. and Mansfield, E. D. (1993) 'Power Politics and International Trade', *American Political Science Review* 87, 2: 408-420.

— (2004) 'Alliances, Imperfect Markets, and Major-Power Trade'. *International Organization* 58, 4: 775-805.

Grieco, J. M. (1988) 'Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Institutionalism', *International Organization* 42, 3: 485-507.

— (1990) *Cooperation among Nations: Europe, America and Non-Tariff Barriers to Trade*, Ithaca: Cornell University Press.

Grieco, J. M. and Ikenberry, G.J. (2003) *State Power and World Markets: The International Political Economy*, New York and London: W.W. Norton and Company.

Gros, D. (1987) 'A note on the optimal tariff, retaliation and the welfare loss from tariff wars in a framework with intra-industry trade', *Journal of International Economics* 23: 357-367.

Grossman, G. and Maggi, G. (1998) 'Free Trade versus Strategic Trade: A Peak into Pandora's Box', in Soto R., Ramachandran R. and Mino K. (eds) *Global Competition and Integration,* Dordrecht: Kluwer Academic.

Grossman, G. M. and Helpman, E. (1994) 'Protection for Sale', *American Economic Review* 84, September: 833-50.

— (1995a) 'Trade War and Trade Talks', *Journal of Political Economy* 103: 675-708.

— (1995b) 'The Politics of Free Trade Agreements', *American Economic Review* 85:667-90.

— (2001) *Special Interest Politics*, Cambridge, MA: MIT Press.

Gruber, L. (2000) *Ruling the World: Power Politics and the Rise of Supranational Institutions,* Princeton: Princeton University Press.

Gruenspecht, H. K. (1988) 'Dumping and Dynamic Competition', *Journal of International Economics* 25: 225-48.

Guzzini, G. (2002) 'A Reconstruction of Constructivism in International Relations', *European Journal of International Relations* 6, 2: 147-182.

Haas, E.B. (1990) *When Knowledge is Power: Three Models of Change in International Organizations*, Berkely, Los Angeles, London: University of California Press.

Haas, P. M. (1992) 'Introduction: Epistemic Communities and International Policy Coordination', in P. M. Haas (ed) *Knowledge, Power, and International Policy Coordination*, Columbia: University of South Carolina Press. pp. 3-35.

Haggard, S. and Simmons, B.A. (1987) 'Theories of International Regimes', *International Organization* 41, 3: 491-517.

Harms, P., Mattoo, A. and Schuknecht, L. (2003) 'Explaining liberalization commitments in financial services trade', *World Bank Policy Research Paper* 2999.

Hasenclever, H., Mayer P. and Rittberger V. (1997) *Theories of International Regimes*, Cambridge: *University Press*.

— (2000) 'Integrating Theories of International Regimes', *Review of International Studies* 26, 1: 3-33.

Hillman, A. and Ursprung, H. W. (1988) 'Domestic Politics, Foreign Interests and International Trade Policy', *American Economic Review* 78, 4: 729-45.

Hirschman, A. O. (1980) *National Power and the Structure of Foreign Trade* (First published in 1945.) Expanded edition, Berkeley, CA: University of California Press. pp. v-52.

Holsti, K. J. (2004) *Taming the Sovereigns: Institutional Change in International Politics*, Cambridge: Cambridge University Press.

Horowitz, S. (2004) 'Reversing Globalization: Trade policy consequences of World War I', *European Journal of International Relations* 10, 1: 33-59.

Howse, R. and Nicolaidis, K. (2001). 'Legitimacy and Global Governance: Why Constitutionalizing the WTO is a Step too Far', in Porter, R. B. et al. (eds), *Efficiency, Equity, Legitimacy: The Multilateral Trading System at the Millennium,* Washington, D.C.: Brookings Institution Press.

Hudec, R. E. (1993) 'Circumventing Democracy: The Political Morality of Trade Negotiations', *N.Y.U. Journal of International Law & Politics* 25: 311-322.

Hull, C. (1948) *The Memoirs of Cordell Hull,* London: Hodder and Stoughton.

Ikenberry, G .J. (2001) *After Victory: Institutions, Strategic Restraint, and the Rebuilding of Order After Major Wars*, Princeton and Oxford: Princeton University Press.

Ikenberry, G. J., Lake, D. A., Mastanduno, M. (1989) 'The State and American Foreign Economic Policy', *International Organization* 42, 1: 1-14.

Ikenberry, J. G. and Kupchan, C. A.(1990) 'Socialization and Hegemonic Power', *International Organization* 44, 3: 283–315.

Irwin, D. A. (1993) 'Multilateral and Bilateral Trade Policies in the World Trading System: An Historical Perspective', in de Melo, J. and Panagariya, A. (eds) *New Dimensions in Regional Integration*, New York: Cambridge University Press. pp. 90-119.

— (1996) *Against the Tide: Intellectual History of Free Trade,* Princeton, NY: Princeton University Press.

— (1998) The Smoot-Hawley Tariff: A Quantitative Assessment, *The Review of Economics and Statistics*, Vol. LXXX.

Jackson, J.H. (1969) *World Trade and the Law of GATT,* New York: Bobbs-Merrill.

Jawara, F. and Kwa, A. (2004). *Behind the Scenes at the WTO: The Real World of International Trade Negotiations: Lessons of Cancun ,* 2nd edition, London and New York : Zed Books (distributed by Palgrave, New York).

Johnson, H. G. (1953-1954) 'Optimum tariffs and retaliation', *The Review of Economic Studies* 21, 2: 142-153.

Kapstein, E. (2003) 'Two Dismal Sciences Are Better Than One Economics and the Study of National Security, A Review Essay', *International Security* 27, 3: 158-187.

Keohane, R. O. (1984) *After Hegemony: Cooperation and Discord in the World Political Economy*, Princeton: Princeton University Press.

— (1993) 'Institutional Theory and the Realist Challenge After the Cold War', in Baldwin, D. A. (ed) *Neorealism and Neoliberalism: The Contemporary Debate*, New York: Columbia University Press pp.269-300.

— (2002) *Power and Governance in a Partially Globalized World*, London and New York: Routledge.

— (2005) *After Hegemony: Cooperation and Discord in the World Political Economy* (with a new preface by the author), Princeton and Oxford: Princeton University Press.

Kindleberger, C. P (1989) 'Commercial Policy between the Wars', in Mathias, P. and Pollard, S. (eds), *The Cambridge Economic History of Europe*, Volume VIII, The Industrial Economies: The Development of Economic and Social Policies, New York: Cambridge University Press. pp. 161-196.

— (1973) *The World in Depression*, *1929-1939*, Berkely: University of California Press.

— (1975) 'The Rise of Free Trade in Western Europe,1820-1875', in *The Journal of Economic History*, Volume XXXV.

Krasner, S. D. (1976) 'State Power and the Structure of International Trade', *World Politics* 28, 2: 317-347.

— (1983) ‘Structural Causes and Regime Consequences: Regimes as Intervening Variables’, in Krasner, S. D. (ed) *International Regimes*, Ithaca and London: Cornell University Press.

— (1991) ‘Global Communications and National Power: Life on the Pareto Frontier’, *World Politics* 43: 336-366.

— (1999) *Sovereignty: Organized Hypocrisy,* Princeton: Princeton University Press.

Kratochwil, F. V. (1989) *Rules, Norms, and Decisions: On the Conditions of Practical and Legal Reasoning in International Relations and Domestic Affairs*, Cambridge: Cambridge University Press.

Kratochwil, F. V. and Ruggie, J.G. (1986) ‘International Organization: A State of the Art on an Art of the State’, *International Organization* 40, 4: 753-775.

Krishna, P. and Mitra, D. (1999) ‘Reciprocated Unilateralism: A political Economy Perspective’, mimeo, Brown University.

— (2005) ‘Reciprocated Unilateralism in Trade Policy’ *Journal of International Economics* 65, 2: 461-487.

Kydland, F. E. and Prescott, E. C. (1977) ‘Rules Rather Than Discretion: The Inconsistency of Optimal Plans’, *Journal of Political Economy* 85, 3: 473-91.

Lake, D. (1993) ‘Leadership, Hegemony, and the International Economy: Naked Emperor or Tattered Monarch with Potential?’, *International Studies Quarterly* 37: 459-489.

Lal, D. (2006) *Reviving the Invisible Hand*, Princeton: University Press.

Lamy, P. (2001) ‘Harnessing globalisation: do we need cosmopolitics?’, Lecture given at the London School of Economics on February 1, 2001. Available http://trade-info.cec.eu.int/doclib/docs/2004/october/tradoc_119391.pdf. Accessed 06/02/07.

Lang, A. T. F. (2006) ‘Reconstructing Embedded Liberalism: John Gerard Ruggie and Constructivist Approaches to the Study of the International Trade Regime’, *Journal of International Economic Law* 9, 1: 81-116.

Lapan, H. E (1988) ‘The Optimal Tariff, Production Lags and Time Consistency’, *American Economic Review* 78, 3: 395-401.

Lavergne, R. P. (1983) *The Political Economy of US Tariffs: An Empirical Analysis*, Toronto: Academic Press.

League of Nations (1927) Economic and Financial Section, International Economic Conference, Documentation, ‘Tariff Level Indices’, Geneva.

— (1942) Economic and Financial Transit Department, ‘Commercial Policy in the Interwar Period. International Proposals and National Policies’, Geneva.

— (1945) Report of the Economic and Financial Committees, ‘Commercial Policy in the Post-War World’. Official No.: C.31.M.31.1945.II.A (April 1945).

Lewis, A. (1981) The Rate of Growth of World Trade, 1830-1973, in Grossmann and Lundberg (ed) *The World Economic Order. Past and Prospects*.

Liepmann, H. (1938) *Tariff Levels and the Economic Unity of Europe*, London: Allen, G. & Unwin.

Limão, N. (2005) ‘Preferential agreements as stumbling blocks for multilateral trade liberalization – evidence for the U.S.’, *CEPR Discussion Paper* No 4884, London: Centre for Economic Policy Research.

— (2006) ‘Preferential Trade Agreements as Stumbling Blocks for Multilateral Trade Liberalization: Evidence for the United State’, *American Economic Review* 96, 3: 896-914.

Mac Callum, P. (2004) ‘Protection for Sale and Trade Liberalization: an Empirical Investigation’, *Review of International Economics* 12, 1: 81-94.

Maddison, A. (1962) 'Growth and Fluctuation in the World Economy, 1870-1960', *Banca Nazionale del Lavoro Quarterly Review*, No. 61, June.

— (2001) *The World Economy: A Millennial Perspective*, Paris: OECD.

Magee, S. P., Brock, W. A. and Young, L. (1989) 'Black Hole Tariffs and Endogenous Policy Theory: Political Economy in General Equilibrium', Cambridge: Cambridge University Press.

Magelby, D. B. and Nelson, C. J. (1990) 'The Money Case: Congressional Campaign Finance Reform', Washington, DC: Brooking Institution.

Maggi, G. and Rodriguez-Clare, A. (1998) 'The Value of Trade Agreements in the Presence of Political Pressures', *Journal of Political Economy* 106, 3: 574-601.

— (2007) 'A political Economy Theory of Trade Agreements', *American Economic Review*, forthcoming.

Mansfield, E. D. and Bronson, R. (1997) 'Alliances, Preferential Trading Arrangements, and International Trade', *American Political Science Review* 91, 1: 94-107.

Mansfield, E. D. and Reinhardt, E. (2003) 'Multilateral Determinants of Regionalism: The Effects of GATT/WTO on the Formation of Preferential Trading Arrangements', *International Organization* 57, 3: 829-862.

Mansfield, E. D., Milner, H. V. and Rosendorff, B. P. (2002). 'Why Democracies Cooperate More: Electoral Control and International Trade Agreements', *International Organization* 56, 3: 477-513.

Martin, L. L. (1993) 'The Rational State Choice of Multilateralism', in Ruggie, J.G. (ed.) *Multilateralism Matters: The Theory and Praxis of an Institutional Form,* New York: Columbia University Press. pp. 91-121.

Martin, L. L. and Simmons, B. A. (1998) 'Theories and Empirical Studies of International Institutions', *International Organization* 52, 4: 729-775.

Martin, P., Mayer, T. and Thoenig, M. (2005) 'Make Trade not War?', *CEPR, Discussion Paper Series* N. 5218.

Maskin, E. and Newberry, D. (1990) 'Disadvantageous Oil Tariffs and Dynamic Consistency', *American Economic Review* 80: 143-56.

Matsuyama, K. (1990) 'Perfect Equilibria in a Trade Liberalization Game', *American Economic Review* 80:480-492.

Mavroidis, P. (2007) *Trade in Goods*, Oxford, UK: Oxford University Press (forthcoming).

Mayer, W. (1984) 'Endogenous Tariff Formation', *American Economic Review* 74: 970-85.

— (1994) 'Optimal Pursuit of Safeguard Actions Over Time', in Deardoff, A. and Stern, R. (eds) *Analytical and Negotiating Issues in the Global Trading System*, Ann Arbor: University of Michigan Press.

McGinnis, J. O. and Movsesian, M. L. (2000) 'The World Trade Constitution', *Harvard Law Review* 114: 511-605.

McLaren, J. (1997) 'Size, Sunk Costs and Judge Bowker's Objection to Free Trade', *American Economic Review* 87: 400-20.

— (2002) 'A Theory of Insidious Regionalism', *Quarterly Journal of Economics* 117, 2: 571-608.

Mearsheimer, J. J. (1995) 'The False Promise of International Institutions', *International Security* 19, 3: 5-49.

Melitz, M. J. (2003) 'The Impact of Trade on Intra-Industry Reallocation and Aggregate Industry Productivity', *Econometrica* 71, 6: 1695-1725.

Mill, J. S. (1844) *Essays on some unsettled questions of political economy*, London: Parker.

Miller, J. N. (2000) 'Origins of the GATT: British resistance to American multilateralism', *Cambridge University Jerome Levy Economics Institute at Bard College, Working Paper* no. 318.

Milner, H. V. (1988) *Resisting Protectionism: Global Industries and the Politics of International Trade*, Princeton, NJ: Princeton University Press.

— (1998) *Interests, Institutions and Information: Domestic Politics and International Relations*, Princeton: Princeton University Press.

— (2002) 'International Trade', in Carlsnaes, W., Simmons, B. and Risse, T. (eds) *Handbook of International Relations*, London, Thousand Oaks, New Delhi: Sage. pp. 448-461.

Milner, H. V. and Rosendorff, B. P. (1997) 'Democratic Politics and International Trade Negotiations: Elections and Divided Government as Constraints on Trade Liberalization', *Journal of Conflict Resolution* 41, 1: 117-46.

Mitra, D. (1999) 'Endogenous Lobby Formation and Endogenous Protection: A Long-Run Model of Trade Policy Determination', *American Economic Review* 89: 1116-34.

Mitra, D., Thomakos, D. D. and Ulubasoglu, M. A. (2002) 'Protection for Sale in a Developing Country: Democracy versus Dictatorship', *Review of Economics and Statistics* 84, 3: 497-508.

Moravcsik, A. (1997) 'Taking Preferences Seriously: A Liberal Theory of International Politics', *International Organization* 51, 4: 513-553.

— (1998) *The Choice for Europe: Social Purpose & State Power from Messina to Maastricht*, London: Cornell University Press.

Morgenthau, H. (1948) *Politics Among Nations: The Struggle for Power and Peace,* New York, NY: Knopf.

Morrow, J. D. (1994) 'Modeling the Forms of International Cooperation: Distribution Versus Information', *International Organization* 48, 3: 387-423.

— (1997) 'When Do 'Relative Gains' Impede Trade?', *Journal of Conflict Resolution* 41, 1: 12-37.

Nolde, B. (1932) *La Clause De La Nation La Plus Favorisée et les Tarifs Préférentiels*, Académie de Droit International, Recueil de Cours, Tome 39.

Norbohm, J. O. (1962) *International Trade Statistics 1900-1960*, (unpublished document of UN Statistical Office), New York.

Odell, J. (1990) 'Understanding International Trade Policies: An Emerging Synthesis', *World Politics* 43 (October): 139-167.

Odell, J. and Sell, S. (2006) 'Reframing the Issue: The Coalition on Intellectual Property and Public Health in the WTO, 2001' in Odell, J. (ed.) *Negotiating Trade: Developing Countries in the WTO and NAFTA*. New York, NY: Cambridge University Press.

O'Rourke, K. (2007) *Power and Plenty: Trade, War, and the World Economy in the Second Millennium*. Forthcoming Fall 2007, Princeton University Press.

O'Rourke, K. and Williamson, J. (1999) *Globalization and History. The Evolution of a Nineteenth Century Atlantic Economy,* Cambridge MA: MIT Press.

Ostrom, E. (2003) 'How types of goods and property rights jointly affect collective action', *Journal of Theoretical Politics* 15, 3: 239-270.

Pauwelyn, J. (2006) 'Optimal Protection of International Law: Navigating between "European Absolutism" and "American Voluntarism", mimeo. Available at http://www.law.duke.edu/fac/pauwelyn/pdf/optional_protection.pdf. Accessed 06/02/2007.

Penrose, E. F. (1953) *Economic Planning for the Peace.* Princeton, NJ: Princeton University Press.

Petersmann, E.-U. (1986) 'Trade Policy as a Constitutional Problem. On the 'Domestic Policy Functions' of International Trade Rules', *Aussenwirtschaft* 41: 405-439.

— (1995) 'The Transformation of the World Trading System Through the 1994 Agreement Establishing the World Trade Organization', *European Journal of International Law* 6: 1-61.

— (1998) 'From the Hobbesian International Law of Coexistence to Modern Integration Law: The WTO Dispute Settlement System', *Journal of International Economic Law* 1: 175-198.

— (2005) 'Addressing Institutional Challenges to the WTO in the New Millennium: A Longer-Term Perspective', *Journal of International Economic Law* 8, 3: 647-665.

— (2006) 'Multilevel Trade Governance in the WTO Requires Multilevel Constitutionalism', in: Joerges, C. and Petersmann, E.-U.: *Constitutionalism, Multilevel Trade Governance and Social Regulation*, Hart Publishing, Portland, OR.

Polachek, S. W. (1992) 'Conflict and Trade: An Economic Approach to Political Interactions', in Isard, W. and Anderton, C.H. (eds) *Economics of Arms Reduction and the Peace Process*, Amsterdam: North-Holland.

— (1997) 'Why Democracies Cooperate More and Fight Less: The Relationship Between International Trade and Cooperation', *Review of International Economics* 5, 1: 295-309.

Pomfret, R. (1997) *The Economics of Regional Trading Arrangements,* Oxford: Clarendon Press.

Posner, R. A. (1988) *Economic Analysis of the Law*. Boston, MA: Little, Brown and Co.

Powell, R. (1991) 'Absolute Gains and Relative Gains in International Relations Theory', *American Political Science Review* 85, 4: 1303-1320.

Putnam, R. D. (1988) 'Diplomacy and Domestic Politics: The Logic of Two-Level Games', *International Organization* 42, 3: 427-60.

Rappard, W. (1938) *Post-War Efforts For Freer Trade,* Geneva Studies, Volume IX, No.2, Geneva.

Ravenhill, J. (ed) (2005) *Global Political Economy*, Oxford, UK: Oxford University Press.

Regan, D. (2006) 'What Are Trade Agreements For? – Two Conflicting Stories Told by Economists, With a Lesson for Lawyers', *Journal of International Economic Law* 9, 4: 951-988.

Reus-Smit, C. (1997) 'The Constitutional Structure of International Society and the Nature of Fundamental Institutions', *International Organization* 51, 4: 555-589.

Riedel, J. C. (1977) 'Tariff Concessions in the Kennedy Round and the Structure of Protection in West Germany: An econometric Assessment', *Journal of International Economics* 7: 133-43.

Rittberger, V. (1993) 'Research on International Regimes in Germany: The Adaptive Internalization of an American Concept', in Rittberger, V. (ed) *Regime Theory and International Relations*, Oxford: Clarendon Press. pp. 3-22.

Rodrik, D. (1995) 'Political Economy of Trade Policy', in Grossman, G. and Rogoff, K. (eds) *Handbook of International Economics.* Amsterdam: New Holland. pp. 457-1494.

Ruggie, J. G. (1982) 'International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order', *International Organization*, 36, 2: 379-415.

— (1983) 'International Regimes, Transactions and Change: Embedded Liberalism in the Postwar Economic Order', in Krasner, S.D. (ed) *International Regimes*, Ithaca and London: Cornell University Press. pp. 195-231.

— (1998) *Constructing the World Polity: Essays on International Institutionalization*, London and New York: Routledge.

Ruggie, J. G. (ed) (1993) *Multilateralism Matters: The Theory and Praxis of an Institutional Form,* New York: Columbia University Press.

Sandler, T. (1992) *Collective Action. Theory and Applications*, Ann Arbor: University of Michigan Press.

Schermers, H. and Blokker, N. (1995) *International Institutional Law: Unity Within Diversity.* 3rd rev. edition, Cambridge, MA: Kluwer Law International.

Shaffer, G. (2005) 'Power, Governance, and the WTO: A Comparative Institutional Approach', in Barnett, M. and Duvall, R. (eds) *Power in Global Governance*, Cambridge: Cambridge University Press. pp. 130-160.

Shirono, K. (2003) 'Are WTO tariff negotiations reciprocal ? an analysis of tariff liberalization', mimeo, Columbia University.

Simmons, B. A. and Martin, L. L. (2002) 'International Organizations and Institutions', in Carlsnaes, W., Simmons, B. and Risse, T. (eds) *Handbook of International Relations*, London, Thousand Oaks, New Delhi: Sage. pp. 192-211.

Snidal, D. (1985) 'The Limits of Hegemonic Stability Theory', *International Organization* 39, 4: 579-614.

— (1991) 'Relative Gains and the Pattern of International Cooperation', *American Political Science Review* 85, 3: 701-726.

— (1997) 'International Political Economy Approaches to International Institutions', in Bhandari, J.S. and Sykes, A.O. (eds) *Economic Dimensions in International Law: Comparative and Empirical Perspectives*, Cambridge: Cambridge University Press. pp. 477-512.

— (2002) 'Rational Choice and International Relations', in Carlsnaes, W., Simmons, B. and Risse, T. (eds) *Handbook of International Relations*, London, Thousand Oaks, New Delhi: Sage. pp. 73-94.

Snyder, J. M. Jr (1990) 'Campaign Contributions as Investments: The US House of Representatives, 1980-86', *Journal of Political Economy* 98: 1195-1227.

Staiger, R. W. (2004) 'Report on the international trade regime for the international task force on global public goods', available at http://www.gpgtaskforce.org/uploads/files/200.pdf. Accessed 22/02/2007.

— (2006) 'Review of Behind the Scenes at the WTO: the Real World of International Trade Negotiations: Lessons of Cancun', *Journal of Economic Literature* XLIV: 428-442.

Staiger, R. W. and Tabellini, G. (1987) 'Discretionary Trade Policy and Excessive Protection' *American Economic Review* 77, 5: 823-837.

— (1989) 'Rules and Discretion in Trade Policy', *European Economic Review* 33: 1265-77.

— (1999) 'Do GATT Rules Help Governments Make Domestic Commitments?', *Economics and Politics* 11, 2: 109-144.

Stein, A. (1983) 'Coordination and Collaboration Regimes in an Anarchic World', in Krasner, S.D. (ed) *International Regimes*, Ithaca and London: Cornell University Press. pp. 115-140.

Steinberg, R. H. (2002) 'Consensus-Based Bargaining and Outcomes in the GATT/WTO', *International Organization* 56, 2: 339-374.

Strange, S. (1982) 'Cave! Hic Dragones: A Critique of Regime Analysis', *International Organization 36,* 2: 479-496.

Sykes, A. O. (1999) 'International Trade', in Bouckaert, B. and de Geest, G. (eds) *Encyclopedia of Law and Economics,* Ghent: Edward Elgar, University of Ghent, Chapter 5910, pp. 1114-32.

Tarullo, D. (2002) 'Book Review: The EU and the WTO: Legal and Constitutional Issues', *Journal of International Economic Law* 5, 4: 941-943.

Thorn, G. (1970) 'Développement économique et obstacles au commerce international au XIX siècle', in *Revue de l'Institut de Sociologie* N° 3: 497-517, Université de Bruxelles.

Tornell, A. (1991) 'Time Inconsistency of Protectionists Programs', *Quarterly Journal of Economics*, 106, August: 963-74.

Torrens, R. (1844) *The budget: on commercial policy and colonial policy*, London: Smith, Elder.

Tosini, S. C. and Tower, E. (1987) 'The Textile Bill of 1985: The Determinants of Congressional Voting Patterns', *Public Choice* 54, 1: 19-25.

Trefler, D. (1993) 'Trade Liberalization and The Theory of Endogenous Protection: An Econometric Study of US Import Policy', *Journal of Political Economy* 101: 138-60.

Tumlir, J. (1985) 'Conception of the International Economic and Legal Order', *World Economy* 8: 85-87.

United Nations (1970) *Statistical Yearbook 1969*, New York: United Nations.

Wallerstein, I. (1974) *The Modern World-System: Capitalist Agriculture and the Origins of the European World-Economy in the Sixteenth Century,* New York, NY: Academic Press.

Waltz, K. (1954) *Man, State, and War: A Theoretical Analysis*, New York, NY: Columbia University Press.

Wendt, A. (1999) *Social Theory of International Politics,* Cambridge: Cambridge University Press.

Whalley, J. (1985) *Trade liberalization among major trading areas*, Cambridge: MIT Press.

Williams, J. (1947) 'Economic lessons of two world wars', *Foreign Affairs*, October.

Wolfe, R. (2006) 'New Groups in the WTO Agricultural Trade Negotiations: Power, Learning and Institutional Design', *CATPRN Commissoned Paper* CP 2006-2.

Woodruff, W. (1971) 'The emergence of an international economy 1700-1914', in Cipolla (ed) *The Fontana Economic History of Europe* 4: 662.

Young, O. R. (1999) *Governance in World Affairs*, Ithaca and London: Cornell University Press.

C THE DESIGN OF INTERNATIONAL TRADE AGREEMENTS

In Section B we discussed a range of reasons why nations may share an interest in cooperating with one another in trade matters. In this section we extend the analysis to examine fundamental issues of treaty design, focusing on two main questions. First, what are the core rules that any good trade agreement must contain so as to reap the envisaged benefits from cooperation? Second, how does the creation of a formal organization (or institution) ensure the effectiveness of rules and foster the objectives of an agreement?

The Section begins (Section 1) by asking why institutions[1] may be needed along with the rules that make up an agreement. We then go on to examine what specific rules trade agreements must have to realize the benefits of cooperation. Among the principal rules discussed here are those on reciprocal liberalization (Section 2), the preservation of gains from market access commitments (Section 3), contingency protection (Section 4), enforcement (Section 5), and transparency (Section 6). International trade agreements typically include more rules than these, but we have selected those we consider to be among the most important. Relevant provisions in GATT 1994, the WTO Agreement and regional trade agreements will be used to illustrate the expression of these rules.

1. THE ROLE OF INSTITUTIONS

Signatories to trade agreements typically confer some authority on an independent agent in the belief that a neutral or internationalized body is more effective in governing trading relations than the signatories themselves. In what follows, we shall attempt to link institutional necessity back to the earlier discussion of the various rationales for trade agreements. We start with a discussion of how well theories of trade agreements and theories of institutions match. Economists focusing on the purpose of trade agreements have typically assumed away the very reasons why institutions are needed. We need to reconcile the established (politico-economic) models of trade cooperation with explanations for the existence of institutions. These models can be enhanced so as to identify a range of functions for an independent institution administering trade affairs, such as a repository of knowledge, an archivist, a provider of research and trade assistance, an information gatherer and disseminator, a negotiation forum, a mediator, a facilitator, a monitor, a surveillance agent and an adjudicator.

Moreover, from an international relations (IR) perspective formal institutions may be more than just a site for international cooperation or passive facilitators of trade. As active and independent agents in the international system, institutions can also shape expectations and thereby influence the behaviour of parties. They can help to establish the basis for orderly and constructive trade negotiations and actively manage cooperation. Multilateral institutions can also foster peaceful relations among countries, thereby creating the general conditions for profitable exchange through trade.

(a) Matching theories of trade agreements with theories of institutions

Until relatively recently, economics paid little attention to international rules and institutions for the conduct of trade policy.[2] But starting in the 1990s, different strands of trade agreement literature have gone beyond a narrowly-drawn analysis of incentives driving trade policy preferences, and have focused more on issues such as the rationale for trade agreements, substantive obligations, and enforcement mechanisms. So far, however, attempts to integrate work in these various areas have been limited. Models that focus on the rationale for trade agreements are typically "institution-free" – that is, they have little to say about the role of an independent third party in trade agreements. Models focusing on the need for formal trade institutions, on the other hand, oftentimes fail to establish an explicit and systematic link

[1] The term "institution" is understood here to refer to a formal institutional body. Note that international relations scholars and international lawyers sometimes use the term differently. There, an "institution" may denote a regime, a political system or a legal provision.

[2] See Staiger (1995).

back to the rationale of an agreement underlying the institutional model. In this subsection and the next we will show how theories of trade agreements and theories of trade institutions can be reconciled, and will review the relevant literature.

Reconciling analytical approaches to the rationale for trade agreements and for trade institutions is not an easy task, largely because theories on trade agreements assume away the very reasons for having an institution.[3] Most formal models of trade cooperation rest on a set of simplifying assumptions. Box 4 summarises these assumptions.

Box 4: Commonly utilized assumptions in externality-models of trade cooperation

Formal models of trade cooperation (at least in their simplest form) maintain the following set of simplifying assumptions:[4]

Assumption (i) – Game set-up:
The "trade game" is modelled as an infinitely repeated prisoners' dilemma between equally powerful (symmetrical) actors.[5]

Assumption (ii) – Maximum mutual deterrence:
Cooperation is sustained by the "shadow of the grim trigger". Parties mutually threaten to punish any kind of defection by ceasing cooperation indefinitely and returning to non-cooperation (protectionism).

Assumption (iii) – Unchanging circumstances ("stationarity" of the environment):
External circumstances are assumed to remain unaltered throughout the course of the agreement. The models are non-dynamic in their approach to trade; changes in environmental conditions, such as technological innovations, demand or supply shocks, or special interest group pressure are not expected to occur.

Assumption (iv) – Symmetrical information:
All players (trade-policy decision-makers) have the same information at the outset of the negotiations as well as at any point in time during the game. Information about the environment, trade-related policies and Members' intentions ("types") are immediately known by all parties.

Assumption (v) – Rationality:
All "players" (i.e. negotiators) possess complete rationality and sophistication. They are fully forward-looking, self-interested utility maximizers.[6]

Assumption (vi) – No transaction costs:
Negotiations, trade flows, and disputes are cost-free and frictionless.[7]

---

[3] Economic theories have made assumptions that minimize the role for trade institutions since their goal was to highlight the logic of agreements. This was made for analytic convenience rather than motivated by the firm belief that institutions do not matter.

[4] Note that these assumptions do not underlie any motive for trade cooperation, but only externality-based rationales for trade, as reviewed in Section B, subsections 2.(a) and (b) (see footnote above).

[5] Bagwell and Staiger (2002: 40) note an overwhelming consensus in the literature that "trade agreements may be formally analyzed using a theory of repeated games". This undoubtedly applies in the terms-of-trade and political externalities schools of thought, which rely on the prisoner's dilemma as the key rationale for cooperating (see e.g. Bagwell and Staiger,1999a, 2002; and Ethier, 2004, 2006).

[6] This assumption does not suggest that all economic actors are perfectly rational. The political-externality approach to trade agreements, for example, sometimes rests on the assumption that domestic importers are "bounded rational" and give more weight to the direct effects of trade policy (see Ethier 2004).

[7] Transaction costs are real-life costs of interaction between actors (here: trade negotiators). Strictly speaking, the presence of transaction costs is not an additional assumption, but rather a consequence of the combination of unlimited rationality and stationarity of the environment. Nothing is lost, however, in treating transaction costs as an independent assumption.

Under these commonly utilized assumptions listed in Box 4, the simple models reviewed in Section B cannot justify the existence of an institution.[8] Take the example of the terms-of-trade approach to trade agreements, as elaborated in Section B.2.(a), which models multilateral agreements as infinitely repeated prisoners' dilemma games between equally powerful (symmetrical) actors. Reciprocal tariff cuts are enforced through the mutual threat of responding to any contractual defection with an immediate and complete withdrawal of cooperation. This is the so-called "grim trigger" response to deviation.[9] This model setup, although beneficial in highlighting the rationale for trade cooperation (overcoming an opportunistic externality problem), brings with it three important consequences.

First, an international trade agreement is viewed as what can be called a "fully efficient contract". It is a perfect contract that exhausts all possible gains from trade and therefore never needs to be altered, revised, amended, or renegotiated.[10] The agreement represents a stable negotiation equilibrium that never needs to be renegotiated.

Second, given that the original agreement is both perfect and stable, neither deviations nor applied sanctions ever occur. This is so because under grim-trigger enforcement, rational parties would defect only if their "hit-and-run" advantage (the opportunistic gains achieved from a one-time defection at the expense of other parties) is larger than the sum of all future pay-offs from eternal cooperation. Hence, owing to the "shadow of the grim trigger", once the agreement is concluded deviation from the original terms of the agreement is not rational – and therefore never occurs. In other words, there is no room for disagreement and trade disputes. Consequently, neither the parties nor an independent institution have to be concerned with them.[11]

Third, trade cooperation emerges as an "endogenous negotiation equilibrium". The contract is a tacit agreement (Dixit 1987) that is concluded and maintained without the outside help of any third party. Welfare-maximizing cooperation emerges spontaneously. As a result, there is no room for an institution. A secretariat or a directorate would involve costs and yield no benefits. In their most basic form, therefore, economic theories disregard imperfections that may occur during the contracting phase (i.e. before the contract is signed) and during the performance phase of a trade agreement.[12] But the superfluity of institutions within this framework is belied by the fact that formal institutions do exist.

From an economic standpoint, an institution is viewed as an equilibrium outcome of a game of strategic interaction (North, 1990). This means that the presence of an institution should not be assumed, but must be an outcome of a model of interaction. An institution is therefore part of multiple possible bargaining outcomes – or equilibria, and is chosen because it provides contracting parties with distinct benefits that could not have been reaped otherwise (Calvert, 1995; Schotter, 1981). In other words, given that institutions are costly to establish and sustain, their existence must yield a higher level of welfare to the signatories than the *status quo*.

Models of institutions take into consideration imperfections that the establishment of a formal organization can overcome, or at least mitigate. Matching theories of trade agreements with theories

8 It should be pointed out that not all of the above assumptions (i)-(vi) are required concurrently or additively to reach this conclusion. Some formal models have been developed in which players use a punishment strategy different from the maximal grim-trigger strategy, face changing circumstances, or have private information. Papers of this kind then assume that actors are able to coordinate sufficiently on an equilibrium outcome without using the outside help of institutions.

9 Enforcement of trade agreements is discussed in Section C.5 below.

10 A fully efficient contract is also known as a "complete", or "Pareto-optimal complete contingent" contract in the literature. A contract of this sort provides a complete description of every possible state of nature, and prescribes in detail all rights and obligations of each contracting party, including the set of policy instruments that parties may or may not use. The fully efficient contract thereby exhausts all possible gains from trade – it is the first-best contract between trade partners (see Shavell 1980).

11 If trade disputes do in fact occur, they are equivalent to the breakdown of the system.

12 To be sure, the terms-of-trade argument has been formally extended beyond the simple version introduced in Section B. It is the only approach that formally links the discussion of the purpose of trade agreements with a discussion of the rules and obligations of trade agreements. But this "workhorse" model of trade agreements has not yet been formally extended so as to motivate formal institutions.

of trade institutions requires a systematic and structured approach. While staying within the confines of the externality-driven rationale for trade agreements, we will now consider how this framework can be modified successfully in order to explain the need for institutions. Although this attempt at fusion is a far cry from moulding a unified whole, it seems a useful first step in linking institutions back to the rationale for trade cooperation.

(b) Expanding the traditional models of trade cooperation: the economics of institutions in trade agreements based on externalities

Trade institutions can contribute to facilitating negotiations, enhancing transparency and settling trade disputes.

(i) The presence of transaction costs: the institution as negotiation forum, information disseminator, and trade facilitator

"Transaction costs" is used as a general term here for all those real-life costs that states must incur when they cooperate internationally in trade matters.[13] Such costs include sorting and searching costs, information gathering costs, bargaining costs, as well as litigation, enforcement and policing costs. By assuming the function of a negotiation and dispute forum, an information disseminator, and trade facilitator, an institution reduces transaction costs.

The institution as a forum for negotiations and disputes

During ongoing trade rounds, or during negotiations with accession candidates, transaction costs may be substantial. Costs include the collection of trade data and institutional information about (potential) trade partners, meeting and bargaining with the parties involved until consensus is reached, assessing vantage points and shaping compromise. A central negotiation forum where parties can convene, exchange information, negotiate and take decisions is economical and efficiency-enhancing.

In the same vein, institutions can help to reduce transaction costs connected to trade disputes and litigations. Since trade disputes (renegotiation after unilateral defection) are a costly endeavour, Ludema (2001), for example, argues the case for a single body. Instead of having to renegotiate/litigate bilaterally in multiple fora and according to different procedures (so-called "forum shopping"), it is rational to deal with disputes in a centralized fashion.

The institution as information repository

Once transaction costs are taken into consideration, a second role for an independent trade institution emerges. Consistent with a strand of international relations literature called "neoliberal institutionalism" (usually associated with the works of Keohane, 1984, and Oye, 1986 – see Section B.4 above), there is a strong case to be made for the informational role of the institution. By acting as an "institutional memory" – storing, archiving, retrieving, editing, processing and publishing crucial information – the institution reduces transaction costs and increases transparency.[14] This vital information may be too costly for every country to generate and process alone. Even if that were not the case, and Members could individually extract the same data, unnecessary duplication would occur. Thus the organization helps its signatories save costs by providing accurate and timely information. Over and above the support of ongoing trade negotiations and disputes between sovereign states, the organization can also provide non-signatories with information.

---

[13] Early work on transaction costs dates back to Coase (1937) and Williamson (1979; 1975).

[14] Institutions collect and make available information on Members, sectors, multilateral processes and rules, current negotiations and ongoing litigation. Thus, in addition to activities such as translation and duplication, the organization routinely provides background data and summarizes negotiating positions in order to provide a basis for further negotiations.

The institution as trade facilitator

"Opening the books" to non-state agents not only satisfies the claims of the private sector to remain informed about the activities of governments. In addition, providing information to economic actors can reduce transaction costs of international trade through technical assistance. By explaining the intricacies and implications of the trade agreement to various stakeholders in signatory countries (customs officers, importers, exporters, consumers, chambers of commerce, industry associations, etc.), the organization can effectively function as a trade facilitator. Information and analysis may be transmitted, for example, through publication on the internet, public symposia, and seminars. In cutting the transaction costs of international trade in this manner, the institution will be contributing to human capital formation and may also be promoting trade by reducing the prices of goods and services.

(ii) Questioning the "grim trigger" assumption of enforcement: the institution as honest broker and conciliator

Many formal models of trade cooperation assume that enforcement against contractual misdemeanour involves the maximum possible punishment – that is, the grim trigger strategy of enforcement.[15] Some authors have questioned whether one-time defection really leads to a complete breakdown of the system, thus challenging assumption (ii) above. The argument is that a victim's threat to cease cooperation forever is not credible. The grim trigger strategy is too costly to apply and uphold. By returning to protectionism, the punishing victim foregoes sizeable gains from international trade. Hence, the victim country has an incentive to return to the negotiation table in order to access the benefits of future cooperation (Downs and Rocke, 1995; Klimenko et al., 2002; Furusawa, 1999). With this knowledge, parties may have an incentive to deviate from the terms of the original agreement, hoping that such behaviour does not trigger a trade war.

In order to forestall this kind of opportunistic behaviour and the detrimental dynamics it may entail,[16] a neutral "external legal institution" may be empowered to act as a conciliator or "honest broker" (Thompson and Snidal 2005), whenever a defection from the terms of the initial agreement occurs. Klimenko et al. (2002) show that this neutral body must be vested with the authority to rule and that parties must not be able to exert undue influence on its verdict.[17] Importantly, dispute resolution will occur with a delay, implying time costs (lost cooperation) that parties cannot control. While the dispute settlement body has no actual enforcement power over countries, its ability to delay judgement and to impose (*ex ante* unknown) costs on both parties can serve as a credible punishment.[18] The institution as conciliator forces parties to make a trade-off between undisturbed beneficial cooperation and costly

---

15 A few formal models may count as exceptions here: Ethier (2001); Rosendorff (2005); Rosendorff and Milner (2001); Herzing (2004); and Bagwell and Staiger (2005a). Some models assume the possibility of escape clauses, i.e. contingency rules where one-time deviation for exceptional reasons is tolerated (see subsection 4 below on contingency).

16 Note that if the grim trigger response is a non-credible threat, the dominant strategy for all countries may be to (partially) defect from the initial agreement. This can prevent the contract from being concluded in the first place.

17 To be sure, dispute settlement need not necessarily be carried out by a formal dispute settlement institution. Other signatories to the agreement who are not involved in the dispute could take over this task – given they are independent and neutral. However, in a repeated-game setting with a limited number of actors, neutrality can be assumed to wane over time.

18 In this model, absent a neutral body, countries would not resolve the dispute among themselves, as they would always renegotiate disciplines to restore cooperation more quickly. In the words of the authors, "external enforcement is valuable precisely because the countries are unable to manipulate the parameters of the enforcement process". (Klimenko et al., 2002: 4). Countries would always be back at square one. The authors reject approaches that explicitly link renegotiation outcomes to the history of policy choices. They cast doubt on the assumption of reduced bargaining power of the defecting country, or the existence of smaller sets of possible agreements following defections (as assumed, for instance, by Ludema, 2001). They contend that bargaining power is history-invariant and that only independent dispute settlement will help countries condition their agreements and future policies on past actions.

trade disputes. Hence, the mere presence of a neutral dispute settlement agent provides parties with an a priori incentive to honour commitments.[19]

Robert Keohane (1984) also questions the relevance of the grim-trigger punishment scenario in repeated games. The longer successful trade carries on, the expectations of signatories will converge. Reciprocity (characterized by contingency protection and equivalence in retaliation) can effectively replace grim trigger responses when players trust each other. A neutral dispute settlement institution can help to achieve and maintain that trust in the system.

(iii) The presence of asymmetric information: the institution as information disseminator and monitor

The presence of private (asymmetric) information is another factor that provides a role for an independent trade organization. In this case, the institution acts as a provider of information and an agent for surveillance. Sometimes, countries depart from their commitments on account of "special circumstances" envisaged in an agreement (Articles XIX, XX or XXI of the GATT may count as examples in relation to trade contingency). However, in contrast to the assumption of symmetrical information maintained in traditional trade cooperation models (see Assumption (iv) above), parties are often asymmetrically informed about whether or not these special circumstances have really occurred and to what extent they would justify a temporary departure from obligations.

Opportunistic behaviour may occur if the party concerned stands a chance of not being discovered (Copeland, 1990). This party is better informed than those affected by the action, for whom it is difficult or impossible to assess conclusively whether or not the alleged event (e.g. a balance-of-payment crisis) has occurred and if so, whether it is covered as a valid exception in the agreement. Private information about contingency conditions may lead to strategic misrepresentation and consequently to disputes which can spiral out of control if countries retaliate and counter-retaliate.

In the presence of asymmetric information, and the subsequent danger of strategic misrepresentation of reality by the better informed party, a neutral dispute settlement body can inject additional transparency into the system by acting as a disseminator of information. Once aware of being affected by a contract infringement, parties can proceed to self-enforce their claims. Thus, the institution facilitates the enforcement of negotiated agreements through providing parties with relevant information.[20]

Closely connected to the role of an institution as information disseminator is that of a monitor of trade affairs. Potential injurers, aware of being monitored by a "trade watchdog", are less likely to deviate. The institution can deter defections against agreed-upon rules of trade, thereby contributing to an environment of stability in international trade. By effectively discouraging defections, institutions are apt

---

19 The value of a lengthy (and therefore costly) adjudication process in trade disputes is also derived by Ethier (2001) and Reinhardt (2000) – albeit for different reasons. Both authors see the institution as a "tool" rather than an agent. Ethier assumes that parties are able to punish a defection instantaneously, but choose to delay instead. Lengthy procedures provide for an unsanctioned breather (temporary escape) during which an injurer can de facto violate the agreement without punishment. Reinhardt sees the DSU as a mechanism to maintain bilateral uncertainty over the actual enforcement power of the institution. Due to this uncertainty, lengthy adjudication procedures (high transaction costs) increase the chances that international conflicts end cooperatively in a mutually agreed settlement. A speedy ruling is counterproductive, since the lack of uncertainty over the ruling motivates parties to settle early according to present power relationships. By contrast, Ludema (2001) and Kovenock and Thursby (1992) argue that lengthy procedures are a disadvantage of dispute settlement.

20 See Maggi (1999), Kovenock and Thursby (1992), Hungerford (1991), Ozden (2001), Bütler and Hauser (2002), and Bagwell and Staiger (2002, Chapter 6) for an elaboration of the information gathering and transmission role of an institution in trade disputes. In the field of institutional economics, the role of institutions as information providers to uninformed parties has long been recognized and documented. The literature on law merchants, for example, explains a system of neutral intermediaries within merchant guilds in medieval Italy. Law merchants acted as information repositories for traders (notably on each other's credentials) who had never interacted before. They thus supported cooperation through facilitating the use of a bilateral reputation mechanisms and multilateral enforcement (e.g. Milgrom et al., 1990, Greif et al., 1994).

to facilitate liberalization negotiations and to reduce power asymmetries among parties (Bagwell and Staiger, 2002: 39).

(iv) Trade agreements as incomplete contracts: the institution as active information gatherer, adjudicator, arbitrator, and gate-keeper of the rules of the game

It has been repeatedly pointed out that trade agreements are incomplete contracts.[21] If the assumption of an unchanging environment (and hence complete certainty about future events) is relaxed (Assumption (iii) in the last subsection), uncertainty over future contingencies will then reflect incompleteness of the contract. Based on a methodology developed by Battigalli and Maggi (2002), Horn et al. (2005, 2006) show that in a dynamic, non-stationary world it is both rational and efficient for contracting parties to deliberately leave contractual gaps in a trade agreement and to refrain from writing a fully contingent contract. In this way, governments accept uncertainty over future conditions in the world and possible policy responses that may prove desirable.[22]

Textual ambiguities, for instance, may then lead to inefficiencies, misunderstandings, disputes and, possibly, the need to re-negotiate. Whereas under subsection (iii) above the institution functions as an information broker that balances informational asymmetries in the system, the case is different here. Whenever the contract is incomplete, an independent institution may be called upon to actively gather information (not just to distribute it). In addition, since not all relevant situations have been foreseen, an independent adjudicator may have to interpret the contract (unless or until a new negotiated solution is reached) in a manner that supposedly corresponds to how the contracting parties would have wanted it, had they anticipated the situation. When contract incompleteness is coupled with private revelation of information,[23] the institution may also function as an arbitrator and calculator of damages. If uncertainty over the future is allowed by relaxing the assumption of perfect rationality of trade negotiators, yet another function of the institution emerges, namely that of a gate-keeper of the rules of the game.

The need for an information gatherer

Whereas in subsections (i) and (iii) above the role of an institution as an information repository and disseminator was considered, a neutral body can also act as an active information gatherer if the assumption of an unchanging environment (and hence complete certainty about future events) is relaxed. Consider the example of dispute settlement. Hungerford (1991) models uncertainty over future events as random import demand impacts (exogenous shocks). Asymmetrical information emerges in the form of non-observable non-tariff barriers (NTBs). In a contracting environment, where exogenous shocks disrupt trade flows, but where each party has an incentive to defect by secretly enacting NTBs, the institution as an independent dispute settlement body can support members by extracting information about the true nature of an observed outcome. It can find out whether an external shock has indeed occurred (in response to which the NTB may be legitimately taken) or whether the Member in question has instead enacted a prohibited NTB.[24] That way, the information gatherer helps to limit undesirable (and unfair)

[21] See Dunoff and Trachtman (1999), Downs and Rocke (1995), Rosendorff and Milner (2001), Ethier (2001), Rosendorff (2005), Hauser and Roitinger (2004), Horn et al. (2006).

[22] According to the authors, trade agreements can be called "rationally incomplete contracts". The transaction costs involved in researching, writing and bargaining over treaty obligations and permitted policy instruments under the full range of possible environmental conditions simply make contractual completeness impractical. The costs involved outweigh the potential gains from trade. This is typically the case with complex contracts that feature a large number of low-probability contingencies, as well as a great variety of possible responses to such events. The major contribution of Horn et al. (2005, 2006) is that the authors endogenously derive contractual uncertainty over future events – and consequently the incompleteness of the contract – without having to give up the assumption of rationality. Even rational parties find it too difficult to anticipate, evaluate and write down every possible detail that the future may bring.

[23] Uncertainty over future contingencies is often coupled with private information. In reality, previously unforeseen contingencies are privately revealed to some parties (this is tantamount to dropping Assumption (iv) above).

[24] Kovenock and Thursby (1992: 167) ascribe a similar role to independent dispute settlement as a "device that distinguish[es] between true deviations ... and mistaken perceptions ... that such a deviation has occurred". However, like Hungerford (1991) the authors do not specify how a neutral body manages to extract such information and why it would do a better job than the affected parties themselves.

punishments by providing crucial evidence to those affected by a measure. This prevents the system from spiralling into a retaliatory trade war and secures higher initial liberalization commitments.[25]

The need for an arbitrator and calculator of damage awards

In case of uncertainty and asymmetric information, an institution may fulfil yet another role. Unforeseen events may prompt a signatory to adapt to the new context by enacting an appropriate domestic policy (say, a health measure or a tariff increase). This – legitimate or illegitimate – trade-related policy causes adverse effects on affected parties. If the latter were always able to observe the occurrence of the conditions that have led one party to defect and to monitor the effects of the measure it has taken in response, they could in principle agree *ex ante* on commensurate (tit-for-tat) punishments (Sykes, 1991; Ethier, 2001). If this simple rule of punishment were followed, the implementation of such a temporary escape measure would not necessarily require the presence of an independent dispute settlement body (Downs and Rocke, 1995; Rosendorff and Milner, 2001).[26] Yet several authors ascribe a role for the institution even if all parties possess the same knowledge about unforeseen events, arguing that since the ultimate punishment can only be determined *ex post,* the involvement of a neutral entity is required.[27]

In effect, it is likely that the damage caused by trade-related policies of partner countries cannot be assessed unambiguously. Some authors contend that the size of trade damages suffered is often private information to the victim(s). Both the conditions leading to temporary defection and the resulting damages cannot be observed by all parties alike (Herzing, 2004; Bagwell and Staiger, 2005a). Parties affected by a measure are likely to overstate the damage caused. Dissent will follow from a mismatch between the damage claimed and the compensation offered. In the presence of asymmetric information and the incentive to misrepresent the true state of affairs, a neutral body is needed to arbitrate between the disputing parties and to calculate the true damages suffered as the result of a measure (Sykes, 2000; Schwartz and Sykes, 2002; Rosendorff 2005).[28]

The need for an adjudicator

When negotiating the design of dispute settlement, negotiators are aware that they cannot foresee all future contingencies. They therefore create provisions that allow them to respond adequately to previously unforeseen circumstances. Two problems remain, however. First, as discussed above, safety valve provisions allowing parties to respond to unforeseen circumstances are often difficult to operationalize. In many instances it is not clear whether a contingency has occurred, whether the event falls under the ambit of an escape clause or whether specific policy measures taken violate the terms of the agreement. Second, in addition to these "efficiency gaps" created by contractual fallback rules, treaties may contain inadvertent gaps (Mavroidis, 2007; Ethier, 2001; Lawrence, 2003; MacLeod, 2006). Parties make errors when negotiating complicated contracts: They omit crucial details, write down contradictory clauses or neglect the dynamic effects of their regulations. In addition, contracting parties may agree on terms that are subject to interpretation, such as "appropriate countermeasures", "serious injury", "material damage", "unforeseen developments", "like products" or "best efforts".

---

[25] Parties would likely be willing to make more far-reaching trade liberalization commitments if they do not risk to punishment for adapting to external shocks. Equally, potential victims are more likely to make greater commitments if a neutral body deters other parties from defecting at their expense.

[26] In other words, an unconditional escape clause emerges endogenously at the outset of the negotiations of a trade agreement. Both the possibility to react flexibly to political and economic shocks, and the voluntary payment of commensurate compensation for damages incurred emerge as a negotiation outcome.

[27] Ethier (2001) specifies lengthy dispute settlement procedures. Rosendorff requires a sufficient level of uncertainty as to the direction of the ruling in order to ensure certain costs are incurred from using an escape clause. Arguably, this requirement is necessitated more by mathematical constraints than economic intuition (Rosendorff, 2005: 398).

[28] Interestingly, Kaplow and Shavell (1996) find that an independent arbitrator need not be omniscient or operate flawlessly. As long as its judgement is not systemically biased, the organization's verdict will be acceptable to parties (see also Rosendorff, 2005). Most models do not make the distinction between the bilateral enforcement remedy of (voluntary) compensation and multilaterally endorsed retaliation. For a notable exception see Bown (2002).

Some may argue that whenever parties leave contractual gaps (including when they use ambiguous language) they cease to be "rational" (as assumed in theoretical models of trade agreements – Assumption (v) above). Seen from this perspective, an independent body may always be required to adjudicate, where possible, or else parties may have to renegotiate. However, Tirole (1994) warns against giving up the assumption of rationality in the absence of a theory of "bounded rationality". The author contends that any theory of bounded rationality and human error should be able to specify when errors occur, why they occur and what the consequences are. He rejects an "errors happen" approach as arbitrary and unscientific.[29] Horn et al. (2005, 2006) derive the role for institutions adjudicators even without giving up the central tenet of rationality. Thus, as in the previous two subsections, under the assumptions of uncertainty and asymmetrical information, contracting parties are conscious of their incapacity to write a complete and flawless contract. Signatories know that the contract cannot be enforced as written, since its text does not fully correspond with what they actually want. The contracting parties are also aware of the fact that private information may provoke strategic misrepresentation of the truth, and consequently opportunistic behaviour.

The presence of uncertainty and private information creates the potential for conflicts that can be dealt with in two ways. Either parties agree to disagree about the true state of the world and its applicability to the contract. The victim party (which may or may not be a "true" victim) may decide to take unilateral measures of reprisal, usually referred to as "vigilante justice" or self-help mechanisms. If the targeted party is convinced that its original measures were in line with the initial agreement and therefore feels wrongly accused and punished, this party may counter-retaliate. The dispute may set off a downward spiral of mutual reprisal and end in a trade war situation (Schwartz and Sykes, 2002). Alternatively, rational contracting parties (if they do not renegotiate) may wish to defer the solution of conflicts regarding adherence to obligations to an independent dispute settlement body and commit to accepting its rulings. Interpretations rendered by such an institution may be accepted as precedents and general guidelines for the future.

The institution as a surveillance agent and "gate-keeper" of rules

If uncertainty over the future is allowed by relaxing the assumptions of stationarity of the environment and perfect rationality of trade negotiators, yet another role emerges for the institution, namely that of a gate-keeper of the rules of the game. In the presence of uncertainty over the future, countries can then be assumed to negotiate the details of a trade agreement "behind a veil of ignorance" (Rawls 1971).[30] The veil of ignorance will prompt contracting parties to write a trade agreement that is geared towards the common general welfare of all signatories to the agreement, since no party knows with certainty its position decades down the road (Sykes 1991, Ethier 2001). Under the influence of the veil of ignorance the trade agreement is perceived *ex ante* as fair and efficient to every participant.

Signatories will then want to confer on the institution the role of a gate-keeper of the previously agreed "rules of the game". The organization acts as a surveillance mechanism that can effectively prevent countries from diluting, disregarding and reneging on the original agreement once the "veil of ignorance" is lifted and reality is exposed to the signatories. *Ex post facto,* all parties know with certainty where they stand and what is best for them. Thus, they may experience regret over the original terms of the agreement and have an incentive to skew, bend or even change the rules of the agreement to their

[29] See also Maskin and Tirole (1999). However, law and economics scholars have frequently disregarded this advice. They have taken it as "given" (exogenous) that contracting parties regularly make errors when negotiating contracts and that an adjudicating institution exists to help them remedy any unplanned situation. With quite some success this literature seeks to assess court strategies to help parties continue their contractual relations (so-called relational contracts). Unfortunately, only a few authors so far have approached international contracts (treaties) from this perspective (Bhandari and Sykes, 1998; Dunoff and Trachtman, 1999; Posner, 1988).

[30] A veil of ignorance means that contracting parties do not know the future distribution of gains and losses from an initial agreement with certainty. Negotiations among prospective signatories to a trade agreement take place in ignorance of; (i) the identity of future acceding countries; (ii) the economic significance of a country in the distant future; (iii) the role of contracting parties in future trade disputes, and (iv) generally of how future contingencies are going to impact on signatories' political and economic well-being.

benefit. In the face of significant pressure by economically and politically influential players to renegotiate or otherwise change an agreement, it may be in the founding parties' interest to instruct the institution to ensure ongoing commitment to a previously agreed rules-based negotiating environment. By keeping an eye on fixed procedures, instruments and timelines, the institution may contribute in upholding an environment of reasonably stable and secure property rights over negotiated market access claims.

This gate-keeping role of the institution will sustain confidence in the system. On the one hand, it will stimulate and facilitate ongoing liberalization rounds. On the other, it provides parties with an institutional commitment to a rules-based negotiating environment, which further reduces transaction costs of negotiating, and may encourage weaker countries to overcome their fear of exploitation by stronger trading partners and to participate in the negotiations (see Bagwell and Staiger, 2002: 69).

(v) Summary: the economics of institutions matter

The traditional politico-economic models of trade agreements confer a fleeting role to an independent, formal trade organization. Once real-life features of world trade are taken into consideration by enhancing formal trade models based on externalities, various important functions for trade institutions emerge. They can enhance transparency, serve as negotiating fora and help settle trade disputes. Trade negotiators may therefore be inclined to confer significant responsibility and authority to a formal organization.

(c) Non-economic approaches to formal institutions

The previous subsection was concerned with exploring the economic rationality behind the establishment of a formal organization in support of a trade agreement. Efficiency considerations took centre stage in explaining the existence of a neutral party to oversee international trade affairs. The discussion mainly centred around theories supported by formal models of choice. Non-economic approaches based on an IR analytical framework can also provide important insights into the question why formal institutions (international organizations in IR parlance) matter in international trade.

(i) Relative lack of research on international organizations

International relations research on international organizations (IOs) – in terms of their rationale and functioning – is surprisingly sparse. In the early post-war years, IOs (such as the United Nations) were very much at the centre of academic attention. This early work on IOs was largely legal-descriptive (Abbott and Snidal, 1998). However, given the challenge facing IOs of remaining relevant in the Cold War, researchers gradually lost interest in studying them. The gulf between international politics and formal organizations began to open in ways that were not easy to reconcile (Simmons and Martin, 2002). Organizational design and other formal attributes could not explain what IOs really did. It was clear that IOs were not the main actors in the game of international governance (Kratochwil and Ruggie, 1986). Therefore, mainstream IR turned to the conduct of international relations – regime theory – and tended to neglect questions of organization.[31]

This move away from consideration of IOs as actors resulted in a shift of emphasis towards rules, norms and values as the central variables under study (Abbott and Snidal, 1998). Questions surrounding institutional form and structure (regime design) were overlooked (Young, 1994; Koremenos et al. 2001; Morrow, 1994). Thus issues such as why IOs matter at all and what sets them apart from alternative forms of organization – such as decentralized cooperation, alliances, treaty rules, or ad-hoc contracting and informal consultation – received relatively little attention. In the words of Abbott and Snidal (1998: 4), "surprisingly, contemporary international scholarship has no clear theoretical answers to such questions".

[31] This is of course not to say that there was no academic work done on IOs during the time of the Cold War and after. The work of Cox and Jacobson in the 1970s (e.g. Cox and Jacobson, 1973) is a good example that IOs remained the subject of some serious research throughout the post-World War II era.

The regime movement represented an effort to theorize about international governance more broadly, detached from technical questions of design and organization. During the Cold War and with the continuing decline of United States' hegemony, regime theorists sought to explain why states found incentives to collaborate. Krasner's (1983) definition of regime defined as "rules, norms, principles and procedures that focus expectations regarding international behaviour" was seen as canonical and all-encompassing, but hardly workable. Hence, scholars moved on to the study of "institutions", which sought to explain more comprehensibly just how rules of cooperation affected state behaviour. To that end, the various IR schools of thought defined "institutions" in ways that suited their own research agenda and methods (Simmons and Martin, 2002).

In terms of contemporary IR theories reviewed in Section B.3, realists and neorealists recognize that states sometimes operate through institutions, but IOs are basically seen as "arenas for acting out power relations" (Carr 1964: 189). It is the most powerful states in the system that create and shape institutions so that they can maintain their share of world power or even increase it. International organizations are tools in the hands of powerful countries and have minimal influence on state behaviour (Mearsheimer, 1994). Within this analytical framework, the study of IOs as independent actors with purpose and influence would seem rather pointless.

A more nuanced neorealist account of IOs has been proposed by theorists advocating hegemonic stability. They claim that IOs are consciously established by dominant powers during periods of hegemony. In order to signal to other nations that it will not abuse the institution opportunistically, the hegemon must grant the IO a certain degree of autonomy. The definition of "institutions" advocated by hegemonic stability theory is broad, however, and can encompass anything from the establishment of a liberal economic order to the conclusion of a treaty. Moreover, it is not entirely clear what functions an IO can assume that a hegemon itself cannot fulfil.

The school of neoliberal institutionalism gives little consideration to IOs (Simmons and Martin, 2002). Cooperation in this framework is the result of a rational contract between sovereign states. Institutions – broadly understood as "persistent and connected sets of rules … that prescribe behavioural roles, constrain activity, and shape expectations" (Keohane 1989: 3) – are solutions to problems of collective action. This approach to IOs is similar to that of neorealism, for functionalists institutions play a passive role. As for facilitating interaction, they can reduce transaction costs, improve information and raise the costs of violations. This functional understanding of institutions as sites of cooperation (not as actors) precludes any sensible operational activity for IOs that may motivate their establishment, such as monitoring, arbitrating, or information provision (Glaser, 1995). Seen from the perspective of neoliberal institutionalists, then, IOs do little more than lubricate cooperative arrangements among states.

Constructivist (or cognitivist) theory, on the other hand, grants IOs a bigger role in international cooperation. As noted in Section B.3, constructivists emphasize the primacy of social construction and the complexity of interactions. International organizations are thus seen as more than purely objects of choice. They are both a reflection of ongoing social processes and prevailing ideas and participants in the shaping of those processes and ideas. Finnemore and Sikkink (1998), for example, describe IOs as "chief socializing agents" that instil states with inter-subjective meanings in the form of common norms and values. Thus, IOs "can alter the identities and interests of states as a result of their interactions over time within the auspices of a set of rules" (Simmons and Martin, 2002: 198). Despite the active role that constructivists grant to IOs, its proponents still have trouble explaining why IOs are created by countries in the first place.

Three shortcomings are highlighted in the literature. First, Checkel (1998) contends that constructivism suffers from "monocausality" – that is, it is too much focused on describing how ideas travel from the system into states, yet lacking in explanations in regard to the mechanisms and processes of social construction and diffusion. There is no clear theory of how ideas and new norms emerge in IOs, how they become salient, and how they then connect with agents (but see Lumsdaine, 1993). Second, constructivists tend to stress the impact that IOs have on individual state behaviour without explaining

why states intentionally create IOs in the first place (Kratochwil and Ruggie, 1986). Third, constructivism also tends to overlook why IOs are special arrangements for norm diffusion and in what ways they are embedded in larger systems of norms and principles, such as the liberal international economic order of the post-war period (Ruggie, 1983).

More recent mainstream IR literature has rediscovered international organizations as a worthwhile field of study, recognizing that IOs are important agents in international life that contribute substantively to unique cooperative outcomes. Contemporary research makes a conscious effort to transcend the old rifts that have characterized IR theory in the past. Striving for a synthesis of rationalist (including neorealist) and constructivist thinking, recent approaches argue that states consciously use IOs to reduce transaction costs, enhance efficiency, prepare the ground for cooperation, and monitor both the rules of the game and state actors. International organizations also create ideas, norms, and expectations, so as to deepen and fortify the aims pursued by the initial arrangement. This basket of roles and functions that IOs assume, is called "regime management" (Abbott and Snidal, 1998, Thompson and Snidal, 2005), and clearly overlaps in significant respects with politico-economic analyses of the kind described above.

(ii) The role of international trade organizations: regime management

The analytical starting point for examining any cooperative effort is the assumption that the nature of the contract is complex and a potential source of conflict. Despite sharing a common vision of why it is in the interest of all signatories to conclude a contract, negotiating parties often have heterogeneous preferences. Different countries cooperate for different reasons. Trade cooperation, in particular, is a "mixed motive game" (cf. Section B.5 above). But even when states share the same motivations, discussion over the distribution of gains is likely to arise. As a result, although every party knows that it is generally better off cooperating, various details of cooperation are subject to disagreement. This gives rise to potential conflicts and incentives to defect temporarily from the agreement.

There is also oftentimes considerable uncertainty regarding the future, contracts are necessarily incomplete and transaction costs are inevitable (see subsection 1.(b) above). In order to deal with these contractual challenges in an expeditious way, states establish international trade organizations. The main task of the organization is to manage the international trade regime so as to enhance the efficiency and legitimacy of collective actions.[32] Regime management can be broken down into various functions.

Brokering cooperation among heterogeneous partners

Thompson and Snidal (2005) contend that an important task of IOs is to "manage and stabilize the equilibrium path". The central insight is that in a complex contract heterogeneous preferences of signatories will inevitably lead to disagreement over distributional issues. And although parties know that cooperation is generally welfare-improving, they fail to settle for a specific outcome. Disagreement is likely to increase with the number of parties and issues under negotiation, and with the complexity of the contract. In order to avoid endless bargaining, or even a deadlock in negotiations, signatories delegate authority to an impartial organization that selects one welfare-improving outcome (Fearon, 1998). This coordination equilibrium is an outcome in the collective interest and mutually acceptable to every party. Box 5 provides a more technical elaboration of an institution's role in attaining the equilibrium path.

A precondition for this contribution from an IO is that it possesses a certain degree of autonomy. The IO must be considered neutral and impartial, and capable of credibly representing the collective interest of the parties (Thomspon and Snidal, 2005: 12). When brokering among heterogeneous preferences, IOs will often use strategies, such as issue linkage, agenda setting, pooling, information gathering and distribution, and incessant communication support by their specialized and experienced staff.

[32] Note that organizational form and the assigned functions of individual trade regimes may vary with the nature, identity, and level of ambition of the cooperating parties.

Trade agreements are usually "member-driven", which means that important decisions are taken by the parties as a whole. In the case of the WTO, Thompson and Snidal (2005: 20) note: "As an organization, the WTO is dominated by its member states and has only a weak bureaucracy with little agenda setting power and resources."

Manage substantive operations over time

Although the basic bargains in trade cooperation are forged by the states themselves, it is the detailed operations of the regime that give effect to them in specific circumstances. The IO is often authorized to take responsibility for the functioning of inter-governmental agreements.[33] Thus, more than brokering negotiation breakthroughs, IOs fulfil their role of regime management in a quiet, steady way. Regime management often means the implementation and operation of the cooperative equilibrium created by an agreement over time.[34] The IO is an important gate-keeper of the rules and has some control over the "path dependency" of the agreement (Thomson and Snidal, 2005: 14). The IO's actions reflect an attempt to interpret the collective cooperation equilibrium. This in turn provides vital information to parties regarding how they are expected to conform to the cooperation equilibrium – it creates and maintains shared expectations. Therefore, the IO's rule management feeds back into how parties behave and interact.

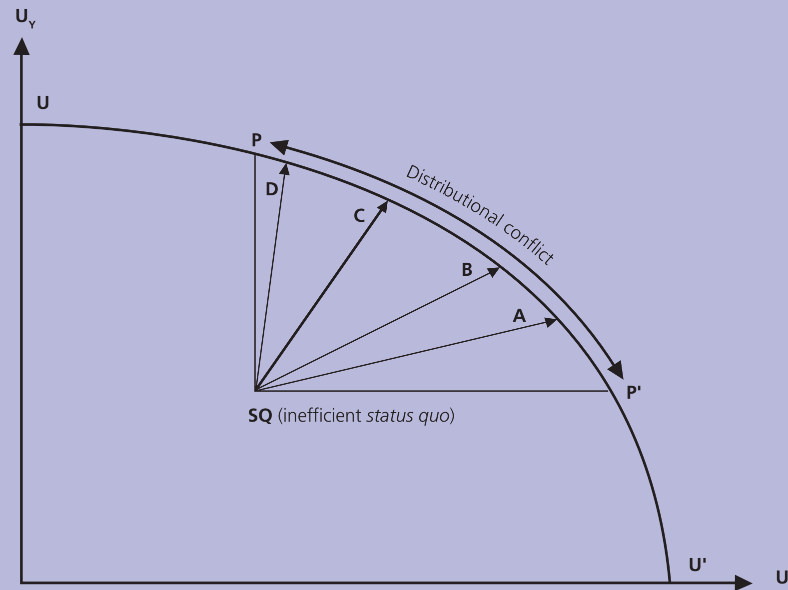
Box 5: The role of IOs in attaining the equilibrium path

In order to illustrate how IOs can help negotiating parties attain the equilibrium path in a cooperative setting, consider the following Chart. There, the utility of two countries (*X* and *Y*) is plotted on the axes (U_x and U_y). Both countries recognize that the non-cooperative *status quo* (point *SQ*) is inefficient, and that they can improve on their welfare by cooperating. Suppose the parties understand the details of the contract possibility curve *UU'* (the locus of all efficient contracts). Every point on the *PP'*-segment (corresponding to a unique cooperation outcome) is mutually welfare-improving, since every player is placed in a better position without making the other worse-off. Solutions between *P* and *P'* in principle are acceptable to both parties. Yet, party *X* prefers agreements as far to the right of *P* as possible (preferably point *P'*), while party *Y'*s welfare increases the higher up the agreement point is (preferably point *P*). In the presence of multiple equilibria, the two parties are in disagreement over which specific cooperative outcome shall be chosen (schematically represented by points *A*, *B*, *C*, and *D*) . Bargaining over this distributional conflict might drag on for a long time, which frustrates the gains from cooperation and binds other resources (e.g. Fearon, 1998). The prospect of significant bargaining costs and even a possible breakdown of negotiations creates a need for an IO. The contracting parties decide to delegate the decision of specifying a Pareto-improving outcome to an impartial third party. The IO suggests one equilibrium (in this case point *C*) that is then accepted as the focal outcome.

[33] "Leaving these smaller issues to be handled by an IO is much more efficient than direct negotiation, since the costs of interstate bargaining loom large compared to potential gains" (Thompson and Snidal, 2005: 13).

[34] Given that the trade agreement cannot be explicit about all cooperative details, the tasks of a trade organization may typically include filling in details of the agreement as the regime develops, interpreting and applying its rules when certain issues are unclear (clarifying what sort of behaviour is permissible), handling unforeseen circumstances, or addressing new issues as they arise.

Distribution conflict in cooperation agreement



Source: Graphical analysis by authors, based on Powell, 1994.

Note that this representation is highly schematic. It only involves two players who are fully informed about the details of their cooperation. The role of the IO as equilibrium setter becomes even more pronounced, if one considers multiple players, negotiations on multiple issue areas, and a highly dynamic environment. Under those circumstances, the number of possible cooperation alternatives explodes. At the same time, growing complexity and high volatility of party preferences result in less certainty – many countries will not be able to detect the Pareto frontier any more. All this leads to more distributive disagreement between parties. Hence, in situations of multiple equilibria and multiple, heterogeneous principals, signatories have an interest in creating an institution, the tasks of which are to safeguard the attainments of the Pareto frontier (i.e. that no party hijacks the process, or that no crucial detail is overlooked), and to suggest those cooperative alternatives that most closely reflect the collective interest. If the process of doing so is perceived as neutral, fair, and legitimate, the proposed outcome will become focal and the welfare-improving equilibrium is enacted. Even if some state "loses out" in one aspect of the contract, it will remain supportive of the cooperation outcome if it expects to gain overall from the resulting outcome.

Centralize operations (regime support)

Another role for IOs is the centralization of collective activities through a concrete and stable organizational structure, and a supportive administrative apparatus (Koremenos et al. 2001, Abbott and Snidal 1998). As was shown in section B.1.(b) above, states delegate powers to the IO with the aim of economizing on transaction costs, and to increase general efficiency. Whenever states pool resources, IOs can more effectively improve the quality and flow of information, provide background research, and technical assistance. Regime support is largely a passive role for an international organization. However, centralization efforts can also "enhance the organization's ability to affect the understandings, environment and interests of states" (Abbott and Snidal 1998: 5).

Monitor and maintain the equilibrium

As was pointed out above (subsection 1.(b)), an important part of IO regime management involves the settling of disputes and the monitoring of parties' trade policies. Those are important tasks in maintaining a stable cooperation equilibrium.

Whenever unforeseen circumstances require a reinterpretation of the contract, whenever gaps occur due to lack of a mutually-accepted bargain, or when textual ambiguities or opportunism provoke a trade dispute between parties, the IO is charged with imposing a structure-induced equilibrium (at least temporarily). As an arbiter and dispute settlement organ, its role is not to restrain state power, but to provide a focal point, which directs the behaviour of parties until the issue is resolved in an intergovernmental forum. In fulfilling this function, the IO is guided by the collective spirit (the object and purpose of the agreement) and bound by its mandate. Its role is to protect weaker states, mitigate the influence of those individual actors that threaten to harm the collective benefit, and to secure compliance with general rules of international law. Monitoring state policies is another important aspect of supervising the equilibrium path. Lacking executive powers, this typically involves information creation and dissemination.

The perception of an IO as neutral is essential to its autonomy (Milgrom et al., 1990; Greif et al., 1994). If an IO is known to be "captured" by one or more parties, its reputation as a reliable and credible source of information and judgement diminishes in the eyes of the other parties.

Regime evolution

An important (albeit controversial) insight from constructivist theory is that through the development of specific competencies and channels of communication, IOs can influence agendas and goals (Cohen et al., 1972, Cyert and March, 1963). As "creators of meaning and of identities" (Olsen, 1997), organizations are said to forge international perception, discourse, norms and values (Finnemore, 1996; Finnemore and Sikkink, 2001). It is important to stress that it is a deliberate choice by countries to commission IOs with the task of shaping and evolving the equilibrium path in a way that is compatible with the collective interest. Regime evolution does not happen exogenously, but is tied to the principal-agent relationship, and the interests of the membership. As stated by Abbott and Snidal (1998: 25) "[t]he creation and development of IOs often represent deliberate decisions by states to change their mutually constituted environment and thus themselves. IOs can affect the interest and values of states in ways that cannot be fully anticipated. Yet it is important to stress that these processes are initiated and shaped by states and constrained by institutional procedures".

Regime evolution usually pursues the objective of deepening cooperation. To that end the IO undertakes efforts to modify the political, normative, and intellectual context of interstate interactions. The channels of influence are usually personal involvement of IO officials (as mediators in negotiations and as prominent members of "epistemic" communities that aim to transmit new ideas), technical assistance, information gathering and creation, and research.[35]

(iii) Issues of control – the balance between autonomy and oversight

Shareholders of companies regularly hand over significant authority to their management. Managers exercise this autonomy under the supervision of the company ownership. The same is true for the case of international organizations (Thompson and Snidal, 2005). As we have seen, states entrust IOs with some autonomy because this allows them to achieve levels of cooperation that might otherwise be unattainable due to distributional conflicts among them.

[35] The legitimacy of the IO as a manager of regime evolution stems from inclusiveness, neutrality, and technical competence.

The question then for signatories to a trade agreement is what level of autonomy should the IO be granted, and how much oversight should there be by individual parties, or by the membership as a whole. States are hesitant to grant too much autonomy to IOs, since this may produce "sovereignty costs" (unwanted policies, lost disputes, or simply a loss of control; cf. Thompson and Snidal, 2005: 16). Yet more individual control means sacrificing collective benefits. Strong individual supervision will produce less gains from IO autonomy – the IO may not be able to achieve the goals for which it was established in the first place. In addition, individual control may provoke hostile reactions from other Members, who will put less trust in an IO that suffers from "agency capture". Stricter collective control,[36] in turn, implies higher sovereignty costs for individual Members due to majoritarian decisions, and to time-consuming decision-making processes (the very "collective action" problem that motivated the creation of the IO in the first place). In short, a country can never concurrently enjoy the benefits of IO autonomy and exercise fully satisfying levels of control. Therefore, a trade agreement is always a delicate balance among short-term and long-term individual, collective and distributional interests.

Does that mean that the problem of "mission creep", i.e. unchecked evolution of the IO into unanticipated and unwanted areas is inevitable (Barnett and Finnemore, 2004)? Probably not. Two important factors keep the autonomy of an IO within reasonable bounds. First, collective control mechanisms and majority interests can address possible runaway problems. Second, the IO's autonomy is naturally constrained by its need to maintain the cooperation equilibrium by making sure that no parties wish to (partially) exit the institution.

Box 6: Is the WTO a public good?

It is sometimes argued that the benefit of having a trade agreement spills over to those countries who could never have afforded to craft and design a detailed trade agreement. In this context the question arises whether trade agreements – and the WTO as the most prominent example of a multilateral trade agreement – provide the international community with public goods.

Public goods are usually defined as those sharing the two characteristics of non-rivalry in consumption and non-excludability.[37] Since the WTO as a treaty applies exclusively to Members (and therefore features excludability), it may be more apt to concentrate the discussion on whether the WTO is a club good of sorts.[38]

Robert Staiger (2004) argues that the creation and maintenance of the WTO has important global public good features, but that its utilization by Member governments need not exhibit the features of a global public good. The idea is that the main collective action problem lies in creating and maintaining the institution as an effective negotiating forum for Member governments. However, the use to which the negotiating forum is put by Members is more likely a private good.[39]

[36] Collective control mechanisms are oversight bodies, voting rules, budgetary control, or managerial control (e.g. selection of top bureaucrats).

[37] Non-rivalry means that the consumption of a good by one individual does not reduce the amount of the good available for consumption by others. Non-excludability means it is not possible to exclude individuals from consumption of the good. Fresh air is usually cited as an example of a (pure) public good. For reasons of collective action dynamics and market failure, public goods are often provided by society as a whole (e.g. a government).

[38] Club goods are defined by non-rivalry in use and excludability (e.g. Aggarwal and Dupont, 1999). Internet access is a prominent example of a club good. To be sure, with a Membership of 150 countries (as of January 11, 2007), the circle of "club members" is bigger than those currently out of it. This is not to say that the WTO does not produce any non-excludable benefits at all. Arguably, through its promotion of global peace, rule of law, or stability and predictability in international trade, the WTO yields some benefits to non-Members.

[39] As discussed in Section B, this is so because Members who use the WTO as an escape from a terms-of-trade driven prisoner's dilemma can effectively internalize all the benefits accruing from their negotiations. Two countries negotiating non-discriminatory tariff reductions on a reciprocal basis manage to improve the competitiveness of their respective export sectors, which are therefore best placed to exploit the additional market access offered by their trading partner's market liberalization.

Staiger's arguments highlight two important aspects relevant to the overall discussion of the public good character of trade agreements. First, the author makes clear that he argues within the strict confines of the terms-of-trade theory. Second, Staiger insists on the distinction between the rationale for an agreement (WTO as negotiation/cooperation forum) and the rationale of creating an organization. This captures well the central concerns pursued so far in Section B (reviewing different rationales for trade cooperation), and Section C.1 (giving reasons for the existence of formal trade organizations).

Trade cooperation as a club good?

Staiger's suggestion that the actual trade cooperation is a private good enjoyed by two (or more) large negotiating countries is accurate for the terms-of-trade rationale of trade agreements, which mainly considers reciprocal tariff liberalization. But does the same logic hold in WTO areas that do not feature reciprocal tariff cuts, such as TRIPS and TRIMs? If the WTO is understood as a commitment device, once in existence, every Member of a trade agreement can "peg" its domestic trade policy decisions to the external trade deal at no cost. Economics aside, considering rationales for a trade agreement from the literatures of IR and international law further shows that the benefits of a multilateral trade cooperation agreement may effectively spill over to all signatories (and arguably even beyond the membership), no matter how active they were in the initial negotiations. If motives like bloc-building, promoting peace, or spreading a global liberal trading order are considered to be at the core of the decision to cooperate, then the WTO can hardly be seen as a private good. Also, trade cooperation perceived as a global constitution aiming at instituting a rule-of-law based trading order (as maintained by some legal scholars), also may yield benefits to those small Members that kept a low profile in initial negotiations.

Membership in the Organization as a club good?

Under the umbrella of the WTO, all signatory countries enjoy the same membership rights (including a de facto veto right), and have equal access to the services of the Organization. Legal scholarship has long maintained that WTO rights and obligations (codified in rules)[40] are applied *erga omnes partes,* i.e. to the Member community as a whole (e.g. Pauwelyn 2001). The *erga omnes partes* principle applies to non-discriminatory trade liberalization commitments just as much as to disputes panel recommendations, or to information and transparency requirements – they are owed to the membership as a whole and not bilaterally between large nations.[41] Therefore, it is probably fair to say that all WTO Members benefit from this legal precept. Section C.1 reviewed a large number of roles that an independent trade organization can deliver to its Members. In providing its services (information provision, dispute settlement, trade assistance, negotiation facilities, etc.), the organization does not discriminate among countries and hence represents a common good to every WTO Member.

To conclude, as a negotiating forum as well as a formal trade organization it is probably accurate to regard the WTO as a club good that delivers significant advantages even to those Members that either cannot afford actively to participate in all negotiations, or that have not yet made significant tariff liberalization commitments in the various trade rounds.

40 Subsections 2-5 below will review the most important rules that any trade agreement should feature.

41 For example, as was shown in subsecton.5 above, economically small countries do benefit from an MFN clause, even though they technically cannot change world prices with their behaviour. Other examples are standardized prohibitions of non-tariff barriers (e.g. in the SPS Agreement), or notification and transparency provisions that benefit to the efficiency of the trading system as a whole.

(d) Summary: the role of institutions

This section was concerned with an important topic of treaty design – namely, why contracting parties to trade agreements regularly cede a part of their sovereignty and confer authority and decision-making capacity to an institution? What sets formal trade organizations apart from alternative cooperative arrangements, such as decentralized cooperation, informal contracting and ad-hoc contracts? If we presume that countries predominantly conclude trade agreements to overcome economic and political cross-border externalities then we can safely conclude that that institutions matter for at least four important reasons.[42]

First, institutions prepare the ground for trade cooperation. The discussion of non-economic approaches to institutions showed that formal trade institutions can contribute substantially to establishing the general conditions for trade cooperation. Institutions can foster peaceful relations among countries, can shape the generation of common norms and values, and help countries with heterogeneous preferences achieve a cooperative equilibrium in the first place.

Second, institutions enhance transactional efficiency. The creation of a neutral body administering and overseeing trade relations enhances the efficiency of international trade. It was pointed out that institutions can significantly reduce transaction costs and improve transparency in generating and disseminating information to the membership.

Third, institutions enforce the explicit "rules of the game"**.** Although there is no supranational enforcement agency in international trade, institutions can nevertheless help to lend weight to the agreed-upon rules and procedures of the contract. By keeping an eye on procedures and timelines, by informing previously ignorant parties of treaty infringements, by facilitating trade litigation, by conciliating and arbitrating, and by continuously supervising compliance with the explicit treaty rules, institutions add substantially to the predictability and stability of the international trading order.

2. TRADE LIBERALIZATION

(a) Reciprocal liberalization

As explained in Section B above, international trade cooperation provides a way of escaping from the terms-of-trade prisoner's dilemma and relaxes the political economy constraints faced by policymakers at home. Cooperation allows countries to reduce levels of protection below what they would have chosen individually. The process that produces this cooperative outcome – where countries achieve higher levels of international trade and welfare – is reciprocal liberalization.

Reciprocal liberalization means parties to a trade agreement are required mutually to reduce levels of protection below the prisoner's dilemma (suboptimal) starting point. The nature of these reductions can be defined generally or more precisely. In Mayer (1981), reciprocal liberalization is equivalent to moving to the "efficiency locus"[43]. It is not necessary for the terms of trade at this cooperative outcome to be equal to what prevailed at the prisoner's dilemma point. In Bagwell and Staiger (2002), not only are countries required to be on the efficiency locus, but also reciprocal liberalization between parties to an agreement must leave their terms of trade unchanged. The coordinated reduction of protection by all parties to the negotiation expands the volume of trade, which is welfare enhancing for all. On top of this, the terms of

[42] One important issue left out of the scope of our debate is what roles institutions assume once the overarching tenet of national governments as unitary (or monolithic) actors is relaxed. Some governmental entity (say, the executive) may then grant significant authority to an outsider (the IO) in an attempt to prevent other domestic entities (say, the legislature) from torpedoing or retracting from earlier commitments. In the same vein, the idea of the IO as a unitary actor can be relaxed (Elsig 2007). In general, the use of more intricate principal-agent models featuring multiple domestic principals and multiple institutional agents is a promising field of research on the nature and roles of international organizations (see. e.g. Hawkins et al., 2006; or Checkel, 2007).

[43] These are pareto-efficient outcomes where improvements in one country's welfare will come only at the expense of the welfare of its partner. The locus is characterized by the tangencies of the welfare curves (defined over the policy instruments) of the parties to the negotiations.

trade remaining unchanged means that this trade expansion is not accompanied by world price changes that leave one of the parties less well off. In contrast, a unilateral reduction of tariffs by one of the parties to the negotiation would cause a deterioration in its terms of trade and must hurt it. This helps to explain the apparent mercantilist behaviour of governments during trade negotiations when they resist moves to open their markets but at the same time attempt to pry open the markets of their partners.

If there are only two parties involved in a negotiation, the reduction in tariffs offered by one country is clearly intended to apply to the other party. If there are more than two parties involved in the negotiation, how should the reciprocal liberalization take place? Should a country provide different market access offers to its partners or should it make only one market access offer that is applied to all its partners in a non-discriminatory fashion?[44]

Efficiency requires that reciprocal liberalization in this multi-country setting be non-discriminatory (Bagwell and Staiger, 2002). If a country discriminates among its different partners, by applying different rates of protection, there would be different "world prices" (or terms of trade) applying to each. This creates the possibility of opportunistic gains for subsets of countries from reciprocal liberalization, which would be at the expense of non-participants whose terms of trade deteriorate.

Thus, to escape fully the prisoner's dilemma outcome in a multi-country setting, one needs both reciprocal liberalization and its application in a non-discriminatory fashion. The role of the non-discrimination principle is to ensure that all terms of trade externalities are channelled only through a single world price. The role of reciprocal liberalization is to ensure that the world price (terms of trade) remains unchanged even as mutual tariff reductions increase the volume of trade and welfare.

The political economy approaches to international trade cooperation can also provide support for reciprocal liberalization. Reciprocal liberalization mobilizes a country's exporters to lobby for greater domestic trade liberalization since it is the avenue through which they gain better access to foreign markets. A counterweight to the import-competing sector is thereby created, diminishing the political heft of these domestic producers.

Although the discussion of reciprocal liberalization is often couched in terms of the tariff rate, it is not the only policy instrument that could be used. The theoretical literature (Mayer, 1981; Bagwell and Staiger, 2002) shows that other instruments, e.g. import subsidies, would be required in the cooperative outcome and that export taxes achieve the same effect on trade and resource allocation as a tariff (Lerner, 1936).[45] So the discussion of reciprocal liberalization should be read in the light of a broader set of policy barriers (e.g. quotas, import bans) – more restrictive in some circumstances than tariffs – that countries could mutually liberalize.

44 A more extensive discussion of the MFN or non-discriminatory principle as applied in the GATT/WTO is to be found below.

45 The intuition for why export taxes have the same effect as tariffs (the Lerner symmetry theorem) can be provided in the context of a two-commodity world involving x (an exportable good) and m (an importable good). Resource allocation in such a simplified world depends only on the relative price (Pm/Px) of the importable with respect to the exportable good. A tariff reduces imports and raises the domestic price of the import-competing good. This leads to a re-allocation of resources in the domestic economy from the exportable sector to the import-competing sector. Thus production in the export sector falls while production in the import-competing sector is ramped up. As a consequence, the tariff not only reduces imports; but due to the induced re-allocation of resources, it reduces exports too. The same outcome can be achieved with an export tax. An export tax reduces exports and the domestic price of the exportable good. This leads to a shift of resources from the exportable to the import-competing sector. As the production of the import-competing sector expands, imports are consequently reduced.
An import subsidy increases imports and reduces the domestic price of the import-competing good. This leads to a re-allocation of resources in the domestic economy from the import-competing sector to the exportable sector. Thus production in the import-competing sector falls while production in the exportable sector expands. As a consequence, exports rise. Thus, the import subsidy not only increases imports, but due to the induced re-allocation of resources, it expands exports too. The same outcome can be achieved with an export subsidy. An export subsidy increases exports and the domestic price of the exportable good. This leads to a shift of resources from the import-competing sector to the exportable sector. As the production of the import-competing sector contracts, imports increase.

(i) Reciprocal liberalization in the multilateral setting

Bagwell and Staiger (2002) have defined reciprocal liberalization in the GATT as a set of tariff changes that bring about changes in the volume of each country's imports that are of equal value to the changes in the volume of its exports. It can be shown that this is equivalent to a set of tariff changes that leave the world price (and hence the terms of trade) unchanged.[46]

Barton et al. (2006) also describe reciprocity in the GATT/WTO as equivalent (trade) value from access to markets. They described the conduct of negotiators in the first round of negotiations, which they argue became the norm subsequently, thus:[47]

> "... the Geneva talks began with countries sending product requests to each other for potential concessions. This was followed by the presentation of a list, to each country, of the concessions the other was willing to grant. Countries were expected to balance the value of concessions with a commensurate value of access to their home market".

Although reciprocity is an explicit criterion in GATT Article XXVIII *bis* (Tariff Negotiations) and thus in the negotiations leading to multilateral trade liberalization, there is no precise definition of it, in the GATT or in the GATS, leaving the concept ambiguous. Besides GATT Article XXVIII *bis*, there are many other GATT and WTO provisions that could be considered relevant to liberalization covering all merchandize goods (agricultural and non-agricultural goods) and services (see Box 7). This has led some long-time observers of the GATT/WTO to emphasize the political aspect of reciprocity ('reciprocity is in the eye of the beholder'). Jackson (1997) considers the process of governments appraising reciprocity in market access negotiations as one that involves making a political judgement. Finger (2005) tends to be sceptical of the theoretical definition offered by Bagwell and Staiger. For him, reciprocity in the GATT/WTO involves an outcome that each member considers advantageous by whatever standard the Member chooses to apply. He refers to an early GATT working party report which, in response to a proposal to establish rules for how concessions should be measured, stated that "governments participating in negotiations should retain complete freedom to adopt any method they might feel most appropriate for estimating the value of duty reductions and bindings."[48]

Box 7: Liberalization-related provisions in multilateral agreements

GATT Article XXVIII *bis* provides a mechanism for Members to conduct periodic "... negotiations on a reciprocal and mutually advantageous basis, directed to the substantial reduction of the general level of tariffs and other charges on imports ..." The negotiations may be directed towards the reduction of duties, the binding of duties at existing levels or undertakings that individual duties or the average duties on specified categories of products shall not exceed specified levels.

Two things need to be noted about Article XXVIII *bis.* First, it refers to the binding of duties at specified levels, suggesting that the undertaking to bind tariffs has an intrinsic value to negotiating parties, a point that economic theorizing about GATT focusing on the terms of trade problem has tended to neglect.[49] Second, the Article does not refer to free trade as a goal, only to the "substantial reduction" in tariffs.

[46] This requires that there be balanced trade between the parties before they begin mutually reducing tariffs.

[47] See Barton et al. (2006), p. 39.

[48] See Finger (2005), p. 30.

[49] Some recent papers that have tried to explain the difference between bound and applied rates include Bagwell and Staiger (2005b) and Maggi and Rodriguez-Clare (2007).

The provisions on subsidies are found in GATT Article XVI and the Agreement on Subsidies and Countervailing Measures (SCM). GATT Article XI prohibits the use of quantitative restrictions – quotas, import licensing, etc. – to limit trade, prescribing instead the use of import duties, taxes or other charges. It could be argued that Article XI has less to do with liberalization than with efficiency[50] or even transparency. But there are strong reasons for believing that, at least in the first decade or so of the GATT, the elimination of quantitative restrictions was a critical tool of trade liberalization. In the immediate post-war era, the principal obstacles to international trade were not tariffs, but quotas, import prohibitions and foreign exchange controls (see Section D). By forcing governments to give up those measures, the GATT provided an important boost to trade liberalization. The tariff bindings negotiated in the first few rounds of GATT negotiations then prevented governments from undoing this liberalization through tariff increases.

The Agreement on Agriculture (AoA) was intended to initiate a process of reform in trade in agricultural products. The reform process is to consist of progressive reductions in agricultural support and protection. Articles IV, VI and VIII of the AoA involve market access, domestic support and export competition commitments respectively.

Finally, GATS Article XIX asks WTO Members to enter into successive rounds of negotiations "with a view to achieving a progressively higher level of liberalization" of trade in services. As in the case of the GATT, the goal is not free trade, only progressive liberalization.

Reciprocity in the GATT/WTO has also been weakened in the case of developing countries by the principle of special and differential treatment (a fuller discussion of S&D, going beyond the relationship to reciprocal liberalization, is to be found in Section D). There are two aspects to the dilution of reciprocity that S&D has brought about. The first aspect involves providing non-reciprocal market access to developing countries through such arrangements as the Generalized System of Preferences (GSP). The second aspect involves requiring less liberalization from developing countries than from developed countries in multilateral rounds of negotiations.

While this discussion has focused primarily on mutual tariff reductions, it is important to remember that liberalization in the GATT not only means reduction in tariff rates, but the binding of those rates. The contracting parties to the GATT and the WTO membership have attached as much importance to the legal commitment not to raise tariffs beyond a certain level, and the security in market access that this implies, as towards the reduction of duties. What the GATT/WTO has accomplished in terms of liberalization, through security as a result of bindings, and enhanced market access as a result of reduction in protection, are further discussed in Section D of this Report.

(ii) Reciprocal liberalization in regional trade agreements

How is trade liberalization managed in other trade agreements, in particular regional trade agreements? Two questions are particularly germane. How deep is trade liberalization? And to what extent is reciprocal liberalization achieved?

On the whole, liberalization has been much more ambitious in regional trade agreements (Section D contains a discussion of some of the empirical work in this area). In most of these agreements, the objective is to achieve reciprocal free trade in merchandise goods, a goal more ambitious than the "substantial reduction of tariffs and other barriers to trade" expressed in the WTO Agreement. The available empirical evidence suggests that there is substantive elimination of merchandise trade barriers

[50] There exists a tariff rate that would result in the same level of imports as a quantitative restriction which, for example, limits imports only to some level Q. If demand and supply curves shift around, a tariff that on average allows Q imports reduces welfare less than the quantitative restriction.

although sensitive sectors such as agriculture and textiles and clothing are important exceptions. It is less clear how effectively services barriers are being eliminated in regional trade agreements.

The free trade commitment is also decidedly reciprocal. There is a marked absence of "special and differential treatment" in RTAs even though many of them have both developed and developing country members. The elimination of barriers to trade is expected as much from the developing country as from the developed country member. Thus, there is little of the diminution of reciprocity in market access that is found in the multilateral setting.

(b) A more extensive analysis of the trade liberalization in the most favoured nation principle

The MFN principle stipulates that each Member grant the same treatment to like products originating in all other Members that it extends to its most favoured trading partner; in other words, Members are forbidden from discriminating among their trading partners. Thus, if a country improves the benefits that it gives to one trading partner, it has to give the same "best" treatment to imports of like products from all other WTO Members so that they all remain "most-favoured". Given the dominance of the MFN principle in multilateral trade negotiation, it is often referred to as one of the so-called "pillars" of the WTO.

Thus far the logic of trade liberalization has mainly been expounded with reference to only two countries. Extending the bilateral terms-of-trade driven prisoners' dilemma to a multilateral setting complicates the analysis but does not negate the logic of trade liberalization as discussed above – reciprocal tariff reductions facilitate mutual alleviation of the beggar-thy-neighbour effects of governments' trade policies.

However, the rationale underlying the decision by governments to establish a multilateral trade negotiating framework based upon non-discriminatory liberalization does not easily follow from this logic and thus requires explanation. Why have governments committed themselves to extending concessions made to one trading partner to all Members of the WTO? What benefit do they obtain from restricting themselves in this manner?

This subsection provides an introduction to the MFN principle, both historically and theoretically. Moreover, it also provides a discussion of the rationale underlying exceptions to MFN as provided for in the GATT via the potential to form discriminatory regional trade agreements and to give special and differential treatment to developing countries.

(i) MFN before the GATT

The inclusion of clauses relating to non-discriminatory treatment in trade agreements can be traced back to the 12th century, with the first reference to the phrase "most favoured nation" appearing at the end of the 17th century.[51] The emergence of the concept of non-discrimination stemmed from the decline in mercantilism and from a desire to link commercial treaties through time and among states. In the intervening period up until the formation of the GATT, bilateral and plurilateral MFN trade deals were conducted utilizing both the conditional form of MFN, where concessions were granted on the condition of receiving adequate compensation, and the unconditional form, where concessions were granted without reciprocal compensation. The wave of liberalism that swept Europe in the second half of the 19th century engendered widespread use of the unconditional form of MFN. The United States, however, being a relative newcomer to international trade, retained the conditional form at that time. Following the end of the First World War, the United States experienced a considerable increase in demand for its exports from Europe. Therefore, in the 1920s US MFN policy changed to that of unconditional MFN in a bid to entice other countries to do the same with respect to the United States, thus reducing discrimination against US exports. The modern day version of MFN, enshrined in WTO jurisprudence via GATT Article II and GATS Article II, is a direct descendent of the MFN clauses in bilateral agreements between the United States and its trading partners.

---

[51] See US Committee on Finance (1973*), The Most Favoured Nation*, Executive Branch GATT Study, No. 9.

The MFN principle is also applied in numerous regional trade agreements. Indeed, it is important to distinguish between MFN and "multilateralism", which, as noted by Jackson (1997), are sometimes confused with each other. Multilateralism is an approach to international negotiation that involves the interaction of a large number of nation-states. MFN, instead, is a principal applied within negotiations, regardless of whether those negotiations are conducted multilaterally, plurilaterally or bilaterally.

A number of authors have argued that MFN embodies strictly political benefits. For example, both Jackson (1997) and Pomfret (1997) argue that non-discriminatory behaviour mitigates potential tensions that would otherwise arise were countries to be excluded from trade agreements. Indeed Pomfret (1997) notes that frequent controversies involving the United States and nations excluded from their discriminatory trade agreements was one reason why the United States embraced the notion of unconditional MFN after the First World War. Moreover, Ghosh et al. (2003) posit that initial advocacy of the MFN clause by the Organisation for Economic Cooperation and Development (OECD) countries stemmed from a desire to prevent newly independent developing countries from being drawn into adopting a communist regime. Thus, MFN can be viewed as a strategic tool in international relations.

(ii) The economic rationale for the MFN principle

There is widespread belief among policy makers that there is also a strong economic rationale for the MFN provision. This belief is largely based on the presumption that discrimination is inherently undesirable. In a world where free trade maximizes global welfare, there is, of course, no scope for tariffs at all, discriminatory or not. The efficiency of MFN tariffs thus becomes an issue only when diverging from such a scenario.[52] In such a case, there is no a priori argument to be made for non-discrimination as a feature of tariff schedules. For instance, both the literature on optimal taxation and the industrial organization literature on price discrimination suggest reasons why discrimination may be socially desirable.[53] More generally, it could be argued that it is more obvious that discrimination would increase welfare. A move from a policy of non-discrimination to a policy permitting discrimination removes a constraint on tariff policy, and optimization subject to fewer constraints can only result in a higher optimum.

Viner (1931), however, had already pointed out in the 1930s that even in situations where discriminatory tariffs are desirable, the administration of such discriminatory tariffs is costly because of the need to keep track of product origin. Related rules for the issuance of certificates of origin, direct shipment requirements and other relevant administrative procedures can impose significant costs on both enterprises and governments. Costs tend to be higher for products not produced in one single stage, as proof is needed to show that a product has been sufficiently processed in the partner country in order to receive preferential treatment. With MFN, instead, there is no need to keep track of product origin. By simplifying customs procedures, MFN thus significantly reduces informational as well as administration costs.

Furthermore, Horn and Mavroidis (2001) argue that MFN makes policy makers less prone to capture by producers, as it appears to be the case that more "fine tuned" trade policies give more scope for interest groups to influence tariff setting. Authors such as Grossman and Maggi (1997) and Irwin (2002) argue that commitment to a specific trade policy not only guards against subversion of government policy by politically strong minorities at the expense of politically weak minorities, but it also reduces incentives to engage in wasteful political lobbying.

A strong argument in favour of the MFN principle comes from Bagwell and Staiger (1999a, 2002), who emphasize that it is necessary in order for governments to engage in the mutually beneficial bargaining process described before. Previous sections have established that reciprocity is a key pillar of the GATT as it neutralises the terms-of-trade effects of trade liberalization and thus allows governments to remove tariffs and thereby assuage the domestic distortions that they induce. A crucial element in this approach

52 See Horn and Mavroidis (2001).

53 For example, an optimal tariff schedule would involve discriminating among trading partners on the basis of differences in the elasticity of supply of their exports.

is that the beggar-thy-neighbour effects of trade policy travel through world prices alone. Bagwell and Staiger (1999a, 2002) argue that, absent MFN, the trade policies of governments would also influence local prices. Accordingly, they contend that the MFN provision restricts the cross-border effects of trade policy to world prices and thus facilitates reciprocal liberalization. When MFN is violated, the principle of reciprocity is impaired and the efficacy of the WTO diminished. The intuition is that in a discriminatory environment, governments are no longer just concerned with the total amount of imports (i.e. the world price), but also with the relative share of imports coming from each supplying country (i.e. local price abroad) as they enter under a different tariff, implying different tariff revenues. This generates local-price externalities which inhibits the ability of reciprocity to maintain the terms-of-trade. By forcing governments to treat trading partners equally, the MFN principle removes consideration of relative import shares from government decision-making and thereby makes world prices the primary factor of concern. This restores the incentive for governments to fully engage in reciprocal liberalization.

Furthermore, Bagwell and Staiger (2002) have argued that MFN in combination with reciprocity enhances the stability of the multilateral trading system. This argument builds on the possibility for WTO Members to renegotiate their bindings agreed upon in a previous round, as provided for in GATT Article XXVIII. However, the agreement imposes certain limits on what can be achieved through such a renegotiation. Affected parties should be offered compensation for the withdrawal of concessions in the form of an extension of concessions on other goods on an MFN basis by the country seeking the withdrawal, such that the affected parties are fully compensated.[54] Alternatively, if the parties cannot agree on such compensation, affected Members may become entitled to take countermeasures by withdrawing "substantially equivalent" concessions of their own. Theoretical analysis has shown that MFN and this latter type of reciprocity may work in concert to make initial agreements immune to renegotiation. But the MFN principle has rather complex effects on negotiators' strategic behaviour and on the efficiency of negotiated outcomes, as illustrated in the following discussions.

MFN and the bargaining process

Whilst the above logic suggests that MFN is an essential element for facilitating multilateral trade bargaining, it has been suggested that the MFN principle also plays a role in shaping the actual process of bargaining. There are three potentially co-existing effects: the circumvention of the concession-erosion effect; the foot-dragger effect; and, the free-rider effect. Of these three, only the circumvention of concession-erosion effect acts to the benefit of multilateral negotiations. Whilst it is conceivable that the net result of these three effects may be negative, it is important to highlight that the logic in the above paragraphs implies that multilateral trade bargaining requires MFN to exist in the first place.

The logic of concession-erosion has been discussed by a number of authors.[55] Assume that countries A and B agree to liberalize trade via reciprocal tariff concessions. If they are free to discriminate between trading partners then one of them, e.g. country B, may later make another trade deal with a third country C giving that third country even higher concessions. In this case, the initial benefits obtained by country A will be eroded via trade diversion to country C. Foreseeing this, country A would be willing to offer less in the initial negotiation and the scope for trade deals would be duly diminished. MFN tempers the potential for concession diversion in two ways.[56] Firstly, by stipulating non-discriminatory behaviour by country B towards country A, it ensures that the market access bargained for by country A is not diverted entirely to one of its competitors at a later stage. Secondly, if country C is bound by MFN then any concession it offers to country B must be extended to all of country B's competitors. Accordingly, any further trade deal negotiated by country B will simply amount to further reciprocal liberalization. This removes country B's incentive to deal sequentially and thus encourages country B to make an optimal deal in the first place.[57]

54 Bown (2004) provides empirical verification of the extent to which this form of reciprocity occurs in reality.

55 See Ethier (2004), Schwartz and Sykes (1997) and Bagwell and Staiger (2004a).

56 See Ethier (2004) and Bagwell and Staiger (2004a) for models on concession diversion.

57 Bagwell and Staiger (2005b) argue that MFN is not enough to eliminate concession erosion. They show that MFN eliminates concession erosion only in combination with a reciprocity condition and that MFN and reciprocity together also eliminate the free-rider effect.

The "foot-dragging" and "free-rider" effects act to the detriment of trade negotiations in that they provide countries with incentives to hold back from making deals in order to maintain bargaining chips for future negotiations (in the case of the foot-dragging effect) or to capture the gains from unreciprocated concessions granted to them via the MFN trade deals of other countries (in the case of the free-rider effect).

The foot-dragging effect arises when agreements within multilateral negotiations are undertaken sequentially. For example, consider the case where countries A and B are initially in talks about potential reciprocal liberalizations but where country A expects that at a later date it will commence similar talks with country C, a larger country. The MFN clause stipulates that any market access concession extended to an initial negotiating partner is automatically extended to any future negotiating partner, thus country A's concession to B would automatically be extended to country C. In such a context, country A may offer little in the way of initial concessions to B so as to retain a stronger bargaining position for its subsequent negotiation with country C.[58] This inhibits the formation of trade deals at every stage and thereby restricts potential welfare improvements from both an individual country and a global perspective. Jackson (1997) argues that the single undertaking principle that was introduced during the Uruguay Round (and which remains part of the Doha Ministerial Declaration) reduces the incentives for foot-dragging by ensuring that the deals within any specific round must be completed simultaneously and accepted universally. However, Bagwell and Staiger (2004a) note that, in reality, most issues within multilateral talks are negotiated by a subset of countries and that dynamic shifts in levels of economic development and the accession of new Members means that it is routine that a country will engage in negotiations on a product with one country, having previously negotiated on that product with another country. Thus, they conclude that sequential bargaining is prevalent and that the possible damage caused by MFN-induced foot-dragging is significant.

The "free-rider" argument is one that has long been recognised and has received considerable attention in the literature.[59] In essence the logic of this objection to MFN stems from the fact that foot-dragging nations can benefit from unreciprocated concessions when other like-minded nations go ahead with a trade deal despite their reluctance to participate. For example, consider again the case of countries A, B and C. If countries B and C decided to conduct an MFN-based trade deal but country A decided to abstain from the deal, then country A would benefit from the concessions B and C offer to each other via MFN, but would not have to make equivalent concessions itself. MFN would then slow down trade liberalization and countries would be worse off than if they chose to liberalize without MFN.

Some economists have presented theoretical arguments scaling down the possible negative effects of MFN-induced free-riding effects. It has, for instance, been argued that MFN-induced free-riding serves to smooth the effects of bargaining power asymmetries between negotiating parties and leads to a more equitable distribution of gains from trade liberalization.[60] Others cast doubt on the relevance of MFN-induced free-riding in practice. Ludema (1991), for instance, presents a model, where countries can make agreements conditional on similar agreements being made by other parties. This feature accords, according to the author, well with the ratification procedures governments engage in before accepting trade deals. Under these conditions, the decision of one country to free-ride would trigger a temporary breakdown in negotiations. With sufficiently high discount factors, countries elect not to free-ride in equilibrium because the postponement of liberalization acts as an effective deterrent.

The existing empirical literature, however, indicates that free-riding may indeed have had the effect of slowing down trade liberalization in the past. For example, Finger (1979) analysed tariff concessions during the first six rounds of the GATT and noted that, in order to circumvent MFN, countries negotiated on very narrow product descriptions such that concessions were generally extended to negotiating partners and not to potentially free-riding third parties. A study of US tariffs prior to the Tokyo Trade

58 See the discussion in Bagwell and Staiger (2004a).

59 Viner (1924, 1931, 1936) was a key author in the initial recognition of the "free-rider" problem; Johnson (1965) provided the first formal model; see also Baldwin and Murray (1977) and Baldwin (1987) for further discussions.

60 See Caplin and Krishna (1988, Section 6) and Ludema (1991).

Round by Lavergne (1983) found that tariffs were consistently higher with respect to goods produced predominantly by developing countries. After controlling for political factors, Lavergne (1983) interpreted this as evidence that the United States was engaging in less liberalization in order to avoid extending MFN concessions to free-riders. This finding has been corroborated recently by Ludema and Mayda (2005) who find that US tariffs are lower with respect to goods in which they, and their negotiating partner, have a larger market share, i.e. in which there are less potential free-riders. They argue that this is evidence of a significant free-rider effect in WTO negotiations.

If the free-rider problem becomes acute, there are various options for changing the structure of negotiations to try to reduce it. One possibility is for nations to abandon the product-by-product negotiations over concessions and instead agree that every nation will afford tariff cuts in accordance with a mutually agreed formula.[61] The difficulty here is that across-the-board cuts fail to exploit the joint political gains from a more subtle and tailored set of concessions. However, Hoda (2001) notes that in the past countries deviated significantly from the formula approach on an item-by-item basis, and that some countries ignored the formula completely. The more that countries deviate significantly from the formula with their item-by-item exceptions list, the more the free-rider problem re-emerges.

The logic presented here suggests that, whilst MFN is potentially an essential element for the formation of multilateral trade negotiations, the net result of its subsequent effect on the bargaining process is ambiguous. However, a number of authors have ventured separate arguments in favour of MFN. Such arguments generally focus on the efficiency gains resulting from non-discriminatory trade liberalization.

Non-bargaining based benefits of MFN

Theoretical examinations of the efficiency effects of the MFN principle are typically based on models that assume global markets are not perfectly competitive. Assume a world with three countries where one country imports a good from the two other countries. In each exporting country one single firm produces and exports the relevant good. These firms therefore have market power and take advantage of it by extracting rents from consumers in the importing country. The importing country government may then decide to take some of those rents back through tariffs.

An incentive for discrimination will now arise if one firm is more productive than the other. The most productive firm will have higher rents and the importing country government will want to impose higher tariffs on that firm as this approach generates higher tariff revenues. With respect to the allocation of world production, this leads to inefficiencies, because the most efficient firm is "punished" and production is shifted to its less efficient counterpart in the other exporting country.[62]

In such a situation the MFN rule would make it impossible for the importing country to discriminate among producers with different levels of efficiency and the world would end up with an efficient production structure. However, not every country would be better off under the MFN principle. In fact, only the country hosting the most efficient exporter gains. The other exporting country looses, as it would have preferred preferential treatment by the importing country. The importing country also looses, as it would have preferred to extract higher rents from the most efficient exporter.

This set-up, thus, provides one possible explanation, why countries would want to form preferential or regional trade agreements, a concept that is developed further below. It has therefore been argued

61 A formula approach was used in the Tokyo and Kennedy Rounds and it appears to be the favoured approach in the ongoing non-agricultural market access negotiations in the context of the Doha Round.

62 See Hwang and Mai (1991). A model similar to the one by Hwang and Mai (1991) is constructed by Gatsios (1991), who considers the same production structure but incorporates the possibility that the governments of the exporting countries can subsidise exports. The results are virtually identical with several policy active countries, as the government of the importing country will endeavour to extract the greatest rents from the lowest cost producers by levying a higher tariff on imports from the relevant country. Saggi (2004) extends the analysis by considering a more complicated production and market structure in which trade is intra-industry and the global market is oligopolistic in nature.

that in order for governments to agree to include an MFN rule in the framework used for multilateral trade liberalization, the framework should allow for exceptions or be accompanied by some transfer mechanism compensating those who lose out from such a rule. In particular, the above model has been interpreted as representing a scenario involving an industrialized country importer, an industrialized country exporter and a less efficient least developed country exporter. MFN is thus most desirable from the efficient industrialized-country perspective in this context, as it would experience a relative decrease in the tariffs levied on its exports. The MFN principle is not beneficial for developing country exporters and the rationale developed above can therefore be seen as providing some justification for non-reciprocal concessions made to developing countries (in this context by the industrialized country importer). The same logic can also be applied to justify side-payments, such as aid-for-trade, in order for developing countries to accept MFN more readily.[63]

Yet, simple extensions of the set-up described above generate different outcomes and, in particular, predict that the MFN principle makes everybody better off. By adding a preceding stage to the set-up, it can be shown that the MFN principle can help to solve a time inconsistency problem. Imagine a situation where exporting firms choose the level of cost reducing investment before trading partners chose their tariffs. Firms are aware of the fact that any competitive advantage obtained through additional investments would ex post be taxed away by importing countries. It can be shown that as a result companies invest less in cost reducing investments than they would do if they had a guarantee that all companies are taxed equally, independent of their level of productivity. In such a situation MFN would constrain importing countries' ability to tax investments ex post and is also welfare improving for importing countries as they will take advantage of cost reductions and resulting reductions in import prices.[64]

In more complicated economic models involving three countries, the MFN provision can be seen as an avenue of escape from a discriminatory-tariff-driven prisoners' dilemma. Out of three individual players it is rational to discriminate between two trading partners, but where, as a consequence of the resulting strategic interactions, each of the three players ends up being worse off than without discrimination. If, for instance, in country A consumers have a stronger preference for goods from country B than from country C, it would make sense for the government of country A to levy a higher tariff on country B imports than on country C imports if it pursues the objective of maximizing tariff revenues. But such a policy would not be good for consumers and would end up making each country worse off. The MFN principle would ensure a better global outcome, because it would impede the government's ability to extract rents from those consumers who have a high valuation for imported products.[65]

Moreover, MFN can add credibility to the domestic commitments of governments. The political-economy literature regarding the formation of Preferential Trade Agreements (PTAs) has posited that, absent MFN, special-interest lobbies may be able to exert sufficient pressure on their governments to influence them to create a PTA that is beneficial for the lobbies but detrimental to national welfare.[66] Whilst the government would ideally like to refuse to participate in such a PTA, it cannot ignore the votes it would lose as a result of upsetting these lobbies. Adherence to the MFN clause makes the formation of PTAs under these circumstances much more difficult. Accordingly, the government can credibly refuse to concede to the demands of any lobby group on the issue of PTA formation. As a result, MFN allows governments to pursue policies of national welfare maximization rather than being controlled by special-interest groups.

63 See Gatsios (1991).

64 See Choi (1995). See To (1999) for another time inconsistency model, where the source of the inconsistency comes from taxation of domestic consumers in future periods.

65 See Caplin and Krishna (1988, section 3).

66 See Grossman and Helpman (1995), Levy (1997) and Krishna (1998).

(c) Exceptions to the most-favoured-nation principle

Despite the central importance of the MFN principle in the GATT/WTO, it is not without exceptions. In the following part of the Report, two key exceptions will be discussed: the exception given to RTAs and the exception given to developing countries in the form of special and differential (S&D) treatment. In keeping with the conceptual nature of Section C, the focus will be on explaining the reasons behind the exceptions and also presenting the arguments against the exception. A more historical account of how the regionalism and S&D exceptions have fared in the multilateral trading system is given in Section D of this Report.

(i) Regional trade agreements as an exception to MFN

A central exception to the MFN principle in the GATT/WTO is that allowed for customs unions and free trade areas. The exception, under GATT Article XXIV, was allowed from the very beginning of the GATT (see Section D for a historical overview of the article). It is not the only legal instrument used for granting exceptions. The Enabling Clause and GATS Article V also provide for exceptions for MFN for customs unions and free trade areas.

Why does the GATT give this exception to regional trade agreements? There are two arguments that could be made for the exception. The first is that regional trade agreements could contribute to world trade growth.[67] A second argument is that by allowing regional trade liberalization, these preferential arrangements serve as building blocs to further liberalization at the multilateral level. To what extent can these arguments be substantiated by economic theory?

Welfare effects of trade creation and trade diversion

First, it is the welfare effect of RTAs rather than the expansion of world trade that is the right metric to apply in assessing the impact of RTA formation. The reduction in intra-regional trade barriers will stimulate intra-regional trade so trade among the members is bound to increase (trade creation). To the extent that this expanded trade substitutes imports for higher cost domestic products, economic efficiency is increased. But part of the intra-regional trade expansion may be at the expense of trade from cheaper sources outside of the RTA (trade diversion). Box 8 discusses these concepts in greater detail. A country can lose from paying a higher price, in terms of exports, for the goods now being obtained from the RTA partner. Thus, the criterion of world trade expansion may not even be the right criterion to apply to RTAs, because not all of the trade expansion that occurs between RTA partners is necessarily desirable. If the additional trade among the partners is a result of trade diversion, a country can suffer a welfare loss. Whether a country gains or loses from entering into an RTA will depend on the balance between the trade creating and trade diverting effects of the RTA. It then becomes an empirical question whether the welfare gains outweigh the losses.

Box 8: Trade creation and trade diversion

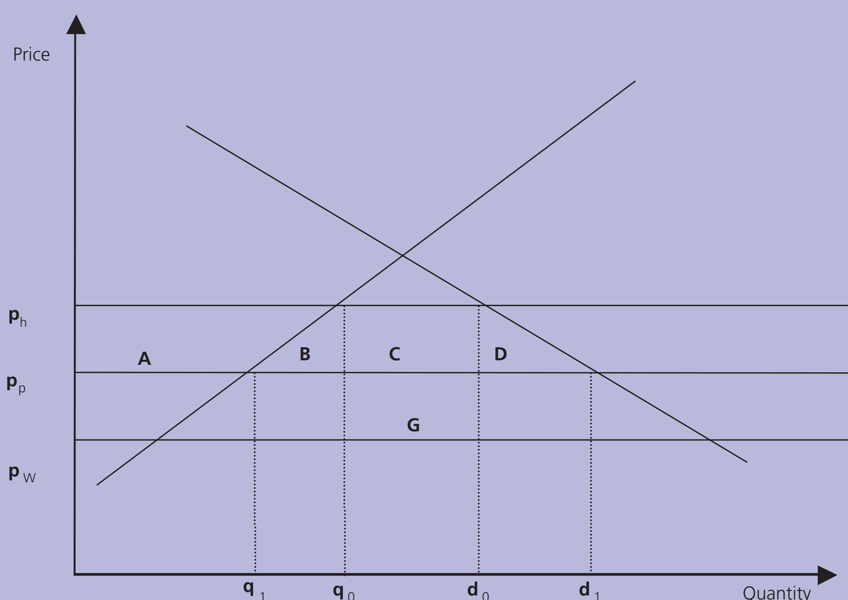
Viner (1950) introduced the concepts of "trade creation" and "trade diversion" in the economic analysis of preferential trade arrangements. They have since become the standard way of analysing the static effects of preferential arrangements. There is however a difference in the way that Viner originally defined these concepts and how "trade creation" and "trade diversion" are presently understood. Viner focused solely on the production effects of customs union. He defined trade creation as the displacement of domestic production by imports from other customs union members, implying that this was economically desirable since production shifts from costly domestic producers to lower cost customs union partners. Trade diversion was the shift in the source of imports from a cheaper non-member to a higher-cost custom union member, which for Viner was undesirable because production shifted from low-cost to higher-cost countries.

[67] In fact, the preamble to the Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994 states that this exception to MFN reflects a recognition by WTO Members of "the contribution to the expansion of world trade that may be made by closer integration between the economies of the parties to such agreements".

Starting with Lipsey (1957), it was understood that a welfare analysis needed to take the consumption effects of customs union into account. This implied that what Viner would consider a purely trade diverting custom union might still increase welfare, once the impact on consumer surplus by the increased trade is taken into account. Johnson's (1960) partial equilibrium analysis of the effects of a customs union probably represents the closest to the contemporary understanding of these concepts. The partial equilibrium analysis of these concepts can be illustrated below:

Consider a three-country model, where the home country (H) is assumed to be small compared to the partner (P) and the rest of the world (W). It faces an infinitely elastic supply at prices p_p and p_w; that is, at these prices country H can import whatever quantity it demands, but it cannot affect the price. Before forming a free trade agreement (FTA), H is assumed to have a non-discriminatory ad valorem tariff τ on imports. Assume W is the least-cost source of foreign supply, before the regional trade agreement. Then, H will import d_0-q_0 at the price $p_h=p_w(1+\tau)$.

Suppose now that country H and P form a FTA. Country H will now import from P, since p_p is less than p_h (the price it would have to pay for imports from W, since tariffs from the rest of the world did not change). Consumers will now pay p_p and imports will rise to d_1-q_1. As a result of the FTA, overall imports increase by q_0-q_1 plus d_1-d_0 and domestic prices fall. Consumers gain as they can consume a higher quantity for a lower price (the area A+B+C+D represents this gain). Producers lose (area A) and the government loses tariff revenue (area C+G). The area B + D represents the welfare increase from the trade creation effect of the FTA. The area G represents the welfare loss from the trade diverting effect of the FTA. Note that another way of looking at area G is that it represents the additional cost of importing d_0-q_0 from the higher-priced (p_p) partner instead of the cheaper (p_w) world market. The overall welfare effects of an FTA will depend on the difference between the increased welfare from trade creation (areas B + D) and the decrease in welfare from trade diversion (area G). In this example, the FTA increases overall trade but the welfare effect is ambiguous (it may have gone down, gone up or remained the same).



There is a tendency to overestimate the trade creation effects of a PTA. In the case of free trade agreements, for example, where external tariffs may differ, rules of origin are often erected to prevent imports from third countries from being routed through the RTA member with the lowest external tariff. Only goods meeting a given content requirement are eligible to receive preferential tariff treatment. This origin requirement increases the cost for producers in a country which is a member of the RTA to avail themselves of the preferential tariffs. Beyond the fact that they limit the possible trade creation

effect of the RTA, they create economy-wide distortions by leading producers away from the least-cost option. The availability of the tariff preferences give an incentive to producers to use inputs produced in countries who are members of the preferential trade arrangement instead of those outside the bloc. Krueger (1997) and Krishna and Kruger (1995) have called attention to the possible use of rules of origin as a means of protection. Even as tariffs among trade partners in a RTA are reduced, the content requirement could be so configured so that an industry actually receives greater effective protection than before the RTA was established!

What factors are likely to affect the strength of the trade creation and trade diversion effects? All things being held constant, the lower the initial level of MFN tariffs of the countries entering into the RTA, the smaller are the risks of a welfare loss from trade diversion. It has also been suggested that a free trade agreement is more likely to be welfare enhancing the higher is the proportion of trade among the members and the lower the proportion with the outside world (Lipsey, 1960). This has led to the hypothesis of "natural trading partners", the idea that there are certain countries, which because of geographical contiguity or low transport costs are bound to conduct a disproportionate amount of trade with one another so that a preferential trade agreement among them is likely to be welfare increasing (Wonnacott and Lutz, 1989). Krugman (1991) has argued that while the theoretical argument against RTAs may be strong, in practice the welfare loss will be small if the members of the RTAs are natural trading partners. In similar fashion, Summers (1991) assigned crucial importance to whether the members of the trading blocs that form are natural trading partners or not. However, in perhaps the only empirical test to be conducted on the hypothesis so far, Krishna (2003) is unable to find support for the natural trading partner hypothesis in the case of the United States and the FTAs where it is a member.

Beyond the members of the trade bloc, RTA formation will come at the expense of non-RTA members who lose out from trade diversion and from the deterioration in their terms of trade. The expansion of intra-RTA trade may lead to such a decline in demand for the exports of non-members that the prices of those export goods decline in world markets. Some evidence of this effect on excluded countries is given in Chang and Winters (2001). Now there are steps that countries entering into a regional trade agreement can take to ensure that non-members do not lose out. In the specific case of customs unions, where members adopt a common external tariff, it is possible to leave the welfare of non-members no worse off than before if the external tariffs are chosen to leave the volume of trade between the non-members and the customs union members unchanged (Kemp-Wan theorem, 1976; 1986). See Box 9 below for an explanation of the Kemp-Wan theorem. But this is just a "possibility" result; it demonstrates the existence of an external tariff that would leave non-members of the customs union as well off as before. But it does not guarantee that members of the customs union will actually pursue this course of action.

Box 9: Explaining the Kemp-Wan Theorem

The Kemp-Wan theorem (1976, 1986) provides a set of sufficient conditions so that the establishment of a preferential trade agreement increases the welfare of the members without reducing the welfare of non-members. The Kemp-Wan theorem was derived in the context of a customs union, which has a common external tariff. The focus in this discussion is on the second part of the theorem, providing some intuition of how it is possible for non-members to be shielded from the adverse effects of the establishment of a custom union.

The logic behind the theorem is simple. The rest of the world is not adversely affected by the establishment of a custom union if there is no resulting change in the volume of its trade (and, hence, also the terms of trade) with the customs union.

Consider the pattern of trade prevailing before the establishment of the custom union. For each product, aggregate the members' trade with the rest of the world. In some products, the members would be net exporters; in other products, they would be net importers. The removal of tariffs

among the members of the customs union will establish a new economic equilibrium – a new set of internal prices (denoted by the vector p^) and quantities (production and consumption). If the authorities take no further action, this new equilibrium is likely to lead to an expansion of intra-custom union trade that would be at the expense of non-members. But the common external tariff can be adjusted so that for each product the custom union's trade with the rest of the world will remain unchanged.

How are we sure that such adjustments can always be made to the common external tariff? This is the contribution of the theorem. Assume that the pre-union levels of these net exports and net imports are part of the initial endowments of the custom union. Then for purposes of the analysis, one can consider this customs union, with its initial endowments, as a single closed economy. It is then possible to appeal to the Arrow-Debreu (1954) conditions which guarantees the existence of a set of prices (denoted by the vector p*) that will be the general equilibrium of this closed economy, i.e., where for each market, supplies will exactly match demands. Given how the initial endowments of this economy have been constructed, this set of prices will be consistent with the pattern of trade that prevailed before the creation of the customs union. Since this general equilibrium of the closed economy always exists, so must the common external tariff that preserves the customs union's trade with the rest of the world. This common external tariff would be derived from taking the difference between the actual internal prices that prevail after the customs union is established and the general equilibrium prices of the hypothetical closed economy described above. Thus, if for some product j, p^(j) is greater than p*(j) , the common external tariff on that product must be lowered.

Beyond these static welfare considerations, the economic literature has also considered the dynamic interaction between regionalism and multilateralism. One strand of thought suggests that preferential trade liberalization ultimately builds support for liberalization at the multilateral level (building bloc view). But, another stand of the literature, takes the opposing view that regionalism is detrimental to multilateralism (the stumbling bloc view). These ideas and the empirical evidence for each view is discussed in Section D of this Report.

Some conclusions

One of the chief exceptions to MFN in the GATT and WTO is that given to customs unions and free trade areas. This permissiveness partly accounts for the large number of RTAs that have been established since the middle of the 20th century. There appears to be two arguments for this exception. One is that, by allowing deeper liberalization among its members, RTAs promote the expansion of international trade. Second, this liberalization among RTA partners will spur greater liberalization at the multilateral level. On both counts, economic theory tends to be ambivalent. Changes in welfare rather than trade expansion should be the appropriate metric. International trade expansion from preferential trade agreements does not guarantee an increase in the RTA members' welfare and is likely to adversely affect the welfare of non-members. While arguments could be assembled to demonstrate that the members of preferential trade agreements are likely to be beneficiaries, similar arguments could be made to suggest that PTAs will impose welfare losses on non-members because of the trade diversion and terms-of-trade effects. The idea that preferential trade liberalization ultimately builds support for liberalization at the multilateral level will be examined in greater detail in Section D of this report. At this point, it suffices to say that negotiating regional trade agreements absorbs a lot of resources that could be devoted to multilateral discussions. The harmonization of rules and policies, which sometimes accompany regional integration, may lock-in members to the agreement. And once RTA members establish preferential footholds in their partners' markets, very strong incentives are thereby created to try and maintain that. Multilateral liberalization could be seen as a threat to that privileged access.

(ii) *The case for special and differential treatment (S&D)*

S&D may be portrayed as an exception to the MFN principle in the sense that a sub-set of parties is allowed to provide more favourable treatment to (some or all of) the remaining parties than that which they accord to each other. However, most S&D provisions currently available under the WTO would not be characterized as carrying MFN implications, since developing Members are granted rights that are not available to developed countries by the membership as a whole (who would, hence, all violate the MFN clause). Developing countries then usually may not implement the authorized measures (such as trade restrictions for balance-of-payments purposes or export subsidization) in a way that discriminates among trading partners, i.e. are not authorized to exert their special rights in a way that would have different implications for different trading partners. However, specific forms of S&D may require Members (often on a best endeavour basis) to provide more favourable treatment to developing countries than to the remainder of the WTO membership and, hence, imply departures from MFN. The most prominent examples are non-reciprocal references under GSP schemes. But calls for targeted technical assistance to individual developing countries or other rules that allow Members to treat developing countries more favourably, such as the lesser duty rule in antidumping proceedings or longer time-frames / simplified procedures when enacting trade restrictions for TBT or SPS purposes, could also be seen as exceptions from MFN.

Two questions arise in trying to explain the rationale and existence of S&D in trade agreements. First, why would other countries have an incentive to agree to more lenient obligations for a sub-set of parties? Second, on what grounds can developing countries claim to be systematically different from advanced economies, and to what extent do temporary exemptions from the general rules (otherwise considered economically beneficial) constitute an appropriate response?

Why do parties agree to S&D in trade agreements?

Not much theoretical literature exists on asymmetric obligations in international trade agreements.[68] Bagwell and Staiger (1996 and 2002) have justified non-reciprocity as a form of S&D in an agreement between large and small countries, in order to prevent terms-of-trade losses for the latter. As discussed above in Sections B.2, B.5 and C.2.(b), according to theories of trade agreements based on terms-of-trade externalities, the MFN political optimum is internationally efficient. This implies that, in order to achieve the global optimum, large countries must make market access concessions on an MFN basis, i.e. extend MFN to small countries as well, in order to avoid a deviation of trade from the latter.[69] Also, small countries should not be asked to make market access concessions on an MFN basis (and, thus, receive S&D), since small countries are already (unilaterally) making trade policy choices that, while potentially very trade-restrictive, are nevertheless efficient from an international perspective, since their choices cannot possibly be motivated by international cost-shifting (Staiger, 2006).[70] The authors raise the question when a country can be considered small; once a country acquires some market power for a product to influence relative prices, it may be considered “large” (or “intermediate”) and may be called upon to reciprocate market access concessions.[71]

68 The underlying problem is that most theories are silent on why large countries would have an incentive to negotiate with small countries in the first place.

69 To recall, MFN treatment is necessary in an agreement between large countries in order to avoid an opportunistic erosion of concessions on a bilateral basis. Large countries should be indifferent as to whether or not to bring small countries on board (and extend MFN to them), since the latter are not in a position to impose terms-of-trade externalities. However, the point here is that, from a global efficiency point of view, they should do so.

70 In other words, positive tariffs in a small country represent a domestic political optimum (or else tariffs would be zero) and already reflect the true costs of its policy choices. By contrast, a large country can shift some of the costs of its policies onto other countries through manipulation of its terms-of-trade.

71 More precisely, even apparently small countries have some power over their terms-of-trade, provided that the industry is monopolistically competitive. Also, since transportation costs encourage trade between proximate countries, even seemingly small countries may be able to pass on some of the incidence of an import tariff to exporters in its trading partner. See Bagwell and Staiger (2002).

Political economy approaches, notably in regard to time-inconsistency problems,[72] offer an alternative explanation. As explained in Section B.5, commitments in the context of international trade agreements can help (self-interested) governments to resist demands for protection by domestic interest groups (Staiger and Tabellini, 1987; Matsuyama, 1990; Tornell, 1991; Maggi and Rodriguez-Clare, 1998). Conconi and Perroni (2005) model a time-inconsistency problem in a small(er) developing country as being related to pressure from import-competing industries.[73] The government engages in a trade agreement with a large developed country to solve its commitment problem.[74] At the same time, the smaller country gives a credible signal to put in place high tariffs in the absence of cooperation and therefore manages to engage a large partner that would otherwise have no interest in an agreement. The authors show that it is beneficial for both partners to agree on temporary S&D for the developing country to speed up the transition process towards mutually low tariffs, which are beneficial for both compared to non-cooperation.[75] As suggested in Section B.4, commitment theory may provide a better explanation for bilateral North-South agreements than for multilateral liberalization. The question also remains whether the underlying domestic political economy concerns are not equally pertinent in the developed world.

Finally, contract theory allows for the fact that obligations by trading partners are not necessarily symmetric, reciprocal and simultaneous. Trading partners may differ in their flexibility to make commitments since their probability distribution of future events leading to contract incompleteness may not be the same. Horn et al. (2006) find that, while core disciplines on border measures, such as tariffs, should apply to all trading partners and be rather rigid, discretion (over domestic instruments) is relatively more attractive in a trade agreement; (i) when countries have less policy instruments at their disposal to manipulate the terms-of-trade or when these instruments are less effective; and (ii) when the importing country has less monopoly power in trade. These conditions are more likely to be met by smaller developing countries than by larger developed countries.[76] The authors conclude that S&D might be warranted for smaller developing countries when it comes to contracting over internal measures (such as subsidies).

All three approaches provide a trade-related rationale why developed countries may be willing to accommodate S&D demands within a trade agreement. Of course, they may do so for other reasons as well, such as security concerns or development motives that may either be altruistic or otherwise in their own interest (e.g. an attempt to contain migratory pressures). In any event, for large industrialized countries, the benefits foregone (e.g. in terms of increased market access) are likely to be of little economic importance, while the benefits of increased flexibility may matter for a smaller/weaker country.

How are developing countries different?

The attributes of "smallness", "domestic commitment problems" or "increased uncertainty" used to describe developing countries in the above models are sufficiently unspecific to make the case that

72 Possibly, a model yielding similar results could be constructed using the assumption of international political economy externalities and the bounded rationality of exporters. The large country would then have an interest to provide temporary S&D to foster political demands by exporters in the smaller country to liberalize.

73 More precisely, investment decisions in the import-competing sector are based on expected tariffs; *ex post*, investors exert pressure for protection so as to maximize the quasi-rents generated by unanticipated deviations of actual tariffs from expected tariffs. With policy commitment, tariffs are fully anticipated and quasi-rents disappear.

74 Besides being smaller, it is assumed that the developing country has less dependable political institutions. Its policymakers cannot credibly pre-commit to certain trade policy choices, whereas policymakers in the large country can do so.

75 In the transition period, the large country accepts a lower surplus than what it could otherwise extract from the small country in order to secure a long-run surplus gain. Conversely, the small country knows that, after temporarily receiving S&D to solve its institutional problems, it might have to accept reduced gains when its privileges are phased out. In the model, the transition to the long-run cooperative equilibrium cannot take place in a single step, since capacity in the smaller country's import-competing sector depreciates slowly and the industry lobbies for the quasi-rents that can be earned in the meantime.

76 Large countries have a rich array of alternative domestic measures which they can use to manipulate their terms-of-trade if tariffs are constrained through an international trade agreement. Moreover, when a country is large in world markets, it faces foreign export supply that is far from perfectly elastic. In this case, the incentive to distort terms-of-trade through domestic instruments is higher.

developing countries are systematically different and require exceptional treatment. In practice, aspects of these broad characteristics can be found in a range of more concrete arguments that are commonly made regarding the special situation of developing countries.

First, certain developing countries produce a limited number of products. In order to increase their production base, they would need to diversify into non-traditional sectors. However, such countries may suffer from markets imperfections that are not present in a similar fashion in the developed world. Notably, new industries are associated with learning-by-doing costs.[77] Therefore, pioneers incur higher costs of production for an initial time period than established (foreign) producers (infant industry argument) (Melitz, 2005).[78] Realizing the potential for future gains, venture capitalists should be interested to invest in these new activities despite losses in the learning phase. However, the developing country concerned usually faces two problems. First, capital markets may also be characterized by imperfections, such as a lack of transparency and imperfect competition. Consequently, capital is allocated inefficiently and business opportunities in new sectors are not realized. Second, new entrepreneurs cannot appropriate all the productivity gains in the presence of knowledge spillovers.[79] Information asymmetries and externalities of this sort justify government intervention. Finally, the argument goes, in the presence of market failures, countries may wish to pursue second- (or n-) best policies, such as trade restrictions, assuming that an optimal intervention (establishing equity markets or providing production subsidies to compensate pioneers) may not be possible (Grossman, 1990).

Second, developing countries are sometimes confronted with limited market outlets due to a small domestic market size or due to high trade barriers in other markets. In order to improve productivity, new industries in developing countries eventually need to be exposed to competition. In the presence of scale economies, local markets cannot sustain a large number of producers. In addition, import substitution policies put in place in developing countries to protect new industries introduce serious distortions in the economy, including a bias against exports and, hence, exposure to foreign competition (Puga and Venables, 1998). As a means to overcome domestic market limitations while cushioning fledgling industries in developing countries against the full impact of global competition, trade preferences have gained in currency as a strategic complement to import substitution policies. Preferential access is expected to help developing country exports to gain a foothold in foreign markets and to ultimately become competitive under MFN conditions (Langhammer and Sapir, 1987; UNCTAD, 1999).

Third, developing countries are resource-constrained. This has at least three major consequences: (i) developing countries find it harder to adjust to the impact of trade liberalization. They lack the transfer mechanisms to compensate the losers. The costs of structural adjustment are borne by companies who need to invest in new technologies to remain competitive or go out of business and by workers who lose their job and run down their savings while looking for new employment opportunities or undergoing retraining (Falvey et al. 2006). In developing countries, households living at the subsistence level can ill-afford an extended period of unemployment (Matusz and Tarr, 1999). In response, the government may need to establish social safety nets, improve education and revisit its regulatory framework, e.g. in regard to labour laws and wage-setting (Andersson et al., 2005). (ii) Developing countries also face supply-side constraints which may prevent their industries from taking advantage of new trading opportunities, for instance due to inadequate transport infrastructure (Limão and Venables, 2001). They also lack the enabling environment, notably a sound macroeconomic framework, as a complement to trade reform (WTO, 2004). And (iii), the costs of implementation of certain trade obligations are associated with

[77] Learning-by-exporting, whereby pioneer exporters should be compensated for the exploration of foreign markets, is a special case that has been made to justify export subsidization. For a critical analysis see Greenaway and Kneller (2004).

[78] The author also discusses a number of industry characteristics that should be considered in the decision to afford protection, and compares the effectiveness of different instruments, such as subsidies, tariffs and quotas.

[79] More recent variants of the infant industry argument stress the externalities involved in learning what one is good at producing. Entrepreneurs face the costs of discovery, but successful investment opportunities can then easily be imitated by others. The government, it is argued, therefore needs to encourage entrepreneurship and innovation, which otherwise is underprovided (Hausman and Rodrik, 2003).

administrative and infrastructure implications that may strain developing country capacities (Finger and Schuler, 1995). Maskus (2000) notes that sophisticated intellectual property regimes, for instance, may not correspond to the current development priorities of a majority of developing countries but compete for scarce resources without yielding immediate benefits. For all of these reasons, it is argued that developing countries may need to remain exempted, at least temporarily, from implementing certain provisions. They also require technical and financial assistance as well as longer time periods to manage the transition.

To summarize, the economic literature provides possible rationales for S&D for developing countries within trade agreements. However, it is not straightforward to translate these insights into concrete recommendations for trade policy-makers. The identification of countries that should benefit from S&D, of the appropriate policies that should be authorized as exceptions from the general rules and of the conditions attached to their use poses formidable practical challenges. Section D.4 will further discuss how special developing country concerns have been reflected in the multilateral trading system over time and how the remaining challenges could be addressed.

3. SECURING THE GAINS FROM LIBERALIZATION

Trade cooperation focuses on the design of rules that legally prohibit or discipline a defined set of trade barriers. However, there are always a rather large number of possible non-trade or not explicitly trade-based policies that individual member states can implement, which will undermine the value of the negotiated market access concessions to their trading partners.[80]

Economists have shown that in the absence of appropriate legal provisions governments may indeed be tempted to use internal measures to circumvent negotiated market access and that this may trigger "races to the bottom" in domestic policies and reduce the value of negotiation outcomes. Trade agreements, therefore, often make use of additional legal provisions to protect agreed tariff reductions from being undermined by non-tariff trade barriers or other governmental measures.[81]

(a) Internal measures and the effectiveness of trade agreements

(i) Internal measures can undermine negotiated tariff reductions

Negotiated tariff bindings are effective only if they imply secure market access commitments, in the sense that members cannot undermine their commitments using other internal measures. But a large number of not directly trade-related internal measures can have effects that are very similar to tariffs and the use of such policies can therefore offset tariff concessions. Assume a country binds itself to not increase tariffs on steel beyond 15 per cent *ad valorem*.[82] What would happen, if by legislation the country turns the steel industry into a domestic monopoly? Or if it sets a regulatory standard that foreign competitors in the industry are unlikely to be able to meet, or that it will cost them much more that the domestic industry to meet? Or if the government subsidizes domestic production of steel? All these policies would improve the competitiveness of domestic steel producers with respect to foreign producers and the market access that foreign governments had expected to gain through the bound tariff reductions will be partly or entirely offset.

Although the above-mentioned policy instruments can have similar effects on trade as tariffs, they are unlikely to be perfect substitutes. It has been shown in the literature, that in this case, governments will anyway be tempted to use the imperfect domestic policy to substitute for tariffs, but that the resulting overall level of protection will be lower than if countries were entirely unconstrained in the use of

80 See Howse (2002).

81 See Petersmann (1996).

82 Example taken from Howse (2002).

protectionist measures.[83] In other words, trade agreements with "loopholes" are better than no trade agreements. This argument may, however, not hold for all individuals within countries. If, for instance, government policies are mainly influenced by producer interests, consumers may end up carrying the major part of the burden created by the negative efficiency effects of alternative "trade" policies, while producers take advantage of the protectionist effects of those policies. As a consequence consumer interests may not necessarily be served by agreements that completely eliminate tariffs, because other, more costly instruments may be substituted for tariffs.

Even though agreements with loopholes lead to more liberalization than no agreements, one may want to consider keeping the loopholes as small as possible in order to encourage trade liberalization by limiting the ability of members to replace tariffs by altered "domestic" policies. A failure to do so could not only imply that tariff negotiation lead to little market opening, but could also contribute toward inefficient domestic policy choices. This is the case, because many internal measures are used to pursue policy objectives that are not trade related. Labour legislation may for instance be used for redistributive purposes or to provide security against adverse professional events to workers. Environmental standards are used to remedy environmental production or consumption externalities. If those policies are suddenly also used for protectionist motives, governments could end up trading off protectionism against those other policy objectives. It has been shown that this could eventually lead to a "race-to-the-bottom"-type problem, as governments lower domestic standards in order to raise competitiveness of domestic producers and thus constrain the market access provided to foreign producers through tariff reductions.[84] Countries would thus end up with inefficient domestic policy instruments and levels of trade that are lower than optimal.

(ii) Approaches to discipline the use of internal measures

Having identified the inefficiency associated with unilateral policy choices, the question arises how negotiations could address this inefficiency. In theory, one could consider that governments negotiate directly over all the domestic policy instruments available that could potentially affect market access and design specific disciplines for each of them individually.[85] Although it looks like an entirely unrealistic task to do so for all possible domestic policy measures, WTO Members have arguably chosen to follow the approach of designing specific disciplines for some domestic measures, i.e. intellectual property rights and sanitary and phyto-sanitary measures.

A related approach would be to device general rules that allow trading partners only to use so-called "first best policies" to target market imperfections like environmental externalities or information asymmetries.[86] A "first best policy" is a policy that corrects an existing distortion in the market and that, off all possible remedies to the problem, is the best approach to correct the specific distortion. Any deviation from the "first best policy" would be forbidden. Such an approach would allow governments to reach desired levels of market access by bargaining on trade barriers, like tariffs, only. This approach has two potential problems. First, while the "first best policy" may be a well defined concept in a theoretical model it is in real life often difficult to define what a first-best intervention would be. Second, it has been pointed out in the literature that such an approach can lead to a "war between public orders".[87]

An alternative approach suggested in the literature, the so-called "targeting approach" does not have these disadvantages.[88] According to this approach governments negotiate over the levels of market access

83 See Copeland (1990).

84 See Bagwell and Staiger (2002).

85 See Bagwell and Staiger (2001), Howse (2002).

86 E.g. Mattoo and Subramanian (1998).

87 See Bagwell et al. (2002).

88 This approach has been developed in Bagwell and Staiger (2001) and is further explained in Bagwell and Staiger (2002) and Bagwell et al. (2002).

they are willing to deliver and then each of them decides unilaterally on the best policy mix of tariffs and internal measures with which to deliver the agreed-upon access to its markets. Legal provisions need to guarantee that negotiated market access commitments are secure against unilateral infringement, where such infringement may derive from adjustments in tariffs or standards.

It has been argued that this targeting approach can deliver desired outcomes, even if direct negotiations only concern tariffs.[89] Taking and initial standards as given, governments can negotiate tariffs that would achieve the desired level of market access. Subsequent to this negotiation, if a government seeks to lower its standards from the initial level, it can, provided that it also lowers its import tariff so as to maintain its market access commitment. However, legal provisions would also need to allow countries to raise standards without changes in their market access commitments. In other words, if a government seeks to increase its standard – for instance because of changes in the importance given to environmental problems – it would be permitted to raise its import tariff and thus maintain its market access commitment. If legal provisions were to allow for such an approach, each government would remain free to reconfigure its policy mix in the preferred manner after having negotiated market access levels, as long as any new policy mix fulfils the negotiated market access commitments.

All three approaches discussed in the economic literature are reflected in the WTO Agreements. As indicated before, WTO Members appear to have chosen the first approach, the one of setting explicit disciplines for internal measures, in the TRIPS and to a lesser extent in the SPS Agreement. This approach will be discussed in more detail in Section D.6 of this Report. The second approach has typically been linked to the legal concept of national treatment and, in particular, to GATT Articles III and also XX. The third approach, instead, is linked to the legal concept of "nullification or impairment" and has therefore often been discussed in the context of GATT Article XXIII.

(b) Disciplining the use of trade distorting policies under WTO Agreements

In order to protect the agreed tariff reductions as well as the reciprocal "balance of concessions" from being undermined by non-tariff trade barriers or by other governmental measures, trade agreements, like the WTO Agreements, often make use of one, or a combination, of three complementary legal techniques:[90] (i) substantive legal rules prohibiting or limiting the use of trade restricting or distorting trade policy measures; (ii) procedural rules providing for legal remedies not only in case of treaty violations but also in situations where the commercial opportunities protected by those trade agreements were being nullified by other (e.g. purely domestic) measures; and (iii) termination clauses allowing a disappointed party to terminate the trade policy obligations altogether on short notice (mostly three to six months).

(i) National Treatment

In the GATT the first legal approach is reflected in Articles III and XX. GATT Article III provides a non-discrimination norm to distinguish acceptable from non-acceptable non-trade internal measures, i.e. the national treatment principle.[91] The concept of national treatment implies, that once imported goods have entered the domestic market, they should in principle not be treated differently from domestic goods. In other words, goods that can enter a country's territory thanks to reduced border barriers, should not be discriminated against once they have entered that territory. Article III thus reflects the awareness of treaty writers that internal measures have the potential to substitute for border barriers and Article III is meant to avoid such practices. The most relevant text of this Article is reproduced in Box 10.

89 See Bagwell et al. (2002).

90 See Petersmann (1996).

91 See Howse (2002).

Box 10: GATT Article III "National Treatment on Internal Taxation and Regulation"

1. The Contracting Parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

Interpretative note to paragraph III.2:

A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed.

4. The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, purchase, transportation, distribution or use....

The legal text indicates that imported products should not receive treatment that is "less favourable" than the treatment given to "like" domestic products. It also indicates that internal measures should not be applied "so as to afford protection" to "directly competitive or substitutable products". The degree to which the use of internal measures is disciplined through GATT Article III depends to a large extent to the interpretation given of the terms "like" product, "directly competitive or substitutable product", "no less favourable than" and "so as to afford protection".[92] All four terms have played a prominent role in GATT and WTO disputes.[93]

In order to secure that the gains from negotiations are not undermined by internal measures, WTO Members also need to be ensured that internal measures are applied on an MFN basis. The MFN obligation of Art. 1 GATT, therefore, applies to any kind of duty, administrative procedure, etc. that affects trade in goods. WTO Members must automatically and unconditionally apply MFN to goods and services from their trading partners. However, its ambit is limited by one restriction: it only applies to "like" products, a term also appearing in several other MFN clauses in the WTO Agreements. Again, the interpretation of the term "likeness" is a crucial issue as narrow definitions of likeness open up greater opportunities for discrimination than broader ones. In the context of GATS the additional question arises, whether MFN must only be applied to "like" services or also to service suppliers that are "alike". The existence of four

[92] See, for instance the discussions in Ehring (2002) and Marceau and Trachtman (2002). The interpretation of the terms "likeness" and "no less favourable than" have, for instance, played a role in *EC-Asbestos* and in *Korea-Various Measures on Beef*. The term "directly competitive or substitutable" has been interpreted in *Japan-Alcoholic Beverages II*, *Korea-Alcoholic Beverages* and *Chile-Alcoholic Beverages*. The interpretation of the term "so as to afford protection" played a role in *US-Taxes on Automobiles*, *US-Malt Beverages* and *Japan-Taxes on Alcoholic Beverages*.

[93] Neven (2001) argues that legal texts appear to make a distinction between "like" products and "directly competitive and substitutable" products, but argues that the distinction between "like" and "directly competitive and substitutable" products is not warranted from an economic point of view. Instead, when determining the extent to which domestic firms are protected, one should jointly consider the degree of substitution between domestic and foreign firms and the degree of rivalry in the domestic market.

modes of supply adds to the complexity and it is tempting to conclude that "... the concept of likeness of products ... is more elusive in services than in goods."[94]

Economists have interpreted the implications of Article III in different ways. According to Ederington (2001) the legal texts amount to a blanket proscription of the use of internal measures as a form of protection. He contrasts this treatment of internal measures with the provisions in GATT Articles I and II, which cover trade barriers and which only require that tariff protection does not exceed any "binding levels" that Members may agree to in the GATT negotiations. According to Ederington (2001) this differential treatment reflects a broad presumption that protection in the form of tariffs is preferable to protection in the form of internal taxes or regulations. He argues that this approach makes sense from an economic point of view and shows that when limited enforcement power prevents countries from implementing a fully efficient set of trade and internal measures, countries should set the internal measures to fully counter any domestic distortion and adjust trade policies to maintain the viability of the agreement. Given that the sole international externality in his framework is the terms-of-trade effects of a government's policy decision, the sole reason for defection is to pursue terms-of-trade gains. Therefore, the most efficient means of countering the incentive to deviate from the agreement and to guarantee the stability of the agreement, is to relax only on trade policy, which in the set-up of Ederington (2001) means that countries can use trade policy to retaliate against those who deviate from the agreements.

Ederington's (2001) interpretation of the GATT legal texts is thus that they manage to eliminate the use of internal measures for protectionist motives, but his analysis implies that the texts allow Members to use first-best-policies to counter distortions in domestic markets. Other economists interpret Article III differently. Horn (2006) argues that it is reasonable to assume that Article III implies that WTO Members are not allowed to levy higher international taxation on imported products than on domestically produced products, regardless of the motive. In other words, Members are not allowed to use internal measures for protectionist motives, but they are also not allowed to differentiate between domestic and imported goods to counter any domestic distortions. Horn (2006) argues that such an approach makes sense from an economic point of view as domestic distortions would normally not justify differential treatment of domestic and imported goods. This would only be justified if the distortion occurs at the border and in this case tariffs would be the optimal instrument to counter the distortion and policy makers should take this into account when negotiating tariff reductions. The author, however, acknowledges that it is not very realistic that negotiators will manage to do so. If they don't, then Article III interpreted in a strict way, i.e. implying that Members are under no circumstances allowed to treat imported "like" products different from domestic products, could potentially impede governments ability to apply appropriate internal measures to counter distortions introduced by imported products.

According to Howse (2002), GATT drafters introduced GATT Article XX in recognition of the fact that the rather general non-discrimination norm in Article III may not in all cases be an adequate dividing line between "legitimate" public policies and "cheating" on trade liberalization commitments. Article XX, therefore, provides explicit exceptions for policies that may even entail elements of discrimination, provided that they are justified in terms of certain, explicitly listed, non-protectionist goals and that their application does not entail *unjustified* or *arbitrary* discrimination. GATT Article XX, for instance, stipulates that measures "necessary to protect human, animal or plant life or health" and measures "relating to the conservation of exhaustible natural resources" can be adopted.[95] The word "necessary" is important in this context, as it has been interpreted in terms of a "necessity test", in the sense that

94 Quote taken from Cossy (2006) who refers to "Subsidies and Trade in Services, Note by the Secretariat, S/WPGR/9, 6 March 1996.

95 The fact that rules to avoid circumvention through domestic policies were included in the original GATT texts reflects how important they are in order for trade cooperationeration to function. From this point of view it may seem surprising that one area of government intervention is excluded from the GATT. This area is government procurement. Government purchases of goods and services represent an important part of economic activity in many countries. If domestic suppliers are favoured over their foreign competitors in public procurement this can therefore have significant effects on trade flows. This explains while government procurement has been dealt with in a separate agreement, albeit it is a plurilateral agreement not covering the entire WTO membership.

measures that claim to target the protection of human, animal or plant life or health can only be used if it can be shown that they are "necessary" to achieve this protection.

Other provisions in WTO Agreements have gone further in defining guidelines to distinguish between "legitimate" public policies and policies that are there to cheat on trade liberalization. It has, for instance, been argued that the SPS Agreement should be understood, to some extent, as an expansion of Article XX of GATT, as its drafters were concerned with the need to (i) expand the scientific and procedural requirements for a Member to impose an SPS measure and (ii) encourage reliance on, and participation in, international standard-setting bodies.[96]

The approach taken in the SCM Agreement differs somewhat from the general approach taken in the GATT. The SCM Agreement disciplines the use of subsidies that are "specific" according to the definition given in Article 2 of the Agreement. Most notably, a subsidy is to be considered "specific" if access to it is explicitly or implicitly limited to certain enterprises.[97] A subset of "specific" subsidies faces outright prohibition through the Agreement. This is the case for subsidies contingent on export performance or on the use of domestic over imported goods. Note that such subsidies are in fact explicitly trade-based policies, which explains why they receive different treatment from other "specific" subsidies. Other "specific" subsidies are considered to be "actionable", which implies that they can either be challenged via the WTO dispute settlement or subjected to countervailing measures if they can be shown to cause specified adverse effects to the interests of another country (including injury to the domestic industry of the country importing subsidized goods, or distortion of trade flows).

(ii) Legal remedies in case of nullification or impairment

The GATT legal texts also contain procedural rules representing the second and third legal technique mentioned above in that they provide for legal remedies in situations where the commercial opportunities protected by those trade agreements were being nullified by other measures and that they contain a termination clause allowing a disappointed party to terminate the trade policy obligations altogether.

GATT drafters recognized that it would be next to impossible to catalogue all potential trade distorting policy measures in advance and it was therefore suggested that trade agreements should have another more general provision which would address itself to any other government action that produced an adverse effect on trade benefits accruing under the covered agreements.[98] This eventually led to the inclusion of a provision for non-violation nullification-or-impairment complaints in GATT Article XXIII. GATS contains a similar provision in paragraph (3) of Article XXIII.

Paragraph 1(b) of GATT Article XXIII provides for a right of redress where, even though it does not violate a specific provision of the GATT, a Member engages in actions that undermine the value of negotiated concessions under the GATT. As drafted, GATT Article XXIII:1(b) could be read as providing a basis for requests for compensation, where policy changes adversely affect the value of negotiated concessions.[99] However, under Article 26 of the Understanding on Rules and Procedures Governing the Settlement of Disputes, complainants face a particularly high burden of proof when challenging an internal measure under GATT Article XXIII and need to establish a causal link between the relevant internal measure and the nullification or impairment of a negotiated concession.

96 See also Section D.6 on the SPS Agreement.

97 Article 2.1(b) of the SCM Agreement specified that specificity shall not exist where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions governing the eligibility for, and the amount of, a subsidy, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to. A footnote to this article further explains that objective criteria or conditions mean criteria or conditions which are neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application, such as number of employees or size of enterprise.

98 See Hudec (1990).

99 See Howse (2002).

According to the economic arguments developed in Section 1 above, the concept of non-violation complaints may provide a basis for requests by a GATT/WTO Member for redress whenever it can show that market-access commitments which it had previously negotiated are being systematically offset as a result of an unanticipated change in the policies – policies not necessarily excluding, for example, labour and environmental standards – of another GATT Member, even if such policy change is not in breach of any GATT rule but merely undermines the value of trade benefits arising under covered agreements.[100] If a non-violation complaint is successful, the complaining country is entitled to a rebalancing of market-access commitments, wherein either its trading partners find a way to offer compensation for the trade effects of its domestic policy change (typically in the form of other policy changes that restore the original market access) or the complaining country is permitted to withdraw an equivalent market-access concession if it obtains prior authorization by the DSB.

GATT/WTO jurisprudence suggests that a complainant must establish four conditions in order to be successful with a non-violation complaint. These conditions are: (1) a concession has been negotiated; (2) a subsequent measure is applied by a WTO Member; (3) the complainant could not have reasonably anticipated the application of the measures at the time the concession was negotiated; (4) the value of the negotiated concession has been nullified or impaired as a result of the application of the challenged measure. Throughout the GATT years, the "subsequent measure" involved, in all but one case, the granting of a subsidy to a domestic producer that led to import substitution.[101] In the WTO-era, the *Kodak-Fuji* litigation illustrated that also regulatory subsidies can be the object of a non-violation complaint. At the same time, the *Kodak-Fuji* panel emphasized that the non-violation remedy should be approached with caution and should remain an exceptional remedy. The panel explained that the reason for this caution is that WTO Members negotiate the rules that they agree to follow and only exceptionally would expect to be challenged for actions that are consistent with those rules.[102] Bagwell et al. (2002), however, argue that this approach does not necessarily define fully the scope of potential application of the non-violation concept. They refer, in particular, to the *Asbestos* report, in which the Appellate Body rejected the argument that certain types of measures, such as those with health objectives, are excluded from the scope of application of Article XXIII:1(b).[103]

(c) Reconciling economic and legal approaches

Most disputes concerning the effect of internal measures on market access have been based on GATT Articles III and/or XX, or on WTO Agreements that concern specific domestic measures like the SPS Agreement, the TBT Agreement or the SCM Agreement. The relevant legal provisions give guidelines on how to distinguish a legitimate domestic policy from one that is not legitimate. In economic terms, first best policies, i.e. policies that are the best remedy to correct a domestic market failure, should be considered legitimate. The question whether existing legal texts allow for an interpretation that corresponds to economic thinking has been debated in the relevant literature and different answers have been given to this question. Assuming that the question can be answered in the affirmative, another difficulty is to know in practice which policy can be considered to be a first-best-policy in a given situation of dispute. It has been pointed out in the literature that this approach can lead to a "war between public orders", given that optimal policies depend on characteristics that may be country specific like consumer preferences, moral value or cultural heritage.

Recent contributions to the economic literature have therefore argued in favour of a more extensive use of Article XXIII. That literature has, however, also pointed out that the possible use of Article XXIII would need to be extended. Currently, if subsequent to tariff negotiations a government wished to change its domestic standards in a way that would effectively grant greater market access to its trading partner at existing tariff levels, under the WTO rules it would not have the flexibility to unilaterally raise its tariff so as to secure market access at the negotiated level, and so in this case efficiency cannot be achieved by tariff negotiations. Instead, the current set-up has the potential to lead to a phenomenon of "regulatory chill", as governments do not

[100] See Hudec (1990).

[101] See Bagwell et al. (2002).

[102] See Japan-Measures Affecting Consumer Photographic Film and Paper, WTO document. WT/DS44/R (March 31, 1998).

[103] Reference to AB report.

endeavour to raise standards out of concern about the competitive position of their producers. Bagwell and Staiger (2001) argue that giving this additional flexibility in the context of the WTO Agreements would ensure that governments could achieve efficient trade and domestic policy outcomes with tariff negotiations alone. The fact that Members and legislators have so far been rather hesitant to use Article XXIII may, however, be an indication that the suggested approach has more appeal at the theoretical than at the practical level.

4. CONTINGENCY

(a) Explaining contingency measures in trade agreements

In the received theory of international trade cooperation, contingent provisions are unnecessary if renegotiation is always possible. Given an initial level of reciprocal liberalization, a change in conditions for one of the parties that requires it to increase the level of protection can be accommodated if it is able to offer some compensating liberalization which leaves its trade parties as well off as before. This requires providing an explanation for the presence of contingency rules in trade agreements.

One explanation is that contingent protection is nothing but protectionism. The presence of contingency measures could be explained by the political economy of protectionism (Tharakan, 1995). Trade liberalization around the world has reduced tariff rates to very low levels. The losers from this process have an incentive to secure protection through the political process and politicians may not be too reluctant to meet the demand. Now, contingent measures are typically administered by bureaucracies, which appear to be insulated from political influence. But political influence can be brought to bear on this process by shaping the laws and regulations which govern the work of these bureaucracies (Finger et al., 1982). Indeed, empirical research substantiates the role played by political influence in affecting the decisions taken by these agencies, particularly in the case of injury determination (Schuknecht, 1992; Tharakan and Waelbroeck, 1994). Furthermore, the ambiguities inherent in these contingent events give substantial leeway for bureaucracies to interpret the evidence. So it may not be surprising that falling tariffs have coincided with the more frequent and wider use of trade contingent measures, particularly anti-dumping. In this view, the presence of contingent measures in trade agreements represents the substitution of one form of protection for another.

Barton et al. (2006) have a less cynical view about trade contingent measures. They regard contingency measures as policy instruments that are used by well-meaning policy makers to manage the redistributional effects of more open trade. Trade liberalisation produces winners and losers in a country. However, countries typically do not have identifiable mechanisms for extracting part of the income gains from the winners in order to compensate the losers from trade liberalization. Contingency measures fill this void by providing governments a way to shield vulnerable sectors from the consequences of lower tariff protection.

Jackson (1997) suggests two possible explanations for contingency measures. The first explanation sees contingency measures as a tool to lower the costs of economic adjustment arising from liberalization. Trade liberalization requires resources to move from sectors where a country does not have comparative advantage to sectors where it does have comparative advantage. Such an adjustment may sometimes be difficult to make, with workers facing long spells of unemployment. Temporary protection can be employed to slow down the entry of imports providing time for domestic industry to adjust to the effects of competition. However, he also acknowledges the difficulties with this explanation since trade measures are not necessarily the most efficient ways of facilitating adjustment. Domestic measures to enhance the mobility of workers and of firms would be preferable.

This leads to his second explanation which sees contingency measures as pragmatic tools to deal, not with the cost of adjustment itself, but with the political demands for protection that it provokes. If nothing is done, political pressure may build up to a point where protectionist forces would be able to engineer a permanent reversal of trade liberalization. The introduction of contingency measures in a trade agreement may be thought of as anticipating the possibility of such difficult adjustments and the political pressure for protectionism that they give rise to, and providing a means to deflate this pressure with a temporary reversal of liberalization.

This view implies that the depth of liberalization that can be achieved by a trade agreement *ex-ante* may depend on whether there are built-in escape clauses that recognize the uncertainty in the economic environment. Trade agreements involve governments making commitments on policies that will apply not only at the present time but also in the future. But economic circumstances in the future may evolve in a way which makes maintenance of the present policy untenable because of large adjustment costs. Trade agreements will need to provide governments a means to depart temporarily from the provisions of the trade agreement under well defined and circumscribed conditions. The presence of contingency measures addresses this need. While the use of the contingent measures may result in ex-post welfare losses during periods when the level of protection is temporarily increased, the deeper liberalization that is allowed ex-ante means that this is outweighed by the long-term welfare gains.[104]

(b) Scope of contingency measures

One issue to contend with is the scope of contingency actions. Is it limited only to safeguard or emergency actions or is it also necessary to include actions i.e. anti-dumping and countervailing duties in response to certain types of practices sometimes referred to as "unfair" trade practices?, to the extent that foreign trade practices or policies, irrespective of whether they are fair or unfair, result in increased imports and injury to domestic injury, they can generate domestic demands for protection that may put liberal trade policies at risk. Thus, they give rise to precisely those conditions that contingent measures are meant to address. Hence, safeguard, anti-dumping and countervailing measures are alike to the extent that they can be employed to deflate the build-up of domestic pressure against trade liberalization. Some of the differences in these trade contingent measures, including the conditions under which they can be invoked, are discussed in the subsection below.

A second reason why it may be necessary to include anti-dumping and countervailing duties in the scope of contingency measures is the heavy reliance on them (particularly anti-dumping actions) by countries (see Table 3). Using the notifications made by Members to the WTO, over the 1995-2005 period, safeguard measures were the least relied on. There were 20 times more anti-dumping initiations (2,851) than there were safeguard initiations (142) and nearly 26 times more anti-dumping measures (1,804) than there were safeguard measures (70) applied.[105]

Table 3
Trade contingent actions, initiations and measures, 1995-2005

Trade contingent instrument	Initiations	Measures
Anti-dumping	2,851	1,804
Countervailing measures	182	112
Safeguards	142	70

Source: WTO Secretariat.

Finally, there is a strong link between periods of economic distress and anti-dumping activity. Knetter and Prusa (2003) have found that for four of the major users – Australia, Canada, the EC and the United States – anti-dumping filings were closely correlated with macroeconomic activity and real exchange rate appreciation. Periods of real exchange rate appreciation can lead to a loss of competitiveness in import-competing sectors, thus, triggering a larger flow of imports. Economic downturns cause increased joblessness and financial losses for companies. They contribute to conditions that make anti-dumping measures very attractive for the affected firms.

[104] Finger and Nogues (2005) make a similar point in their examination of the Latin American experience with trade liberalization that "in the larger political context, anti-dumping and safeguards are a necessary quid pro quo to certain important sectors to obtain much more liberalized trade policies for the general economy".

[105] It should be noted though that a safeguard action may involve multiple import sources.

Thus, it could be argued that countries have found anti-dumping rather than safeguard measures the preferred instrument for adjusting to trade difficulties and letting off protectionist steam. So, for the purpose of this discussion all three types of trade remedies will be considered as contingent measures.

(c) Contingency-related provisions in the multilateral system

At the multilateral level, the most important contingency provisions are to be found in GATT Articles VI (Anti-dumping and Countervailing Duties) and XIX (Emergency Action on Imports of Particular Products) and the corresponding multilateral agreements – Anti-Dumping Agreement[106], Subsidies and Countervailing Measures Agreement and the Agreement on Safeguards. The classification of anti-dumping and countervailing duties as contingency measures is partly because of the heavy reliance on anti-dumping actions by countries as is shown in Table 3 above.

But there are other relevant GATT Articles which could also be considered contingent measures. Among these are GATT Articles XII (Restrictions to Safeguard the Balance of Payments) and XXVIII (Modification of Schedules). The latter allows a WTO Member to increase its bound tariff, subject to providing "compensatory adjustment" to affected trade partners.

Finally, one should also note the practice of some WTO Members of using the margin between the bound and applied tariff rates as a de facto trade remedy. The applied tariffs are increased to shelter domestic industries from imports but not to the extent that they move above the bound rate so that no WTO commitment is breached.

Although safeguard, anti-dumping and countervailing duties have been lumped together as contingency measures, there are important differences among them.

Anti-dumping and countervailing measures can only be invoked against imports traded at dumped prices (i.e., below their "normal value"), or subsidized imports, respectively and subject to showing that domestic industry has suffered material injury caused by those imports. A country can apply a safeguard measure against increased imports even though those imports are not dumped or subsidized or otherwise subject to a particular trade practice, if those imports are the cause of serious injury to its domestic industry.

Because dumping or subsidization may be supplier- or country-specific, anti-dumping and countervailing measures are imposed only on those suppliers whose products are found to be dumped or subsidized, i.e., the measures are not applied on an MFN basis. Safeguard measures are in principle applied on an MFN basis, i.e., are meant to apply to all sources of imports, although developing countries can be excluded from their application if those countries account for a small share of imports.

Finally, since anti-dumping and countervailing measures are applied in response to specified trade practices (dumping or subsidization), there is no requirement to offer compensation to the affected trade partner. In contrast, a country applying a safeguard measure – which is in response to an import surge that has harmed its domestic industry, rather than in response to the effects of a particular trading practice – has to offer compensation for the adverse effects of the measure on trade partners.[107]

Some of these differences between anti-dumping and safeguard actions have been identified as the reasons why countries have a preference for using the former. The non-discriminatory feature of safeguard measures has been cited as one reason why this instrument is used less frequently, because governments preferred a more targeted instrument that could be directed at the country or set of countries that are the source of the injury (Barton et al. 2006). The reluctance of countries to use safeguard measures also

[106] The formal name of the Anti-Dumping Agreement is the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994*.

[107] The Agreement on Safeguards provides for a modulation of this general rule, however, in the sense that Article 8.3 prevents Members subject to a safeguard measure from retaliating for the first three years that a measure is in effect provided that the measure has been taken as a result of an absolute increase in imports.

has been linked to countries' aversion to legitimize a protectionist measure that is applied on fairly traded goods as well as to the requirement that compensation be paid (Jones, 2004). This last point hints at an inefficiency that could arise from the use of anti-dumping, rather than safeguards, as a contingent measure in the sense that the former does not leave trade partners as well off as before.[108]

(d) Contingency-related provisions in regional trade agreements

Testifying to the value of contingency measures in international trade agreements, the great majority of the RTAs continue to allow the use of trade remedies in intra-regional trade (Teh et al., 2007). The study examined the trade contingent measures in 74 RTAs, which varied in size, degree of integration, geographic region and the level of economic development of their members. Only a handful of RTAs have achieved abolition of trade contingent measures, although this included the largest RTA, e.g. the European Communities.

The continuing importance of contingent measures in RTAs reflects the balancing act that governments need to perform when committing to additional liberalization in a free trade agreement. Since the decision to establish an RTA has as an objective the dismantling of all barriers to regional trade, this creates new demands from import-competing sectors for protection. To preserve political support for the RTA, governments typically bundle in restrictive rules of origin, long transition periods and sensitive sectors in the agreements. Governments may find the continued existence of trade contingent measures also necessary to preserve political support for the regional trade agreement.

What about those RTAs which have been able to abolish trade contingent measures? These RTAs are characterized by deeper forms of integration that go well beyond the dismantling of border measures; a common external tariff and a higher share of intra-RTA trade (Teh et al., 2007). Thus, the need for contingent measures in trade agreements may also be a function of the degree of economic integration contemplated by the members. If the goal of deeper integration is shared by the political leaderships and peoples of the members, the risk of protectionist forces being able to mount a reversal of economic openness may be much less. Deeper integration is also likely to result in greater coordination, harmonization and even adoption of common regulations, policies and institutions, which allow the countries to better absorb the costs of adjustments from openness to trade.

5. RULES OF ENFORCEMENT AND DISPUTE RESOLUTION

Any trade agreement, in fact, any contract needs (implicit or explicit) rules of enforcement. In the absence of a supra-national authority, most trade agreements must rely on self-enforcement. However, self-enforcement need not be synonymous to the rule of force, but may be an orderly, rules-based process. After giving a short introduction into the basics of enforcement, this subchapter discusses rules of enforcement and dispute settlement.

(a) The basics of enforcement

"[T]he WTO Agreement is a treaty – *the international equivalent of a contract*."[109] Contracts are best defined as a mutual exchange of commitments over time (Craswell, 1999; Dunoff and Trachtman, 1999). Every contract needs to be enforceable, since enforcement gives credibility to the mutual commitments made and deters defection. Without enforcement a contract can be expected to break down, or, more likely, would not have been concluded in the first place.[110]

108 As noted above, however, Article 8.3 softens the retaliatory rights of affected Members, thus reducing the instances in which compensation must be paid by the Member taking the safeguard action.

109 Appellate Body Report, *Japan–Alcoholic Beverages II*, (WT/DS8,10,11/AB/R: 16, emphasis added).

110 Masten (1999: 26) notes: "Without some form of assurance that others will, when the time comes, uphold their end of the bargain, individuals will justifiably be reluctant to make investments, forgo opportunities, or take other actions necessary to realize the full value of exchange".

Enforcement is a function of "enforcement capacity" and "enforceability". Enforcement capacity is the ability to reciprocate credibly against a violation of the terms of the contract. Enforcement can be exercised by the affected party itself (self-enforcement), by a neutral third-party,[111] by society at large or through collective enforcement by a circle of affected or interested parties (such as the membership of a multilateral contract). Enforcement instruments can vary from physical (incarceration), economic (penalty fees) to emotional (reputation loss) measures. Enforceability has three components: observability, verifiability and quantifiability. Observability means that infringements can be detected in the first place – either by the affected party itself or by a third party. A contract violation is verifiable if the affected party can point to a clause in the contract and prove its violation. This presupposes that such a clause is contained in the contract and/or that the violation can be determined by a neutral third party. Finally, quantifiability, implies that the aggrieved party (or a court) can quantify the damage incurred as a result of the breach of the contract.[112]

(i) The level of cooperation and the level of enforcement

Every contract is driven by the desire to cooperate. Parties enter into contractual relationships with the aim of minimizing costs, engaging in risk transfer and/or reaping transaction efficiencies. Cooperation may not be a binary issue, but a matter of degrees. In Chart 3 various degrees of cooperation (C) are plotted on the horizontal axis, where (C^{max}) refers to full cooperation and (C^{N}) to the absence of cooperation. The Chart shows a contract between two players,[113] assumed to cover a long-term relationship with repeated interaction (such as a trade agreement). Each contracting party has an incentive to cheat by deviating from the terms of the agreement. The short-term benefit from defection is called hit-and-run advantage *H&R*.[114] The vertical axis depicts the utility gain in excess of a situation without a contract, i.e in excess of U^{N}.[115] The hit-and-run benefit (if seized by the potential defector) is by definition an opportunistic, that is, inefficient redistribution of welfare to the detriment of the affected party.

Chart 3 displays two mechanisms to enforce continued cooperation.[116] In case of self-enforcement (i.e. no superior enforcement body exists), the affected party exits the agreement (the threat of reverting to the pre-contractual non-cooperative "Nash equilibrium" is also called a "grim trigger" strategy of enforcement). The curve *S-E* ("self-enforcement") in Chart 3 represents the injurer's opportunity costs of reprisal, that is, the discounted value of cooperation.[117] It is the sum of future benefits from cooperation that the injurer foregoes from having defected and prompted the grim trigger response. The potential defector balances the short-term incentive to cheat with the long-term cost from an infinite suspension of cooperation. As the level of cooperation increases, the costs of reprisal exceed the hit-and-run gains from one-time defection until the two curves intersect at C^{SE}, which can be defined as the "most cooperative" cooperation level that can be sustained through self-enforcement. Beyond this point, the gains from one-time infringement of the agreement exceed all the compiled future gains of cooperation. Beyond $C^{S\text{-}E}$ it is irrational for the injuring party

[111] Third-party enforcement may be called "court-and-copper" enforcement, since constitutional states require that a jurisdiction (judge) determines a legal infringement and an executive (police) enforces the law.

[112] Quantifiability may be important where there is no *prima facie* violation of the rules, or in seeking retaliation.

[113] For simplicity, parties are assumed to be symmetrical. Therefore, only one contractor needs to be examined, since the incentives and actions by the other are identical. This is without loss of generalization: In a model with multiple actors, the enforcement can always be represented as a two-player game, namely between a player "X" and a player "rest of the world".

[114] The hit-and-run gain is the additional utility the injurer enjoys from defecting over cooperating as promised. It is a short-term benefit, since it merely stretches from the moment of defection until the time the violation is detected.

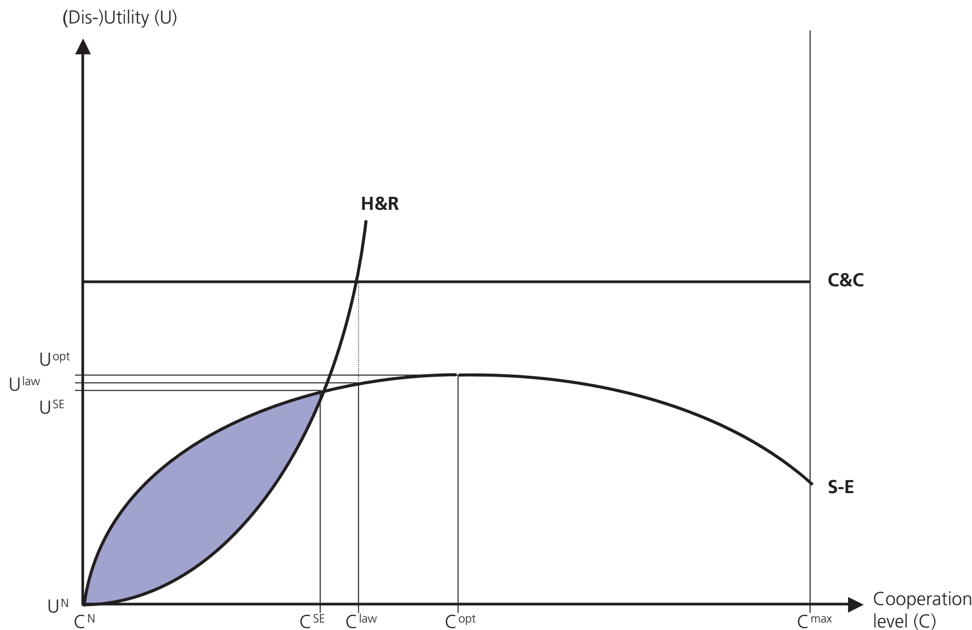
[115] The convex curvature of line *H&R* is intuitive (increasing marginal return from defection), but not necessary. Bagwell and Staiger (2002: 102) provide some arguments in favour of this curvature for the case of the "contract" being a trade agreement. The curve is flat and equal to zero at C^{N}, where the contracted cooperation is equivalent to the situation without agreement.

[116] Other kinds of enforcement are possible, but are not considered here, since they are just variants of the two explained mechanisms.

[117] The discounted value of cooperation is the sum of all future per-period extra-gains from having a contract (*vis-à-vis* having no contract at all). Again, the concave curvature of the *S-E* curve is intuitive (more cooperation in every round is beneficial up to some optimal point C^{opt}). After that point more cooperation has declining, possibly negative returns, for example because of a loss of freedom and sovereignty. See Bagwell and Staiger (2002: 102) for the case of a trade agreement. The *S-E* curve also must go through the origin: The more the contracted cooperation level approaches the no-contract (Nash-cooperation) level, the smaller are the future gains from cooperation.

to comply ("binding constraint"). Anticipating the injurer's behaviour, it is equally irrational for the affected party to agree to a more cooperative deal, even though the welfare-optimal level of cooperation would be C^{opt} (due to symmetry of the players). Hence, without a central enforcement body, only the range between C^N and C^{SE} is self-enforceable yielding an additional utility in the range between U^N and $U^{s\text{-}e}$ (hatched area).

Chart 3
Enforcement constraint in contracts



Note: H&R stands for "hit-and-run". The H&R curve represents the discounted benefits of defecting from the terms of the initial contract. S-E stands for self-enforcement. The S-E curve represents the expected costs (disutility) of defection in a self-enforcing agreement. Those costs are tantamount to the foregone benefits from future cooperation. C&C stands for "court-and-copper"-enforcement. The C&C line is the expected disutility for defection (here, a liquidated damage clause) in a contract that is enforceable by an impartial third party.

Source: Graphical analysis by authors, based on Bagwell and Staiger (2002: 103).

If an enforcement body exists (a court to detect an infringement and coppers to enforce the court's verdict) contracting parties conclude their agreement in the "shadow of the law" (*C&C* in Chart 3).[118] Cooperation is more far-reaching (between C^N and C^{law}), because defection is punished immediately. For the injurer punishment results in a utility amounting to (*H&R – C&C*), which is negative everywhere below the cut-off point C^{law}. Third-party enforcement yields a higher mutual utility than the self-enforcement mechanism (U^{law} instead of U^{SE}). However, as drawn here, the shadow of the law can still not safeguard an optimal mutual cooperation C^{opt}, possibly because the law cannot enforce every little detail of the contract.

(ii) Factors favouring successful enforcement

Enforcement capacity and enforceability determine the strength of an enforcement mechanism and, hence, the scope of the agreement. Under a self-enforcement regime, an affected party's enforcement capacity depends on the injurer's time-value,[119] the affected party's enactment costs of retaliation[120] as well as its general ability to do harm to the injurer (Chart 4). Weak enforcement factors skew the injurer's opportunity-cost curve downwards (shown as the move from the dotted *S-E* to the solid *S-E'* curve in the Chart). Enforceability plays a role for

118 The shadow of the law effectively stretches from C^N to C^{law}, i.e. over the entire contracting space. Beyond C^{law} no contract is possible, since defection is more attractive than legal punishment.

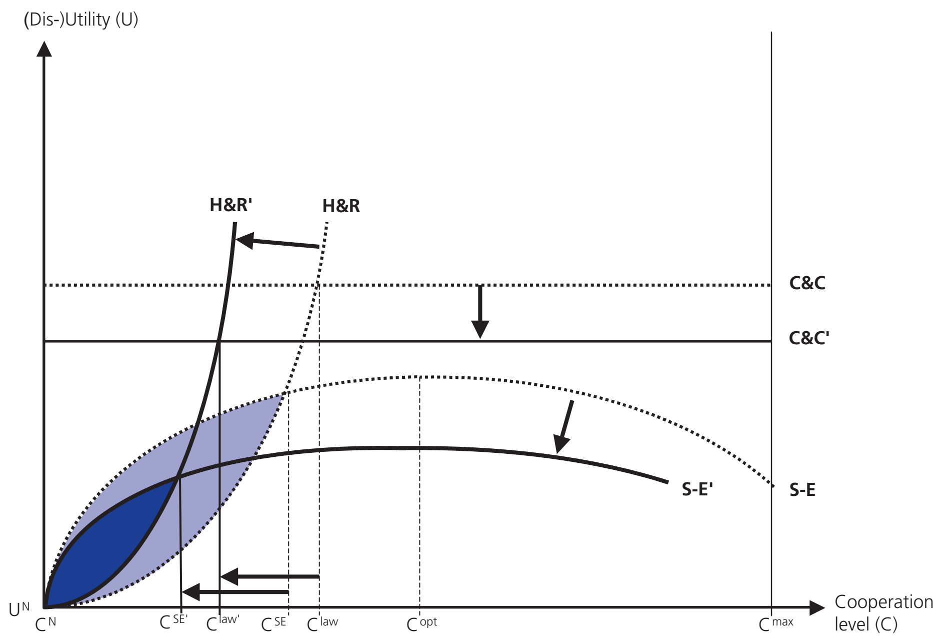
119 The injurer's time value, or "discount factor" describes how much the injurer is interested in the current period *vis-à-vis* future periods. In the extreme case in which the injurer is only interested in today's utility and not at all in the future, a grim strategy has no deterrent effect. Therefore, no agreement would be signed.

120 Any costs connected with enacting a sanction mitigate the victim's power (and willingness) to retaliate. For example, it is sometimes argued that a grim trigger strategy is costly to apply for the victim, since it is not only the defecting party that forgoes future benefits of cooperation, but also the punishing party.

the shape of the short-term hit-and-run curve. Insufficient observability, verifiability and quantifiability make one-time defection more attractive (the *H&R* curve gets skewed to the left, as illustrated in the move from the dotted line to the solid *H&R'* curve). For every level of cooperation, defection pays off more (higher defection utility). Fewer enforcement possibilities result in a smaller self-enforcement range and, consequently, as shown in Box 11, in a small range of ex ante cooperation (previous situation (hatched area) compared to scenario with insufficient enforcement (chequered area) determined by the intersections of the *H&R'* and *S-E'* curves).

Enforcement capacity and enforceability are equally important for contracts concluded under the shadow of the law: Under a weak "court-and-copper" regime (dotted *C-C* line shifts downwards to solid *C-C'* line) and with deficient detection and acquittal possibilities (yielding a leftwards shift of the *H&R* curve), the possible contract range shifts to the left from C^{law} to $C^{law'}$.

Chart 4
The importance of enforcement capacity and enforceability



Note: H&R stands for "hit-and-run". The H&R curve represents the discounted benefits of defecting from the terms of the initial contract. S-E stands for self-enforcement. The S-E curve represents the expected costs (disutility) of defection in a self-enforcing agreement. Those costs are tantamount to the foregone benefits from future cooperation. C&C stands for "court-and-copper"-enforcement. The C&C line is the expected disutility for defection (here, a liquidated damage clause) in a contract that is enforceable by an impartial third party.

Source: Graphical analysis by authors, based on Bagwell and Staiger (2002: 103).

(b) Self-enforcement in trade agreements

In the absence of a supra-national authority, any contract among sovereign nations must rely on self-enforcement.[121] Self-enforcement is not synonymous to vigilante justice, or a self-help system. In the anarchic system of vigilante justice, both ingredients of enforcement – enforceability and enforcement capacity – are in the hands of the affected party. This brings with it some considerable disadvantages: First, enforcement capacity entirely depends on a party's own retaliatory power ("size"). Second, each party (even larger ones) has to observe, verify and quantify the actions by other parties itself in order to detect and prove a contract infringement and calculate the damage incurred. Subjective assessments of that sort are not only costly, they can lead to disagreements over the nature, effects and consequences of a treaty violation between an alleged injurer and an affected party setting off threats of retaliation and

[121] Hippler Bello (1996: 417) states for the case of the WTO: "When a panel established under the WTO Dispute Settlement Understanding issues a ruling adverse to a member, there is no prospect of incarceration, injunctive relief, damages for harm inflicted or police enforcement. The WTO has no jailhouse, no bail bondsmen, no blue helmets, no truncheons or tear gas".

counter-retaliation and, possibly, a trade war.[122] Under an unconstrained self-help system countries can be expected to be reluctant to conclude an agreement or make wide-ranging commitments.[123]

(i) Rules of enforcement and dispute settlement in trade agreements

Aware of the tremendous disadvantages that a pure vigilante system entails, signatories to a trade agreement usually agree to bind themselves to a core set of enforcement rules and dispute settlement procedures. These rules prescribe the proper behaviour in case of disagreement over issues covered in the agreement.[124]

Codified rules of enforcement and dispute settlement can bring significant improvements over a purely vigilante system of enforcement:

- First, by laying down concrete mechanisms, procedures and timelines, rules of enforceability (observability, verifiability and quantifiability) are codified.[125] A rules-based system generates predictability and stability and injects confidence into the system;

- Second, the membership of a trade agreement may agree to enhance the enforcement capacity of weaker states by writing rules of collective or multilateral enforcement. Instead of leaving a small country alone in its effort to retaliate against a defecting member, willing affected (but non-litigating) or even all signatories may step in (see approaches by Maggi, 1999; Bagwell et al., 2007);[126]

- Finally, mutually agreed enforcement rules may prompt signatories to change their enforcement regime to more benevolent and less conflictual mechanisms. Examples include a move from a grimtrigger strategy of enforcement to a regime of commensurate punishment, or the possibility for lenient opt-out mechanisms in times of acute domestic crisis.[127] Another option is the choice of less trade-restrictive enforcement instruments, such as compensation in the form of tariff liberalization or monetary fees.

For all these factors rules of enforcement and dispute settlement may provoke higher levels of trust in the system by all signatories – small and big alike. Mutually agreed and codified rules can enhance enforcement capacity (an upward shift of the *S-E* curve in Charts 3 and 4) and increase the enforceability of the treaty, since defections are more easily detected, proved and punished (skewing the *H&R* curve to the right). This will reduce the potential for opportunistic defection and result in more extensive *ex ante* trade liberalization commitments by the members of the agreement.

---

[122] The risk for the breakout of a trade war may be factored in by signatories in their subjective discount factor.

[123] See Chart 4 above. For small countries, a system of vigilante justice will push down the *S-E* curve (lacking enforcement capacity) and in addition skew the *H&R* curve towards the left, leaving a significantly diminished contract space.

[124] Articles XXII and XXIII of the GATT, entitled "Consultation" and "Nullification and Impairment", respectively, are examples of rules of enforcement and dispute settlement.

[125] In other words, rules of enforcement and dispute settlement lay down the contracting parties' common denominator of *what* exactly constitutes enforceable actions, *how* they can be detected and distinguished from lawful behaviour, *what* the calculative basis for indemnity (remedies) shall be, etc.

[126] Maggi (1999) illustrates the advantages of multilateral over bilateral enforcements with a simply model. Three countries form a trade agreement. Each country exports a single unique good to each trading partner. It also imports two unique goods, one from each other country. However, a circular asymmetry in trade exists: Each country imports substantially more from one trading partner than it exports to that market. For example, country *A* sources most of its imports from *B* while exporting mainly to *C*. In a bilateral enforcement system, *A* cannot reciprocate against defector *C*, since it does not have the import leverage to inflict economic harm by retaliating against *C* through tariff hikes. In a multilateral system of enforcement, however, every country in the model will punish a defector. Country *C* is therefore reluctant to cheat against *A* knowing that *B* will punish it by raising the tariff against its product.

[127] Many authors argue that in a repeated-game setting, a tit-for-tat strategy of enforcement is vastly superior to a grimtrigger response (e.g. Axelrod, 1984; Keohane, 1984; Oye, 1986). For the case of trade agreements this has been established among others by Sykes (1991), Downs and Rocke (1995), Ethier (2001). For a discussion of escape clauses as safety valves in trade agreements, see subsection 4 above. It is claimed that commensurate punishment and ready opt-out mechanisms increase the stability of the agreement, as well as the initial commitment to liberalize (e.g. Rosendorff, 2005, Rosendorff and Milner, 2001, and Herzing, 2004).

(i) The role of a dispute settlement institution in trade agreements

Over time, a rules-based self enforcement regime that depends solely on the letter of the law and the benevolence of the membership can become quite challenging to manage, especially when the complexity of the trade agreement increases. The accession of new and more diverse countries, the inclusion of further industries, new areas of cooperation (such as environmental standards or intellectual property rights), and an increasing overlap with other international regimes will require more extensive and complicated rules and exceptions. A rise in complexity may result in more ambiguities and in more situations of private revelation of information.[128]

If such is the case, disagreements and trade disputes, sooner or later, are likely to occur. As was discussed in subsection 1.(b) above, asymmetrical information makes it easier for an injuring party to act opportunistically since the affected party has difficulties detecting a deviation and proving the size of the damage incurred. Contractual incompleteness – including the existence of ambiguities or loopholes – makes it harder for the affected party to point to a specific clause in the agreement in order to prove his suspicions. The contracting parties would need to negotiate the proper handling of unforeseen developments. Since this negotiation takes place *ex post facto* and if a wider renegotiation is to be avoided, these situations are usually difficult to solve without outside help. In short, contractual complexity may prove a challenge to the smooth and frictionless enforceability of a trade deal. This may motivate contracting parties to give the authority and independence to a formal dispute settlement body to deal with such issues within certain limits (Thompson and Snidal, 2005).

Subsection 1 above has demonstrated why formal institutions matter. It was shown that a formal organization may assume important roles in connection with dispute settlement, once realistic market imperfections, such as asymmetrical information or uncertainty over future events, are taken into consideration. The functions of such an organization may include monitoring and information dissemination, conciliation, arbitration and the calculation of damages, information gathering and adjudication of disputes. Taking the example of the WTO, Box 11 shows that the organization's dispute settlement mechanism (DSM) fulfils many of the institutional roles mentioned above. Box 11 shows that in discharging its functions, the DSM enhances enforceability,[129] but it does not have an impact on the enforcement capacity of the affected party.[130] Hence, "self-enforcement" remains a basic premise of virtually any trade agreement. Successful dispute resolution remains in the hands of the signatories, and ultimately depends on the willingness of the offending party to cooperate and/or in the enforcement capacity of the membership to punish the offending party.

[128] A more complex agreement can make it harder (and more costly) for signatories to anticipate and write down future contingencies, trade instruments and areas of disagreement. The further a trade agreement pervades into internal (as opposed to border) measures, the more difficult it may become for signatories to detect, prove and calculate violations of the agreement.

[129] In assuming the role of an information disseminator, the DSM improves the chances of detecting a violation (observability). Taking up the role of an honest broker, information gatherer, adjudicator and arbitrator the DSM assists in assessing what actions really are sanctionable according to the terms of the agreement and helps to achieve a settlement (verifiability). Finally, when acting as an arbitrator and damage calculator, it ensures better quantifiability.

[130] The DSB (and, more specifically, dispute settlement panels and the Appellate Body assisting it in carrying out its functions) provides Members with rulings on whether certain measures constitute violations of the WTO Agreement and recommends, if applicable, that the Members concerned bring these measures into conformity; ultimately, arbitrators pronounce on the size of countermeasures in the case of non-compliance. Yet, there is no equivalent to a national executive body that can put a verdict into effect. Hence, in the language used above, the institution cannot provide for "court-and-copper" enforcement; it can merely provide for more effective observability, verifiability and quantifiability.

Box 11: The WTO dispute settlement mechanism (DSM)

The DSM is the WTO's instrument for dispute resolution. In the first instance, it provides for consultations and settlement negotiations before resort can be had to the litigation process. In the next step, the complainant requests the establishment of a dispute settlement panel specifying the measure at issue and which provision of WTO law it violates. The parties submit arguments and evidence. In the light of the submissions by the parties, the panel determines the relevant facts of the case relating to the measure at issue. It has the right to gather information so as to ascertain the nature, operation and effects of the measure at issue. The panel also assesses the applicability of legal provisions invoked by the parties, interprets those provisions and applies them to the facts of the case in order to determine whether the challenged measure is inconsistent with the WTO Agreement. When a violation has occurred or trade benefits accruing under the WTO agreements have been nullified or impaired, the Member concerned is required to bring the measure at issue into conformity with WTO law. If it fails to fully comply within a reasonable period of time, and compensation is not forthcoming or not considered appropriate by the aggrieved party, it may impose, with prior approval by the DSB, countermeasures equivalent to the level of economic harm or loss in trade benefits caused. Finally, its role as information repository implies that the DSM monitors compliance and keeps official records about the disputes and their settlement. The DSU covers these functions in the following manner:

Central dispute settlement forum: The DSU applies to all covered agreements (Article II:2 of the WTO Agreement and Article 1 of the DSU). In addition, by virtue of Article 23 of the DSU, the WTO DSM has primacy over outside fora as far as the adjudication of disputes under the WTO agreements and the enforcement of WTO law is concerned.

Consultations: The DSM acts as an "honest broker" between disputing WTO Members. Article 4 of the DSU requires that consultations be held between the parties before litigation may be initiated. The aim of consultations is to reach a mutually acceptable settlement of the dispute. In addition, the DSM offers alternative forms of dispute resolution through conciliation, mediation and the good offices of the Director-General. The respective mandate is contained in Article 5 of the DSU. Article 5.1 of the DSU states that conciliation and mediation procedures are voluntary. In addition, Article 3.7 of the DSU stipulates that "[t]he aim of the dispute settlement mechanism is to secure a positive solution to a dispute". Indeed, on numerous occasions disputing parties have used the DSM to settle their disputes before a final ruling was adopted by the DSB (see Section D.3.(b)).

Information gathering and collection of evidence: Articles 11 of the DSU requires a panel to make an objective assessment of the matter before it, including of the facts of the case. Article 12 and the Working Procedures contained in Appendix 3 of the DSU specify the panel procedures to be followed (unless decided otherwise), including the deadlines for written submissions by parties. In order to obtain additional information or clarification, panels may at any time put questions to the parties and ask them for explanations. In addition, based on Article 13 of the DSU (entitled "Right to Seek Information"), dispute settlement panels "may seek information from any relevant source and may consult experts to obtain their opinion on certain aspects of the matter" (Article 13.2 of the DSU). It is important to note that the Appellate Body is barred from gathering new factual information by virtue of Article 17.6 of the DSU ("An appeal shall be limited to issues of law covered in the panel report and legal interpretations developed by the panel."). Also, the DSM may only deal with cases WTO Members decide to initiate before them. Panels do not have inquisitorial powers similar to *ex officio* prosecution by an attorney general or chief prosecutor. Moreover, in contrast to certain international tribunals, panels and the Appellate Body cannot give advisory opinions.

Adjudication: Article 11 of the DSU requires dispute settlement panels to assess objectively the matter before them as to the facts of the case and the applicability of, and conformity with, the relevant WTO covered agreements in relation to the measures in question.

Arbitration and quantification of damages: Articles 22.6 and 22.7 of the DSU authorize arbitrators to determine the level of economic harm and loss in trade benefits suffered by the aggrieved party and to determine, under Article 22.3 of the DSU, in which trade sectors or under which agreements other than those where the violation occurred retaliation is justified. Thus far, there have been 16 instances (in 7 separate disputes), where, following a request for authorization of countermeasures, arbitrators have determined damage awards.

Information dissemination, monitoring and surveillance: Article 2.2 of the DSU instructs the DSB to "inform the relevant WTO Councils and Committees of any developments in disputes related to provisions of the respective covered agreements". Article 21 of the DSU, entitled "Surveillance of Implementation of Recommendations and Rulings", obliges the DSB to monitor the implementation of adopted rulings.[131] This surveillance includes those cases where compensation has been provided or concessions or other obligations have been suspended but the recommendations to bring a measure into conformity with the covered agreements have not been implemented" (Article 22.8 of the DSU).

6. TRANSPARENCY

(a) Why is there a need for transparency?

The received theory of international trade cooperation has little to say about transparency in trade agreements because it assumes that trade partners have perfect information. This is equivalent to assuming that there are no (transaction) costs to acquiring or processing information. This is an understandable simplifying assumption given that the focus of the analysis is the inefficiency that arises from countries behaving strategically to alter the terms-of-trade to their advantage.

The section on institutions above discussed the problem posed by imperfect information. Imperfect information means that there is bound to be some cost involved in acquiring information and that, consequently, parties may not be fully informed or they may be differently informed, about matters that can have a significant economic impact on them. There are quite specific reasons for believing that the problem of imperfect information is acute in the case of trade agreements.

First, trade agreements involve governments making very detailed commitments on tariffs and other regulations that involve thousands of products. It would be difficult to keep track of all these commitments if they were not inscribed in schedules. In addition, the negotiations leading to these schedules often tend to be confidential. But once these negotiations are concluded, the information is a public good that can be made available without much cost by governments to those who can directly benefit from it - importers, exporters, etc., but who were not parties to the negotiations.

Second, parties are required to implement obligations made in the trade agreement. Given the reciprocal nature of liberalization, there is therefore a legitimate interest by a party to see to it that its partner is implementing its obligation. As the number of parties to an agreement, increases, it can quickly become very costly for one country to, on its own, monitor implementation by all its partners of their commitments across a range of measures and products. It may be more economical to require a country to notify all its trade partners about the status of its implementation of the obligations.

[131] Members may obtain, if necessary, a reasonable period of time for implementation. Moreover, compliance panels and the Appellate Body may be requested to establish whether the DSB rulings and recommendations have been fully implemented.

Third, the need to preserve or secure the gains from market access requires countries to make commitments on domestic regulations, involving among other things, standards, technical regulations, SPS measures and the like, that have non-trade objectives but whose application can have ramifications on trade. It may not always be easy to distinguish between well-intentioned regulations that only have an unintended adverse effect on imports from measures that are intended as hidden protectionism. As noted in the discussion on enforcement above, the ambiguity inherent in such situations can sometimes lead to dispute settlement. Transparency of the regulations and the regulatory process may assist in removing this ambiguity and therefore avoid costly dispute settlement proceedings in situations where none is called for.

There is also another aspect to transparency that has to do with the institution (organization) that, because of transaction costs and imperfect information, has been established to help the Members better implement the rules of the trade agreement. There are two aspects to this institutional transparency. One is internal transparency, which involves making the decision-making process as open as possible to the membership. The Members of the institution need not have the same access to financial and human resources. While it is not possible to fully correct for such differences, there are some which have a public good aspect, that with little cost can be disseminated with a significant improvement in the quality of the decision-making process. The second aspect is external transparency, which involves the institution's openness to the public.

Transparency helps achieve two objectives. The first is improved compliance by the parties to the commitments they have made under the trade agreement. Shining a spotlight on the parties keep them on the straight and narrow. Second, going beyond the parties to the agreement, transparency should help private economic agents better understand the environment in which they operate and enable them to make better decisions. Markets will function more efficiently when economic agents have better information.

(b) Transparency in the WTO

Provisions on transparency are spread across the range of WTO Agreements. While the transparency provision in a particular WTO Agreement may be concerned only with the narrow range of measures covered under that Agreement, such as subsidies or SPS regulations, the cumulative effect of these provisions is to diminish the opaqueness of a Member's trade regime and trade policymaking process. There could be a number of ways of classifying these transparency provisions. This sections closely follows Wolfe (2003) who groups the transparency provisions into: a) tariff and services schedules which codify Members' commitments; b) the Trade Policy Review Mechanism; c) publication and notification; d) internal transparency by which is meant transparency of the institution to its Members (particularly those with limited resources or with no presence in Geneva) and e) external transparency to civil society.[132] Although Wolfe (2003) does not speak about surveillance, it is a function that is explicitly provided for in a number of WTO Agreements. Thus, the meaning of surveillance, how it is linked to transparency and how it may help reduce the incidence of disputes is also discussed.

(i) Schedules of concessions

Although not explicitly identified as a mechanism for transparency, the schedules of concessions and schedules of specific commitments by WTO Members are probably some of the most valuable. The schedules, which frequently run into hundreds or even thousands of pages, codify in great detail the obligation of each WTO Member with respect to import duties and limitations on trade in services that are to be applied to other Members.

In GATT 1994, the relevant article is Article II (Schedules of Concessions) which comes immediately after the MFN clause. For non-agricultural goods, the schedule usually consists of tariff bindings but in the

132 In his classification, Wolfe (2003) also includes independence from the executive branch of government.

case of agricultural products, the schedule also includes tariff rate quotas, limits on export subsidies and domestic support. The schedules are considered an integral part of the GATT.

Article XX (Schedules of Specific Commitments) is the corresponding provision in the case of the GATS. The schedules identify the service sectors to which a Member will apply the market access and national treatment obligations of the GATS and any exceptions from those obligations it wishes to maintain. The commitments and limitations are listed with respect to the four modes of supply – cross-border supply; consumption abroad; commercial presence; and presence of natural persons. The schedules are considered an integral part of the GATS.

(ii) Trade Policy Review Mechanism

The Trade Policy Review Mechanism (TPRM) was established under Annex 3 of the Marrakech Agreement. Its purpose is: "to contribute to improved adherence by all Members to rules, disciplines and commitments made under the Multilateral Trade Agreements and, where applicable, the Plurilateral Trade Agreements, and hence to the smoother functioning of the multilateral trading system, by achieving greater transparency in, and understanding of, the trade policies and practices of Members. Accordingly, the review mechanism enables the regular collective appreciation and evaluation of the full range of individual Members' trade policies and practices and their impact on the functioning of the multilateral trading system. It is not, however, intended to serve as a basis for the enforcement of specific obligations under the Agreements or for dispute settlement procedures, or to impose new policy commitments on Members." This objective is to be realized through regular reviews of a Member's trade policies and practices. Before this, a peer review mechanism of a Member's trade policy had been provisionally established in 1988.

The frequency of a review depends on a Member's share of world trade. The four biggest traders are to undergo a review every two years. The next 16 are to be reviewed every four years. The rest of the Membership is to go through a review every six years, with possibly a longer period for LDCs. Each review is conducted on the basis of a report by the Secretariat and a statement by the Member concerned. Any Member is allowed to comment on the report, which stresses the transparency aspect of the above objective, or the policy statement, thereby providing an opportunity for an exchange of views. Each report is subsequently published and made available to the general public.

Reviews are conducted by the WTO's Trade Policy Review Body (TPRB). For each review of a Member, two documents are prepared. One is a policy statement by the Member under review. The second is a detailed report written by the WTO Secretariat on its own responsibility. The Secretariat's report consists of detailed chapters examining the trade policies and practices of the Member and describing trade policymaking institutions and the macroeconomic situation. The Secretariat report and the Member's policy statement are published after the review meeting, along with the minutes of the meeting and the text of the TPRB Chairperson's concluding remarks delivered at the conclusion of the meeting.

The review of Members' policies, practices and measures under the TPRM throws light on how policies and measures not covered by WTO rules may nonetheless have an important bearing on the international movement of goods, services, capital and labour, and can have effects equivalent to or that vitiate measures subject to existing WTO disciplines. The review of broad macroeconomic and structural policies attempt to place trade and trade-related policies in their broader policy setting, thereby contributing to a better assessment of the coherence of these policies in achieving their objectives.

The transparency that is achieved in the TPRM process covers four key elements of economic policymaking. First, a clear description of the nature of policies and measures. Second, their rationale or objectives. Third, the costs incurred in terms of expenditures or taxes forgone in pursuit of these policies and measures. And lastly, an economic evaluation of the effectiveness of policies and measures (relative to viable alternatives) in achieving their objectives. Accordingly, the TPRM enables the regular collective appreciation and economic evaluation of a full range of individual Members' trade policies and practices,

their consistency with the broad principles of non-discrimination and predictability that underlie the WTO, and their impact on the functioning of the multilateral trading system.

(iii) Publication and notification obligations

Article X of the GATT requires Members to "publish promptly in such a manner as to enable governments and traders to become acquainted with them" all information related to the administration of trade regulations. The essential idea behind the publication obligation is that other WTO Members that are likely to be affected by governmental measures should have a reasonable opportunity to acquire information about such measures and either to adjust their activities or to seek modification of such measures.[133]

Notification provisions are, in terms of count, the most commonly found transparency mechanism in the WTO Agreements. Notifications are required to inform other Members about the enactment of legislation, or the adoption of new measures, or the progress made in the implementation of commitments. A number of Agreements also contain obligations to publish information on a relevant measure or establish enquiry points so that members know where they can obtain the relevant information.

(iv) Institutional transparency (internal and external transparency)

Internal and external transparency have less to do about clarification of the provisions in multilateral agreements as with laying bare the process of decision-making in the institution or organization itself. The objective of internal transparency is to make decision-making in the WTO transparent and genuinely inclusive. It includes the outreach by the WTO to the smallest and poorest WTO Members, particularly to those without WTO missions in Geneva (non-resident delegations).

External transparency refers to the WTO's efforts to engage with civil society groups and the public at large. Much of this involves making available official WTO documents, reports, submissions by WTO Members and trade-related statistics. Other activities related to external transparency involve giving civil society groups access to relevant WTO meetings, including the Ministerial Conferences, and the holding of public forums to better explain the institution and WTO Agreements.

Section D provides a detailed account of how the GATT/WTO has responded to the challenge of ensuring internal and external transparency in its dealings with members and with the public.

(v) Surveillance

While transparency is an obligation by the Members to ensure that the trade measures they take are clear and easily understood, surveillance goes beyond that. It implies keeping watch over the compliance by Members to the obligations they have incurred under the WTO Agreements. It is almost always an activity which is vested in the institution (and its bodies) rather than in the Members.

A number of WTO Agreements contain explicit provisions on surveillance. The Dispute Settlement Understanding (Article 21:6) requires the Dispute Settlement Body to keep under surveillance the implementation of adopted recommendations or rulings. Article 26 of the SCM Agreement requires the Committee on Subsidies and Countervailing Measures to review Members' subsidies notifications at special sessions held every third year. The surveillance function assigned by Article 13 of the Safeguards Agreement to the Committee on Safeguards appears to have a wider ambit. But those functions include monitoring the implementation of the agreement, examining and monitoring the phase-out of VERs (for more of VERs, see Section D of this Report) and receiving and reviewing all safeguard notifications.

But even though other WTO Agreements do not contain an explicit provision on surveillance, almost all of them establish bodies that perform essentially many of the same functions described above. Article 68

133 See Appellate Body Report on *US-Underwear*, p. 21.

of the TRIPS Agreement mandates the TRIPS Council to monitor the operation of the TRIPS Agreement and in particular, Members' compliance with their obligations under that Agreement. The Agreement on Agriculture (under Article 17) requires the Committee on Agriculture to monitor the progress in the implementation of commitments negotiated under the Uruguay Round reform programme. Any Member may bring to the attention of the Committee on Agriculture any measure which it considers ought to have been notified by another Member. The Committee on Technical Barriers to Trade (under Article 15) is to review annually the implementation and operation of the TBT Agreement. The Committee on Trade-Related Investment Measures (under Article 7) is to monitor the operation and implementation of the TRIMS Agreement. The Committee on Antidumping provides semi-annual reports of anti-dumping actions taken by WTO Members within the preceding six months.

Surveillance in the WTO, takes place principally through the various committees or WTO bodies that have been established by the WTO Agreements. The raw material of this surveillance comes from the notifications, complaints and requests for consultations by Members as well as reports prepared by the Secretariat. Thus there is an important link between the observance of transparency by Members, their ability to provide timely and accurate notifications to various WTO organs and the quality of the surveillance function of the WTO.

The existence of the Trade Policy Review Mechanism, in particular, has occasioned comparisons with the surveillance activity conducted by the International Monetary Fund. There are similarities but also important differences in the surveillance performed by the IMF and the surveillance in the WTO. In terms of differences, there appears to be two essential ones. First, the IMF has been given an explicit legal mandate to conduct surveillance over exchange rate arrangements in its Articles of Agreement (Article IV, section 3 of the Articles of Agreement). This surveillance has two interrelated aspects: surveillance over the entire international monetary system and, to fulfil that function, surveillance "over the exchange rate policies of members". While specific bodies in the WTO may be tasked with surveillance (such as the Dispute Settlement Body, or the Committee on Subsidies and Countervailing Measures, or the Committee on Safeguards), there is no surveillance provision in the WTO Agreements that has the same overarching scope as in Article IV of the IMF Articles of Agreement.

Second, the objective of Fund surveillance is to produce "specific principles for the guidance of all members" with respect to their exchange rate policies. All Fund Article IV staff reports provide a set of policy recommendations that are submitted to the IMF Board for discussion. The Board's views are subsequently summarized and transmitted to the country's authorities, clearly with a view to influence policy. In the case of the WTO, there are quite explicit restrictions on what could be done with the product of transparency. As noted above, the Trade Policy Review Mechanism explicitly rules out the TPRM as a "basis for the enforcement of specific obligations ... or for dispute settlement procedures, or to impose new policy commitments on Members."

But this is not to say that the surveillance conducted by WTO bodies together with the observance of the transparency provisions of WTO Agreements by Members does not have the same potent effect. The transparency required of the measures that Members take, and in general of their trade regime, and the knowledge that the institution stands on watchful guard for possible violations create a powerful incentive for Members to abide by their commitments. That increases the level of confidence in the value of commitments made by the Members.

It also means there are less wilful violations of the Agreements and hence less frequent recourse to dispute settlement proceedings. Unnecessarily frequent disputes and recourse to dispute settlement are costly to WTO Members and to the institution because they require expenditures on resources and they can damage the reputation of the institution. To the extent that WTO surveillance reduces the frequency of such disputes among Members, it performs a valuable function.

(c) Transparency provisions in RTAs

Transparency provisions in RTAs appear to resemble many of the elements found in the multilateral trading system. Thus, bilateral and regional trade agreements typically contain schedules of concessions, as well as notification and publication obligations on a wide range of trade and regulatory measures (see Section D for a more extended discussion of transparency in RTAs). The one big difference may be the absence of a peer review mechanism like the Trade Policy Review Mechanism of the WTO. Moreover, given that membership in these agreements is considerably smaller than in the WTO, there is less of a requirement for internal transparency. Except for the largest regional integration agreements, such as the EC or NAFTA, there appears to be no equivalent effort to engage civil society groups and the general public by providing access to official documents or events.

7. CONCLUSIONS

This chapter began by asking two questions. What are the rules that make up a trade agreement? Why are institutions often established in addition to the rules?

In answer to the first question, five areas of rule-making were identified. Rules on reciprocal liberalization allow the parties to the trade agreement mutually to reduce levels of protection below that of the prisoners' dilemma outcome. Rules on anti-circumvention, such as national treatment, prevent parties from using domestic policy instruments to erode the value of trade concessions granted to partners. Rules on contingent measures allow parties to the agreement to escape temporarily from their liberalization commitments when domestic producers suffer injury. They trade off short-term protectionism in order to lock in deeper levels of liberalization. Enforcement deters defection from the terms of the agreement. Rules on transparency reduce the cost of acquiring information about trade partners' measures and policies so as to better to assess compliance with the terms of the agreement.

In answer to the second question, institutions are established because of the presence of transaction costs and information asymmetries. An institution is created because trade agreements may be incomplete contracts and because of a demand for a conciliator or honest broker. The institution is often vested with substantial authority and given important responsibilities. Among these important responsibilities are facilitating negotiations, disseminating information and settling international trade disputes.

The discussion in this chapter of the institution and the rules in trade agreements has been primarily of a conceptual or theoretical nature. But it provides an useful lens for assessing the contributions that can be made by trade rules and institutions. It shall be left to the last part of this Report – Section D – to narrate how these rules and the institution itself have evolved in the multilateral trading system, to identify the principal achievements of the system and the challenges that have emerged along the way.

BIBLIOGRAPHY

Abbott, K. and Snidal, D. (1998) 'Why States Act through Formal International Organizations', *The Journal of Conflict Resolution* 42, 1: 3-32.

Aggarwal, V. K. and Dupont, C. (1999), 'Goods, Games and Institutions', *International Political Science Review* 20, 4: 393-409.

Andersson, J., Bonaglia, F., Fukasaku K. and Lesser, C. (2005) 'Trade and Structural Adjustment Policies in Selected Developing Countries', *OECD Development Centre Working Paper* No. 245, DEV/DOC(2005)05, Paris: OECD.

Arrow, K. J. and Debreu, G. (1954) 'Existence of an equilibrium for a competitive economy', *Econometrica* 22, 3: 265-290.

Axelrod, R. (1984) *The Evolution of Cooperation*, New York, NY: Basic Books.

Bagwell, K. and Staiger, R. W. (1996) 'Reciprocal Trade Liberalization', *National Bureau of Economic Research (NBER) Working Paper* No. 5488, Cambridge, Mass.: NBER.

— (1997a) 'Multilateral tariff cooperation during the formation of Free Trade Areas', *International Economic Review* 38, 2: 291-319.

— (1997b) 'Multilateral tariff cooperation during the formation of Customs Unions', *Journal of International Economics* 42: 91-123.

— (1998) 'Will Preferential Agreements Undermine the Multilateral Trading System?', *The Economic Journal* 108, 449: 1162-1182.

— (1999a) 'An Economic Theory of GATT', *American Economic Review* 89, 1: 215-248.

— (1999b) 'Regionalism and Multilateral Tariff Cooperation', in Piggot, J. and Woodland, A. (eds) *International Trade Policy and Pacific Rim*, London: MacMillan.

— (2001) 'Domestic Policies, National Sovereignty, and International Economic Institutions', *Quarterly Journal of Economics* 116, 2: 519-562.

— (2002) *The economics of the world trading system*, Cambridge, Mass.: MIT Press.

— (2004a) 'Backward Stealing and Forward Manipulation in the WTO', *NBER Working paper,* No.10420,

— (2005a) 'Enforcement, Private Political Pressure and the GATT/WTO Escape Clause', *The Journal of Legal Studies* 34, 2: 471-513.

— (2005b) 'Multilateral Trade Negotiations, Bilateral Opportunism and the Rules of GATT/WTO', *Journal of International Economics* 67: 268-294.

Bagwell, K., Mavroidis, P. C. and Staiger, R. W. (2002) 'It's A Question of Market Access', *The American Journal of International Law* 96: 56-76.

— (2003) 'The Case for Auctioning Countermeasures in the WTO', *National Bureau of Economic Research (NBER) Working Paper* No. 9920, Cambridge, Mass.: NBER.

— (2007) 'Auctioning Countermeasures in the WTO," *Journal of International Economics*, forthcoming.

Baldwin, R. and Robert-Nicoud, F. (2005) 'Juggernaut Model – The Lego Version', mimeo, GIIS.

Baldwin, R. E. (1987) 'Multilateral Liberalisation', in Finger, J. M. (ed), *The Uruguay Round: A Handbook on the Multilateral Negotiations*, World Bank: Washington, D.C.

— (1994) *Toward an Integrated Europe*, London: CEPR.

— (1995) 'A Domino Theory of Regionalism' in Baldwin, R., Haaparanta, P. and Kiander, J. (eds) *Expanding Membership of the EU*, Cambridge: Cambridge University Press. pp. 25-48.

— (2006) 'Multilateralising Regionalism: Spaghetti bowls as building bloc on the path to global free trade', *World Economy* 29, 11: 1451-1518.

Baldwin, R. E. and Murray, T. (1977) 'MFN Tariff Reductions and Developing Country Trade Benefits Under the GSP', *Economic Journal* 87: 30-46.

Barfield, C. E. (2001) *Free Trade, Sovereignty, Democracy. The Future of the World Trade Organization,* Washington, D.C.: American Enterprise Institute.

Barnett, M. and Finnemore, M. (2004) *Rules for the World*, Ithaca, NY: Cornell University Press.

Barton, J. H., Goldstein, J. L., Josling, T. E. and Steinberg, R. H. (2006) *The Evolution of the Trade Regime*, Princeton and Oxford: Princeton University Press.

Battigalli, P. and Maggi, G. (2002) 'Rigidity, Discretion, and the Costs of Writing Contracts', *American Economic Review* 92, 4: 798.

Bawn, K. (1995). 'Political Control versus Expertise: Congressional Choices about Administrative Procedures', *American Political Science Review*, 89: 62-73.

Bhala, R. (1999) 'The Precedent Setters: *De Facto Stare Decisis* in WTO Adjudication', (Part Two of a Trilogy), *Journal of Transnational Law and Policy* 9: 1-151.

Bhandari, J. S. and Sykes, A. O. (1998) *Economic Dimensions in International Law: Comparative and Empirical Perspectives*, Cambridge: Cambridge University Press.

Bown, C. P. (2002) 'The Economics of Trade Disputes, the GATT's Article XXIII, and the WTO's Dispute Settlement Understanding', *Economics and Politics*, *14*, 3: 283-322.

— (2004) 'Trade Policy Under the GATT/WTO: Empirical Evidence of the Equal Treatment Rule', *Canadian Journal of Economics* 37, 3: 678-720.

Bütler, M. and Hauser, H. (2002) 'The WTO Dispute Settlement Mechanism: A First Assessment from an Economic Perspective', *Journal of Law, Economics & Organization 16*, 2: 503-33.

Calvert, R. (1995) 'The Rational Choice Theory of Social Institutions', in Banks, J. and Hanushek, E., *Modern Political Economy*, Cambridge, UK: Cambridge University Press. pp. 216-67.

Caplin, A. and Krishna, K. (1988) 'Tariffs and the Most-Favoured-Nation Clause: A Game Theoretic Approach', *Seoul Journal of Economics* 1, 267-289.

Carr, E. H. (1964) *The Twenty Years Crisis, 1919-1939,* New York, NY: Harper and Row.

Chang, W. and Winters, A. L. (2001) 'How regional blocs affect excluded countries: the price effects of MERCOSUR', *American Economic Review* 92, 4: 889-904.

Checkel, J. (ed) (2007) *International Institutions and Socialization in Europe*, Cambridge, U.K.: Cambridge University Press.

Checkel, J. T. (1998) 'The Constructivist Turn in International Relations Theory', *World Politics* 50, 2: 324-348.

Choi, J. P. (1995) 'Optimal tariffs and the choice of technology: discriminatory tariffs vs. the "Most Favored Nation clause"', *Journal of International Economics,* 39: 143–160.

Coase, R. H. (1937) 'The Nature of the Firm', *Economica* 4, 16: 386-405.

Cohen, M. D., March, J. G., and Olsen, J.P. (1972) 'A Garbage Can Model of Organizational Choice', *Administrative Science Quarterly,* 17: 1-25.

Conconi, P. and Perroni, C. (2005) 'Special and Differential Trade Regimes', mimeo.

Copeland, B. (1990) 'Strategic Interaction among Nations: Negotiable and Non-Negotiable Trade Barriers', *Canadian Journal of Economics* 23, 1: 84-108.

Cossy, M. (2006) 'Determining "likeness" under the GATS: Squaring the Circle?', *Staff Working Paper* 2006-08, Geneva: World Trade Organization.

Cox, R. and Jacobson, H. (1973) *The Anatomy of Influence: Decision-making in International Organization,* New Haven, NJ. Yale University Press.

Craswell, R. (1999) 'Contract Law: General Theories', in Bouckaert, B. and de Geest, G., *Encyclopedia of Law and Economics*, Ghent: Edward Elgar, University of Ghent. Chapter 4000: pp. 1-24.

Curzon, P. V. (1991) 'GATT's New Trade Policy Review Mechanism', *The World Economy* 14,2: 227-238.

Cyert, R. M. and March, J. G. (1963) *A Behavioral Theory of the Firm,* Englewood Cliffs: Prentice Hall.

Davey, W. J. (2001) 'Has the WTO Dispute Settlement System Exceeded Its Authority? A Consideration of Deference Shown by the System to Member Government Decisions and Its Use of Issue-Avoidance Techniques', *Journal of International Economic Law* 4, 1: 79-110.

Dixit, A. (1987) 'Strategic Aspects of Trade Policy', Bewley, T. F. (ed.), *Advances in Economic Theory: Fifth World Congress*. New York: Cambridge University Press. pp. 329-62.

Downs, G. W. and Rocke, D. (1995) *Optimal Imperfection? Institutions and Domestic Politics in International Relations*, Ann Arbor, Michigan: University of Michigan Press.

Dunoff, J. L. and Trachtman, J. P. (1999) 'Economic Analysis of International Law', *Yale Journal of International Law* 24, 1: 1-59.

Ederington, J. (2001) 'International Coordination of Trade and Domestic Policies', *The American Economic Review* 91, 5: 1580-1593.

Ehring, L. (2002) 'De Facto Discrimination in World Trade Law: National and Most-Favoured-Nation Treatment – or Equal Treatment', *Journal of World Trade* 36, 5: 921-977.

Elsig, M. (2007) 'The World Trade Organization's Legitimacy Crisis: What Does The Beast Look Like?', *Journal of World Trade*, forthcoming.

Ethier, W. J. (1998) 'Regionalism in a Multilateral World', *Journal of Political Economy* 106:1214-45.

— (2001) 'Punishments and Dispute Settlement in Trade Agreements', *Penn Institute for Economic Research (PIER) Working Paper* 01-021, Philadelphia, PA: University of Pennsylvania.

— (2004) 'Political Externalities, Non-discrimination, and a Multilateral World', *Review of International Economics* 12, 3: 303-320.

— (2006) 'Selling Protection for Sale', *PIER Working Paper* 06-14.

Falvey, R., Greenaway D. and Silva, J. (2006) 'Trade, Human Capital and Labour Market Adjustment', University of Nottingham Research Paper 2006/03, Globalisation and Labour Markets Research Paper Series.

Fearon, J. D. (1998) 'Domestic Politics, Foreign Policy, and Theories of International Relations', *Annual Review of Political Science* 1: 289-313.

Finger, J. M. (1979) 'Trade Liberalization: A Public Choice Perspective,' in Amacher, R. C.; Haberler, G., and Willet, T. D., (eds) *Challenges to a Liberal International Economic Order*, Washington, DC: American Enterprise Institute.

— (2005) 'A diplomat's economics: reciprocity in the Uruguay Round negotiations', *World Trade Review* 4, 1: 27-40.

Finger, J. M. and Nogues, J. J. (2005) Safeguards and Antidumping in Latin American Trade Liberalization: Fighting Fire with Fire, Palgrave MacMillan.

Finger, J. M. and Schuler, P. (1995) 'Implementation of Uruguay Round Commitments: The Development Challenge', *World Economy* 23, 4: 511-526.

Finger, J. M., Hall, H. K. and Nelson, D. R. (1982) 'The political economy of administered protection', *American Economic Review* 72, 3: 452-466.

Finnemore, M. (1996) *National Interests in International Society*, Ithaca: Cornell University Press.

Finnemore, M. and Sikkink, K. (1998) 'International Norm Dynamics and Political Change', *International Organization* 52, 4: 887-918.

— (2001) 'Taking Stock: The Constructivist Research Program in International Relations and Comparative Politics', *Annual Review of Political Science* 4: 391-416.

Furusawa, T. (1999) 'The Optimal Penal Code vs. Infinite Nash Reversion in Trade Liberalization' *Review of International Economics* 7, 4: 673.

Gatsios, K. (1991) 'Preferential Tariffs and the "Most-Favoured-Nation" Principle: A Note', *Journal of International Economics* 28: 365-373.

Ghosh, M., Perroni, C. and Whalley, J. (2003) 'Developing-Country Benefits from MFN Relative to Regional/Bilateral Trade Arrangements', *Review of International Economics* 11, 4: 712-728.

Glaser, C. (1995) 'Realists as Optimists: Cooperation as Self-Help', *International Security* 19: 50-93.

Greenaway, D. and Kneller, R. (2004) 'Industry Differences in the Effect of Export Market Entry: Learning by Exporting?', *University of Nottingham Working Paper* No. 2004/33.

Greif, A., Milgrom, P. and Weingast, B. R. (1994) 'Merchant gilds', *Journal of Political Economy* 102: 745-76.

Grossman, G. (1990) 'Promoting new industrial activities: A survey of recent arguments and evidence', *OECD Economic Studies* No. 14, Paris: OECD.

Grossman, G. and Helpman, E. (1995) 'The Politics of Free Trade Agreements', *American Economic Review* 85, 4: 667–690.

Grossman, G. and Maggi, G. (1997) 'Free Trade vs. Strategic Trade: A Peek into Pandora's Box', *NBER Working Paper,* No. W621.

Gruber, L. (2000) *Ruling the World Power Politics and the Rise of Supranational Institutions*, Princeton, NJ: Princeton University Press.

Hauser, H. and Roitinger, A. (2004) 'Two Perspectives on International Trade Agreements', *Zeitschrift für ausländisches öffentliches Recht und Völkerrecht* 64,3: 641-58.

Hausman, R. and Rodrik, D. (2003) 'Economic development as self-discovery', *Journal of Development Economics* 72, 2: 603-633.

Hawkins, D.G., Lake, D., Nielson, D. L. and Tierney, M. J. (eds) (2006) *Delegation and Agency in International Organizations* Cambridge, U.K: Cambridge University Press.

Herzing, M. (2004) *Essays on Uncertainty and Escape in Trade Agreements*, Dissertation at Stockholm University. Stockholm, Sweden.

Hippler Bello, J. (1996) 'The WTO Dispute Settlement Understanding: Less is More', *American Journal of International Law* 90, 3: 416-418.

Hoda, A. (2001) *Tariff Negotiations and Renegotiations under the GATT and the WTO: Procedures and Practices,* Cambridge: University Press.

Hoekman, B. and Kostecki, M. (2001) *The Political Economy of the World Trading System*, New York, NY: Oxford University Press.

Horn, H. (2006) 'National Treatment in the GATT', *American Economic Review* 96, 1: 394-494.

Horn, H. and Mavroidis, P. (2001) 'Economic and Legal Aspects of the Most-Favoured Nation Clause', *European Journal of Political Economy* 17, 2: 233-279.

Horn, H., Maggi, G. and Staiger, R. W. (2005) 'The GATT/WTO as an Incomplete Contract and the Role of Dispute Settlement Procedures', mimeo.

— (2006) 'The GATT/WTO as an Incomplete Contract', *NBER Working Paper No.* W12745.

Howse, R. (2002) 'From Politics to Technocracy – and Back Again: The Fate of the Multilateral Trading Regime', *The American Journal of International Law* 96: 94-117.

Hudec, R. E. (1990) *The GATT Legal System and World Trade Diplomacy*, Salem, N.H.: Butterworth Legal Publishers.

Hungerford, T. (1991) 'GATT: A cooperative equilibrium in a non-cooperative trading regime?' *Journal of International Economics* 31, 3-4: 357-369.

Hwang, H. and Mai, C.-C. (1991) 'Optimum Discriminatory Tariffs Under Oligopolistic competition', *Canadian Journal of Economics* 24, 3: 693-702.

Irwin, D. (2002) *Free Trade Under Fire,* Oxford: Princeton University Press.

Jackson, J. (1997) *The World Trading System—Law and Policy of International Economic Relations,* (2nd ed.) Cambridge, MA.: The MIT Press.

Johnson, H. (1960) 'The economic theory of customs union', *Pakistan Economic Journal* 10, 1: 14-32.

— (1965) 'An Economic Theory of Protectionism, Tariff Bargaining and the Formation of Customs Unions', *Journal of Political Economy* 73, 3:256-283.

Jones, K. (2004) 'The safeguards mess revisited: the fundamental problem', *World Trade Review* 3, 1: 83-91.

Kaplow, L. and Shavell, S. (1996) 'Property Rules Versus Liability Rules: An Economic Analysis', *Harvard Law Review* 109, 4: 713-90.

Karacaovali, B. and Limão, N. (2005) 'The Clash of Liberalization: Preferential versus Multilateral Trade Liberalization in the European Union', *The World Bank Policy Research Working Papers Series* N. 3493.

Kemp, M. C. and Wan, H. Y. Jr. (1976) 'An Elementary Proposition Concerning the Formation of Customs Unions', *Journal of International Economics* 6, 1: 95.98.

— (1986) 'The Comparison of Second-Best Equilibria: the Case of Customs Unions', *Zeitschrift für Nationalökonomie* Supplement 5 161-167.

Keohane, R. O. (1984) *After Hegemony: Cooperation and Discord in the World Political Economy*, Princeton, NJ: Princeton University Press.

— (1989) 'Neoliberal Institutionalism: A Perspective on World Politics', in Keohane, R. O. (ed) *International Institutions and State Power: Essays in International Relations Theory*, Boulder, CO: Westview. pp. 1-20.

Klimenko, M., Ramey, G. and Watson, J. (2002) 'Recurrent Trade Agreements and the Value of External Enforcement', mimeo.

Knetter, M. and Prusa, T. (2003) 'Macroeconomic factors and antidumping filings: evidence from four countries', *Journal of International Economics* 61, 1: 1-17.

Koremenos, B., Lipson, C., and Snidal, D. (2001) 'The Rational Design of International Institutions' *International Organization* 55, 4: 761-99.

Kovenock, D. and Thursby, M. (1992) 'GATT dispute settlement and cooperation', *Economics and Politics* 4, 2: 151-170.

Krasner, S. D.(1983) (ed) *International Regimes*, Ithaca, NY: Cornell University Press.

Kratochwil, F. and Ruggie, J. G. (1986) 'International Organization: A State of the Art on an Art of the State', *International Organization* 40, 4 (Autumn): 753-775.

Krishna, K. and Kruger, A. (1995) 'Implementing free trade areas: rules of origin and hidden protection', in Levinsohn, J., Deardorff, A. and Stern, R. (eds) *New Directions in Trade Theory,* Ann Arbor: University of Michigan Press.

Krishna, P. (1998) 'Regionalism and Multilateralism: A Political Economy Approach', *Quarterly Journal of Economics* 113: 227–252.

— (2003) 'Are regional trading partners "natural"?', *Journal of Political Economy* 111, 1 :202-226.

Krueger, A. (1997) 'Free trade agreements versus customs unions', *Journal of Development Economics* 54, 1: 169-187.

Krugman, P. (1991) 'The Move to Free Trade Zones', paper presented at the symposium sponsored by the Federal Reserve Bank of Kansas City, Policy Implications of Trade and Currency Zones, Jackson Hole, Wyoming, 22-24 August, pp. 7-41.

Langhammer, R. and Sapir, A. (1987) *Economic Impact of Generalized Tariff Preferences*, London: Trade Policy Research Centre.

Lavergne, R. P. (1983) *The Political Economy of U.S. Tariffs,* New York: Academic Press.

Lawrence, R. Z. (2003) *Crimes and Punishments? Retaliation under the WTO*, Washington, D.C.: Institute for International Economics

Lerner, A. (1936) 'The symmetry between import and export taxes', *Economica* 3, 11: 306-313.

Levy, P. (1997) 'A Political–Economic Analysis of Free-Trade Agreements', *American Economic Review* 87, 4: 506–519.

Limão, N. (2002) 'Are preferential trade agreements with Non-trade Objectives a stumbling block for Multilateral liberalization?', University of Maryland, Center for international economics, *Working Paper* N. 02-02.

— (2006) 'Preferential Trade Agreements as Stumbling Blocks for Multilateral Trade liberalization: Evidence for the United State', *American Economic Review* 96, 3: 896-914.

Limão, N. and Venables, A. J. (2001) 'Infrastructure, Geographical Disadvantage, Transport Costs, and Trade', *World Bank Economic Review* 15, 3: 451-479.

Lipsey, R. G. (1957) 'The Theory of Customs Unions : Trade Diversion and Welfare', *Economica* 24, 1: 40-46.

— (1960) 'The theory of customs unions: a general survey', *Economic Journal* 70, 279: 496-513.

Ludema, R. D. (1991) 'International Trade Bargaining and the Most-Favoured-Nation Clause', *Economics and Politics 3,*1: 1-20.

— (2001) 'Optimal international trade agreements and dispute settlement procedures', *European Journal of Political Economy* 17, 3: 355-376.

Ludema, R. D. and Mayda, A. M. (2005) 'Do countries free ride on MFN', *Discussion Paper* N. 5160, the Centre for Economic Policy Research.

Lumsdaine, D. H. (1993) *Moral Vision in International Politics: The Foreign Aid Regime 1949-1989*, Princeton, NJ: Princeton University Press.

MacLeod, W. B. (2006) 'Reputations, Relationships and the Enforcement of Incomplete Contracts', Center for Economic Studies & Ifo Institute for Economic Research (CESifo) *Working Paper* No. 1730, Munich: CESifo.

Maggi, G. (1999) 'The role of multilateral institutions in international trade cooperation', *American Economic Review* 89, 1: 190-213.

Maggi, G. and Rodriguez-Clare, A. (1998) 'The Value of Trade Agreements in the Presence of Political Pressures', *Journal of Political Economy* 106, 3: 574-601.

— (2007) A political-economy theory of trade agreements', mimeo.

Marceau, G. and Trachtman, J. P. (2002) 'The Technical Barriers to Trade Agreement, the Sanitary and Phytosanitary Measures Agreement, and the General Agreement on Tariffs and Trade: A Map of the World Trade Organization Law of Domestic Regulation of Goods', *Journal of World Trade* 36,5: 811-881.

Maskin, E. and Tirole, J. (1999) 'Unforeseen Contingencies and Incomplete Contracts', *Review of Economic Studies*, 66: 83-114.

Maskus, K. E. (2000) *Intellectual Property Rights in the Global Economy*, Washington D.C.: Institute for International Economics (IIE).

Masten, S. (1999) 'Contractual Choice', in Bouckaert, B. and De Geest, G., (eds) *Encyclopaedia of Law and Economics*, Ghent: Edward Elgar, University of Ghent. pp. 25-45 (Chapter 4100).

Matsuyama, K. (1990) 'Perfect Equilibria in a Trade Liberalization Game', *American Economic Review* 80, 3: 480-492.

Mattoo, A. and Subramanian, A. (1998) 'Regulatory Autonomy and Multilateral Disciplines: The Dilemma and a Possible Resolution', *Journal of International Economic Law* 1: 303-322.

Matusz, S. J. and Tarr, D. (1999) 'Adjusting to Trade Policy Reform', *World Bank Policy Research Working Paper* No. 2142, Washington D.C.: World Bank.

Mavroidis, P. C. (2000) 'Remedies in the WTO Legal System: Between a Rock and a Hard Place', *European Journal of International Law 11*, 4: 763.

— (2007) 'Trade in Goods', Oxford, UK: Oxford University Press (forthcoming).

Mayer, W. (1981) 'Theoretical considerations on negotiated tariff adjustments', *Oxford Economic Papers* 33, 1: 135-153.

McCall Smith, J. (2003) 'WTO dispute settlement: the politics of procedure in Appellate Body rulings', *World Trade Review* 2: 65-100.

McLaren (2001) 'A theory of Insidious Regionalism', University of Virginia, mimeo.

Mearsheimer, J. J. (1994) 'The False Promise of International Institutions', *International Security* 19,3: 5-49.

Melitz, M. J. (2005) 'When and how should infant industries be protected?', *Journal of International Economics* 66, 1: 177-196.

Milgrom, P. R., North, D. C. and Weingast, B. R. (1990) 'The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and the Champagne Fair', *Economics and Politics*, 2, 1: 1-23.

Morrow, J. (1994) 'The Forms of International Cooperation', *International Organization* 48: 387-424.

Neven, D. J. (2001) 'How Should "Protection" Be Evaluated in Article III GATT Disputes?', *European Journal of Political Economy* 17: 421-444.

North, D.C. (1990) 'Institutions, Institutional Change, and Economic Performance', New York: Cambridge University Press, 1990.

Olsen, J. (1997) 'European Challenges to the Nation State', in Steunenberg, B. and van Vught, F., (eds) *Political Institutions and Public Policy,* Dordrecht, NL: Kluwer: 157-88.

Organization of Economic Cooperation and Development (OECD) (2001) 'Regional Integration: Observed Trade and Other Economic Effects', Working Party of Trade Committee, TD/TC/WP(2001)19/Rev.1, Paris: OECD.

Oye, K. (1986) *Cooperation under Anarchy*, Princeton, NJ: Princeton University Press.

Ozden, C. (2001) 'Trade Agreements Under Asymmetric Information and Efficiency Gains from WTO's Dispute Settlement Process', mimeo, Emory University.

Pauwelyn, J.. (2001) 'The Role of Public International Law in the WTO: How Far Can We Go?', *American Journal of International Law 95*, 3: 535-78.

Petersmann, E.-U. (1996) *The GATT/WTO Dispute Settlement System: International Law, International Organizations and Dispute Settlement*. London: Kluwer Law International.

Piermartini, R. and Budetta, M. (2006) 'A Mapping of Regional Rules on Technical Barriers to Trade', paper presented at the workshops on "Regional Rules and the Global Trading System" held on 26-27 July 2006 in Washington D.C.

Pomfret, R. (1997) *Unequal Trade: The Economics of Regional Trading Arrangements*, New York: Basil Blackwell ltd.

Posner, R. A. (1988) *Economic Analysis of the Law*, Boston, MA: Little, Brown and Co.

Powell, R. (1994) 'Anarchy in International Relations Theory: The Neorealist-Neoliberalist Debate', *International Organization* 48,2: 313-344.

Puga, D. and Venables, A. J. (1998) 'Agglomeration and Economic Development: Import Substitution Vs. Trade Liberalization', Centre for Economic Policy Research (CEPR) *Discussion Paper* No. 1782, London: CEPR.

Rawls, J. (1971) *A Theory of Justice*, Cambridge, Mass: Harvard University Press.

Reinhardt, E. (2000) 'Aggressive Multilateralism: The Determinants of GATT/WTO Dispute Initiation, 1948-1998', mimeo.

Rosendorff, B. P. (2005) 'Stability and Rigidity: Politics and Design of the WTO's Dispute Settlement Procedures', *American Political Science Review* 99, 3: 389-400.

Rosendorff, B. P. and Milner, H. V. (2001) 'The Optimal Design of International Trade Institutions: Uncertainty and Escape', *International Organization* 55, 4: 829-857.

Ruggie, J. G. (1983) 'International Regimes, Transactions and Change: Embedded Liberalism in the Postwar Economic Order', in Krasner, S. D. (ed) *International Regimes*, Ithaca, NY: Cornell University Press.

Saggi, K. (2004) 'Tariffs and the most favoured nation clause', *Journal of International Economics 63,* 2: 341-368.

Schotter, A. (1981) *The Economic Theory of Social Institutions*, Cambridge, UK: Cambridge University Press

Schuknecht, L. (1992) *Trade Protection in the European Community,* Reading: Hardwood Academic Publishers.

Schwartz, W. F. and Sykes, A. O. (1997) 'The Economics of the Most-Favoured Nation Clause', in Bhandari, J. and Sykes, A. (eds) *Economic Dimensions in International Law*, Cambridge, UK: Cambridge University Press.

— (2002) 'The Economic Structure of Renegotiation and Dispute Resolution in the WTO/GATT System', *Journal of Legal Studies* 31, 1: 179-204.

Shavell, S. (1980) 'Damage Measures for Breach of Contract', *Bell Journal of Economics 11*, 2: 466-90.

Simmons, B.A. and Martin, L. L. (2002) 'International Organizations and Institutions', in Carlsnaes, W., Risse, T. and Simmons, B.A. (eds) *Handbook of International Relations,* London, UK: Sage.

Staiger, R. W. (1995) 'International Rules and Institutions for Trade Policy' in Grossman, G. and Rogoff, K., (eds) *Handbook of International Economics*, vol. III. Amsterdam: North Holland.

— (2004) 'Report on the International Trade Regime for the International Task Force on Global Public Goods', mimeo. Available at http://www.gpgtaskforce.org/uploads/files/41.pdf. Accessed 16/03/2007.

— (2006) 'Review of Behind the Scenes at the WTO: the Real World of International Trade Negotiations: Lessons of Cancun', *Journal of Economic Literature* XLIV: 428-442.

Staiger, R. W. and Tabellini, G. (1987) 'Discretionary Trade Policy and Excessive Protection', *American Economic Review* 77, 5: 823-837.

Summers, L. (1991) 'Regionalism and the world trading system', paper presented at the symposium sponsored by the Federal Reserve Bank of Kansas City, Policy Implications of Trade and Currency Zones, Jackson Hole, Wyoming, 22-24 August, pp. 295-302.

Sykes, A. O. (1991) 'Protectionism as a "Safeguard": A Positive Analysis of the GATT "Escape Clause" With Normative Speculations', *University of Chicago Law Review* 58, 1: 255-305.

— (2000) 'The Remedy for Breach of Obligations under the Wto Dispute Settlement Understanding: Damages or Specific Performance?', in Bronckers, M. and Quick, R. (eds) *New Directions in International Economic Law*, The Hague: Kluwer Law International. pp. 347-57.

Teh, R., Prusa, T. F. and Budetta, M. (2007) 'Mapping trade remedy provisions in regional trade agreements', WTO Working Paper ERSD-2007-03, Geneva: WTO.

Tharakan, P. K. M. (1995) 'Political Economy and Contingent Protection', *Economic Journal* 105, 433: 1550-1564.

Tharakan, P. K. M. and Waelbroeck, J. (1994) 'Antidumping and countervailing duty decisions in the EC and in the US: an experiment in comparative political economy', *European Economic Review* 38, 1: 171-193.

Thompson, A. and Snidal, D. (2005) 'Guarding the Equilibrium: Regime Management in the WTO', paper presented at the Annual Meeting of the American Political Science Association, Washington, D.C., 1-4 September 2005.

Tirole, J. (1994) 'Incomplete Contracts: Where Do We Stand?', *Econometrica* 67, 4: 741-81.

To, T. (1999) 'Dynamic and Discriminatory Import Policy', *Canadian Journal of Economics* 32, 4: 1057-1068.

Tornell, A. (1991) 'Time Inconsistency of Protectionist Programs', *Quarterly Journal of Economics*, 106, 3: 963-974.

United Nations Conference on Trade and Development (UNCTAD) (1999) 'Quantifying the benefits obtained by developing countries from the Generalized System of Preferences', Note by the UNCTAD secretariat UNCTAD/ITCD/TSB/Misc.52, Geneva: UNCTAD.

United States Committee on Finance (1973) 'The Most Favoured Nation', *Executive Branch GATT study* No. 9.

Viner, J. (1924) 'The Most-Favoured-Nation Clause in American Commercial Treaties', *Journal of Political Economy* 32, 1: 101-129.

— (1931) 'Cost Curves and Supply Curves', *Zeitschrift für National Ökonomie* 3: 23-46.

— (1936) 'Mr Keynes on the Causes of Unemployment', *Quarterly Journal of Economics*, 51: 147-67

— (1950) *The Theory of Customs Unions,* New York: Carnegie Endowment for International Peace.

Williamson, O. E. (1975) *Markets and Hierarchies: Analysis and Antitrust Implications*, NY: The Free Press.

— (1979) 'Transaction-Cost Economics: The Governance of Contractual Relations', *Journal of Law and Economics* 22: 233-61.

— (1985) *The Economic Institutions of Capitalism*, New York, NY: Free Press.

Wolfe, R. (2003) 'Regulatory transparency, developing countries and the WTO', *World Trade Review* 2, 2: 157-182.

Wonnacott, P. and Lutz, M. (1989) 'Is there a case for free trade areas?', in Schott, J. J. (ed) *Free Trade Areas and U.S. Trade Policy,* Washington: Institute for International Economics.

World Bank (2005) *Global Economic Prospects*, Washington, DC: The World Bank.

World Trade Organization (WTO) (1994) *The Results of the Uruguay Round of Multilateral Negotiations: The Legal Texts*, Geneva: WTO.

— (1995) *Regionalism and the World Trading System,* Geneva: WTO.

— (2003) *World Trade Report 2003,* Geneva: WTO.

— (2004) *World Trade Report 2004: Exploring the Linkage between the Domestic Policy Environment and International Trade*, Geneva: WTO.

Young, O. (1994) *International Governance,* Ithaca, NY: Cornell University Press.

D SIXTY YEARS OF THE MULTILATERAL TRADING SYSTEM: ACHIEVEMENTS AND CHALLENGES

Earlier Sections in this Report have sought to understand why international cooperation in trade matters seems to make sense to governments and how such cooperation translates into institutions and rules. We will now focus on the main achievements of multilateral trade cooperation over the last six decades and explore some of the core challenges and issues that the system faces today. The Section begins with a brief historical journey from the birth of the GATT to the establishment of the WTO. Subsection 2 records the efforts of governments over the years to reduce tariffs and address non-tariff measures. It also discusses briefly what can be said about the relationship between the GATT/WTO's role in reducing and consolidating tariffs and the growth of trade. Subsection 3 analyses the evolution of dispute settlement in the GATT/WTO, focusing on how the system has developed and performed during the last six decades. The theme of subsection 4 is developing country participation in the multilateral trading system. The subsection focuses on how developing country issues have increasingly found their way onto the multilateral agenda and the systemic challenges posed by a heterogeneous membership with divergent needs, interests and priorities. Subsection 5 addresses the phenomenon of regionalism and how the multilateral trading system has attempted to address burgeoning regional and bilateral trade policy tendencies. Subsection 6 deals with two procedural issues that have far-reaching systemic implications and go to the heart of legitimacy questions confronting the WTO. The subjects at hand are decision-making processes in the WTO and the relationship between the WTO and the outside world – specifically, non-state actors. Finally, subsection 7 explores the complex question of what can be said about how the WTO agenda is shaped and whether there exists a meaningful sense in which limits may be set to subject areas for cooperation under the WTO.

1. FROM GATT TO WTO: THE BUILDING OF AN ORGANIZATION

Here we examine the history of the trading system as it moved from the GATT to the WTO, including the seven rounds of trade negotiations prior to the Uruguay Round. Some of the key themes during this period will be taken up in more detail later.

A mix of economic and political factors conditioned the evolution of the trading system between 1947 and 2007. The six decades of the GATT/WTO can be divided roughly into four time periods. The first period is between 1947 and 1963 when the Contracting Parties were gaining experience with the rules to which they had committed as well as establishing procedures for negotiations. By 1963, two specific challenges faced the trading system – how to deal with non-tariff measures and the concerns of developing countries. We shall examine how the GATT responded to these challenges in the second period between 1963 and 1979. The third period, from 1980 to 1995, was dominated by efforts to launch a new trade negotiation, then by the Uruguay Round negotiations, and finally the birth of the WTO. The fourth period deals with life so far under the WTO, marked in particular by the launch of the Doha Round and the negotiations which continue today.

(a) The emergence of an Organization: The GATT between 1947-1963

(i) A difficult birth

The United States emerged as the leading political and economic power after World War II. In contrast to the aftermath of World War I the United States was now willing to take over a large share of responsibility in building a new international economic system. Concerning international trade policy, the United States wanted to avoid at any cost a renewed protectionist battle, as happened in the 1930s (see Section B.1). Trade was an essential component of the Bretton Woods plan.

As in the case of the other Bretton Woods institutions, the first negotiations between the United States and the British government over the design of a post-war trade system had already begun in 1941 (Atlantic Charter). During these negotiations two major disagreements emerged. First, whereas the

Americans advocated non-discrimination without exception, the British wanted to continue with their system of preferential treatment of Commonwealth countries (Low, 1993). Second, in contrast to the Americans the British wanted to see the inclusion of rules that would have allowed the use of temporary import barriers. In the end, the two parties agreed in the suggested "Charter for the International Trade Organisation" that preference systems in existence at a specific date be excepted from the general rule, but that members of the forthcoming organisation pledge themselves not to increase existing margins but to reduce them through negotiation, the ultimate aim being total elimination (Kock 1969:44) and that trade restrictions could be imposed in the case of balance-of-payment difficulties.

Based on this American-English proposal, the Economic and Social Council of the United Nations called for a conference to establish the International Trade Organization (ITO). Eighteen countries joined the preparatory committee that held four meetings to draft the ITO Charter from October 1946 to March 1948. The last meeting took place from November 1947 until March 1948 in Havana[1] and the Charter for an International Trade Organization (ITO) was signed by 53 nations. The ITO Charter contained 106 Articles and 16 annexes covering not only trade policy, but agreements on employment and economic activity, restrictive business practices and inter-governmental commodity agreements.

A majority in the United States Congress opposed the Charter. Several business groups in the United States judged the Charter overloaded with topics only indirectly related to trade (e.g. employment and antitrust). Others were concerned that foreign investment was inadequately protected under the Charter (Ostry, 1997). At the end of 1950, President Truman decided not to submit the ITO for congressional approval. Even though the ITO was a stillbirth, this did not man the demise of the multilateral trading system.

The GATT emerged as a by-product of the negotiations around the ITO Charter. Originally, it was intended to serve as a temporary agreement until the ratification of the ITO Charter. Once the Charter was to have come into existence, GATT would automatically expire. The provisional character of GATT was also reflected in the fact that the signatories were called "Contracting Parties" in order to dispel any concern that an international organization had been established. The GATT was signed by 23 countries[2] on October 30, 1947, during one of the meetings of the preparatory committee for the ITO held in Geneva, and entered into force on January 1, 1948.

The GATT consisted mainly of the commercial policy provisions of the ITO Charter, with minor formal adjustments. The overall objective of the GATT was to reduce barriers to trade, especially tariffs, and to limit the use of certain trade barriers, such as quotas. The negotiating parties agreed that substantial tariff cuts could only be achieved if certain exceptions were included in the structure of trade rules. The GATT therefore contains several escape clauses and contingent provisions. Among these are remedies against dumping and subsidies (Article VI), balance-of-payment exceptions (Article XII), and safeguards against import surges (Article XIX). A cornerstone of the GATT system was the principle of non-discrimination or the most-favoured nation (MFN) principle. Again, several exceptions from this principle were permitted, mainly to facilitate reconstruction of postwar Europe and a continuation of existing preference systems. Compared to the ITO Charter, the commitments of the GATT were less binding and the coverage of topics much narrower. However, flexibility and a more concentrated focus facilitated the adoption and ratification of GATT.

(ii) A hopeful beginning: the Geneva, Annecy, and Torquay Rounds

The negotiation leading to the creation of the GATT provided the first major step toward tariff reductions. In this first round of multilateral trade negotiations the Contracting Parties concluded 123 agreements covering around 15,000 tariff items, affecting about 40 per cent of world trade (see subsection 2.(a).(i)).

[1] For this reason the ITO Charter later became known as Havana Charter.

[2] Australia, Belgium, Brazil, Burma, Canada, Ceylon, Chile, China, Cuba, Czechoslovakia, France, India, Lebanon, Luxembourg, Netherlands, New Zealand, Norway, Pakistan, Southern Rhodesia, Syria, South Africa, the United Kingdom and the United States.

It is interesting to note that the tariff negotiations had taken place on a bilateral and product-by-product basis.[3] This meant that prior to the negotiations countries would establish lists of "requests" for tariff concessions on various products from each trading partner. The negotiating parties would then exchange these requests and attempt to match them with offers. If a country agreed to reduce a tariff in a negotiation with one trading partner, the tariff reduction would automatically be extended via MFN to all other parties. We lack appropriate data to gauge the precise extent of the tariff cuts. Only for the United States is a detailed analysis available (see Section D.2.(a) below). However, it is generally recognized that the United States made the most generous tariff concessions reflecting its strong economic situation and relatively high level of tariff protection. Improved access to the US market allowed Western European countries to expand their exports and in return buy US capital goods.

The second tariff conference was held in Annecy in October 1949 and resulted in the accession of eleven countries. The original 23 Contracting Parties did not negotiate tariff concessions with each other, but only with the acceding countries. As a consequence, the negotiations delivered tariff commitments on only 5000 items, delivering a modest reduction in overall tariff levels (ICITO, 1952). Another boost for growth of world trade came from the Organization for European Economic Cooperation (OEEC), which had been founded in 1948 mainly to help administer the Marshall Plan for the reconstruction of Europe after the second World War. OEEC members decided to launch a programme to eliminate progressively trade barriers within Europe, such as licenses, quotas, and exchange restrictions. The first move towards the elimination of quotas in 1949-50 led to a strong recovery of intra-European trade volumes, helping to clear the way for the creation of a Common Market some years later (Irwin, 1994).

All tariff reductions and bindings agreed upon in Geneva and Annecy were supposed to expire by January 1, 1951. In light of this approaching deadline, the Contracting Parties met again in the fall of 1950. They first decided that any renegotiations of tariff concessions made during the previous rounds should be consolidated at Torquay. The new tariff schedules resulting from the negotiations should then be extended for another three years. The negotiations took place among existing Contracting Parties and between the Contracting Parties and six acceding countries, – most importantly the Federal Republic of Germany. The outcome of the Torquay Round was impressive. The Contracting Parties agreed to leave the vast majority of commitments made during the Geneva and Annecy Rounds intact, and even decided to add another 8700 tariff items to the agreement (ICITO, 1952).

Despite this success, progress in certain negotiations was disappointing. The Commonwealth countries were hesitant to grant substantial tariff cuts because they would have reduced the preference margins they accorded one another. Disparities in tariff levels constituted another problem. A number of European countries with relatively low tariff levels felt they had exhausted their bargaining power in the last two rounds and were unable to offer more in order to obtain further concessions from other countries. Finally, President Truman's decision not to submit the ITO to Congress also cast a shadow over the Torquay negotiations.

(iii) Development issues, the Review Session, and the Geneva and Dillon Rounds

With the ITO definitely dead, the Contracting Parties in 1954 decided to discuss the long-term future of the GATT. They therefore convened an extraordinary session, the so-called Review Session, to undertake a review of the GATT. One proposal was to try again to create a formal international organization, this time to be called the Organization for Trade Cooperation (OTC). However, once again the US Congress refused to ratify the OTC charter, and the Contracting Parties had to agree on less ambitious reforms. The participating governments conducted a thorough review of the GATT's provision and came up with three basic changes (Hudec, 1987). First, it was agreed to rewrite Article XVIII which contained the infant-industry exceptions. The introduction of Article XVIII was rephrased to characterize the exceptions as part of GATT policy and not from derogation of it. The provision that granted a veto against the use of exceptions by certain affected countries was removed and rules regarding the use of quantitative

[3] The same principle was applied during subsequent rounds of multilateral trade negotiations.

restrictions for infant-industry purposes were relaxed. The second major change concerned the use of quantitative restrictions by developing countries in times of balance-of-payments difficulties. The Contracting Parties agreed on more flexible provisions for developing countries facing a balance-of-payments crisis. The third modification was a further attempt to accommodate the special needs of developing countries. A new Article XXVIII(*bis*) was introduced which requested Contracting Parties when calculating reciprocity to take into account "the needs of less developed countries for a more flexible use of tariff protection.". This meant that the principle of full reciprocity did not apply to developing countries.

Despite the more favourable treatment accorded developing countries, their share in world trade declined (see Appendix Tables 4 and 5). Developing countries tried to curb this trend by applying policies of import substitution and, later on, export promotion. They increasingly resorted to balance-of-payment restrictions. They were also able to raise many tariffs without violating the GATT, since very few developing countries had bound their tariffs in previous negotiations. While many developed countries were critical of what they saw as an absence of real GATT obligations, they also recognized that the overall success of GATT depended on its capacity to take into account the needs and concerns of developing countries. Against the backdrop of the Cold War, the developed country Contracting Parties were eager to avoid a failure of the GATT in this regard. The Soviet Union was pushing for the creation of a global trade organization within the United Nations as an alternative to the GATT.

Against this background, 22 of the Contracting Parties met in Geneva for a fourth round of multilateral trade negotiations. Further progress was made in reducing and binding tariffs. About two-fifths of international trade was now bound against tariff increases. Despite this success, concerns persisted about the position of developing countries in the system. Ministers of GATT Contracting Parties therefore decided to commission a panel of experts to analyse the challenges facing developing countries in integrating into the world trading system. The expert group summarized their findings in a report entitled "Trends in International Trade", which was published in October 1958 and later became known as the Haberler Report.[4] Among its conclusions, the Report states "We think that there is some substance in the feeling of disquiet among primary producing countries that the present rules and conventions about commercial policies are relatively unfavourable to them".[5]

Besides the difficult question of how better to integrate developing countries into the world trading system, the GATT faced another mounting challenge. Since the beginning of the 1950s, six European countries (Belgium, Luxembourg, France, Federal Republic of Germany, Italy and the Netherlands,) had made considerable efforts to achieve deeper economic integration. After the successful creation of a common market for coal and steel in 1951, the six countries adopted the Treaty of Rome in 1957 which established the European Economic Community. For the GATT the question was how to manage trade relations between the members of this upcoming customs union and the other Contracting Parties. The fear was that an unsatisfactory adjustment would undermine the multilateral trading system (ICITO, 1957).

The emergence of a strong movement towards an integrated European market was one of the main driving forces behind the fifth round of multilateral trade negotiations which opened in September 1960. The negotiations were named the Dillon Round in honour of United States Under-Secretary of State, Douglas Dillon who proposed the negotiations. The main objective of this round was to transform the tariffs of the six EEC members into a common schedule applied by all six towards non-member countries. In accordance with Article XXIV of GATT, the new common external tariff could be no higher on average than the separate tariffs of the six countries. Whenever the EEC members wanted to deviate from this rule, they had to offer tariff concessions on other items as compensation. The negotiations made satisfactory progress, except in the field of agriculture.

---

4 In honour of Professor Gottfried Haberler, the Chairman of the Panel of Eminent Economists.

5 GATT (1958:11) Trends in International Trade. A Report by a Panel of Experts. This feeling was one of the major forces behind the creation of the United Nations Conference on Trade and Development (UNCTAD) in 1964.

Until the Dillon Round, trade negotiations dealt almost exclusively with industrial products. The major economic powers in the GATT, namely the United States and the EEC, were hesitant to include agriculture in the negotiations, since their agricultural policies were designed to detach domestic prices from global market mechanisms. In the Dillon Round negotiations, the EEC did not want to agree to new bindings on several agricultural products and argued that they needed underdetermined rates for the design of the future Common Agricultural Policy (CAP). Because of the sensitivity of the issue, the six EEC members had not yet agreed among themselves upon a common external tariff for these products (Curtis and Vastine, 1971). The United States was very concerned about this decision since they had previously enjoyed low or even zero duties for these agricultural products. Differences between the EEC and the United States on this issue brought the negotiations to the brink of failure, but finally the United States decided that the further integration of the European market should take priority over certain US agricultural export interests.

The Dillon Round also included traditional tariff negotiations. By the time the Round was concluded in July 1962, about 4000 tariff concession had been made by the Contracting Parties covering $4.9 billion of trade. Another important outcome of the negotiations was the Arrangement on Cotton Textiles which was agreed upon as an exception to the GATT rules. The Arrangement permitted the negotiation of quota restrictions with cotton exporting countries.[6] A success for developing countries was that developed countries accepted the idea that duty-free entry for tropical products should be a priority objective, but the Dillon Round brought only meagre advances in this regard. Overall the Round gave a flavour of the challenges that would mark the future rounds, namely agriculture and the integration of developing countries into the world trade system.

(b) Consolidating the GATT: 1963-86

(i) The Kennedy Round: 1964-67

The push for a new round of multilateral trade negotiations in the early 1960s came from two sides. After the relatively modest outcome of the Dillon Round, developing countries were eager to shape the trading system in a way that would open up new export opportunities for them. The second force behind launching a new round came from the United States. In a Special Message to Congress, President John F. Kennedy enumerated five challenges that had made previous United States trade policy obsolete.[7] Out of the five, the growth and steady integration of the European Common Market was perceived as the biggest threat to United States trade interests. The total volume of US exports to the EEC that constituted the Common Market amounted to $3.55 billion, about 17 per cent of total US exports and the second largest export market after Canada. Moreover, it was expected that other European countries would join the Common Market.

The United States was not against the expansion and further integration of the Common Market. On the contrary, the United States had two major reasons for supporting this process. First, enhancing economic and political cooperation among European countries, and especially between France and Germany, would minimize the risk of war. Second, the US government believed that Western European unification was an effective bulwark against communist expansion. However, the United States also had economic interests in Europe and did not want to be on the wrong side of a European tariff wall. In addition to this economic reason for promoting new multilateral negotiations, President Kennedy saw a new round as an important step in promoting the strength and the unity of the Atlantic Community. Liberalizing trade between Western Europe and the United States would result in a greater sharing of economic and political interests, and thus also help combat the expansion of communism.

[6] This arrangement lasted until 1974 when the Multifibre Arrangement entered into force.

[7] Special Message to the Congress on Foreign Trade Policy, January 25, 1962. Public Papers of the Presidents,1962,pp 68-77. (reproduced in Preeg (1970)) .The five factors were: i) the growth of the European Common Market; ii) growing pressure on the balance of payments position; iii) the need to accelerate US economic growth; iv) the communist aid and trade offensive, and v) the need for new markets for Japan and developing nations.

Invoking both economic and political arguments, President Kennedy was able to convince Congress of the necessity to start a new round of trade negotiations. The corresponding authority was contained in the 1962 Trade Expansion Act. It gave the President almost five years, until July 1, 1967, to achieve an agreement. The Act authorized the President to decrease tariffs by 50 per cent with certain product-specific exclusions. All communist countries or countries under communist influence were excluded from any tariff concessions. Even though the Trade Expansion Act remained silent on the method of bargaining, it granted the President a variety of techniques to negotiate tariff reductions. This meant, that in contrast to previous rounds, bargaining could encompass broad categories of goods rather than requiring an item-by-item approach.

The Kennedy Round was launched at a GATT Ministerial meeting in May 1963, but negotiations started officially only one year later. The negotiating parties agreed to aim at a 50 per cent linear tariff cut across-the-board, but confirmed that exceptions to the 50 per cent cut were possible. Such exceptions should be kept to a bare minimum and "be subject to consultation and justification".[8] The Kennedy Round put several new topics on the negotiating table, including the liberalization of agricultural commodities, the inclusion of non-tariff measures, and the special treatment of developing countries. Another novelty was that countries bargained with the EEC on its common external tariff and no longer with individual countries. It was important for the negotiations that the EEC had become a prominent economic player by the 1950s, perceived by the United States as a bargaining partner of comparable strength during the Kennedy Round (Preeg 1970:262; Curtis and Vastine, 1971).

The Kennedy Round ended in 1967. In the field of tariff reductions on industrial goods the results achieved were substantial, amounting to an average cut of 38 per cent covering two-thirds of developed countries' tariff-bound industrial imports, worth some $40 billion. The tariff reductions for textiles products, however, remained much below the average cuts for industrial products. In respect of other sectors and issues (e.g. agricultural products, quantitative restrictions, internal taxes), the outcome of the negotiations was meagre (Kock 1969; UNCTAD, 1968).

For the first time, the negotiating parties agreed on the inclusion of agricultural products as a major negotiating topic. Previous rounds had shied away from agriculture. At the launch of the Kennedy Round, governments had acknowledged that trade in agriculture was distorted by highly interventionist policies. The intention to address this issue was frustrated by fundamental differences between the United States and the EEC. In the end, the EEC managed to keep its CAP largely intact, but its proposal to conclude world commodity agreements for certain agricultural products, came to nothing, with the one exception of cereals.

The Kennedy Round was the first round that went beyond tariffs and dealt with certain non-tariff measures. From the beginning the negotiating parties showed some reluctance to "plunge into this rather novel field"[9] and as a consequence the results were rather modest. Only one basic code resulted, namely the 1967 International Anti-Dumping Code, which tackled the complex problem of dumping and provided a valuable model for future negotiation on similar problem areas. Another outcome of these negotiations was a separate protocol agreement embodying several non-tariff measures.

The Kennedy Round was the first GATT trade negotiation that explicitly addressed the concerns of developing countries. From the outset, the developed countries had expressed their willingness to take into account the special interests of developing countries in the negotiations. However, these negotiations were complicated by the fact that several European countries maintained and expanded preferential trade arrangements with former colonies. By the beginning of the 1960s the EEC had entered into preferential trade agreements with numerous developing countries.[10] Typically, the EEC arrangements with former

---

[8] GATT, TN. 64/28, 21 May 1964.

[9] GATT, TN. 64/28, 21 May 1964.

[10] As a consequence of this policy, by 1970 the EEC had potential association agreements with six country groups making up half of the countries of the non-Communist world (Curtis and Vastine, 1971).

colonies not only granted preferential market access, but also guaranteed substantial financial aid. The most prominent example was the Yaoundé Convention which was signed in 1963 between the EEC and 18 francophone African countries. This triggered demands from developing countries outside this association for equal treatment.

While the idea of preferential market access was not opposed by developed countries, they argued that asymmetries should be avoided. Raul Prebisch, the first Secretary-General of UNCTAD, followed this idea and at the first UNCTAD conference in 1964 proposed that developed countries grant all developing countries preferential market access. This suggestion became known as the Generalized System of Preferences (GSP) and was adopted four years later at UNCTAD II in New Delhi. Under the GSP, developing countries received preferential treatment (reduced or zero tariff rates over the MFN rates) for selected products.[11]

A major objective for developing countries was that commitments made by them were not required to be fully reciprocal with those of developed countries. The idea of non-reciprocity had been formulated for the first time in the Ministerial Resolutions of GATT Contracting Parties in May, 1963. Some criticism was voiced against the adoption of the principle of non-reciprocity. The United States argued that the 1962 Trade Act obliged them to obtain reciprocity from all parties. Leading economists pointed out the possible distortionary effects of non-reciprocal market access concessions (e.g. Johnson, 1967).[12] The principle of non-reciprocity was nevertheless adopted and found its final formal expression in part IV of the GATT. The application of the principle was reflected in the fact that developing countries generally offered very few tariffs cuts and left the vast majority of tariffs unbound.

(ii) The Tokyo Round: 1973-79

Pleas made by the Director-General of GATT, Sir Eric Wyndham White to build upon the momentum of the successful conclusion of the Kennedy Round and launch a new negotiation were not supported by the GATT Members. The timing was not right for new steps in trade liberalization as governments were fighting to hold off protectionist demands. Recourse to voluntary export restraints and the unwillingness of the United States to abolish the American Selling Price (ASP) system in US customs valuation reflected the mood in the late 1960s. At the beginning of the 1970s the international monetary system faced significant challenges which eventually led to the break-up of the Bretton-Woods system of fixed exchange rates. The Nixon Administration, under protectionist pressure, imposed a temporary import surcharge of 10 per cent to moderate the growing US merchandise trade deficit. In Congress, a view emerged that the United States had paid too high a price in the past trade negotiations, helping other economies more than their own to expand exports (Low, 1993; Ostry, 1997). A major motivation for the United States to start multilateral trade negotiations was the wish to rectify this perceived imbalance and to reduce the trade deficit. Furthermore, the US administration feared that the enlargement of the EEC would have a negative impact on US trade and investment. It was believed that the possible application of the Common Agricultural Policy (CAP) in the three new member countries would hamper US exports of agricultural goods. In particular, the membership of the United Kingdom, which accounted for three-quarters of total US investment in the EEC, was perceived as a threat.[13] Another concern shared by other GATT Contracting Parties, was the growing importance of non-tariff measures, which became more prominent as industrial tariffs came down.

The EEC was less enthusiastic, in the first instance, than the United States about starting another round of multilateral trade negotiations. The focus of European concern was primarily the integration of the common market and the inclusion of new members. However, the break up of the Bretton Woods

11 Since GSP schemes violated the MFN principle, in 1971 the Contracting Parties approved a waiver to Article I of GATT for a period of 10 years. UNCTAD became the focal point within the UN system for monitoring and assessing the GSP.

12 Subsequent empirical studies found evidence for this scepticism (Cooper 1972; Murray 1973; Baldwin and Murray 1977).

13 On 1 January, 1973 Denmark and Ireland joined the EEC along with the United Kingdom.

System and the subsequent weakening of the US dollar put the EEC under mounting pressure. The EEC was looking to introduce exchange rate discussions into the negotiation and sought the definitive abolition of the ASP in US customs valuation.[14]

When the Tokyo Round was launched in 1973, it was regarded as the most comprehensive and wide-ranging of all rounds since the inception of GATT. Tokyo was chosen strategically as the location to initiate a new multilateral round of trade negotiations. Japan had become one of the biggest world exporters and several other Asian economies were gaining expanding shares of world trade. In the Tokyo Declaration of September 12, 1973 the Contracting Parties committed to the "progressive dismantling of obstacles to trade and the improvement of the international framework for the conduct of world trade". The Declaration recognized "the need for special measures to be taken in the negotiations to assist the developing countries in their efforts to increase their export earnings and to promote economic development". Mention was made of the special needs of the least-developed countries. The main protagonists of the round were again developed countries, in particular the United States, the EEC and Japan. However, since the agenda also included a variety of development issues, countries not Contracting Parties of GATT were invited to participate in the negotiations. Nearly thirty developing countries took up this invitation increasing the number of participants to over 100 countries.

Soon after the launch of the negotiations a number of political and economic factors emerged that brought negotiations almost to a standstill. Developed countries experienced an economic downturn and increasing difficulties with their balance of payments. Rising unemployment and inflation fuelled protectionist tendencies and greater liberalization suddenly seemed an insurmountable challenge (Commonwealth Secretariat, 1978). As a consequence, the developed countries agreed to focus on making world trade fairer rather than freer, thus putting non-tariff measures in the spotlight of the negotiations. It was recognized that tariffs were only one factor influencing international trade, and that the trading system needed greater discipline in the application of non-tariff measures.

The negotiations on agriculture presented the greatest difficulty from the beginning. Attempts to reconcile the positions of the United States and the EEC failed during 1975 and 1976 and held up progress in almost every other area of the negotiations. In July 1977 both parties agreed to drop most substantive questions dividing them, such as market access and subsidies. This at least allowed the negotiations to go forward. At the end of the round, the negotiations in the Group on Agriculture resulted in two agreements (bovine meat and dairy products) and a proposal to establish a multilateral agricultural framework. Agriculture had, once again, proved intractable. (UNCTAD, 1982; Ostry, 1997).

The negotiations on tropical products were more successful. Tropical products had been singled out in the Tokyo Declaration as a priority sector, given the particular interest of developing countries. In the negotiations, developing countries requested the removal of all trade barriers faced by tropical products in developed countries. A majority of developed countries acceded to this request and liberalized trade on many of those products without seeking reciprocity from developing countries.[15] The liberalization measures were a combination of preferences and MFN tariff reductions. The most significant measures affected coffee, tea, and cocoa, while markets for fishery products, sugar, and tobacco were opened to a lesser degree.

In the tariff field the agreed cuts were far from the 60 per cent average originally envisaged. However, the tariff reductions covered about $126 billion or some 90 per cent of industrial trade in 1976 (US Department of Commerce, 1982). The United States agreed to reduce its average tariff on industrial products from 6.3 to 4.3 per cent, and the EEC from 6.5 to 4.6 per cent (see Table 7). In order to calculate the amount of tariff reduction, Switzerland suggested a mathematical (non-linear) formula which would cut high tariffs to a greater extent than lower tariffs and thereby contribute to a greater

14 A comprehensive account of the preparation for and conduct of the Tokyo Round negotiations, together with an evaluation of its results, is found in Winham, 1986.

15 Only the United States asked for some reciprocity (Kemper, 1980).

harmonization of the tariff schedule. This formula, which later became known as the Swiss formula, was used by the major participants and applied to a wide range of products.[16] The vast majority of the tariff cuts were to be implemented in eight equal annual instalments. Several exceptions were agreed upon. For example, the United States lowered its tariffs on imports (except for textile and clothing products) from least-developed countries in one step on 1 January, 1980.

Despite these substantial cuts, the outcome of the Tokyo Round with respect to tariffs fell short of the expectations of developing countries. Developing countries had requested that the GSP be maintained or even improved. Developed countries argued that MFN tariff cuts also benefited developing countries because of their binding and unconditional nature. They further pointed out that efforts had been made to avoid the erosion of preferences (Commonwealth Secretariat, 1978). However, the Tokyo Round generally reduced preference margins that developing countries enjoyed under GSP. On the imports of the EEC, Japan, and the United States from beneficiaries of their respective preferential schemes, which amounted to $19.4 billion in 1976, the trade-weighted average preference margin declined from 9.2 to 6.7 per cent (UNCTAD, 1982). In addition, MFN tariffs were cut by less than average on products not covered by the GSP and which were of particular export interest of developing countries. The average MFN tariff on non-GSP products decreased from 17.4 to 13.5 per cent and thus the tariff cut only amounted to about 22 per cent compared to the roughly 33 per cent overall reduction (UNCTAD, 1982). Despite this criticism from developing countries, it should be noted that tariffs for a large number of products of potential export interest for developing countries experienced larger cuts (Kemper, 1980).

Paragraph 9 of the Tokyo Declaration stated that “consideration shall be given to improvements in the international framework for the conduct of world trade which might be desirable in the light of progress in the negotiations”. The first item in the programme of the Group “Framework” was the question of how to create a legal framework for the special and differential treatment for developing countries. The negotiating parties agreed on a clause that allows GATT Members to accord differential and more favourable treatment to developing countries without according the same treatment to other countries, notwithstanding the MFN provisions of Article I of the GATT. This provision became known as the “Enabling Clause”. The Enabling Clause constituted a comprehensive specification of special and differential treatment for developing and least-developed countries and it amounted to a permanent waiver from the MFN clause.

Developed countries insisted that the Enabling Clause was linked to the question of reciprocity. More precisely, developed countries wanted language indicating that developing countries were expected to accept greater obligations under GATT as their economic situation improved. Moreover, the extent of special and differential treatment was to become more limited as the development, financial and trade needs of developing countries changed. Despite strong resistance from developing countries, the so-called “graduation provision” entered the final agreement. Some observers feared that this graduation could be used by developed countries to discriminate among developing countries in an arbitrary manner (UNCTAD, 1982).

A major accomplishment of the Tokyo Round was the introduction of several agreements on non-tariff measures, known as “codes”. The codes covered the following :

(1) The Customs Valuation Agreement provided greater uniformity in the methods of calculating the value of goods on which *ad valorem* duties were based. It therefore limited the arbitrary valuation of imported goods which in many cases restricted trade;

(2) The Agreement on Import Licensing Procedures was designed to simplify the administration of import licensing and to prevent licensing from becoming an import barrier in its own right;

[16] It may be noted that the coefficient used differed from country to country. Japan, Switzerland and the United States used 14, whereas Australia, EEC and the Scandinavian countries used 16. Canada used a slightly modified formula. Other countries such as Iceland and New Zealand did not follow the formula approach and offered item-by-item based tariff reductions.

(3) The Agreement on Government Procurement aimed at promoting greater competition in the government procurement market by opening it up to foreign firms;

(4) The Agreement on Subsidies and Countervailing Measures sought to control the use of subsidies and ensure they were not an unwarranted distortion of trade. Countervailing duties should not impede trade in an unjustifiable way;

(5) The Agreement on Technical Barriers to Trade (Product Standards) aimed to prevent governments from establishing standards that created unnecessary obstacles to international trade. Furthermore, countries were encouraged to use existing international standards and to be transparent in establishing and applying national standards;

(6) The Antidumping Agreement regulated the use of anti-dumping duties and associated procedures when governments decided to impose such duties in situations where exports were sold at less than their normal value.

The Tokyo Round did not produce an agreement on safeguard measures although discussions had taken place in relation to the concept of selectivity. Safeguard measures could be taken under Article XIX of GATT where increased imports threatened or caused serious injury to a domestic injury. Certain countries sought the right to apply discriminatory safeguard measures whereas others argued that the MFN rule should apply. Some observers considered the lack of agreement on safeguards as a major shortcoming of the Tokyo Round (UNCTAD, 1982).

In the event, only a handful of developing countries subscribed to the codes.[17] Some authors argued that it would have been in the interest of developing countries to subscribe to these agreements. Opting out of the codes reduced the opportunity to participate effectively in shaping them. The list of signatories differed for all the codes leading to a patchy coverage in terms of legal disciplines. The codes were drafted as stand-alone agreements that obliged only those countries that had signed and ratified them to abide by their provisions. However, since GATT obligations were generally applied on a MFN basis, GATT Members that had not signed the codes generally received the same treatment from the signatories as those who had signed.

Finally, the Tokyo Round did not tackle some non-tariff measures in areas of interest to developing countries. It left intact the NTMs on imports of agricultural goods and foodstuffs, textiles and clothing products, iron and steel products, consumer electronics, and shipbuilding. These barriers were substantial in the majority of developed countries and impeded considerably the exports of developing countries. The emerging economies in Asia were especially hurt by these measures. Several observers (UNCTAD, 1982; Deardorff and Stern, 1982) came to the conclusion that the Tokyo Round was only of limited significance to developing countries.

Despite these limitations, the negotiations on non-tariff measures demonstrated the willingness of governments to deepen and to an extent broaden the scope of the GATT. The negotiations provided an important impetus for the Uruguay Round some years later. However, the failure to reform the safeguard provisions and to eliminate quantitative restrictions, such as voluntary export restraints (VERs), fed protectionist tendencies at the time.

The overall results of the negotiations did not meet the expectations of developing countries. Not only was the outcome on NTMs disappointing, the effects of the tariff reductions for developing countries were also considered as modest (Deardorff and Stern, 1982). The spokesman for the developing countries at the thirty-fifth session of the Contracting Parties held at the end of the Tokyo Round in November 1979 expressed this frustration, stating that "it was difficult for the developing countries to determine what additional benefits were obtained in the negotiations, since the results did not correspond to their aspirations as expressed in the Tokyo Declaration" (GATT, 1979). Despite these misgivings, observers of the negotiations agree that the Tokyo Round marked an important change in the structure of the trade

[17] See Table 13 in subsection 2.(c).

negotiations (Winham, 1986 and 1990; Ostry, 1997). Even though developed countries dominated by and large the Round's agenda, developing countries participated actively and, for the first time, made a significant impact on GATT negotiations. The economic weight of developing countries in the world economy would further increase in following years, and hence also their role in the GATT.

(iii) The post-Tokyo Round period

The decade of the 1980s began with a radical swing in US economic policy which had far-reaching consequences for the entire international economic system. In 1981, the new United States' President Ronald Reagan announced drastic tax cuts to stimulate the United States' economy which had stagnated in 1980 and recorded a sharply rising federal budget deficit. The Reagan administration, under increasing protectionist pressure, persuaded Japan to apply voluntary export restraints (VERs) on automobiles in 1981. In the following years, the United States' steel industry brought a group of largely successful countervailing duty and antidumping petitions against suppliers from Brazil, the EEC, Japan, Mexico and Republic of Korea. President Reagan announced a negotiating programme to limit steel imports to 18.5 per cent of the United States' market. The United States was not the only one to make extensive use of trade remedies. The EU, followed by Canada and Australia, invoked "unfair trade" arguments and launched numerous antidumping investigations.

In order to fight double-digit inflation the Chairman of the US Federal Reserve System, Paul Volcker, introduced a strict monetary policy which had severe repercussions for the international macroeconomic system. As US interest rates surged, several developing countries found themselves unable to finance their debt obligations and were pushed into a debt crisis. In 1981 it became evident that increased protectionism and a growing North-South divide needed to be addressed and that the world trade system had to be put back on track again. The Contracting Parties, therefore, agreed to hold a first Ministerial meeting in 1982, the first since the 1973 meeting that had launched the Tokyo Round.

The meeting was not a success and brought the GATT close to a breakdown (Croome, 1995). Agriculture, in particular, proved to be a major source of conflict. The United States' delegation, backed by Australia and New Zealand, voiced the complaints of United States' farmers that they were not only denied access to the European market, but also third-country markets because of massive European subsidies (Ostry, 1997). The EEC argued that the CAP was compatible with the GATT and that the United States itself intervened heavily in its agricultural market. Another area of conflict concerned the inclusion of services as a new topic for trade negotiations. Developing countries strongly opposed this project, which had been put forward by the United States.

The final Ministerial Declaration achieved barely more than an expression of the determination to create "a renewed consensus in support of the GATT system". This meagre outcome was a clear signal that a fresh and wide-ranging round of multilateral negotiations was needed. The work programme established by the Ministerial meeting provided important guidelines for the preparation of future negotiations (Low, 1993; Croome, 1995). The GATT started to work on agriculture, services, trade in counterfeit goods and other issues, and thus set the main parameters for the subsequent round.

In the light of these rather mixed results, the US government abandoned its overriding commitment to multilateralism and started making active use of regional approaches to trade. The first United States Regional Trade Agreement, the Caribbean Basin Initiative, was proposed by President Reagan in February 1982 and one year later the United States started negotiating a free trade area with Israel. The reasons for this shift in approach were several. Fundamentally, the view in the United States was that while the US economy was the most open in the world, many others were imposing obstacles on trade, most notably Japan. It would require bilateral and multilateral approaches to trade relations to redress these asymmetries (Ostry, 1997). Furthermore, the US government had increasing doubts about the viability of the multilateral process. A multi-track approach to policy was regarded as the most appropriate strategy, particularly in terms of securing buy-in from others to multilateral negotiations, which were seen as part of the solution to the existing difficulties.

In high-level meetings following the Ministerial Meeting of 1982, support for a new round grew among developed countries. In contrast, developing countries showed considerable reluctance, fearing that the trade topics which were vital for them, such as textiles and agriculture, would not receive the necessary attention. In April 1985, the trade ministers of OECD countries agreed that a preparatory meeting should take place to launch a new round. They also stressed the importance of developing country participation in the preparations (European News Agency, 1986). A GATT Council meeting was held in July 1985 in order to set the date for a preparatory meeting for a new round. Several developing countries, most prominently Brazil and India, established a list of conditions which had to be fulfilled for the negotiations to take place. Among the numerous conditions were the recognition of the undesirability of the Multifibre Agreement and an agreement on safeguards. These conditions were unacceptable to the supporters of the new round and it proved impossible to reach agreement. The United States considered that the only way out of this impasse was to organize a session of the Contracting Parties. Decisions in this highest GATT body did not have to be taken by consensus, but could also be approved by a two-thirds majority of votes. The session reached agreement that "a preparatory process on the proposed new round of multilateral trade negotiations has now been initiated". And shortly afterwards, the Contracting Parties decided that a Preparatory Committee should start organizing a ministerial meeting, which was to be held in September, 1986.

(c) From the GATT to the WTO

(i) The Uruguay Round Negotiations: 1986-94

The preparations for the Ministerial Meeting turned out to be as painful as the decision to launch a new round. In nine meetings, from January to July 1986, the Preparatory Committee discussed all topics on the list for the new round of negotiations without making significant progress. Several major developing countries opposed the inclusion of new subjects, such as services, trade aspects of intellectual property rights, and trade-related investment measures. They regarded the inclusion of these new issues as a threat to the ability of governments to intervene in the economy (Ostry, 1997). As the July deadline for recommendations by the Preparatory Committee approached and no substantive results had been achieved, a small group of developed countries (EFTA countries, Australia, Canada and New Zealand) decided to form an informal working group. They invited 20 developing countries who were supposedly eager to see the new round launched to join them. The EC, Japan and the United States first stood back and joined the group only in the last stages. At the end of July, the group, led by Switzerland and Colombia, presented a draft declaration for the Ministerial Meeting, which was to become the basis for negotiation.

On 14 September, 1986 the Ministerial Meeting opened in Punta del Este, Uruguay.[18] Two major issues still had to be settled. First, on the topic of agriculture the final text called for "greater liberalization", as requested by developing countries, and at the same time for "more discipline and predictability," taking into account the position of the EC. The negotiations sought a balance between the two objectives. The second source of conflict was about the new issues – services, intellectual property rights, and investment. The participants eventually agreed to cover all three aspects, but in a way such that they were sufficiently separated from the traditional areas of GATT negotiations. After a week of intensive negotiations, the Punta del Este meeting was concluded on 20 September. The Punta del Este Declaration was adopted and the Uruguay Round had finally been launched.

The Punta del Este Declaration contained mandates for negotiations on tariffs, non-tariff measures, tropical products, natural resource-based products, textiles and clothing, agriculture, GATT Articles, safeguards, the codes of the Tokyo Round, subsidies and countervailing measures, dispute settlement, trade-related aspects of intellectual property rights, trade-related investment measures, the functioning of the GATT system and trade in services. The wide range of topics made the Uruguay Round the most

[18] A developing country venue had been chosen to underscore the development aspect of the Round.

ambitious trade negotiation ever undertaken. Overall, 15 negotiating groups were formed and began their work in February 1987.

The Ministerial Meeting in Montreal in December 1988 was supposed to serve as a mid-term review of the negotiations. Six negotiating groups were able to report substantial progress, but all the others were blocked by the diverse interests among participants. The most contentious issues in Montreal proved to be agriculture, safeguards, TRIPS, and textiles and clothing. The negotiations were under additional strain on account of the fact that a new President had been elected in the United States and in the EC new commissioners were being installed.

The negotiating group on agriculture was dominated by disagreements between the United States and the EC. The United States insisted on the abolition of all trade-distorting subsidies in agriculture and proposed an agreement on short-term reform measures. The EC was only prepared to make limited and gradual reductions of agricultural subsidies. The blockage on agriculture brought to a halt the negotiations on the other unresolved subjects. In order to avoid the loss of progress made on other issues, the Ministers decided at the end of the Montreal meeting to give more time to seek agreement. They set a new deadline of four months, until April 1989. Little progress was made in this interval and governments agreed to continue the negotiations.

Agriculture dominated the debate in the 18 months between April 1989 and the Ministerial Meeting in Brussels in December 1990, but did not bring the EC and the United States any closer. During the meeting the positions of both parties remained far apart and all efforts to find a compromise remained fruitless. The failure of this Ministerial Meeting was a severe blow to the GATT's credibility and implied that the overall deadline for 1 June 1991, would not be met. Fortunately, in May 1991, President Bush was successful in lobbying for an extension of his fast-track negotiating authority by two years, so that the negotiations could continue in the summer of the same year.

The negotiations received fresh impetus with the decision of the EC Commission to reform the CAP. In the hope of an impending deal in agriculture the negotiations made considerable progress and soon the shape of a final agreement began to emerge. The draft agreement contemplated a unified dispute settlement mechanism and a new multilateral trade organization to replace GATT. In December 1991 the Secretariat issued a version of the Draft Final Act, but once again, governments were not ready to adopt it. The disagreement was again between the EC and the United States on the issue of agriculture. For the EC the compromise on agriculture was not acceptable since it threatened the foundation of the CAP, whereas for the United States, supported by a range of agricultural exporting economies, it did not go far enough. This deadlock was only broken nearly one year later, when both parties met in Washington and agreed on a set of changes to the Draft text.

In the meantime, other participants began to express their fatigue and frustration with the Uruguay Round. With the agricultural blockage solved, they feared that the EC and the United States would overlook their concerns and therefore presented additional demands. The situation became further complicated by the signing of NAFTA in December 1992 and the inauguration of Bill Clinton as new US President in January 1993. Time to find a final agreement grew shorter and shorter as the US administration's fast track authority was to expire on June 1, 1993. The Uruguay Round had again reached a low point and some observers concluded that the Round would continue to 1994 and beyond.

At this critical moment, the climate for the Round began to improve. In March 1993, 37 developed and developing countries sent a letter to the Governments of the United States, EC, and Japan asking them "to display leadership at this critical time and to give the Round the priority it so clearly deserves" (cited in Croome, 1995). In April, the United States and the EC reached an agreement on market access for heavy electrical equipment and settled a bilateral dispute on government procurement. Finally, the US Congress extended President Clinton's fast-track negotiating authority until 15 April, 1994, which required the completion of substantive negotiations by 15 December, 1993. This deadline gave the participants the necessary push to go forward with the negotiations.

In the summer and fall of 1993 the Round made considerable progress, especially in the area of market access, institutions, and services. However, it became obvious that on the most sensitive issues a settlement between the United States and EC was needed. The two parties started to negotiate bilaterally and after several meetings in Washington and Brussels they presented their results to the other partners at the beginning of December. Developing countries showed some reluctance, but since few days were left before the final deadline, they returned to the negotiating table. More and more pieces of the Uruguay Round puzzle began falling into place. The last days were marked by frenzied activity and the negotiations continued until the morning of 15 December. The same day in the afternoon the Director-General, Peter Sutherland, announced the end of substantive negotiations and a consensus among all participants. Seven long years of multilateral trade negotiations had finally succeeded and brought the most massive reform of the multilateral trading system since the inception of GATT.

(ii) The outcome of the Uruguay Round

The amount of ground covered by the Uruguay Round was impressive: twenty-five thousand pages detailed all aspects of the Agreement. The legal structure of the Agreement reflects the main contributions of the Round. The WTO Charter, a mere ten pages long, precedes the whole document and is the umbrella that embraces all parts. It establishes the WTO as international organization and defines its functions and structure. Furthermore, it has four important annexes which contain all of the other negotiated texts of the Round. Annex 1 to Annex 3 are part of a "single-undertaking" approach and thus binding on all Members. Annex 1 contains the three major agreements, namely on goods (GATT 1994 and eighteen related agreements), services (GATS and Annex 1 B), and trade-related aspects of intellectual property rights. Annex 2 covers the Dispute Settlement Understanding and Annex 3 the Trade Policy Mechanism. Annex 4 departs from the single-package idea since it contains four plurilateral agreements that only apply to those Members who signed them.

In the field of tariffs, developed countries agreed to cut their tariffs on industrial goods from an average of 6.3 to 3.8 per cent, with most of the cuts to be phased in over five years starting from 1 January, 1995.[19] Another major achievement was the increase in bindings of tariffs by all parties. Measured by the number of bound product lines, developed countries increased their percentage from 78 to 99 per cent, economies in transition from 73 to 98 per cent, and developing countries from 21 to 73 per cent. This increase was in some measure due to the fact that all tariffs on agricultural goods were bound. The high percentage of bound tariffs rendered the world trading system more stable and predictable.

The Uruguay Round was the first time that the multilateral trading system succeeded in covering agricultural trade in a substantive manner. The programme for liberalizing agriculture was set for ten years and the policy approach was to divide measures into three categories – market access, domestic support and export subsidies. As already indicated, all agricultural tariffs were bound. Domestic support was measured as a composite of interventions called the Aggregate Measure of Support. In each of the three pillars, Members undertook specific reduction commitments. A "peace clause" was intended to guard against legal action that might otherwise have been feasible under WTO provisions on subsidies. In retrospect, many commentators have suggested that while the Uruguay Round Agreement on Agriculture may not have occasioned much trade liberalization, it had the virtue of incorporating agriculture into the multilateral trade rules and set the scene for future liberalization.

Another success of the Uruguay Round was the Agreement of Textiles and Clothing which brought to an end the exceptional treatment of this sector. The parties agreed that all quantitative trade restrictions would be phased out over a period of ten years and hence, in the end, the textiles and clothing sector would become fully integrated into the multilateral trading system. This was a major positive result for the developing countries as textiles and clothing accounted for a similar share to that of agricultural products in their merchandise exports. On the other hand, it should be noted that many tariffs in this sector remained well above the average tariff on industrial products in developed countries.

[19] GATT, The Results of the Multilateral Uruguay Round Negotiations, Geneva, November 1994.

The Uruguay Round introduced strengthened disciplines in the field of trade remedies.[20] The Agreement on Safeguards provided stricter rules on the temporary use of safeguard measures as well as dealing with compensation issues. In addition, it eliminated the use of so-called "grey-area" measures, such as voluntary export restraints. The provisions on subsidies established for the first time a definition of subsidies and developed clearer rules and procedures. The new rules on anti-dumping further clarified the rules on the determination of dumping, the use of anti-dumping measures and causality between dumping and injury. Furthermore, the Agreement elaborated upon the procedures to be followed in initiating and conducting anti-dumping investigations, and in implementing anti-dumping measures.

The Dispute Settlement System underwent a major overhaul in the Uruguay Round. All trade disputes between Members were to be handled by the Dispute Settlement Body (Annex 2). The previous agreements on dispute settlement had no fixed timetables and rulings could easily be blocked. The new Agreement introduced a more structured process with stricter deadlines in order to ensure prompt settlement of disputes. In addition, it was made impossible for countries losing a case to block the adoption of a ruling. It was hoped that the strengthened disciplines would limit trade frictions and contribute to the predictability and efficiency of the multilateral trading system.

Annex 3 introduced the Trade Policy Review Mechanism (TPRM) as an instrument to review trade policies and practices of WTO Members and thereby to contribute to improved adherence to WTO rules through greater transparency. It was agreed that the reviews would be conducted on a regular basis, but the frequency of review depends on a Member's share in world trade. Each review consists of two documents – a policy statement prepared by the government under review, and a detailed report written independently by the WTO Secretariat.

The Agreement on Trade in Services (GATS)

Two very important results of the Uruguay Round were the establishment of the General Agreement on Trade in Services (GATS) and the Agreement on Trade-Related Intellectual Property Rights (TRIPS). Neither of these additions to the multilateral trading rules at the time of the establishment of the World Trade Organization in 1995 have been dealt with fully in this Report. This omission is a reflection of space limitations and not a view on the significance of these additions to the trading system. On the contrary, both Agreements have taken the system in new and significant directions.

The GATS[21] was inspired by essentially the same objectives as its counterpart in merchandise trade. Services transactions account for over 60 per cent of global production and employment, but represent no more than 20 per cent of total trade (measured on a BOP basis).[22] Many services, which have long been considered genuine domestic activities, have increasingly become internationally mobile. This trend is likely to continue, owing to the introduction of new transmission technologies (e.g. electronic banking, tele-health or tele-education services), the opening up in many countries of long-entrenched monopolies (e.g. voice telephony and postal services), and regulatory reforms in hitherto tightly regulated sectors such as transport. Combined with changing consumer preferences, such technical and regulatory innovations have enhanced the "tradability" of services and, thus, created a need for multilateral disciplines.

The GATS applies in principle to all service sectors, with two exceptions. Article I(3) of the GATS excludes "services supplied in the exercise of governmental authority". These are services that are supplied neither on a commercial basis nor in competition with other suppliers. Cases in point are social security schemes and any other public service, such as health or education, that is provided under non-market conditions. Further, the Annex on Air Transport Services exempts from coverage measures affecting air traffic rights and services directly related to the exercise of such rights.

20 See the discussion in subsection 2.

21 This material is largely taken from http://www.wto.org/english/tratop_e/serv_e/serv_e.htm.

22 Statistics on trade in services are highly incomplete. A proper reckoning of services in international trade, based on the definition of services under the GATS, would certainly amount to more than 20 per cent of world trade.

The GATS distinguishes between four modes of supplying services: cross-border trade, consumption abroad, commercial presence, and presence of natural persons. Cross-border supply is defined to cover services flows from the territory of one Member into the territory of another Member (e.g. banking or architectural services transmitted via telecommunications or mail). Consumption abroad refers to situations where a service consumer (e.g. tourist or patient) moves into another Member's territory to obtain a service. Commercial presence implies that a service supplier of one Member establishes a territorial presence, including through ownership or lease of premises, in another Member's territory to provide a service (e.g. domestic subsidiaries of foreign insurance companies or hotel chains). Presence of natural persons consists of persons of one Member entering the territory of another Member to supply a service (e.g. accountants, doctors or teachers). The Annex on Movement of Natural Persons specifies, however, that Members remain free to operate measures regarding citizenship, residence or access to the employment market on a permanent basis.

The reason for this seemingly complicated set of distinctions regarding modes of supply reflects the fact that many services may be supplied only through the simultaneous physical presence of both producer and consumer. There are thus many instances in which, in order to be commercially meaningful, trade commitments must extend to cross-border movements of the consumer, the establishment of a commercial presence within a market, or the temporary movement of a service provider. Even where suppliers can choose among modes of supply, the modal taxonomy of the GATS is necessary in order to capture the use of different options by suppliers.

The GATS expressly recognizes the right of Members to regulate the supply of services in pursuit of their own policy objectives, and does not seek to influence these objectives. Rather, the Agreement establishes a framework of rules to ensure that services regulations are administered in a reasonable, objective and impartial manner and do not constitute unnecessary barriers to trade. A major difference between trade in goods and trade in services concerns regulation – services are typically more intensively regulated than goods. This relates not only to the various options in regard to modes of delivery. It is also to do with the intangibility of services, the fact that consumption and production may be simultaneous, and that many seemingly similar or even identical services are highly heterogeneous. These factors are among the reasons that account for the relative regulation-intensity of many service sectors.

Obligations contained in the GATS may be categorized into two broad groups. First, there are general obligations, which apply directly and automatically to all Members and services sectors. Second, there are obligations triggered by specific commitments relating to market access and national treatment in specifically designated sectors. Such commitments are laid down in individual country schedules whose scope may vary widely among Members. The relevant terms and concepts are similar, but not necessarily identical to those used in the GATT. For example, national treatment is a general obligation in goods trade and not negotiable as under the GATS.

Among the general obligations are MFN treatment (although certain time-bound exemptions are permitted), transparency obligations, the establishment of administrative review and appeals procedures, and disciplines on the operation of monopolies and exclusive suppliers. Obligations contingent on specific commitments include market access and national treatment, which are negotiated commitments in specified sectors. Market access commitments may be made subject to various types of limitations. For example, limitations may be imposed on the number of services suppliers, service operations or employees in the sector, the value of transactions, the legal form of the service supplier, or the participation of foreign capital. National treatment commitments imply that the Member concerned does not operate discriminatory measures benefiting domestic services or service suppliers. The key requirement is not to modify, in law or in fact, the conditions of competition in favour of the Member's own service industry. Again, the extension of national treatment in any particular sector may be made subject to conditions and qualifications.

Members are free to tailor the sector coverage and substantive content of such commitments as they see fit. The commitments of Members thus tend to reflect national policy objectives and constraints, overall

and in individual sectors. While some Members have scheduled less than a handful of services, others have assumed market access and national treatment disciplines in over 120 out of a total of roughly 160 services. The existence of specific commitments triggers further obligations concerning, *inter alia*, the notification of new measures that have a significant impact on trade and the avoidance of restrictions on international payments and transfers.

Each WTO Member is required to have a Schedule of Specific Commitments which identifies the services for which the Member guarantees market access and national treatment and any limitations that may be attached. The Schedule may also be used to assume additional commitments regarding, for example, the implementation of specified standards or regulatory principles. Commitments are undertaken with respect to each of the four different modes of service supply.

Most schedules consist of both sectoral and horizontal sections. The "Horizontal Section" contains entries that apply across all sectors subsequently listed in the schedule. Horizontal limitations often refer to a particular mode of supply, notably commercial presence and the presence of natural persons. The "Sector-Specific Sections" contain entries that apply only to the particular service.

The Agreement on Trade-Related Intellectual Property Rights (TRIPS)

The TRIPS Agreement[23] covers copyright and related rights (i.e. the rights of performers, producers of sound recordings and broadcasting organizations), trademarks including service marks, geographical indications including appellations of origin, industrial designs, patents including the protection of new varieties of plants, the layout-designs of integrated circuits, and undisclosed information including trade secrets and test data. The Agreement comprises three main features – substantive intellectual property standards, domestic enforcement provisions, and dispute settlement.

In respect of each of the main areas of intellectual property covered by the TRIPS Agreement, the minimum standards of protection are specified. Each of the main elements of protection is defined, namely the subject-matter to be protected, the rights to be conferred and permissible exceptions to those rights, and the minimum duration of protection. The Agreement sets these standards by requiring, first, that the substantive obligations of the main conventions of the WIPO, the Paris Convention for the Protection of Industrial Property (Paris Convention) and the Berne Convention for the Protection of Literary and Artistic Works (Berne Convention) in their most recent versions, must be complied with. With the exception of the provisions of the Berne Convention on moral rights, all the main substantive provisions of these conventions are incorporated by reference and thus become obligations under the TRIPS Agreement.

The enforcement provisions of the TRIPS Agreement deal with domestic procedures and remedies for the enforcement of intellectual property rights (IPR). The Agreement lays down certain general principles applicable to all IPR enforcement procedures. In addition, it contains provisions on civil and administrative procedures and remedies, provisional measures, special requirements related to border measures and criminal procedures, which specify the procedures and remedies that must be available so that right holders can effectively enforce their rights. The Agreement's dispute settlement provisions makes disputes between WTO Members about the respect of the TRIPS obligations subject to the WTO's dispute settlement procedures.

In addition the Agreement provides for certain basic principles, such as national and most-favoured-nation treatment, and some general rules to ensure that procedural difficulties in acquiring or maintaining IPRs do not nullify the substantive benefits that should flow from the Agreement. The TRIPS Agreement is a minimum standards agreement, which allows Members to provide more extensive protection of intellectual property if they so wish. Members are left free to determine the appropriate method of implementing the provisions of the Agreement within their own legal system and practice. Finally,

[23] This material is taken from http://www.wto.org/english/tratop_e/trips_e/intel2_e.htm. See this site for further details.

Article 40 of the TRIPS Agreement recognizes that some licensing practices or conditions pertaining to intellectual property rights which restrain competition may have adverse effects on trade and may impede the transfer and dissemination of technology. Members may adopt, consistently with the other provisions of the Agreement, appropriate measures to prevent or control practices in the licensing of intellectual property rights which are abusive and anti-competitive.

(iii) The aftermath of the Uruguay Round

Despite the considerable success of the Uruguay Round in reforming the multilateral trading system, it was evident that in many fields more work was needed. As part of the Uruguay Round agreements an ambitious timetable was established for future negotiations on more than 30 items. In some areas, the timetable detailed the assessments or reviews of certain commitments, most importantly the Agreement of Textiles and Clothing. In other areas, it included the time and date for new or further negotiations. Negotiations on services took the most prominent place in the schedule. Many of the market commitments of GATS did little more than consolidate the status quo in some sectors. The United States, in particular, pushed for more. In 1996 and 1997, GATS negotiations were successfully extended to include liberalization involving more than 95 per cent of the global market in telecommunication services as well as to large parts of the financial services industry. Important regulatory innovations were also secured in the telecommunications sector. The completion of the financial services negotiations in the midst of the Asian financial crisis demonstrated the determination of WTO members to close an agreement in spite of difficult market conditions One may also note that this same spirit of international cooperation, based on established commitments, contributed to the maintenance of open trade notwithstanding the challenges posed by financial turmoil.

In addition to pursuing the built-in Uruguay Round agenda, further efforts were promoted by some Members to accommodate new issues that emerged. One issue that was brought up by civil society concerned the transparency of the WTO as an international organization. Starting in 1995, proposals were made on how to eliminate GATT procedures which denied public access to documents, until action had been taken to de-restrict the access. Following this initiative, the WTO adopted new procedures on document access in 1996 and 2002 establishing that all WTO documents are in principle unrestricted. Other initiatives were also taken to improve transparency. (See subsection 6 below for a more detailed discussion).

Another concern taken up by the WTO was regionalism. During, and following the Uruguay Round, regionalism had exerted a growing influence on international trade relations. Prior to the 1980s, regional arrangements in international trade were largely concentrated on the EC and EFTA. There were other agreements as well, but these implicated much smaller shares of trade. After the failure of the GATT Ministerial Meeting in November 1982, the United States abandoned its long-standing opposition to PTAs and opened negotiations with Canada which were successfully concluded in 1989. The United States had also concluded a free trade agreement earlier with Israel. The view was increasingly gaining ground that regional agreements complemented rather than undermined multilateral trade liberalization. By the end of the Uruguay Round almost all WTO members had signed one or several regional agreements. The continued growth of such agreements around the world led to increasing fears about their inherent discrimination and their impact on world trade. In February 1996, the WTO established a Committee on Regional Trade Agreements (CRTA) with the task of examining these agreements and assessing whether they are consistent with WTO rules. The CRTA had limited success in focusing attention on this issue and it was carried forward into the Doha negotiations (see subsection 5 for a further discussion of regionalism).

The WTO Agreement required that Ministerial meetings be organized at least every two years. The Singapore Ministerial Meeting in December 1996 provided an opportunity to start discussions over the items that would be added to the agenda of the upcoming round. The United States proposed the launch of negotiations on transparency in government procurement, while the EU pushed for the inclusion of trade facilitation. The Clinton administration tried to include talks on trade and labour rights, but was

not able to overcome the fierce resistance of developing countries. The EU wanted to see the topics of trade and investment as well as trade and competition on the agenda, although the United States voiced scepticism on both topics. In the end, WTO Members decided to set up three working groups on trade and investment, trade and competition, and transparency in government procurement. Together with trade facilitation, the four subject areas became known as the "Singapore issues." These issues were taken up again in the context of the Doha negotiations and only trade facilitation survives on the Doha agenda. One major achievement of the Singapore Ministerial Meeting was the Information Technology Agreement (ITA), which had been promoted by the United States. The ITA provided for further tariff cuts on IT products and was signed by all major traders in this sector, including Chinese Taipei, which was not yet a WTO Member.[24]

The next Ministerial Meeting took place in Geneva in May 1998 and was mainly devoted to marking the 50th anniversary of multilateral trading system. The notion that it was time to launch a new round of negotiations met considerable opposition from a number of developing countries. Led by India, several developing countries requested a review of the outcome of the Uruguay Round before launching a new round. They argued that they were unable to meet the obligations undertaken in the Uruguay Round. Tensions were heightened when the Cairns group insisted on the elimination of agricultural subsidies as a precondition for a new round. The EC refused to agree to any such commitment up front and pushed, together with Japan, for negotiations on trade and investment as well as trade and competition. Several weeks of discussion in Geneva did not bring the negotiating parties closer on a range of outstanding issues. As a consequence, the Seattle Ministerial Meeting in late 1999 was not able to agree on an agenda. As no new schedule for negotiations was accepted, the Seattle Meeting was largely perceived as a failure. The multilateral trading system needed to take a breath and await a more favourable political environment.

New negotiations were eventually launched in Doha in November 2001. The Doha Round encompassed a wide range of negotiating issues and a work programme, including market access in agriculture and manufactured goods, trade in services, TRIPS, trade and investment, trade and competition, transparency and government procurement, trade facilitation, WTO rules, dispute settlement, trade and environment, electronic commerce, small economies, trade, debt and finance, transfer of technology, special and differential treatment, and implementation-related issues and concerns. Not all these issues were slated for negotiations, and some of them have been dropped as the negotiations have proceeded. At the time of writing (early 2007), the Doha Round is still in progress and it will not therefore be subject to further analysis in the present context.

[24] China joined the ITA when it became a WTO Member in 2001.

Table 4
GATT/WTO Trade Rounds, 1947-2007

Name of round or meeting	Period and number of parties	Subjects and modalities	Outcome
Geneva	1947 23 countries	Tariffs: item-by-item offer- request negotiations	Concessions on 15,000 tariff lines
Annecy	1949 33 countries	Tariffs: item-by-item offer- request negotiations	5,000 tariff concessions; 9 accessions
Torquay	1950 34 countries	Tariffs: item-by-item offer- request negotiations	8,700 tariff concessions; 4 accessions
Geneva	1956 22 countries	Tariffs: item-by-item offer- request negotiations	Modest reductions
Dillon Round	1960-1 45 countries	Tariffs: item-by-item offer- request negotiations, motivated in part by need to rebalance concessions following creation of the EEC	4,400 concessions exchanged; EEC proposal for a 20 percent linear cut in manufactures tariffs rejected
Kennedy Round	1963-1967 48 countries	Tariffs: formula approach (linear cut) and item-by-item talks. Non-tariff measures: antidumping, customs valuation	Average tariffs reduced by 35 percent; some 33,000 tariff lines bound; agreements on customs valuation and antidumping
Tokyo Round	1973-1979 99 countries	Tariffs: formula approach with exceptions. Non-tariff measures: antidumping customs valuation, subsidies and countervail, government procurement, import licensing, product standards, safeguards, special and differential treatment of developing countries	Average tariffs reduced by one-third to six percent for OECD manufactures imports; voluntary codes of conduct agreed for all non-tariff issues except safeguards. guards.
Uruguay Round	1986-1994 103 countries in 1986 117 as of end-1993	Tariffs: formula approach and item-by-item negotiations. Non-tariff measures: all Tokyo issues, plus services, intellectual property, preshipment inspection, rules of origin, trade-related investment measures, dispute settlement, transparency and surveillance of trade policies.	Average tariffs again reduced by one-third on average. Agriculture and textiles and clothing subjected to rules; creation of WTO; new agreements on services and TRIPs; majority of Tokyo Round codes extended to all WTO Members.
Doha Round	2001-? 150 countries as of beginning 2007	Tariffs: formula approach and item-by-item negotiations. Non-tariff measures: trade facilitation, rules, services, environment,	

Source: Hoekman and Kostecki (2001) and authors' extensions.

Appendix Table 4

World merchandise exports by region and selected economy, 1948-2005

(Billion dollars and percentage)

	1948	1953	1963	1973	1983	1993	2003	2005
				Value				
World	59	84	157	579	1838	3675	7369	10159
				Share				
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
North America	28.1	24.8	19.9	17.3	16.8	18.0	15.8	14.5
United States	21.7	18.8	14.9	12.3	11.2	12.6	9.8	8.9
Canada	5.5	5.2	4.3	4.6	4.2	4.0	3.7	3.5
Mexico	0.9	0.7	0.6	0.4	1.4	1.4	2.2	2.1
South and Central America	11.3	9.7	6.4	4.3	4.4	3.0	3.0	3.5
Brazil	2.0	1.8	0.9	1.1	1.2	1.1	1.0	1.2
Argentina	2.8	1.3	0.9	0.6	0.4	0.4	0.4	0.4
Europe	35.1	39.4	47.8	50.9	43.5	45.4	46.0	43.0
Germany [a]	1.4	5.3	9.3	11.7	9.2	10.3	10.2	9.5
France	3.4	4.8	5.2	6.3	5.2	6.0	5.3	4.5
United Kingdom	11.3	9.0	7.8	5.1	5.0	4.9	4.1	3.8
Italy	1.8	1.8	3.2	3.8	4.0	4.6	4.1	3.6
Commonwealth of Independent States (CIS)	-	-	-	-	-	1.5	2.6	3.3
Africa	7.3	6.5	5.7	4.8	4.5	2.5	2.4	2.9
South Africa [b]	2.0	1.6	1.5	1.1	1.0	0.7	0.5	0.5
Middle East	2.0	2.7	3.2	4.1	6.8	3.5	4.1	5.3
Asia	14.0	13.4	12.6	15.2	19.1	26.1	26.1	27.4
China	0.9	1.2	1.3	1.0	1.2	2.5	5.9	7.5
Japan	0.4	1.5	3.5	6.4	8.0	9.9	6.4	5.9
India	2.2	1.3	1.0	0.5	0.5	0.6	0.8	0.9
Australia and New Zealand	3.7	3.2	2.4	2.1	1.4	1.5	1.2	1.3
Six East Asian traders [c]	3.4	3.0	2.4	3.4	5.8	9.7	9.6	9.7
Memorandum items:								
GATT/WTO Members [d]	63.4	68.7	72.8	81.8	76.5	89.5	94.3	94.4
European Union [e]	-	-	27.5	38.6	30.4	36.1	42.4	39.4
USSR, former	2.2	3.5	4.6	3.7	5.0	-	-	-
Developing countries	31.4	28.3	22.6	20.2	26.8	25.2	30.3	34.1
Developed countries	66.4	68.2	72.9	76.3	68.2	73.3	67.1	62.6

[a] Figures refer to the Fed. Rep. of Germany from 1948 through 1983.

[b] Beginning with 1998, figures refer to South Africa only and no longer to the Southern African Customs Union.

[c] Comprising Hong Kong, China; Malaysia; Republic of Korea; Singapore; Taipei, Chinese and Thailand.

[d] Membership as of the year stated.

[e] Figures refer to the EEC(6) in 1963, EEC(9) in 1973, EU(10) in 1983, EU(12) in 1993, EU(15) in 2003 and EU(25) in 2005. Intra-EU trade is always included.

Note: Between 1973 and 1983 and between 1993 and 2003 export and import shares were significantly influenced by oil price developments.

Source: WTO, International Trade Statistics

Appendix Table 5
World merchandise imports by region and selected economy, 1948-2005
(Billion dollars and percentage)

	1948	1953	1963	1973	1983	1993	2003	2005
				Value				
World	62	85	164	594	1882	3769	7647	10511
				Share				
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
North America	18.5	20.5	16.1	17.2	18.5	21.5	22.6	21.7
United States	13.0	13.9	11.4	12.3	14.3	16.0	17.0	16.5
Canada	4.4	5.5	3.9	4.2	3.4	3.7	3.2	3.0
Mexico	1.0	0.9	0.8	0.6	0.7	1.8	2.3	2.2
South and Central America	10.4	8.3	6.0	4.4	3.8	3.3	2.5	2.8
Brazil	1.8	1.6	0.9	1.2	0.9	0.7	0.7	0.7
Argentina	2.5	0.9	0.6	0.4	0.2	0.4	0.2	0.3
Europe	45.3	43.7	52.0	53.3	44.2	44.8	45.3	43.2
Germany [a]	2.2	4.5	8.0	9.2	8.1	9.1	7.9	7.4
United Kingdom	13.4	11.0	8.5	6.5	5.3	5.6	5.1	4.9
France	5.5	4.9	5.3	6.4	5.6	5.8	5.2	4.7
Italy	2.5	2.8	4.6	4.7	4.2	3.9	3.9	3.6
Commonwealth of Independent States (CIS)	-	-	-	-	-	1.2	1.7	2.1
Africa	8.1	7.0	5.2	3.9	4.6	2.6	2.1	2.4
South Africa [b]	2.5	1.5	1.1	0.9	0.8	0.5	0.5	0.6
Middle East	1.8	2.1	2.3	2.7	6.2	3.4	2.7	3.1
Asia	13.9	15.1	14.2	15.1	18.5	23.3	23.1	24.7
China	0.6	1.6	0.9	0.9	1.1	2.8	5.4	6.3
Japan	1.1	2.8	4.1	6.5	6.7	6.4	5.0	4.9
India	2.3	1.4	1.5	0.5	0.7	0.6	0.9	1.3
Australia and New Zealand	2.9	2.3	2.2	1.6	1.4	1.5	1.4	1.4
Six East Asian traders [c]	3.5	3.7	3.2	3.9	6.1	9.9	8.2	8.6
Memorandum items:								
GATT/WTO Members [d]	58.6	66.0	74.2	89.1	83.9	88.7	96.1	96.1
European Union [e]	-	-	29.0	39.2	31.3	34.3	41.6	39.3
USSR, former	1.9	3.3	4.3	3.6	4.3	-	-	-
Developing countries	31.3	28.3	22.0	18.7	25.6	26.5	26.3	28.9
Developed countries	66.7	68.4	73.8	78.0	70.1	72.3	71.9	69.1

[a] Figures refer to the Fed. Rep. of Germany from 1948 through 1983.

[b] Beginning with 1998, figures refer to South Africa only and no longer to the Southern African Customs Union.

[c] Comprising Hong Kong, China; Malaysia; Republic of Korea; Singapore; Taipei, Chinese and Thailand.

[d] Membership as of the year stated.

[e] Figures refer to the EEC(6) in 1963, EEC(9) in 1973, EU(10) in 1983, EU(12) in 1993, EU(15) in 2003 and EU(25) in 2005. Intra-EU trade is always included.

Note: Between 1973 and 1983 and between 1993 and 2003 export and import shares were significantly influenced by oil price developments.

Source: WTO, International Trade Statistics.

2. MARKET ACCESS NEGOTIATIONS: LIBERALIZATION AND CONSOLIDATION

Tariff reductions are seen by many observers as one of the main success stories of the GATT/WTO.[25] This section assesses the GATT/WTO's actual contribution to lower tariffs and more open markets. It starts with an examination of developed countries' market access commitments in the GATT/WTO system. The GATT has played a core role in the reduction of non-agricultural tariffs in developed countries. A careful examination of the immediate post-World War II situation, however, suggests that some of the oft-quoted trade liberalization figures may be misleading. Subsection (b) then examines how developing countries have used the GATT/WTO system to reduce their tariffs. Evidence suggests that for many decades prior to the Uruguay Round they made little use of the GATT to reduce or bind their tariffs. As for the centrally planned economies, the USSR, China and most other planned economies remained outside the orbit of the GATT/WTO multilateral trading system for five decades.[26] Uruguay Round commitments have mostly extended the binding coverage, sometimes at levels far above the applied rates. This does not mean that developing countries have not liberalized their tariff regimes – only that they have not made much use of the multilateral system to do so. Most tariff reductions were unilateral and remained unbound. The WTO, however, has been instrumental in the reduction of tariffs of some of the newly acceded Members (since 1995). The Information Technology Agreement (ITA) has also had a significant effect for some of its signatories. Subsection (c) turns to non-tariff measures. The architects of the GATT had broadly in mind a system that would inhibit the use of border barriers other than tariffs and then organize negotiations to reduce tariffs. Having examined achievements on the tariff front, it is thus important to evaluate the effect of the GATT/WTO on other border measures. Here again, the multilateral system can claim partial success. Subsection (e) considers the GATT/WTO's contribution to world trade growth and subsection (f) concludes with a brief discussion on challenges ahead in the market access area.

(a) Tariff negotiations: developed countries

In order to situate the beginning of the tariff negotiations under GATT in their general historical context a few observations might be useful to recall the economic situation in 1947. The repercussions of World War II on the world economy were still omnipresent and the level of international trade was very depressed. For example, in 1948 global trade flows were still below their level in 1938 and 1929 in real terms, even though inflation had lifted the value of global trade to $57 billion, twice the level in 1938.[27] The low level of trade went together with major trade imbalances. The United States, Canada and most Latin American countries recorded substantial trade surpluses while the war-afflicted European countries and Japan recorded large deficits. The United Kingdom, which up to 1931 had followed a very liberal trade policy with minimal protection for almost one hundred years (except during the World War I period), had retreated via the Ottawa Agreement into a preferential trading system reinforced by a common clearing system for sterling balances. The United Kingdom, still the world's largest importer[28], tried to regain the convertibility of the British pound by returning to the gold standard in 1947, but this attempt ended in a financial crisis and had to be abandoned.

On the other hand, the Unites States had shifted away from its extreme protectionist trade policies in the early 1930s through the conclusion of reciprocal bi-lateral trade agreements with 17 countries between 1934 and 1939. As these agreements were applied on an unconditional MFN basis the bi-laterally agreed reductions benefited all countries within the system. These agreements significantly reduced the Smoot-

[25] See for instance Jackson (1997).

[26] China had been a founding member of the GATT but departed after its revolution in 1949. The USSR declined the invitation to participate in the drafting of the ITO charter (London Conference) and stayed outside the tariff negotiations. See Hoda (2001) for an interesting discussion of Poland's and Romania's market access commitments in accession and further negotiations.

[27] According to Maddison (2001) the ratio of world merchandise exports to world output was even in 1950 still lower than in 1913.See Appendix Table 3 and Appendix Chart 3.

[28] The share of the United Kingdom in world imports was 13.4 per cent in 1948, exceeding still that of the United States (Appendix Table 5).

Hawley protection level for many of America's major trading partners. In addition, the extensive use of specific duties in the US tariff schedule[29], in combination with the strong price increases between 1939 and 1947, had sharply reduced the *ad valorem* equivalent of these rates.[30] Despite these reductions, the average US tariff in 1947 was still considered to be among the highest in the major industrial countries. The relative large share of duty-free trade in the United States reflected the highly skewed protection pattern, with duty-free imports of raw materials not produced domestically and high tariffs on imports of processed agricultural and industrial products.[31]

Another important feature of the trade situation was the extensive use of non-tariff trade barriers by the European countries and widespread government control of international transactions in order to manage scarce foreign exchange reserves of US dollars.

With regard to the participation of countries in the first GATT negotiations, one should recall that Germany and Japan had not been given back sovereignty in the conduct of their trade policy and that the USSR did not accept the invitation to join the tariff negotiations.

(i) The start of the GATT tariff negotiations[32]

The UN Economic and Social Council, which had organized the London Conference to prepare for the ITO Charter, had no mandate for tariff negotiations. Nevertheless the participants of this conference agreed, at the suggestion of the United States, to hold tariff meetings in parallel to the preparatory work for the ITO charter. Various reasons have been given for the start of tariff negotiations at such an early stage.

First, it was thought that concrete actions in tariff negotiations might facilitate the discussions of non-tariff trade issues. Second, the US President's authority to reduce tariffs expired in June 1948 and the United States wanted to dispel the mistrust of other countries as to the sincerity of the United States intention to depart definitively from its high tariff protection policy of the past and reduce significantly its own tariffs. Third, the separation of tariff negotiations from negotiations on the institutional framework was also meaningful as the US President already had the authority to sign an agreement on tariff reduction, while the new trade charter would still need the approval of the Congress in the future.

The London conference set out both the objective and the procedures for the tariff negotiations. The objective was "to bring about a substantial reduction of tariff and the elimination of tariff preferences". The basic rules of the negotiations were the same as those "tested" in the negotiations under the US Reciprocal Trade Agreement Act. Thus, benefits of the negotiations should be: (a) "reciprocal" and "mutually advantageous"; and, (b) conducted according to the "principal supplier" rule through requests and offers. However, this time the negotiations had to be conducted among 23 countries more or less simultaneously. The challenge for the negotiating teams was to achieve tariff reductions with an overall balance of concessions and a larger tariff cut than that which would be possible if concessions had to be balanced bi-laterally.

The technique consisted in a three-step approach. Firstly, each country put forward a list of products for which it intended to request concessions from the participants before the negotiations started. Secondly, at the beginning of the negotiation each participant presented an offer list of the concessions it was willing to grant. Thereafter, negotiations could start bilaterally or among a group of countries.

[29] According to the 1959 Report of the Secretary of the Treasury more than three-quarters of US dutiable imports were subject to specific and compound duties in 1948.

[30] According to the United States Tariff Commission (1948) about half of the decline of the tariff incidence between 1930-33 and 1948 can be attributed to higher prices and the other half to the negotiations in the various trade agreements. Irwin (1996) reports on the impact of price developments on United States' average tariffs in a historical perspective(1821 to 1973).

[31] The share of duty free imports in total US imports stood at 61 per cent in 1947. For the unprocessed goods (comprising crude materials and crude foodstuffs and food animals) the share was 74 per cent while for processed and manufactured goods (comprising manufactured foodstuffs, semi- and finished manufactures) the share was 48 per cent. US Department of Commerce, 'Statistical Abstract of the United States, 1955'. Calculations are based on Table 1130 (p.927) .

[32] The overview on the first years of GATT tariff liberalization draws heavily on Gardner (1969) and Kock (1969).

The potential benefits from the negotiations for each participant were not limited to the results of a participant's own bi-lateral negotiations but depended also on the indirect benefits obtained through the application of the MFN rule on tariff cuts agreed among third parties. In order to encourage more generous concessions each country could ask for information on the progress made in negotiations among third parties in respect of products on which it also had a strong interest. The principal supplier rule limited the number of trading partners with which a country had to enter into negotiations and ensured under the reciprocity rule that the requesting countries would grant substantial concessions in return. A major disadvantage of the principle supplier rule was that small traders might have a strong interest in a given product but could not ask to enter into negotiations for concessions as their import share remained too small to qualify as a principal supplier. The rule of "reciprocity" and "mutually advantageous benefits" also caused some difficulties in their application as countries with a relatively low level of tariffs had difficulties in offering enough "concessions" in negotiations with high tariff countries. These difficulties were attenuated by the recognition that the binding of a low tariff could be considered a concession equivalent to the partial reduction of a high tariff rate. This recognition is found later in part of GATT Article XXVII *bis*.

The five-month long negotiations faced a major obstacle to their successful conclusion at the final stage, when the US proposal on the gradual elimination of the Commonwealth Imperial Preferences was rejected by Great Britain.[33] In the United States, the elimination of the discriminatory preferential trade regime was considered a major objective of the negotiations, which would justify the tariff concessions the United States was willing to grant, namely reductions of up to 50 per cent from the pre-agreement rates of 1934. In the United Kingdom, political and economic considerations, (i.e. maintenance of the Commonwealth solidarity and the British external financial crisis in June 1947) led to a hardening of the negotiating position. In order to save the negotiations and avoid adverse effects on its foreign policy, the United States agreed to be content with rather modest concessions in respect to the reduction and elimination of preferences which the Commonwealth members granted to each other.[34]

The results of the Geneva tariff negotiations are laid down in 20 tariff schedules which are an integral part of the GATT.[35] The schedules enumerate the detailed tariff bindings, and the prevailing preferential rates are also bound and included in the schedules. The evaluation of this first GATT round of tariff negotiations consolidated in the 20 schedules presented in two volumes and a total of 1265 pages is not an easy task. The schedules report only the new bound rates and not the previously applied rate, which precludes the calculation of the tariff reductions undertaken. The total number of tariffs bound does not provide a reliable indicator of the "binding coverage" as the total number of tariff positions, including the unbound, is not shown. The diversity of classification systems used for the various national tariff schedules also complicates comparisons. International (mainly European) efforts to harmonize tariff classifications started to bear fruit only from 1950 onward. Another difficulty in the evaluation is the widespread use of specific duties which define the duty as a fixed amount per unit (weight, number) for which an *ad valorem* equivalent can only be determined when the average import value is known. This information on imports is not contained in the GATT schedules. The calculation is further complicated by the fact that duties on some products have been bound at a higher rate than prevailed before the World War II, when protection primarily took the form of quantitative restrictions, which were lifted after the war.[36] This last feature reminds the reader that even if one could establish with precision the binding coverage and the exact size of the average tariff reduction, one would still not know the impact on overall trade restrictiveness. The latter would require knowledge of protection for each product during a period when non-tariff measures were widespread, especially in European countries. Given these difficulties, no overall rate of average tariff reductions has been calculated.

---

33 The United States' proposal was a three year moratorium and afterwards a staged elimination of preferences over a maximum period of ten years.

34 For a detailed discussion on the negotiation over Imperial preferences in 1947 see Zeiler (1997) and Gardner (1969: 348-361).

35 General Agreement on Tariffs and Trade, 'Schedules of Tariff Concessions (in two volumes)', Geneva October 1947.

36 France bound its tariffs for clothing items at 20 per cent while its corresponding pre-war tariffs did not exceed 16 per cent. However, the pre-war quantitative restrictions were lifted. (Documentation Française, 1948: 14) .

The US Department of State summarized the result of the first round as follows: the Agreement "covers more than 45000 items and accounts for two-thirds of the import trade of the negotiating countries and for substantially half of total world imports".[37] These summary results were often taken up in other publications but they could not be confirmed by our own recent calculations. While no details of the calculations underlying the Department of State estimates are available, an examination of the original sources suggests that the number of items bound is considerably smaller than indicated (less than half those indicated).[38] With the 23 negotiating countries accounting for about 60 per cent of world merchandise imports in both 1938 and in 1948, a binding coverage in the order of two-thirds would imply that less than 40 per cent (and not substantially a half) of world imports were affected.[39] This latter calculation still overestimates the scope of the Agreement as it does not take into account that MFN treatment was not automatically extended to imports from GATT Members that did not participate in the negotiations (especially the centrally planned economies in Europe and Asia). Box 12 reports on estimates of tariff bindings at the time of the birth of GATT.

Box 12: Estimates of tariff bindings of major developed countries in 1948

What do we know from other sources about the binding levels and can we confirm the overall binding coverage of two thirds indicated above? Very few estimates exist in the literature which indicate the binding coverage in the form of the share of tariff lines bound to total tariff lines. For the United States the earliest estimate we found refers to the situation in early 1953 (which incorporates the results of two further negotiations) and indicates that out of a total of 3337 tariff lines 76 per cent had been reduced and bound and 4 per cent had been bound but not modified. In other words, on the basis of the tariff schedule applied in 1952, 80 per cent of US tariffs had been bound. Assuming that all the reduced rates were actually bound and that the 3337 lines also include the duty-free lines, our own estimates of the US binding coverage in 1948 resulted not in a precise share but in a range with an upper limit of 70 per cent and a minimum level of 49 per cent. The upper limit is based on a comparison of all 408 tariff paragraphs for which at least one tariff item was bound in the GATT schedules (including the 33 revenue code sections) with the total of all 727 tariff paragraphs shown in the US tariff schedule of 1948.[40] The lower bound limit is based on a comparison of the number of 1733 bound tariff items shown in the GATT schedules in 1947, with all the 3505 tariff items reported in the USTC tariff schedule for 1948. The result based on tariff items understates the true binding coverage as the USTC tariff schedule is somewhat more detailed than the GATT schedule as various single tariff items reported in the GATT schedule have been split further into several tariff items in the USTC schedule of 1948. With respect to the binding coverage expressed in terms of import values of 1946, USTC figures indicate that it reached 83 per cent for imports from all sources and 94 per cent for imports from Contracting Parties.[41]

For France, the third largest importer, it is reported that the binding level achieved was "about 50 per cent of the tariff positions but represented more than 85 per cent of the trade volume (import value) of the trade before the war".[42] This statement shows that there can be a large

37 United States Department of State, 'The United States reciprocal trade –agreements program and the proposed International Trade Organization', in *Department of State Bulletin, Vol.XVIII ,No455, Publication 3094*, March 21, 1948.

38 A detailed account of each of the 20 tariff schedules suggest that the items listed in both parts of the schedules (Part I refers to MFN rates and Part II refers to preferential tariffs rate) do not exceed 15000 items.

39 For the evolution of the share of GATT Contracting Parties' imports in world merchandise imports since 1948 see Appendix Table 5.

40 United States Tariff Commission, *'United States Import Duties(1948)'*, Miscellaneous Series TC1.10:Im7/4/1948. This report does not specify which rates are bound while the GATT schedules report the bound rates but not the unbound rates.

41 United States Tariff Commission (1949:138) Table 43.

42 Documentation Françaises (1948) 'La France et les accords tarifaires de Genève'. in Notes Documentaires et Études No.780 p.12.

difference between the coverage measured by tariff lines and that by import values, the latter being in general larger than the former.

The tariff concessions made by the United Kingdom, still the largest importer in 1948, are particularly difficult to evaluate as they comprise MFN and substantial preferential trade flows. A government report to Parliament[43], indicates that imports from foreign countries (i.e. all those not belonging to the Commonwealth) under rates which have been bound without any change (including duty free rates) amounted to £67.1 million in 1938. Imports under tariff rates subject to reduction and binding accounted for £30.4 million in 1938. Altogether, the binding agreed by the United Kingdom covered 36 per cent of the corresponding import value in 1938 (or 24 per cent of total imports). In addition, the United Kingdom had to bind all its preferential rates granted on one half of its imports from Commonwealth countries, which accounted for about one-third of its total imports.[44]

A particular feature of the United Kingdom concessions is the acceptance – in agreement with the other Commonwealth countries – of a reduction or elimination of the preferential margin it enjoyed on its exports to Commonwealth countries. Only 30 per cent of the United Kingdom exports to Commonwealth countries (£94 million in 1938) were affected by these changes.

Summing up the pieces of information on binding levels of the three major developed countries above, the binding coverage measured by import values has most likely somewhat exceeded 60 per cent for the major industrial countries.[45] Assuming a share of binding coverage for the developing countries at 20 per cent (about the ratio observed for India and Brazil), brings the average binding level for all GATT Contracting Parties to 55 per cent. Taking into account that GATT Members accounted for 59 per cent of world imports, one has to conclude that nearly one-third of world merchandise trade was bound through the GATT 1948 tariff schedules.

What about the information on tariff reductions? To our knowledge the only comprehensive estimate concerning the average tariff reduction rate in the first GATT Round of tariff negotiations is provided by the United States Tariff Commission for US tariffs.[46] According to this source, the average reduction rate of US tariffs for all products between 1947 and 1948 was 21 per cent (and 26 per cent if agricultural products covered by US tariff schedule 7 are excluded). If the US tariffs of 1948 are compared with the level before the start of the reciprocal trade agreements (i.e. the level corresponding to the Smoot-Hawley Tariff Act) the decline is 47 per cent.

This calculation of average tariff cuts uses US import values as weights. The risk of this approach is that tariff peaks and their changes are not well taken into account as import values under these tariff lines

---

43 President of the Board of Trade to Parliament by Command of His Majesty, *Report on the Geneva Tariff Negotiations*. November 1947, Cmd 7258.

44 UK imports from Commonwealth countries accounted for about one-third of its total imports in both 1937 and 1948. The proportion of these imports from the Commonwealth enjoying preferential treatment was about one half in 1948 and the average preferential rate had fallen to 6 per cent on all goods by 1948 and about twice the rate on those goods enjoying preferences. Imperial preferences increased markedly through the Ottawa Agreement in 1932 but were lowered subsequently through the US/UK Trade Agreement of 1938 and thereafter through the impact of inflation on the *ad valorem* incidence of specific duties. The latter development is estimated to have been more important than the impact of the trade agreements including the GATT 1947 Agreement according to Macdougall and Hutt (1954).

45 Aggregating the binding coverage of the United Kingdom, the United States and France by using the 1948 import values results in a combined binding coverage of 63 per cent. The share of developed countries in total imports of GATT Contracting Parties imports was 82 per cent in 1948.

46 United States Tariff Commission(1949), Operation of the Trade Agreements Program, June 1934 to April 1948, Report No 160. Table 4 p.16.

tend to be small. It is therefore worth recalling that the US tariff contained a significant number of very high tariffs until the late 1950s.[47]

There are strong indications that overall, tariff reductions by other developed countries were less pronounced than in the case of the United States. First, the United Kingdom and France were in a difficult economic situation in 1947 and therefore had hardly been prepared for a significant reduction in protection levels. For the United Kingdom, the Economist reports that imports covered by tariff reductions accounted for less than 6 per cent of UK imports.[48] In France, the new tariff rates of 1948 were in a few cases sharply reduced (e.g. cars (42 per cent) and also toys), and in many other cases lowered by 20 to 25 per cent (e.g. chemical products), or maintained unchanged (e.g. pulp and paper). In a few cases tariffs were increased (e.g. up by 37 per cent for clothing in order to compensate for the lifting of quantitative restrictions). For France and the United Kingdom, no average rate of reduction has been provided in the various government reports dealing with the results of these negotiations. The tariffs of the Benelux countries at the time had been recognized to be well below the average prevailing in the other industrial countries and therefore these countries made concessions principally by binding most of their tariffs at the already low levels. It is therefore plausible to assume that the average tariff reduction on industrial products of all industrial countries achieved in 1947 was somewhat less than the reduction observed for the United States.

This might look like a meagre result, but one might see it also in a more favourable light if one takes into account that between the mid-thirties and 1947 the prices of internationally traded goods had increased by more than 100 per cent, which implied a significantly lower *ad valorem* incidence of the specific duties at the time of negotiations.[49] Thus, keeping these applied rates unchanged implied a significantly lower protection level for imports subject to specific duties.[50]

What about the tariff levels prevailing before and after the first GATT round? Is it possible to confirm that the average tariff level for industrial countries was around 40 per cent before the first GATT negotiation in 1947? Woytinski and Woytinski (1955) reports estimates for (applied) tariff averages in 1950 for 13 West European countries, covering agricultural and industrial products (see Appendix Table 6). The results confirm the existence of a low tariff country group (comprising Denmark, Norway, Sweden, and the Benelux countries) with tariffs somewhat below 10 per cent and a high tariff group with tariffs averaging close to 20 per cent (comprising France, Italy, Portugal and the UK).[51] The average applied tariff rate among European countries thus ranged somewhere between 10 and 20 per cent. Note that these rates include the rather limited tariff cuts negotiated during the second round of tariff negotiations in 1950 (e.g a supplementary tariff cut of 3 per cent in the case of the United States).

Another reference to prevailing tariff levels in the early 'fifties can be found in the GATT report *International Trade 1952*. In 1952, the GATT Secretariat asked the Contracting Parties to provide estimates of the tariff

---

47 A tabulation of US peak tariffs rates (i.e. defined by the authors as those exceeding 45 per cent ad valorem) contained 373 tariff items (statistical import classes) for which at least some imports were recorded. Total imports subject to these peak tariffs accounted for 1.3 per cent of dutiable and 0.5 per cent of total imports. Unfortunately, the really prohibitive tariffs for which no import transactions took place could not be reported as no *ad valorem* equivalent rate could be calculated from US trade returns. This marginal share of trade under peak tariffs contrasts with an estimated share of more than 10 per cent of all tariff lines (373 out of roughly 3400 tariff lines). See United States Tariff Commission (1953), 'Effect of the Trade Agreement Concessions on United States Tariff Levels based on Imports in 1952', Table 12, Washington.

48 'Trade under the new Tariff' in the Economist, November 22, 1947. The same issue of the Economist makes the following summary comments: an observer "would take due note, in the first place, that for many countries involved – and not least for the United Kingdom – customs tariffs are at present without any influence on the volume of trade (page 827).

49 See Appendix Chart 2.

50 Unfortunately we have no information on the difference between bound and applied rates. In later periods it is known that bound and applied tariff rates had been very similar for the industrial countries.

51 A recalculation of the Woytinski results showed several inaccuracies. For some of the low rate countries errors in the averaging calculations were found which imply that the, relatively low, average rate for Denmark and Norway had been actually somewhat higher than reported. For Austria, Germany and Greece, however, the estimates are upward biased, as the underlying trade flows (and prices) refer not to 1950 but to pre World War II imports with their much lower average prices. Therefore the actual average tariff rates of Austria and Germany (both not yet Contracting Parties in 1950) had been far less above the country group average than indicated by Woytinski and Woytinski (1955).

incidence on a specific list of products.[52] Although the data are not strictly comparable with those of Woytinski, they nevertheless confirm the general view of the existence of a low tariff country group (rates varying between 5 and 9 per cent, comprising the Benelux countries, Denmark and Sweden) and another group with distinctively higher tariff rates, ranging from 16 to 24 per cent (including the United States, Germany, the United Kingdom, France and Italy in ascending order). The industrial countries' arithmetic average of applied tariff rates was still between 10 and 20 per cent (see Appendix Table 7). These estimates also include in principal the cuts made in the third round (Torquay).

These average tariff rate estimates reported in 1950 and 1952 permit a plausible guess about the tariff average prevailing before the first Round. On the assumption that the average tariff cut of the industrial countries did not exceed that of the United States (i.e 27 per cent cumulative between 1947 and 1950 or 31 per cent cumulative between 1947 and 1952) it is most likely that in 1947 the average tariff rate was situated in a range between 20 and 30 per cent. This estimate differs sharply from the widely quoted 40 per cent tariff average for industrial countries. Although this estimate is frequently reported there is no study to the knowledge of the authors of this report which indicates the source and the method (country coverage, product coverage, type of tariff) of how this average rate was estimated.[53]

Table 5
GATT/WTO – 60 years of tariff reductions
(MFN tariff reduction of industrial countries for industrial products (excl. petroleum))

Implementation Period	Round covered	Weighted tariff reduction	Weights based on MFN imports (year)
1948	Geneva (1947)	-26	1939
1950	Annecy (1949)	-3	1947
1952	Torquay (1950-51)	-4	1949
1956-58	Geneva (1955-56)	-3	1954
1962-64	Dillon Round (1961-62)	-4	1960
1968-72	Kennedy Round (1964-67)	-38	1964
1980-87	Tokyo Round (1973-79)	-33	1977(or 1976)
1995-99	Uruguay Round (1986-94)	-38	1988(or 1989)

Note: Tariff reductions for the first five rounds refer to the United States only. The calculation of average rates of reductions are weighted by MFN import values.

Source:
Geneva (1947): US Tariff Commission, Operations of the Trade Agreements Program, June 1934-April 1948, Part III Table 16 (non-agricultural products).

Annecy (1949): US Tariff Commission, Operations of the Trade Agreements Program, April 1949-June 1950, Chapter 5, Tables 7 and 8. Refers to all products.

Torquay (1950-51): United States Tariff Commission, Fifth Report, July 1951-June 1952, Chapter 4, pp.149-170, Tables 5 and 6.

Geneva (1955-56): Estimates based on United States Tariff Commission, Ninth Report, July 1955-June 1956, Chapter 3, pp.100-108 and US Department of State Publication 6348, Commercial Policy Series 158, released June 1956.

Dillon Round (1961-62): Estimates based on United States Tariff Commission, 13th Report, July 1959-June 1960, pp.17-29 and US Department of State Publication 7408, Commercial Policy Series 194, released July 1962.

Kennedy Round (1964-67): Preeg, E.(1970), *Traders and Diplomats*, Tables A2 and A3. Refers to four markets: United States, Japan, EEC(6) and United Kingdom. Own calculations for the aggregate based on 1964 M.F.N. import values.

Tokyo Round (1973-79): GATT, COM.TD/W/315, 4.7.1980, p.20 and 21 and own calculations. Refers to eight markets (United States, EEC(9), Japan, Austria, Finland, Norway, Sweden and Switzerland).

Uruguay Round (1986-94): GATT, *The Results of the Uruguay Round of Multilateral Trade Negotiations*, November 1994, Appendix Table 5 and own calculations. Refers to eight markets (United States, EU(12), Japan, Austria, Finland, Norway, Sweden and Switzerland).

---

[52] Tariff average for the same products retained in the League of Nations tariff estimates for 1913 and 1925 and based on arithmetic average for these 78 commodities (corresponding to 530 items).

[53] To our knowledge this pre-GATT average tariff rate was reported for the first time in the World Bank Development Report 1987 (p. 134): "successive rounds of negotiations in GATT had cut tariffs on trade in manufactures from an average level of 40 per cent in 1947 to between 6 per cent and 8 per cent for most industrial countries even before the last round of multilateral trade negotiations (the Tokyo Round, 1973-79) had taken place". No details are provided on sources and methods used to arrive at this number of 40 per cent. Thereafter, this number was taken up by many other authors in books, articles and pamphlets, but no one gives a hint at methods or data used to arrive at this implausible estimate of 40 per cent.

The tariff reductions in the next four Rounds brought a cumulative reduction in US tariffs of about 15 per cent. More important than the tariff reductions in the early GATT years was the enlargement of the membership. Negotiating the accession of new Contracting Parties such as Germany, Sweden, Austria and Japan implied further tariff reductions and consolidation.[54]

After the fourth GATT Round in 1956 little progress was made on the multilateral tariff level. However, the formation of the EEC brought a substantial tariff liberalization among the six EEC member countries. Progress in European integration brought the risk that non-EEC traders would be at a disadvantage in the EEC market. This spurred the launch in 1964 of the fifth GATT Round named after US President Kennedy. In the course of the negotiations, the 39 participants made concessions affecting trade valued at $41 billion, which represented two-thirds of their imports and about one quarter of world trade. The results of the Kennedy Round were implemented between 1968 and 1972 and brought substantial tariff reductions at the multilateral level. For the major industrial countries (United States, Japan, the EEC(6) and the United Kingdom) the average reduction in tariffs for industrial products (excluding petroleum) was 38 per cent (see Tables 5 and 6).

Table 6
Tariff reductions of the Kennedy Round
(Import weighted bound tariff averages of industrial products and change)

Trader	Pre-	Post-	Reduction	Imports(MFN)
	Kennedy Round rate		in %	Billion $(1964)
United States	9.2	5.9	-36	12
Japan	7.3	4.5	-39	5
EEC(6)	7.7	4.8	-37	16
United Kingdom	12.0	7.2	-40	7
TOTAL of above	**8.9**	**5.5**	**-38**	**41**

Source: Preeg, E.(1970), Traders and Diplomats, Tables A2 and A3.

While the average tariff reductions were quite similar in size for the major importers they differed significantly between sectors. Broadly based and sharp tariff cuts were agreed for the following sectors: chemicals, pulp and paper, machinery, and transport equipment. For iron and steel and textiles (including clothing), however, the concessions affected a smaller share of trade and reductions were less pronounced than the average.[55]

The Tokyo Round started in 1973 but the economic turbulence linked to the first oil price hike and the global recession in 1975 postponed serious negotiations for years. The Round could only be concluded in 1979 and succeeded in lowering substantially the industrial tariffs of industrial countries. The reduction of industrial tariffs were accompanied by a harmonization of tariffs (achieved through the application of the 'Swiss formula') and an increase in their binding coverage. The tariff concessions concentrated largely on industrial products, which accounted for 90 per cent of the import value of $141 billion affected by concessions. In the agricultural sector, tariff action on products of interest to developing countries has mainly taken the form of improvements of the GSP for tropical products. The average tariff reduction for industrial products was 34 per cent if weighted by import values and 39 per cent if measured by simple or arithmetic averages.

As regards import-weighted tariff reductions by stage of processing, the steepest cuts were observed for raw materials (64 per cent) followed by a 34 per cent reduction for finished products and a 30 per cent decrease for semi-manufactures. The depth of tariff cuts for industrial products in which developing countries had an export interest differed sharply among categories. The reduction in tariffs for articles of metal, wood and electrical machinery ranged between 32 per cent and 39 per cent, while the reduction for textiles and clothing was limited to 22 per cent and 18 per cent respectively. For footwear and travel goods, the tariffs remained almost unchanged as the average decreased by 0.1 percentage point to 13.1 per cent. The implementation of the Tokyo Round results stretched over the 1980-87 period (see GATT 1980: 33-41).

[54] See Hoda (2001) for a discussion of tariff negotiations for accessions.

[55] GATT (1967), GATT Trade Negotiations. Brief Summary of Results. Press Release GATT/992; 30 June 1967.

During the Tokyo Round negotiations a significant increase was achieved in the binding level of industrial products for a number of countries including Austria, Canada, Finland, Japan, and Norway. For the United States and the EU, the binding level for industrial products was close to 100 per cent before the start of the Tokyo Round (Appendix Table 8). The binding level for agricultural products after the Tokyo Round remained in a range of 44 to 69 per cent for Japan and the European countries (Appendix Table 9). The full binding of industrial countries' agricultural tariffs was only achieved in the Uruguay Round.

Table 7
Tariff reductions of the Tokyo Round

(Import weighted bound tariff averages of industrial products and change)

Trader	Pre-	Post-	Reduction	Imports(MFN)
	Tokyo Round rate		in %	Billion $(1977)
United States	6.3	4.3	-32	78
Japan	5.4	2.7	-50	32
EEC(9)	6.5	4.6	-29	62
TOTAL of above	**6.2**	**4.1**	**-34**	**172**

Source: GATT, COM.TD/W/315, 4.7.1980, p.20 and 21 and own calculations.

The Uruguay Round brought another substantial tariff reduction in industrial products, estimated at close to 40 per cent, and leading to an average rate of less than 4 per cent in industrial countries (eight major markets). The share of duty-free tariff lines increased from 20 to 44 per cent after the implementation of the Uruguay Round results. The share of peak tariff lines (defined as a rate above 15 per cent) dropped from 14 to 10 per cent. Tariff reductions by sector varied markedly. Three product categories – textiles and clothing, leather, rubber and footwear, and transport equipment – recorded the smallest tariff cuts (ranging from 18 to 26 per cent). These product categories continued to the highest average levels after the Uruguay Round, at 15.5 per cent, 8.9 per cent and 7.5 per cent respectively. In contrast, five other product categories (wood, pulp, paper, metals, non-electric machinery, mineral products and manufactured articles n.e.s.) recorded above-average tariff cuts in the range of 52 to 69 per cent which led to average tariff rates by product category of between 1.1 and 2.4 per cent. (GATT,1994: Table II.3). The tariff escalation observed on products of interest to the developing countries was, in general, reduced (GATT, 1994:15). One of the major gains in liberalization – of particular to the developing countries – was the phasing out of the quantitative restrictions in the textiles sector, which is discussed in more detail below.

For agricultural products, the liberalization gains in developed markets were two-fold: firstly, the tariffication of the remaining agricultural import quotas and the complete binding of all agricultural tariffs, and secondly, a tariff reduction of 37 per cent on all agricultural tariffs (GATT, 1994: Table II.8) Tropical products (part of the agricultural product category) recorded a tariff decrease of 43 per cent.

Table 8
Tariff reductions of the Uruguay Round

(Import weighted bound tariff averages of industrial products and change)

Trader	Pre-	Post-	Reduction	Imports(MFN)
	Uruguay Round rate		in %	Billion $(1988)
United States	5.4	3.5	-35	297
Japan	3.9	1.7	-56	133
EU(12)	5.7	3.6	-37	197
TOTAL of above	**5.2**	**3.1**	**-39**	**627**

Source: GATT, The Results of the Uruguay Round of Multilateral Trade Negotiations, November 1994, Appendix Table 5 and own calculations.

Multilaterally agreed tariff reductions did not come to a standstill after the Uruguay Round. In 1997 the Information Technology Agreement (ITA) was concluded, establishing duty-free trade for a list of about 300 products (including computers, parts and accessories, semi-conductors, semiconductor equipment and telecommunications). For the six major developed importers[56] of ITA products the pre-ITA (1996) average unweighted bound and applied tariff rates were reduced from 5 per cent and 2.3 per cent respectively to zero. These reductions were implemented from mid-1997 onwards and terminated in 2000. Trade in ITA products world-wide is estimated to be in the order of 1.4 trillion dollars in 2005.

Although in most advanced economies tariff rates had been already very low, this was not the case in a number of developing countries. These developing countries agreed to a staged implementation of tariff cuts, lasting eight years for some initial participants (e.g. India). By the first half of 1997, 29 economies had become participants in the ITA. By the end of April 2007, the ITA had 70 participants, counting the EU member countries individually. The share of ITA participants in world imports of ITA products increased from 90 per cent in 1997 and to 96 per cent in 2006 (see Chapter I of this report for a detailed discussion of the ITA).

(ii) Concluding observations

Industrial countries have substantially reduced their tariffs since 1947. Only in a few categories can they still be considered a significant trade barrier. The liberalization progressed in waves associated with the various tariff negotiations. The tariff reductions differed by sector, with less progress in labour-intensive industrial products and agricultural products. The tariff reductions agreed in the GATT negotiations discussed above relate to bound tariffs. MFN applied tariffs have tended to decline somewhat earlier than bound rates. While the tariff reductions of the industrial countries reported above reflect multilateral liberalization in the GATT/WTO framework, one should not lose sight of tariff reductions effected through regional integration agreements and preferential schemes in favour of developing countries. The EU and NAFTA in particular have accounted for major (preferential) tariff reductions in developed countries. Preferential tariff treatment in favour of the least-developed countries has brought duty-free access for most of them in respect of most of their products in major developed markets. A number of other non-reciprocal preference schemes have also benefited many other developing countries.

(b) Tariff negotiations: developing countries

This subsection assesses the impact of the multilateral system on developing country tariffs. Both tariff negotiations for accession and commitments negotiated during rounds are examined. A distinction is made between the GATT years and the WTO period. For the GATT years, because of the scarcity of data and the costs of calculating tariff statistics from paper sources, a number of case studies are used to illustrate the evolution of binding coverage and tariff levels. The regime under which developing countries acceded to the GATT/WTO is of particular importance. Depending on this regime, countries did or did not have to negotiate market access commitments to become parties to the agreements. With developing countries, it is also important to consider both bound and applied tariffs as in many cases they have drifted apart over time, with applied rates coming down faster than bound rates.

(i) Pre-Uruguay Round

Of the original 23 Contracting Parties of the GATT, 12 were developing countries: Brazil, Burma, Ceylon, Chile, China, Cuba, India, Lebanon, Pakistan, South Africa, Southern Rhodesia, and Syria.[57] Among those countries which participated in the 1947 round of negotiations, three (China, Lebanon and Syria) withdrew subsequently, while four others did not conduct the negotiations themselves. The United Kingdom negotiated on behalf of Burma, Ceylon, and Southern Rhodesia, while the results of the

[56] Australia, Canada, EU(15), Japan, Norway and the United States.

[57] Note that South Africa, which considered itself a developed country until after the Uruguay Round, is sometimes counted as such.

negotiations carried out by India were accepted by both India and Pakistan.[58] The colonial powers also negotiated tariffs for their colonies. The schedules of Benelux, France and the United Kingdom include sections relating to the tariffs of 17 dependent overseas territories, and six of these record the results of negotiations on preferential as well as most-favoured-nation duties.[59]

Brazil, Chile, Cuba, India and South Africa conducted negotiations amongst themselves and with the other parties. Boxes 13 and 14 examine in detail the tariff commitments of two developing original contracting parties: Brazil and India. These case studies also document the evolution of Brazil's and India's tariff commitments and their applied tariffs over the GATT period. Estimates suggest that Brazil and India bound approximately 20 per cent of their tariff lines in 1947, a figure which compares with a coverage ranging somewhere between 49 per cent and 80 per cent for the United States and 50 per cent for France, but that their binding coverage fell over time.

Box 13: Case study 1: Brazil, 1947-94

In 1947, Brazil bound 18 per cent of its tariff lines, that is 1047 out of a total of 5936 lines. All the bindings were specific as were almost all applied tariff rates. In the late 1940s, the Brazilian tariff schedule listed three different tariffs. The "general tariff" was applied to goods originating in countries with which Brazil had no commercial agreement. The "minimum tariff" was accorded to products of countries which also guaranteed their minimal tariff in favour of Brazilian products. The "conventional tariff" which corresponded to the MFN binding, was defined as the tariff reserved exclusively to products of countries to and from which Brazil not only accorded and received unconditional and unlimited MFN treatment, but with which Brazil also negotiated on the basis of special advantages and tariff reductions on the minimum tariff.[60] The conventional tariff was thus lower or equal to the minimum tariff. The fact that most tariffs were specific and the existence of general and minimum tariffs makes it difficult to assess and compare the level of Brazilian bound and applied tariffs. However, there are good reasons to believe that it afforded a high level of protection to Brazilian industries. Brazil had shifted towards a strict form of industrial protectionism in 1874 to become one of the three to five most highly protectionist countries in the world.[61] Moreover, our estimates of average tariffs for various groups of products in the 1950s are high. As can be seen in Appendix Table 11, among the 35 product groups distinguished in the nomenclature used by Brazil in 1949-1950, the highest binding coverage ratios are for clocks, watches and scientific and medical apparatus and the lowest for wood, cotton and aluminium, lead, tin and zinc.

In the mid-1950s, the Government of Brazil engaged on a major project of tariff reform which substantially affected its obligations under the General Agreement. The new tariff replaced an out-of-date nomenclature with the Brussels nomenclature, substituted *ad valorem* for specific duties and substantially increased their incidence. Changes in the price levels and a decline in the value of the local currency had eroded the protective effect of the existing specific tariffs and protection had increasingly been given to domestic producers in the form of import restrictions or through exchange control operating on payments for imported goods. The government also wished to increase tariff revenue. The Brazilian Government argued that the revision of the tariff was associated with other urgent measures of fiscal reform, that it amounted to the transfer of various protective measures to the tariff, and that it should not reduce the volume of trade, increase

---

58 See GATT (1950) The attack on trade barriers, A progress report on the operation of the GATT from January 1948 to August 1949.

59 See the case studies of Senegal and Nigeria below.

60 See International Customs Tariffs Bureau (1949) The International Customs Journal, Year 1949-1959, No 6, Brazil, Brussels: International Customs Tariffs Bureau.

61 See Clemens and Williamson (2001), Bairoch (1989).

the cost of imported goods or alter the composition of imports.[62] The reform affected a number of bound duties and therefore involved renegotiations under Article XXVIII.[63] Recognizing the need for the revision of an "out-moded" tariff and the desirability of a simplified system of controls and taxes, the Contracting Parties agreed to waive Brazil's tariff commitments on the understanding that other Contracting Parties would be free to regard as suspended the concessions which they had previously granted to Brazil. The negotiations for the new schedule of bound rates were to be completed within a year of the enactment of the tariff.

With the introduction of its new tariff in 1957, Brazil substantially reduced the coverage of its bindings which subsequently remained around less than 5 per cent until the Uruguay Round. Appendix Table 12 shows that between 1949 and 1958, the number of bound lines dropped from 1047 to 234 while the total number of lines in the nomenclature increased from less than 6000 to slightly more than 6300. Figures for the 1970s and 1980s show a considerably higher number of bound lines which is largely offset by an increase of the total number of lines.[64]

Brazil: Simple average of applied *ad valorem* tariff rates in percentage, selected product groups, selected years

Section	Description	1957	1979	1986	1997	2001
3	Animal and vegetable fats	58.2	76.5	54.0	11.6	11.4
4	Prepared foodstuffs, beverages and vinegar	132.9	138.3	84.9	17.4	17.0
7	Artificial resins and plastic materials	58.4	107.4	71.1	16.3	15.6
9	Wood and articles of wood	62.0	130.2	61.3	12.4	11.8
11.61[a]	Articles of apparel and clothing accessories of textiles fabrics	120.0	203.5	104.9	23.0	22.5
12	Footwear, headgear, umbrellas	116.0	186.0	85.6	24.8	21.9
17	Vehicles, aircraft and associated equipment	42.3	71.9	57.7	24.0	17.4
Total number of lines of selected products		804	1478	1641	1357	1551

[a] Subsection 61 of section 11.

Note: Because of changes in nomenclature, tariff averages are not strictly comparable across years. See technical appendix for further details.

Source: International Customs Journal, Brazil (1957-1958), Brazil (1979-1980); Brazil (1986-1987); WTO-IDB; WTO estimates.

Brazilian applied tariffs were already quite high in the late 1950s, but they were even higher in the late 1970s and only started decreasing in the first half of the 1980s. The Table shows simple applied tariff averages for selected groups of products across six decades.[65] The definition of product groups is kept constant over time.[66] Among the groups selected for this case study, two had particularly high tariffs in the late 1970s. The average tariff on clothing and footwear reached respectively 203 per cent and 186 per cent in 1979/1980. Four product groups – clothing, footwear, food products and vehicles – still had averages exceeding 50 per cent in the late 1980s.

62 See GATT (1956) International Trade 1956, Geneva: GATT.

63 Brazil also initiated Art. XXVIII renegotiations in 1960, 1977 and 1991. See GATT documents Secret/135(1960), Secret/238(1977) and Secret/334(1991).

64 Estimates of binding coverage for different periods are not strictly comparable because of changes in nomenclature. See technical appendix.

65 Post 1994 estimates are provided for comparison but are not discussed.

66 Changes in tariff averages over time should be interpreted cautiously because of changes in nomenclature and methodology. See technical appendix.

For developing countries which became Contracting Parties to the GATT after 1947, a relevant distinction is whether they acceded under Article XXVI:5(c) or under Article XXXIII. Article XXVI:5(c) provided for automatic accession of newly independent States or independent customs territories upon sponsorship through a declaration by the responsible Contracting Party, if the stated conditions were fulfilled. A government becoming a Contracting Party under XXVI:5(c) did so on the terms and conditions previously accepted by the metropolitan government on behalf of the territory in question, including any applicable Schedule of Concessions. Box 15 presents two case studies – Senegal and Nigeria – of countries that have succeeded to Contracting Party status under Article XXVI:5(c). The case studies discuss the evolution of market access commitments from accession until the Uruguay Round. Article XXXIII, on the other hand, stated that the terms of accession had to be negotiated between the acceding government and the Contracting Parties. The case studies of Argentina and the Republic of Korea (see Box 16) provide illustrations of accessions under this provision.

Four developing countries acceded during the Annecy Round in 1949: The Dominican Republic, Haiti, Liberia and Nicaragua.[67] In 1953, Liberia withdrew and Uruguay who had participated in the Annecy Round became a Contracting Party. Indonesia acceded in 1950 upon achieving independence. It was the first country to accede under Article XXVI:5(c). Peru and Turkey negotiated their accession under Article XXXIII during the Torquay Round in 1951. Ghana and Malaysia acceded in 1957 under Article XXVI:5(c) and so did Guinea in 1958.

In the 1950s, the GATT more or less managed to safeguard the stability of import duties bound by Contracting Parties but there were important changes, mainly in an upward direction, in the unbound tariffs of Contracting Parties and the tariffs of other countries. In its annual review of changes in barriers and controls in international trade in 1954, the GATT Secretariat notes a few instances where bound tariff rates were raised by special arrangement or negotiation.[68] It is interesting to note that the review of tariff changes in the early 1950s included discussions of both tariff reductions and duty increases. In the 1953 review for instance, a distinction is made between on the one hand negotiated tariff reductions and unilateral reductions and, on the other hand, tariff increases aimed at offsetting the withdrawal of quantitative import restrictions, those aimed at affording added protection for domestic industries, and those prompted by the desire to increase tariff revenue. Most reviews note that the usual motive for tariff increases was the desire to give more effective protection to domestic producers at a time of keen international competition. The 1953 review also observes an increased tendency in the period under review to impose additional charges of one kind or another on imported goods. In 1953, only very few tariff reductions were brought about by negotiation. Cuba accorded a reduction of tariff on a range of products to Germany in exchange for an assured market for sugar. These reductions involved the disappearance of the preferences previously granted on these products to the United States. At the same time, a number of developing countries unilaterally reduced or removed duties on imports of capital goods required for the development of industry.

Box 14: Case study 2: India, 1947-94

As can be seen from Appendix Table 13, India bound about 20 per cent of its tariff lines in 1947 but its binding coverage decreased progressively to reach about 4 per cent in the wake of the Uruguay Round.[69] The decline of the binding coverage in the first decade reflects an increase in the total number of lines in the tariff schedule and three renegotiations under Article XXVIII.[70]

67 See Appendix Table 10.

68 See GATT (1954) International Trade 1954 (general annual report).

69 Because of repeated changes in nomenclatures, changes in the level of binding coverage over time should be interpreted with caution. See technical appendix.

70 See GATT documents Secret/3(1953), Secret/7(1954), Secret/39(1955). India also initiated Art XXVIII renegotiations in 1969, 1975 and 1976. See Secret/188(1969), Secret/227(1975) and Secret/232(1976).

The absolute number of bound lines did not change much until the late 1960s. A second drop in the level of the binding coverage in the early seventies reflects a drop by two-thirds of the number of bound tariff lines. The distribution of binding coverage across product groups also changed significantly over time. While in the forties, machinery apparatus, footwear, hats, etc, and scientific and precision instruments had the highest binding coverage, in the seventies and eighties, all bindings were concentrated on a few number of products, mainly vegetables and fats, and to a lesser extent chemicals and pharmaceuticals.

Indian applied tariff averages for a sample of selected product groups followed an upward trend from the late forties to the late eighties.[71] The Table below shows simple averages of applied tariffs for selected groups of products and selected years. While Brazilian tariffs reached a peak in the late seventies and started declining in the eighties, Indian tariffs continued to increase until the end of the eighties.

India: Simple average of applied *ad valorem* tariff rates in percentage, selected product groups, selected years

Section	Description	1948	1958	1964	1979	1987	1997	2001
3 [a]	Animal and vegetable fats	29.5	29.7	30.1	57.1	200.0	35.5	63.3
4 [b]	Prepared foodstuffs, beverages and vinegar	35.4	40.8	49.4	122.0	104.0	50.3	45.2
7	Artificial resins and plastic materials	25.0	72.8	72.8	80.0	150.0	38.4	34.4
9	Wood and articles of wood	25.5	42.2	45.0	65.0	63.5	31.4	28.8
11.61[c]	Articles of apparel and clothing accessories of textiles fabrics	25.0	100.0	66.8	100.0	100.0	45.0	35.0
12 [d]	Footwear, headgear, umbrellas	27.0	49.2	54.1	100.0	100.0	44.7	34.8
17	Vehicles, aircraft and associated equipment	25.8	49.7	47.0	58.0	70.4	36.6	36.7
Total number of lines of selected products		110	152	155	72	802	943	1077

[a] The share of specific tariff lines in section 3 ranges from 7.1 to 38.4 per cent in the first three years.

[b] The share of specific tariff lines in section 4 ranges from 3.3 to 38.8 per cent during the period 1948-1987.

[c] Subsection 61 of section 11. The share of specific lines in this section is 62 per cent in 2001.

[d] Share of specific lines in section 12 are 11.1 and 25 per cent respectively in 1958 and 1964.

Note: Because of changes in nomenclature, tariff averages are not strictly comparable across years. See technical appendix for further details.

Source: International Customs Journal, India (1948), India (1957), India (1964), India (1979); India (1987); WTO-IDB; WTO estimates.

In the fifties, India modified its tariffs relatively frequently. In 1954 for instance, the rates on certain uncut precious stones were reduced while in 1955 reduced rates were provided for a limited period on sugar for refining. At the same time, some fiscal tariff rates were increased and reclassified as protective duties. Rates of 15 per cent were imposed on bleaching powder and paste and 85 and 92.5 per cent on spark plugs. There was an increase for leather manufactures, cotton rope, cutlery, metal furniture and fur skins, while for tiles, vacuum bottles and zip fasteners a specific duty was added to the *ad valorem* duty. India also negotiated some increases of bound duties such as for instance on safety razor blades, wines, glass beads and false pearls. In 1956, India increased the duty on a range of products to protect foreign currency reserves which had declined as a consequence of the increasing requirements for the development of domestic industry.

[71] Changes in tariff averages over time should be interpreted cautiously because of changes in nomenclature and methodology. See technical appendix.

In the 1960s, a number of developing countries acceded to the GATT and two rounds of negotiations were organized. Twenty-nine newly independent states succeeded to Contracting Party status on the basis of Article XXVI:5(c) while only seven negotiated their accession under Article XXXIII.[72] The simplified procedures for the acquisition of Contracting Party status under Art XXVI:5(c) adopted in 1963 provided for a certification by the Director-General to the effect that the government concerned had become a Contracting Party.[73] Spain and Portugal, which claimed developing country status at this time, were among the seven countries which had to negotiate the terms of their accession with the Contracting Parties, together with Argentina, Israel, the Republic of Korea, the United Arab Republic and Yugoslavia. Tunisia acceded provisionally in 1959 and a dozen other countries declared they were applying the GATT on a de facto basis. In the early days, accession negotiations entailed an exchange of concessions with both the Contracting Parties and the applicant countries making concessions (Hoda, 2001). In the sixties however non-reciprocity ruled in relation with developing countries. A GATT Secretariat pamphlet entitled "The role of GATT in relation to trade and development" summarized the approach to accession negotiations as follows: "While less-developed countries have made some tariff concessions on their accession, relatively little reciprocity is expected from them and it is accepted that they must, in general, retain freedom to use their tariff flexibility in the light of their development needs".[74]

The case studies of Argentina and the Republic of Korea suggest that even the countries which acceded under Article XXXIII in the 1960s did not bind a large share of their tariffs. As shown in Box 16, Argentina bound around 5 per cent of its tariff lines while the Republic of Korea only bound 60 lines. Just before the Uruguay Round, the binding coverage of the Republic of Korea had increased to 9.5 per cent.

Twenty-five developing countries declared themselves participants in the Kennedy Round (1964-1967). Special procedures were established to give attention to the concerns of developing countries. Developing countries were mainly concerned with improving their access to developed country markets. Except for some attempts by the United States, developed countries made no effort to extract more than token concessions from developing countries, which did not make any significant market access commitments (Hudec, 1987).

Box 15: Case studies 3 and 4: Senegal and Nigeria

Case study 3: Senegal

Senegal became an independent country on 20 June, 1960. On 27 June, 1960 the Government of France advised that as from the day of its independence the Government of Senegal had acquired full responsibility for matters covered by the General Agreement in its territory. The French Government thereby established the fact that Senegal qualified, in the sense of paragraph 5(c) of Article XXVI, to become a Contracting Party. The Government of Senegal which had been applying the General Agreement on a de facto basis since November 1960 advised the Executive Secretary of GATT that it wished to be deemed a Contracting Party under Article XXVI:5(c). Since the conditions were met, Senegal became a Contracting Party. Its rights and obligations date from the day of its independence.

The pre-existing concessions in the French schedule that related to Senegal were continued and a new schedule comprising those concessions was established by using the procedure of certification

[72] A total of 63 countries acceded on the basis of Article XXVI:5(c). See Appendix Table 10.

[73] Before 1963, it was customary to refer requests under Art XXVI:5(c) to the Contracting Parties even though accession under this article is automatic providing that the stated conditions are fulfilled. At its meeting of April/May 1963, the Council agreed to a Secretariat proposal for a simplified procedure for the admission of newly-independent States. See WTO (1995a) Guide to GATT law and practice, Geneva: World Trade Organization.

[74] Quoted in Hudec (1987), p. 59.

of changes to GATT schedules.[75] The concessions made on behalf of Senegal in Geneva in 1947 covered approximately 70 products. The binding levels range from 4 per cent to 30 per cent (cars and car parts) with two exceptions at 75 per cent for cigars and cigarettes. They also bound preferential rates for a dozen of products – mainly petroleum products – imported from the French Union. Six products were added during the Annecy Round (with bindings at 5 per cent and 7 per cent) and another 70 or so were added during the Torquay Round (most bindings at 5 per cent).

Senegal: Simple average of applied *ad valorem* tariff rates in percentage, selected product groups, selected years

Section	Description	1969	1977	1985	2002
3	Animal and vegetable fats	20.8	19.4	58.9	11.9
4[a]	Prepared foodstuffs, beverages and vinegar	23.7	24.2	83.7	16.9
7	Artificial resins and plastic materials	23.2	21.9	56.1	10.7
9	Wood and articles of wood	15.2	20.0	58.5	12.4
11.61[b]	Articles of apparel and clothing accessories of textiles fabrics	35.0	30.0	65.0	20.0
12	Footwear, headgear, umbrellas	21.8	28.8	54.1	17.8
17	Vehicles, aircraft and associated equipment	14.3	13.7	66.4	8.7
Total number of lines of selected products		404	797	900	1116

[a] The share of specific tariff lines in section 4 is 14.7 per cent in 1969 and 12.7 per cent in 1977.

[b] Subsection 61 of section 11.

Note: Because of changes in nomenclature, tariff averages are not strictly comparable across years. See technical appendix for further details.

Source: International Customs Journal, Senegal (1969), Senegal (1977), Senegal (1985); WTO-IDB; WTO estimates.

As shown in the Table above, until the late 1970s, applied tariffs remained relatively low with the exception of clothing and footwear. In the mid-eighties, however, tariffs rose to considerably higher levels before being reduced again in the 1990s. Note that the reduction of applied tariffs went far below the level of the UR bindings which average 30 per cent for both agricultural and non-agricultural products.

Case study 4: Nigeria

Nigeria also succeeded to Contracting Party status under Article XXVI:5(c). Its rights and obligations date from October 1960, the date of Nigeria's independence. For several decades, Nigeria's schedule covered one single product: stockfish.[76] As shown in the Table below, applied tariffs were relatively high in the 1960s, they increased slightly in the 1970s but had already started to decline by the mid-1980s. In the Uruguay Round, Nigeria bound all its agricultural tariff lines at a simple average level of 150 per cent. However only 6.9 per cent of industrial tariff lines were bound at an average level of 48.8 per cent. These bindings impose limited constraints on Nigeria's tariff policy.

[75] See Schedule XLIX established in GATT (1964) Second Certification of Rectifications and Modifications of Schedules to the GATT, 29 April 1964.[Instrument No 92].

[76] See GATT (1962) Protocol to the GATT embodying the results of the 1960-61 tariff conference, 16 July 1962.

Nigeria: Simple average of applied *ad valorem* tariff rates in percentage, selected product groups, selected years

Section	Description	1965	1970	1987	1999	2003
3 [a]	Animal and vegetable fats	35.5	44.4	20.0	25.5	37.6
4 [b]	Prepared foodstuffs, beverages and vinegar	50.8	56.5	33.4	39.9	68.6
7 [c]	Artificial resins and plastic materials	41.6	39.5	21.4	25.4	24.5
9	Wood and articles of wood	53.5	85.2	28.5	28.5	30.1
11.61 [d]	Articles of apparel and clothing accessories of textiles fabrics	40.0	42.7	14.6	50.0	50.0
12	Footwear, headgear, umbrellas	43.4	49.5	35.5	32.6	32.6
17	Vehicles, aircraft and associated equipment	24.8	28.6	33.3	18.3	18.3
Total number of lines of selected products		236	250	248	960	988

[a] Share of specific tariff lines in section 3 are 33.3 and 25 per cent respectively in 1965 and 1970.

[b] Shares of specific tariff lines in section 4 are 28 to 31.8 per cent respectively in 1965 and 1970.

[c] Shares of specific lines in section 7 are 3.2 and 5 per cent respectively in 1965 and 1970.

[d] Subsection 61 of section 11.

Note: Because of changes in nomenclature, tariff averages are not strictly comparable across years. See technical appendix for further details.

Source: International Customs Journal, Nigeria (1965), Nigeria (1970); Zoll- und Handelsinformation by the Bundesstelle für Aussenhandelsinformation, Nigeria (1987); WTO-IDB; WTO estimates.

Box 16: Case studies 5 and 6: Argentina and the Republic of Korea

Case study 5: Argentina

Argentina became a Contracting Party to the GATT at the end of the Kennedy Round in September 1967. Like the Republic of Korea, Argentina gained admission under Article XXXIII by negotiating tariff concessions. As shown in Appendix Table 14, Argentina accepted to bind about 5.5 per cent of its tariff lines. Binding coverage differed across product groups reaching 23 per cent for live animals and 12.1 per cent for vehicles and aircrafts while other product groups such as footwear and wood and articles of wood remained totally unbound.[77] Overall, less than 10 per cent of the bound lines concerned agricultural products. The binding levels for agricultural products ranged from zero for sugar-beet seeds to 140 per cent for whisky or sugar confectionery. Industrial bindings covered mainly capital goods and intermediary inputs amongst others metals and machinery as well as pharmaceuticals. Tariffs on machinery were typically bound at 80 per cent or even higher with peaks at more than 200 per cent for certain products. It is interesting to note that the final bound rates of duty are not systematically lower than the base rates that are indicated in the schedule. In a significant number of cases, the bound rate is higher or equal to the base rate. Argentina scheduled further concessions covering a total of 31 lines in the Tokyo Round.[78] In some cases, the new commitments were further reductions of already bound rates. In other cases, new lines were bound. As with earlier bindings, the level of the bound rate of duty was higher, equal or lower than the base rate.

77 See Schedule LXIV annexed to the Protocol of accession of Argentina in GATT (1967) Legal instruments embodying the results of the 1964-67 trade conference, vol. V, 30 June 1967.

78 See GATT (1979) Geneva Protocol. [Instrument_No_156].

Argentina: Simple average of applied *ad valorem* rates in percentage, selected product groups, selected years

Section	Description	1967	1971	1987	1996	2001
3	Animal and vegetable fats	73.1	68.2	21.8	8.9	11.5
4	Prepared foodstuffs, beverages and vinegar	99.6	108.5	26.6	14.3	16.8
7	Artificial resins and plastic materials	66.9	62.2	24.7	13.8	15.7
9	Wood and articles of wood	61.6	60.7	32.2	10.3	11.9
11.61 [a]	Articles of apparel and clothing accessories of textiles fabrics	140.0	194.5	38.0	20.7	22.5
12	Footwear, headgear, umbrellas	125.0	156.3	24.7	21.9	21.4
17	Vehicles, aircraft and associated equipment	79.6	60.5	27.4	15.3	19.3
Total number of lines of selected products		713	842	1249	1350	1387

[a] Subsection 61 of section 11.

Note: Because of changes in nomenclature, tariff averages are not strictly comparable across years. See technical appendix for further details.

Source: International Customs Journal, Argentina (1967), Argentina (1971), Argentina (1987); WTO-IDB; WTO estimates.

The applied tariff averages for groups of products shown in the Table above, suggest that Argentina's applied tariffs were high in the 1960s and 1970s. Our calculations for the second half of the 1980s however show that tariffs had already been substantially reduced in the early 1980s. As shown in the Table, tariffs were further reduced in the early 1990s. Argentina most likely did not use the Uruguay Round negotiations to reduce its applied tariffs. The average of Uruguay Round final bound rates for Argentina is somewhat above 30 per cent.

Case study 6: The Republic of Korea

Like Argentina, the Republic of Korea became a Contracting Party to the GATT in 1967 around the end of the Kennedy Round of trade negotiations. The Republic of Korea also negotiated its accession under Article XXXIII. The schedule annexed to the protocol for the accession of the Republic of Korea to the GATT covered 60 products.[79] Around 15 per cent of those concerned agricultural products. The level of the agricultural bindings ranged between zero for bovines and 80 per cent for certain prepared food products. Industrial bindings covered a variety of product groups including some clothing products and machinery. A number of bindings were set at zero and a few at 80 per cent. During the Kennedy Round, the Republic of Korea bound another 18 products.[80] For those new bindings, the concession rates were all lower than or equal to the corresponding base rates. In the Tokyo Round, the Republic of Korea made 143 concessions.[81] Some were further reductions of already bound rates while others were new bindings. About 30 per cent of the Tokyo Round commitments concerned agricultural products. No clear pattern emerges from the concessions on non-agricultural products. The level of the bindings ranges between 20 per cent and 40 per cent with a few exceptions at 50 per cent or 60 per cent.

79 See GATT (1967) Protocol for the accession of Republic of Korea to the GATT, 2 March 1967, Geneva.

80 See Schedule LX in GATT (1967) Legal instruments embodying the results of the 1964-67 trade conference, vol. V, 30 June 1967.

81 See Schedule LX in GATT (1979) Protocol supplementary to the Geneva (1979) protocol to the GATT, 22 November 1979, Geneva.

Republic of Korea: Simple average of applied *ad valorem* rates in percentage, selected product groups, selected years

Section	Description	1974	1982	1997	2001
3 [a]	Animal and vegetable fats	41.7	27.0	9.2	8.7
4 [b]	Prepared foodstuffs, beverages and vinegar	61.5	44.5	23.5	22.9
7	Artificial resins and plastic materials	39.1	33.3	9.0	8.8
9	Wood and articles of wood	32.0	12.1	6.5	6.4
11.61 [c]	Articles of apparel and clothing accessories of textiles fabrics	100.0	50.0	8.0	12.5
12	Footwear, headgear, umbrellas	79.2	48.5	8.0	10.4
17	Vehicles, aircraft and associated equipment	67.7	25.1	6.0	5.5
Total number of lines of selected products		495	344	2496	2522

[a] The share of specific tariff lines is 0.87 in 1997 and in 2001 in section 3.

[b] The share of specific tariff lines range from 0.4 to 8 per cent in section 4.

[c] Subsection 61 of section 11.

Note: Because of changes in nomenclature, tariff averages are not strictly comparable across years. See technical appendix for further details.

Source: Korean Customs Association (1974); International Customs Journal, Korea (1982); WTO-IDB; WTO estimates.

The simple averages of applied tariffs for selected product groups shown in the Table above suggest that Korean tariffs were still relatively high by the mid-1970s but that already in the early 1980s, they had been significantly reduced. Tariffs were further reduced as shown by the averages for 1996 and after. At the same time as the averages were reduced, the dispersion between groups was also reduced. In the Uruguay Round, the Republic of Korea bound all its agricultural tariffs at an average rate of more than 50 per cent and 93.8 per cent of its non-agricultural tariffs at 10 per cent on average.

Developing countries did not make many market access concessions in the 1970s or 1980s either. Between 1970 and 1985, six developing countries plus Romania and Hungary negotiated their accession under Article XXXIII and six succeeded to Contracting Party status under Article XXVI:5(c). During the same period, the number of developing countries applying the GATT provisionally or de facto reached 30. The participation of developing countries in the Tokyo Round was not subject to the reciprocity rule. According to Hudec (1987), developed countries pressed a little harder for reciprocity from the larger developing countries but not very much. Nevertheless, 19 developing countries offered tariff reductions or bindings of prevailing tariff rates on 5 per cent of their total MFN imports.[82]

In the late 1980s and early 1990s, that is just before or during the Uruguay Round negotiations, the number of accessions increased significantly. About 25 countries succeeded to Contracting Party status under Article XXVI:5(c) while 13 countries acceded to the GATT under Article XXXIII. Eight of the 13 countries were Latin American (Mexico, Bolivia, Costa Rica, El Salvador, Venezuela, Guatemala, Paraguay and Honduras), three were countries in transition (Czech Republic, Slovak Republic and Slovenia) and two were North African (Morocco and Tunisia).[83] It is interesting to note that the dispersion in the level of commitments undertaken by acceding countries increased significantly during this period. Except for Tunisia and Morocco, all of the countries that acceded under Article XXXIII bound all or almost all their tariff lines. In most cases, the tariffs were bound at an across-the-board ceiling level with a list of exceptions. The level of the ceiling varied between 27 per cent in the case of Slovenia and 55 per cent in the case of Costa Rica. This evolution probably reflects a progressive change in views regarding the role of international trade in promoting growth and development that could be observed during this period.

82 Or about $3.9 billion of their 1976 or 1977 imports.

83 See the details regarding accession in Appendix Table 10.

International financial institutions and developed Contracting Parties were pushing harder in favour of trade reforms in developing countries.[84]

For most of the 13 countries that acceded to GATT after 1986, accession was part of a broader reform agenda. The report of the Working Party on the Accession of Costa Rica describes the tariff reform introduced as part of a Structural Adjustment Program. Costa Rica simplified its tariff structure and significantly reduced its applied rates. Taxes on customs values, surtaxes and surcharges were reduced and unified within the customs tariff. The maximum tariff level for most finished products was set at 40 per cent. At the same time, however, the government bound its entire tariff schedule at 55 per cent *ad valorem* with a few exceptions specified in an annex to its schedule. Most exceptions to the ceiling were set below 55 per cent with only a few bindings set above 55 per cent.

Tables 10 and 11, in the next subsection, show the pre-Uruguay Round binding coverage for agricultural and non-agricultural products for a set of 20 developing countries. Except for the countries which acceded in the late 1980s, all the other countries in the sample have binding coverages for both agricultural and non-agricultural products that are below one third. In agriculture, eight countries had bound less than 5.4 per cent of their tariff lines while for industrial products, 10 countries had bound less than 10 per cent of their lines.

As of 1 January, 1995, the total number of Contracting Parties to the GATT was 128, of which about 100 were developing countries. GATT Contracting Parties which accepted the Marrakesh Agreement and the Multilateral Trade Agreements, and for which the relevant Schedules of Concessions and Commitments are annexed to GATT 1994 and the GATS, became original Members of the WTO.

(ii) The Uruguay Round and after

The 1980s and the early 1990s saw a dramatic change in approaches towards the role of international trade in development strategies.[85] Slowly at first, but rapidly by the late 1980s, many developing countries, encouraged and supported by the World Bank, turned away from earlier import substitution strategies and undertook sometimes radical liberalizations of their trade regimes.[86] This change in strategies was also reflected in the participation of developing countries in the Uruguay Round. Many of them participated actively throughout the Round, while others increased their participation as the Round evolved. Developing countries made offers on market access for both agricultural and non-agricultural products.[87] At the same time, however, they liberalized unilaterally. This subsection attempts to isolate the changes in access to developing country goods markets that were negotiated at the multilateral level. In the same perspective, this subsection also examines the ITA negotiation which took place after the Uruguay Round as well as the market access component of accessions that were negotiated under Article XII of the Marrakesh Agreement.[88]

84 Hoda (2001) notes that industrialized Contracting Parties have been the principal players in the accession negotiations of developing countries. World Bank (2006) shows that Bank lending for trade liberalization peaked in the period 1987-1994.

85 Winters (2000) discusses both the evolution of the thinking about trade policy and the intellectual and experiential factors behind the thinking.

86 See the evaluation of World Bank support for trade (World Bank, 2006).

87 The discussion in this subsection is restricted to market access for goods. While the focus is on industrial products, agricultural market access issues are also covered although in less detail. For a discussion of services commitments, see GATT (1994), Hoekman (1996) and WTO (2001a).

88 Members also conducted sectorial negotiations in services (finance and basic telecommunications) which are not discussed in this section. On financial services, see Sorsa (1997), Dobson and Jacquet (1998), Mattoo (2000), Qian (2000), Woodrow (2000, 2001) and Barth et al. (2006). On basic telecommunications services, see Sherman (1998).

Uruguay Round commitments

With the Uruguay Round, the data situation improved considerably.[89] With regard to tariffs in particular, the GATT/WTO Secretariat's Integrated Data Base allowed detailed calculations to be made electronically for 27 out of a total of 94 developing economy participants. Using these data, a comparison can be made between pre- and post-Uruguay Round binding coverage. On average, the developing countries in the sample substantially increased their binding coverage. Their share of bound lines in all agricultural tariff lines increased from 17 per cent before the Uruguay Round to 100 per cent. For non-agricultural products, the binding coverage expressed in percentage of all non-agricultural tariff lines increased from 21 to 73 per cent. As can be seen from Table 9, these averages hide considerable differences between regions.[90] While almost all Latin American countries bound all their industrial tariff lines at a generally uniform ceiling level, African and Asian countries adopted more diverse strategies. Most of them left a significant number of lines unbound.

Table 9
Pre- and post-Uruguay Round binding coverage for agricultural and non-agricultural products

	Agricultural products				Non Agricultural products			
	Percentage of tariffs lines bound		Percentage of imports under bound rates		Percentage of tariffs lines bound		Percentage of imports under bound rates	
	Pre UR	Post UR	Pre UR	Post UR	Pre UR	Post UR	Pre UR	Post UR
Developing economies	17	100	22	100	21	73	13	61
Transition economies	57	100	59	100	73	98	74	96
Latin America	36	100	74	100	38	100	57	100
Central Europe	49	100	54	100	63	98	68	97
Africa	12	100	8	100	13	69	26	90
Asia	15	100	36	100	16	68	32	70

Source: GATT (1994).

Comparisons of tariff levels over time raise a number of difficulties. While comparisons between pre-Uruguay Round and post-Uruguay Round applied tariffs are relatively straightforward, changes in binding coverage complicate comparisons between pre- and post-Uruguay Round averages of bound rates. In the 1990s, averages of bound tariffs were typically calculated across all tariff lines, bound and unbound, using the applied duty in the base period for unbound lines. Nowadays, averages of bound rates are calculated on bound rates only. These issues warrant for considerable caution in interpreting the statistics, in making comparisons across countries and over time and in making comparisons with previous estimates.

A major achievement of the Uruguay Round was the Agreement on Agriculture and the progress made towards bringing agriculture back into the realm of multilateral trade rules. Although agriculture had always been covered by the GATT, prior to the WTO, the rules that applied to agricultural primary products deviated from the general rules.[91] In the lead up to the Uruguay Round negotiations, it became increasingly evident that the causes of disarray in agriculture went beyond problems with market access strictly defined. To get to the root of the problem, Members decided to tackle market access, domestic support and export subsidies jointly. A comprehensive discussion of the effects of the Agreement on Agriculture on developing countries is beyond the scope of this Report. This subsection focuses on changes in tariff bindings and tariff levels. However, it is important to keep in mind that this only

[89] Uruguay Round market access commitments have been extensively documented elsewhere. See for instance WTO (2001a), OECD (1999), Martin and Winters (1996), GATT (1994).

[90] Averages calculated on a sample of 55 countries (counting the 12 Members of the EU individually) including 27 of the 93 developing economy participants in the Uruguay Round. See the discussion in GATT (1994).

[91] See the discussion in WTO (2001a).

provides a partial picture of the disciplines that developing countries took up in this area when they signed the Marrakesh Agreement.

Table 10
Uruguay Round commitments, agricultural products, selected developing countries

	Binding coverage		Simple average of bound tariffs		Simple average of applied tariffs			
	Pre UR	Post UR [a]	Pre UR	Post UR [a]	Pre UR year	Pre UR Average	Post UR year	Post UR Average
Brazil	5.4	100.0	17.2	35.5	1989	36.4	1997	12.6
Chile	100.0	100.0	35.0	26.0	...	...	1996	11.0
Colombia	100.0	100.0	16.7	91.9	1991	14.1	1996	14.2
El Salvador	100.0	100.0	53.7	42.1	...	...	1996	13.0
Hong-Kong, China	2.2	100.0	0.0	0.0	1992	0.0	1996	0.0
India	14.3	100.0	102.7	114.5	1988	76.3	1996	38.0
Indonesia	4.7	100.0	55.5	47.0	1989	22.0	1998	8.8
Jamaica	...	100.0	...	97.4	1991	28.5	1999	17.3
Korea, Rep. of	20.5	99.1	52.1	52.9	1988	27.2	1996	50.1
Macao, China	...	100.0	...	0.0	1991	0.0	1996	0.0
Malaysia[b]	4.7	99.9	28.3	12.2	1988	9.8	1999	3.8
Mexico	100.0	100.0	54.5	35.1	1988	12.8	1998	20.6
Philippines	3.2	99.4	33.1	34.7	1991	34.3	1996	19.5
Singapore	1.7	100.0	7.3	9.5	1989	0.1	1996	0.0
South Africa[b]	33.1	99.5	54.6	39.8	1988	11.2	2000	9.0
Sri Lanka	4.9	100.0	50.0	49.7	1991	36.1	1998	25.6
Thailand[b]	4.9	100.0	42.0	...	1988	44.3	1999	38.0
Tunisia	...	98.8	...	116.0	1989	32.7	2000	76.6
Turkey[b]	12.4	100.0	23.0	60.1	1989	50.1	1996	42.2
Venezuela	100.0	99.0	71.1	55.7	1990	18.5	1997	14.6

[a] Including post UR rectifications and modifications.
[b] Countries with shares of non-ad valorem tariffs in their agricultural post-UR applied rates exceeding 5 per cent.
Source: WTO Secretariat.

The data in Table 10 show pre-and post-Uruguay Round binding coverages, bound tariff averages and applied tariff averages for agricultural products for 20 developing countries for which information was available.[92] With the exception of 5 countries which had acceded to the GATT in the 1980s, developing countries extended their binding coverage from less than one third of their tariff lines to full coverage. The un-weighted average of post Uruguay Round bound rates across all 20 countries is around 50 per cent. Two countries set their bound tariffs at rates on average higher than 100 per cent. At the other end if one excludes Hong-Kong, China; Macau and Singapore; and Malaysia because of its large share of non *ad valorem* rates, Chile and the Philippines set the lowest agricultural bindings on average. In all cases except Hong-Kong, China; Macao, China; Singapore and Thailand with its large share of non-*ad valorem* rates, applied tariffs in the late 1990s were on average substantially lower than post-UR tariffs. A large majority of countries lowered their applied tariffs during the period under consideration but they went far beyond their commitments.

92 Because non-*ad valorem* tariff rates are not taken into account in the calculations, countries with shares of non-*ad valorem* tariffs in their agricultural or non-agricultural post-UR applied rates exceeding 5 per cent are signalled with a note.

Table 11
Uruguay Round commitments, non-agricultural products, selected developing countries

	Binding coverage		Simple average of bound tariffs		Simple average of applied tariffs			
	Pre UR	Post UR [a]	Pre UR	Post UR [a]	Pre UR year	Pre UR Average	Post UR year	Post UR Average
Brazil	6.8	100.0	28.0	30.8	1989	40.3	1997	14.9
Chile	100.0	100.0		25.0			1996	11.0
Colombia	0.8	100.0	51.3	35.4	1991	11.5	1996	11.2
El Salvador	100.0	100.0	44.5	35.7			1996	8.4
Hong-Kong, China	1.2	37.5	0.0	0.0	1992	0.0	1996	0.0
India	4.6	69.8	44.7	34.3	1988	78.7	1996	38.8
Indonesia	11.4	96.1	32.7	35.6	1989	26.6	1998	9.6
Jamaica	0.0	100.0		42.5	1991	18.3	1999	7.1
Korea, Rep. of	9.5	93.8	31.2	10.1	1988	19.7	1996	7.7
Macao, China	0.0	15.6		0.0	1991	0.0	1996	0.0
Malaysia	0.4	81.2	31.0	14.9	1988	19.7	1999	10.2
Mexico	100.0	100.0	49.0	34.9	1988	13.1	1998	12.6
Philippines	6.4	61.8	23.4	23.4	1991	26.7	1996	13.5
Singapore	0.3	64.5	10.0	6.3	1989	0.5	1996	0.0
South Africa [b]	16.6	96.0	10.4	15.8	1988	20.3	2000	6.1
Sri Lanka	4.1	28.3	17.1	19.3	1991	25.9	1998	9.4
Thailand [b]	2.6	70.9	24.6	24.2	1988	43.7	1999	39.8
Tunisia	0.0	51.1		40.6	1989	28.7	2000	25.6
Turkey	34.4	39.3	23.3	17.5	1989	45.2	1996	7.5
Venezuela	100.0	100.0	50.0	33.9	1990	17.0	1997	11.6

[a] Including ITA and post UR rectifications and modifications.
[b] Countries with shares of non-ad valorem tariffs in their non-agricultural post-UR applied rates exceeding 5 per cent.
Source: WTO Secretariat.

In the non-agricultural market access negotiations, only a subset of all developing countries agreed to bind all their tariff lines. As shown in Table 11, seven out of the 20 developing countries in the sample, that is all Latin American countries plus Jamaica, bound all their industrial tariffs. Indonesia, the Republic of Korea, Malaysia and South Africa bound more than 80 per cent of their industrial tariff lines. Macao, China and Sri Lanka on the other hand bound less than one third of their lines. All the countries in the sample bound their tariffs at levels that are on average lower than the ones negotiated for agriculture. For all countries except two, there is a large gap between bound and applied tariffs.[93] A large majority of the countries reduced their applied tariffs between the early and the late 1990s. However, as in the case of agricultural products, they went beyond what their commitments would have required.

The Information Technology Agreement

As mentioned in subsection 2.(a) above, developing economies participated actively in the ITA. The number of developing country participants increased from 6 out of a total of 28 participants in 1997 to 32 out of a total of 70 by the end of April 2007.[94] A number of developing economies, including large countries such as Brazil, Mexico and South Africa have preferred to stay outside the agreement.[95] While Central America is well represented, not a single South American country participates in the ITA. Similarly, two North African countries participate, but no Sub-Saharan country has signed the Agreement.

Protection levels in developing economies for products covered by the ITA differed widely in 1997. Some developing economies, notably in East Asia, a region heavily involved in global trade of ITA products,

[93] Bound averages must be interpreted jointly with the corresponding figure for the binding coverage. When the binding coverage is incomplete, the bound and the applied averages are not strictly comparable.

[94] Developing country participants include countries in transition.

[95] Note that South Africa was considered a developed Member in the Uruguay Round.

had already very low applied rates (e.g. Hong-Kong, China and Singapore). Others had moderate tariffs and granted generous duty drawbacks for domestic IT industries (e.g. Malaysia or Costa Rica) while a third group had relatively high tariff levels (e.g. India and Egypt). For the latter group it was of particular importance that the staged implementation could be as long as 8 years for some products (e.g. India). While for the major developed economies the average bound tariff on ITA products was typically below 5 per cent, the same average typically ranged between 10 per cent and 20 per cent for developing economies with the important exception of India (66 per cent) on the upward side and Hong-Kong, China and Chinese Taipei (0.0 per cent and 4.7 per cent) on the downside.

Accessions

Since 1995, a total of 22 countries acceded to the WTO under the provisions of Article XII of the Marrakesh Agreement. A majority of those countries were in a process of transition from a planned to a market economy when they joined. A number of them were also on accession track for the European Union. This means that they were engaged in a substantive program of unilateral reforms which significantly complicates any assessment of the role of the WTO in tariff reductions.

Article XII provides that accession to the WTO is on terms negotiated between the WTO and the applicant. Because each accession is a negotiation between the WTO and a different economy, each accession is unique. However, most commentators observe that the price of accession has increased over time.[96] Pursuant to the Agreement on Agriculture, all agricultural tariff lines have been bound by countries that have acceded under Article XII. Newly acceded Members have also bound 100 per cent, or very close to 100 per cent of their non-agricultural tariff lines, which is more than many incumbent Members. They have bound their tariffs at levels that are lower than those at which most incumbent developing members have bound theirs. The commitments of the new Members are difficult to compare with pre-accession tariffs. First, data on pre-accession tariffs are not necessarily available. Second, as countries would in principle be supposed to implement reforms before joining the WTO, it is not clear exactly which point in time would be relevant for the comparison.[97] However, the comparison of commitments with post-accession applied averages in Table 12 clearly shows that in a number of cases commitments must have induced a reduction of applied tariffs. Several Members either have their bound and applied tariffs at the same level, or have their applied tariffs above their bound tariffs, which indicates that they are still in the process of phasing-in their tariff reduction commitments. Most of the newly acceded transition countries are also participants to the Information Technology Agreements, as well as to a substantial part of the sectoral initiatives.

96 See Evenett et al. (2004), Langhammer and Lücke (1999) or Milthorp (1997).

97 Article XIV.2 of the WTO Agreement states that a Member which accepts the Marrakesh Agreement after its entry into force shall implement those concessions and obligations in the Multilateral Trade Agreements that are to be implemented over a period of time starting with the entry into force of this Agreement as if it had accepted this Agreement on the date of its entry into force. Transition periods are thus by no means made automatically available to acceding governments. Article XII on the other hand offers Members a margin of manoeuvre. In practice, Members have made it clear that transition periods will only be granted if the applicant is successful in making a strong enough case to prove that such a period is necessary.

Table 12
Simple average of bound and applied *ad valorem* import tariffs of newly acceded economies

	Agricultural Products		Industrial Products	
	Bound	Applied	Bound	Applied
Albania [a]	9.4	9.0	6.6	7.2
Republic of Armenia	14.7	6.6	7.5	2.3
Bulgaria	35.6	18.4	23.0	8.8
Cambodia [c]	28.1	19.5	17.7	15.9
China	15.8	16.2	9.1	9.5
Croatia [c]	9.4	9.3	5.5	4.1
Ecuador	25.5	14.7	21.1	11.5
Estonia [b]	17.5	12.2	7.3	0.1
FYR of Macedonia	11.3	12.7	6.2	8.7
Georgia	11.7	11.7	6.5	6.9
Jordan	23.7	19.6	15.2	12.1
Kyrgyz Republic [c]	12.3	7.0	6.7	4.3
Latvia [a]	34.6	11.8	9.4	2.2
Lithuania [b]	15.2	9.7	8.4	2.4
Moldova [a]	12.2	10.2	6.0	4.1
Mongolia [c]	18.9	5.1	17.3	4.9
Nepal [c]	41.4	13.5	23.7	13.7
Oman [a]	28.0	10.2	11.6	5.0
Panama [b]	27.7	14.8	22.9	7.4
Saudi Arabia [d]	22.4	7.8	10.5	4.8
Chinese Taipei [c]	15.3	16.3	4.8	5.5
Viet Nam [d]	18.5	24.2	10.4	4.7

Note: Year of applied tariff is 2004 except where indicated as follows: [a] 2001, [b] 2002, [c] 2003, [d] 2006.
Source: WTO-IDB and UNCTAD.

(iii) Summary observations

Overall, a number of lessons can be drawn from this brief overview of the evolution of developing country tariffs and their utilization of the multilateral system. First, for several decades, developing countries did not make much use of the multilateral system to reduce their tariffs. Typically, commitments made in accession negotiations or during the rounds were limited. Binding coverage remained low and in some cases it decreased over time. In the 1950s and 1960s, tariffs were subject to frequent changes. Governments reduced some tariffs and increased others on a yearly basis. Until the mid-1980s, the applied tariffs of a number of developing countries tended to increase rather than to decrease. Second, the GATT contributed significantly to improve transparency in market access conditions and played an important role as a forum for the discussion of trade policies. GATT documents report discussions among Contracting Parties on tariffs, quasi tariffs and non-tariff measures. For most of the period, tariffs were only part of the story. Quantitative restrictions played a very important role and developing countries had all sorts of other restrictive measures in place. The role of GATT in this area is examined below. Third, when views regarding the role of trade in development changed in the second half of the 1980s and external pressure for developing countries to take more commitments grew, their participation in the GATT intensified. A number of countries which acceded to the GATT after 1986 bound all their tariff lines. The bindings, however, were set at a ceiling level, which introduced a significant gap between their bound and applied rates.

Fourth, with the Uruguay Round, the role of the GATT/WTO was further reinforced. Many developing countries significantly extended their binding coverage in the Uruguay Round. They all bound 100 per cent of their agricultural tariff lines and a number of them, in particular in Latin America, extended their binding coverage of non-agricultural products. However, in most cases the bindings were set at levels far above applied rates. In other words, applied tariffs continued to be set independently from bound tariffs. Liberalization was mainly unilateral, whether encouraged by international financial institutions or not. The multilateral binding process followed. After the Uruguay Round, the trend continued. A number of mostly Asian countries used the ITA negotiations to reduce their tariffs on information technology products. While an assessment of the role of accession negotiations is more difficult, evidence suggests that they were instrumental in reducing the tariffs of the new Members. In a number of cases, there is only very little "water" in the tariffs.

(c) Non-tariff measures

This subsection will complement the examination of tariff negotiations with a discussion of the impact of the GATT/WTO on non-tariff measures (NTMs).[98] For two main reasons, however, a comprehensive discussion of the treatment of NTMs in the GATT/WTO is beyond the scope of this subsection. First, given their nature and the lack of quantitative information, the evolution of NTMs over time is difficult to measure. Second, the GATT/WTO system has addressed NTMs in so many different ways ranging from negotiations, to rule making and to dispute settlement that setting the boundaries of the discussion would be difficult. The analysis is thus selective in its attempt to identify some trends in the incidence of NTMs and to provide some sense for the nature of the role played by the multilateral system in addressing those measures.

Non-tariff measures played an important role in GATT times, as mentioned in subsections (a) and (b), and their presence on the Doha agenda testifies to the fact that they are still alive. This however does not mean that the GATT/WTO has failed in its attempt to discipline NTMs. As stated by Jackson:

> "The ingenuity of man to devise various subtle as well as explicit ways to inhibit the importation of competing goods is so great that any inventory of such measures quickly becomes quite large. In addition, it is clear that this ingenuity will never cease: like ways to avoid income tax, human invention of non-tariff barriers will undoubtedly go on for ever." [99]

Over its 60 years of existence, however, the GATT/WTO has fought many battles against NTMs and it can claim a number of successes. The focus here is on quantitative restrictions which played a dominant role in the early years of GATT and on a number of other NTMs that progressively grew in importance with the reduction of tariffs and quantitative restrictions.

(i) Quantitative restrictions

Trade restrictions other than duties, taxes and other charges were pervasive in the immediate post-World War II period. The low post-war level of monetary reserves and the limited earnings of foreign exchange, combined with the general inconvertibility of currencies, had deprived many countries of means of payments. Therefore, they maintained a strict control of imports to ensure that their limited resources would be devoted to what they saw as the needs commanding highest priority. Trade flows were regulated by bilateral agreements and direct government intervention which took the form of state trading, foreign exchange control, licensing requirements and quantitative restrictions. Each government had its own mix of instruments to control trade flows and the measures were readjusted with a considerable frequency. The GATT played different roles for different measures. As discussed below, it played a substantive role in the elimination of quantitative restrictions. Members on the other hand chose a unilateral or regional

[98] The term "non-tariff measure" rather than "non-tariff barrier" is used in this Report. This term includes all traditional measures, such as quotas, licenses and contingent protection measures, whether or not they may be regarded as protectionist in intent.

[99] See Jackson (1997), p. 154.

approach for the elimination of state trading enterprises. As explained in Box 17, GATT's contribution was to discipline the activities of the remaining state-trading enterprises.

Box 17: State trading in the GATT

State-trading occurs when a government or a government-backed agency determines the prices or quantities at which exports and imports have to be traded. Such activity was prevalent during World War II, however, following the cessation of hostilities, a large proportion of state controlled industries were returned to private hands. Whilst this reduction in state-trading generally took place on a unilateral basis, the issue of state-trading has been tackled more formally in the GATT in two ways: disciplining their use, and, limiting the extent of State-trading enterprises (STEs) by former Centrally Planned Economies (CPEs) upon their accession to the GATT.[100]

The GATT 1947 contains several provisions for disciplining the use of STEs. Article XVII states that STEs are to be subject to the GATT principles of non-discrimination[101] and MFN treatment and should be constrained to act only on the basis of "commercial considerations". Article II:4 states that, in the case of importing countries, they should not maintain mark-ups higher than the tariff levels bound in the GATT. In addition to this, the Interpretative Note to Articles XI, XII, XIII, XIV, and XVIII ensures that the prohibition of quantitative restrictions also applies to STEs. Moreover, the issue of transparency is tackled in Article XVII:4. It stipulates that Members should report the products imported or exported by STEs and that Member countries have the right to request information relating to the operations of another Member's STE where they feel that they are adversely affected by such operations. The Uruguay Round Understanding on the Interpretation of Article XVII reinforced the transparency obligations under Article XVII, including by mandating the creation of a new standard questionnaire for STE notifications.

Special attention was paid to the issue of STEs when former CPEs acceded to the GATT/WTO. For example, given the extent of residual state-trading in Poland and Romania, when these countries sought GATT membership in 1967 and 1971 respectively, minimum annual import growth commitments were demanded of them by existing Members and special mechanisms were retained to safeguard existing Members against potentially damaging export behaviour.

When the GATT was drawn up in 1947, Contracting Parties which employed import restrictions accepted the general rule, contained in Article XI, that imports from other Contracting Parties should not be prohibited and should not be controlled by means of restrictions other than duties, taxes and other charges. The Agreement provides exceptions for the use of restrictions in certain circumstances and under defined conditions. The exception contained in Article XII, which allows a Contracting Party to restrict imports, either by quantity or by value, in order to safeguard its external financial position and balance of payments was considered to be the most important in the early 1950s.[102] The Agreement required Contracting Parties which applied restrictions under Article XII to relax them progressively as conditions improved, maintaining them only to the extent that the position of their balance of payments and the level of their monetary reserves still justified their application and to eliminate them altogether when conditions no longer justified their maintenance. Another important exception was the one included in Article XVIII for infant-industry protection.

Balance-of-payments restrictions were a major presence during the first decade of GATT. In 1951, 27 of the 38 Contracting Parties stated that they were resorting to the provisions of Article XII and were

[100] For a discussion of state-provided services under the GATS, see Adlung (2006).

[101] It has been clarified through dispute settlement that this non-discrimination obligation includes the concept of national treatment.

[102] GATT (1951) The use of quantitative import restrictions to safeguard balances of payments, Geneva: GATT.

employing quantitative import restrictions to redress their balance of payments.[103] Nine Contracting Parties, namely, Belgium, Canada, Cuba, Dominican Republic, Haiti, Luxemburg, Nicaragua, Peru and the United States reported that they were not taking action under these provisions. As of January 1954, 16 of the 20 developed Contracting Parties were restricting their imports for balance-of-payments reasons and nine of the 14 developing countries were doing likewise. Of the 25 countries applying balance-of-payments restrictions, 23 were applying them in a discriminatory manner.

Developed countries

By the late 1950s, developed GATT Contracting Parties, which were emerging from the post-war balance-of-payments crisis started to harden the legal pressure from GATT disciplines in order to progressively eliminate their remaining restrictions.[104] The program which was put in place in 1958, when the major western European trading nations established external currency convertibility, had some success, but it was least successful with respect to agricultural products, partly because the United States continued to use agricultural quotas under the 1951 statute for which it had obtained a waiver. Other countries argued that if the United States could use such quotas, they would also use them (Jackson, 1997). Eventually, for developed countries, balance-of-payments restrictions lost their distinctive character and became merged with the general problem of non-tariff measures.[105] Box 18 describes the phasing-out of quantitative restrictions in Europe.

Box 18: The elimination of quantitative restrictions in Europe

The data collected by the OEEC in respect to OEEC member countries in the framework of the European Payments Union provide a good illustration of how quantitative restrictions were progressively phased out in Europe. Among the various measures to help the European reconstruction the European Payments Union intended to facilitate the liberalization among its Members on a non-discriminatory basis of trade and invisible transactions.

Only in late 1949 when the basic recovery of output had taken place, inflation was under control and exchange rate adjustment made, could the (West) European countries agree on coordinated steps for the progressive elimination of quantitative restrictions among themselves. In October 1949 a timetable was agreed according to which the 16 OEEC members should eliminate the quantitative restrictions applied in intra-European trade and conducted on private account. (A separate timetable was established to free from quantitative restrictions, at a later stage, European imports from Canada and the United States).

The agreed timetable for the elimination of quantitative restrictions was the following:

15 December 1949	50 per cent
1 July 1950	60 per cent
1 February 1951	75 per cent
14 January 1955	90 per cent

[103] These are: Australia, Austria, Brazil, Ceylon, Chile, Czechoslovakia, Denmark, Finland, France, Germany, Greece, India, Indonesia, Italy, the Netherlands, New Zealand, Norway, Pakistan, Southern Rhodesia, Sweden, Turkey, Union of South Africa and the United Kingdom. The governments of Burma and Liberia did not inform the Contracting Parties of their position.

[104] See GATT (1955) International Trade 1955, pp.158-159.

[105] For a full description of how developed-country residual restrictions were progressively eliminated, see Hudec (1975) The GATT legal system and world trade diplomacy, New-York: Praeger.

Various developments (Korean War and a number of national crises) led to a postponement of the 90 per cent target to the 30 June, 1959[106]. This was only six months after the external convertibility of European currencies (27 December, 1958) was achieved.

At the end of June 1958, 12 countries had attained the 90 per cent target on private intra-European trade while four countries (e.g. France, Iceland, Norway and Turkey) still missed it by a large margin.

Available evidence clearly shows how already in the 1950s liberalization of developed countries' quantitative restrictions was easier for non-agricultural products than for agricultural products. A 1953 GATT Secretariat report discussing the liberalization of intra-European trade notes that in the agricultural sector the percentages of liberalized trade were significantly lower than those reached in the other sectors and that the relationship between the external financial position of countries and the degree of liberalization in this sector is much less clear.[107] In 1954, at the proposal of Western European countries, which were concerned that the sudden abandonment of protection afforded by quantitative restrictions may lead to serious economic and social consequences, the Contracting Parties adopted a decision which provided a transitional period during which the necessary adjustments could be made. Quantitative restrictions were progressively phased out by developed countries. However, they survived for many years in agriculture and in the textiles and clothing sector. As explained below, the Uruguay Round Agreement on Agriculture required the tariffication of most non-tariff measures including quantitative restrictions and prohibited their use. Similarly, as explained in Box 19, the Uruguay Round Agreement on Textiles and Clothing provided for the progressive phasing out of quantitative restrictions affecting trade in textiles and clothing products.

Box 19: Textiles: long exempt from GATT rules

Textiles and clothing were, until recently, the only industrial products derogated from the rules of the GATT. Instead they were subject to the Agreement Regarding International Trade in Textiles (more commonly referred to as the Multi-Fibre Arrangement, or "the MFA") (1974-94) and thereafter to the WTO Agreement on Textiles and Clothing (ATC) (1995-2005). The MFA involved the extensive application of quotas by major industrialized importers at the expense of the most efficient developing country exporters. It thus contravened the MFN principle and the prohibition of quantitative restrictions (QRs), and it discriminated against developing countries. Eventually, the ATC was negotiated in the Uruguay Round as a measure to gradually integrate the textiles sector into the GATT, with the last quota being lifted on the 1 January, 2005. This box charts the history of the MFA and the ATC and discusses the role of the GATT/WTO in bringing an end to quantitative restrictions to textile trade. It is important to highlight that textiles have been one of the hardest-fought issues in the WTO, as it was in the former GATT system; congruency with GATT principles was initially very weak in this area but, with the conclusion of the ATC, it has been significantly strengthened.

The ancestors of the MFA were the Short Term Agreement on cotton textiles (STA) of 1961 and its 1962 successor, the Long Term Agreement Regarding International Trade in Cotton Textiles (LTA). These agreements allowed importing countries to impose restraints on textile imports from their trading partners whenever such imports caused, or threatened to cause, "market disruption", the definition of which was left to the discretion of the importing country. Impetus for the formation of these agreements came from industrial countries, where protectionist pressure from influential textile industry lobbies was highly potent (Khanna, 1991).

[106] 30 June, 1958 82.6 per cent of private imports in the reference year (generally 1948) was attained were free from quantitative restrictions. See OEEC (1958).

[107] The same report also describes the protection of agriculture by means of import restriction in the US. See GATT (1953) International Trade 1953.

During the term of the LTA, developing country exporters sought to circumvent QRs by switching from cotton to the newly developed man-made fibres, which remained outside the ambit of the LTA. Even though the North American and European producers initially had a lead in textiles of man-made fibres, the nature of the clothing industry meant that they could not compete with their developing country counterparts who benefited from low labour costs. Due to the increased import competition and the strong productivity gains through technological changes, textile and clothing industries in industrial countries suffered a fall in employment during this period. This galvanised renewed protectionist pressure which lead to the development of several *supra*-LTA restrictions on textile trade. Seeking to legitimize such departures from existing international legislation, the MFA was introduced in 1973 so as to bring restrictions against imports of wool and synthetic fibres into the category of exceptions to the GATT. Whilst the agreement was conducted within the environment of the GATT, and deposited with the Director-General of the GATT, it is pertinent to note that its members constituted only a proportion of GATT Contracting Parties and that the text of the GATT itself made no mention of special treatment of textile trade.

The MFA was in many ways similar to the LTA. Essentially it facilitated a framework for bilateral agreements or unilateral actions that established quotas limiting imports into countries facing an actual (or imminent) sharp, substantial and measurable increase in imports causing or threatening to cause serious damage to domestic producers. Such QRs were usually to be maintained for up to one year, and, if extended, were to be subject to an allowance of no less than 6 per cent annual growth in imports, compared with 5 per cent under the LTA. A Textiles Surveillance Body was created to ensure the functioning of the Agreement.

The MFA was renewed several times throughout its 20-year reign, with an increasing number of Contracting Parties. By 1994, MFA-IV had 45 signatories, including 31 developing and Central and Eastern European country (CEECs) exporters, and eight industrialized importers: Austria, Canada, the EU, Finland, Norway, the US, Japan and Switzerland. Increasing developing country disquiet regarding the trade restricting measures of the MFA culminated in the inclusion of negotiations to bring about the end of the MFA in the Uruguay Round. The result was the creation of the ATC, which came into force on 1 January, 1995 and which stipulated *inter alia* that all MFA restrictions were to be phased out in successive liberalization phases by 1 January, 2005. Hoekman and Kostecki (2001) argue that an implicit *quid pro quo* link was established in the Round between the demands of the developed countries to address such issues as services and TRIPs, and the textile market access requests of developing countries.

The ATC involved four phases of liberalization in 1995, 1998, 2002 and 2005. The percentage of textile and garment products to be brought under GATT rules was 16 per cent, 17 per cent, 18 per cent and 49 per cent in each of the four years respectively and the quotas that remained in the intervening periods between stages were subject to annual expansions of 6.96 per cent, 8.7 per cent and 11.05 per cent, respectively. It was stipulated that the products brought into the GATT in each phase should include items from four categories: tops and yarn; fabrics; made-up-textiles; and, clothing. While the rationale underlying the sequential phasing out of restrictions was to allow both importers and less efficient exporters time to adjust with the minimum amount of disruption, the developed countries chose to back load their liberalizations by leaving the most sensitive products until last.[108]

It is important to highlight that the ATC provided for transitional safeguard mechanisms to allow, under strict circumstances, restrictions to be imposed on textile and clothing goods not subjected to quotas and not included in the GATT. These safeguards were not the same as the safeguard measures normally allowed under GATT because they could be applied on imports from specific

[108] In the United States the combined employment of the textiles and apparel industry decreased from 1.53 million people in the first quarter of 1995 to less than 0.67 million people in early 2005 when these industries accounted for 0.5 per cent of US non-farm employment. Under the MFA, the EU sought no restrictions on exports from the poorest countries, such as Bangladesh, hence textiles industries prospered there.

exporting countries. However, the importing country had to show that its domestic industry was suffering serious damage or was threatened with serious damage, and it had to show that the damage was the result of two things: increased imports of the product in question from all sources, and a sharp and substantial increase from the specific exporting country. The safeguard restriction could be implemented either by mutual agreement following consultations, or unilaterally and was subject to review by the Textiles Monitoring Body which oversaw the functioning of the agreement, reviewed requests for the use of safeguards, and facilitated dispute settlement.

Developing countries

For the developing countries, instead of becoming fewer, the use of balance-of-payments restrictions expanded in the second half of the 1950s. A GATT report in November 1959 showed that 13 of the GATT's 16 developing country members were using balance-of-payments restrictions.[109] According to Hudec (1987), emergency restrictions increasingly looked like they would become a permanent feature of developing-country trade regimes, making other GATT obligations irrelevant. Over the course of the next four decades, more than a dozen developing countries invoked the provisions of Article XVIII:B and the duration of their import restrictions ranged from several years to more than three decades in a number of cases (see Appendix Table 15). The process of consultations within the Committee on Balance-of-Payments Restrictions allowed trading partners to exercise surveillance over the consulting country's trade policy and apply "peer pressure" towards adopting more liberal policies, with varying results.

As mentioned above, two exceptions to the general prohibition of quantitative restrictions under Article XI were initially available to developing countries: Article XII and Article XVIII.[110] In the first years and indeed throughout the history of the multilateral trading system, the use of infant-industry exceptions under Section C of Article XVIII was limited partly because the review procedure was very strict. In 1949 and 1950, Cuba, Haiti and India each had a single product quota approved. Ceylon also used Article XVIII in the early 1950s and was the only country ever to use it after 1954. The 1954 review session offered developing countries an opportunity to renegotiate GATT rules. As explained in subsection (a), three major changes were introduced. In particular, the requirements that developing countries had to satisfy in order to use quantitative restrictions to safeguard their balance of payments were relaxed. The new provisions of Article XVIII:B were less stringent than those of Article XII and the language "to ensure a level of reserves adequate for the implementation of its program of economic development" (XVIII:9) permitted the use of this exception on a very wide basis. In tandem, strict surveillance by the IMF over exchange restrictions may have led countries to use trade restrictions where the multilateral surveillance was looser (Frank, 1987).

In 1970, detailed consultation procedures were introduced followed by "simplified" consultation procedures in 1972. Simplified consultations, designed to alleviate excess administrative burden on the developing countries, were held on the basis of a written statement, citing the balance-of-payments situation and the system and effect of the restrictions and without the participation of the IMF.[111] Under simplified procedures, the Committee is only called upon to recommend whether full consultations are desirable.[112] Most of the developing countries exercised this option. Over a 20-year period, Pakistan consulted under full procedures only in 1969, 1978 and 1989; in the interim, it engaged in consultations under simplified procedures.

109 BISD (1960) 8th Supplement, p. 66, cited in Hudec (1987), p.29.

110 Article XII is available to all Members.

111 A particular feature of the balance of payments rules is that the Contracting Parties/Members are required to "consult fully" with the IMF in accordance with Article XV of the GATT. In addition to providing an assessment of the Member's balance of payments situation and prospects, the Fund's advice typically took the form "the restrictions do not go beyond the extent necessary to safeguard the external financial position".

112 It is interesting to read what was said at the time of the adoption of this simplified procedure: "Some delegations feel that detailed discussion of the external financial justifications of the restrictions every two years may not be necessary in all cases and a consultation may become a formality for which adequate preparation may require an amount of energy and attention disproportionate to its value" L/3772/Rev.1)

Following the Tokyo Round, the "1979 Declaration on Trade Measures Taken for Balance-of-Payments Purposes" came into effect. In this Declaration, Contracting Parties stated that they were "convinced that restrictive trade measures are in general an inefficient means to maintain or restore balance-of-payments equilibrium". Furthermore, while the full consultation procedures already provided for "expanded" consultations whereby the Committee could draw attention to alleviating and correcting balance-of-payments problems of developing countries through measures that Contracting Parties might take to facilitate the expansion of export earnings, the 1979 Declaration reiterated this point. It also extended the examination of balance-of-payments measures beyond QRs to all trade measures taken for balance-of-payments purposes, called for prompt notification of new or intensified measures, and introduced the additional conditions of (i) giving preference to measures with the least disruptive effect on trade (i.e. price-based measures); (ii) the submission of a timetable for phasing out restrictions; and, (iii) the need to avoid incidental sectoral protection.

Finally, in the course of the Uruguay Round, there was considerable discussion on strengthening and tightening the provisions, especially (i) notification requirements; (ii) the presentation of a timetable for the removal of the restrictions; and, (iii) the avoidance of the use of quantitative restrictions; the "1994 Understanding" reflects this consensus. In addition, the DSU became the ultimate method of enforcement and, in a case where consensus could not be reached, served as the vehicle by which one WTO Member finally removed its balance-of-payments measures.[113]

Box 20 presents two case studies which illustrate how the discipline of the balance-of- payments principles and provisions were used to aid the process of integration into the multilateral trading system.

Box 20: The phasing out of balance-of-payments restrictions by developing countries: two case studies

Indonesia

In 1967, following the adoption of a stabilization package after a period of hyper-inflation in the mid-1960s, Indonesia had removed import licensing on raw materials[114] and abandoned a system of classified goods for import into separate categories; only imports of passenger vehicles and ceramic tiles were prohibited. Also, an additional duty on imports bound under GATT had been removed. At the time of its consultations, Members of the Committee "appreciated the considerable effort which the Government of Indonesia had recently made to simplify its complex restrictive system."[115]

Following a successful stabilization policy, increased confidence in the rupiah had made possible the reforms of April 1970. By the time of its consultations in 1970, the currency had been made fully convertible, import policy had been revised and simplified and average tariffs lowered from 64 to 58 per cent. A small number of imports (tyres, cars, motor cycles, radio and TV sets) were under conditional import prohibition in order to protect local industry. If a number of conditions (e.g. volume, quality and prices of domestic production) were not met, the prohibition could be revoked. During the consultations, Members "suggested that consideration should be given to other methods, preferably those operating through the price mechanism, but that even quotas would be preferable to outright prohibition.".[116] While a number of surcharges were still levied, their

[113] See India - Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products, WT/DS90/R and WT/DS90/AB/R.

[114] Import licensing has typically been the principal instrument for effecting quantitative restrictions; import regimes were often very complex with licenses designated by end-user or industry.

[115] BOP/R/16, para. 18.

[116] BOP/R/51, 20 November 1970, para 13.

total had been reduced, and the whole system was to undergo a major reform when Indonesia's tariff was converted to the Brussels Tariff Nomenclature the following year.[117]

At its next consultation in 1975, under simplified procedures, Indonesia's statement reflected that domestic industries were protected mainly through tariffs and surcharges and no quantitative restrictions were in force. By 1979, the Committee took note that Indonesia had ceased to apply trade restrictions for balance of payments reasons.[118]

Pakistan

In the case of Pakistan, the phasing out of quantitative restrictions was very gradual. Prior to 1959, all categories of imports were subject to quantitative restrictions, "the trend since then had been to relax restrictions on imports of certain basic materials, consumer goods and a few agricultural and industrial products".[119] In the 1967 consultations, the government representative confirmed that the main feature of the country's import policy since 1960 had been a trend towards liberalization, moving away from direct administrative controls towards fiscal and monetary instruments. The licensing procedure had been simplified and a large number of items restored to the free list.[120] Meanwhile, the IMF commented that Pakistan's import regime remained restrictive and complex.

In 1978, the Committee noted that despite difficulties Pakistan had pursued its efforts towards trade liberalization begun in 1972 and welcomed the intention of the Pakistan authorities to pursue simplification and rationalization of their trade regime. Drawing attention to the external environment, the Committee "recognized that a number of external factors [...] import restraints faced by some exports of Pakistan [...] affected [...] its balance of payments...".[121]

In 1989, the Committee recognized that Pakistan continued to face balance-of-payments difficulties which warranted the imposition of trade measures under Article XVIII:B. Members welcomed the changes which had taken place in Pakistan's import regime since 1983; in particular, the move to a negative list system, the reduction in the number of commodities covered by import restrictions, the simplification of the import system and the rationalization of the tariff structure. One Member noted that even although progress had been made in the reduction of trade barriers, there were still a large number of banned or restricted goods.[122]

Further consultations were held in 1997 and 2000: in 1997, the Committee recognized that Pakistan faced a serious balance-of-payments problem and welcomed the lowering of tariffs and the reduction of items on the negative list.[123] However, they requested a clearer notification in accordance with paragraph 11 of the Understanding and questioned the recourse to QRs when price-based measures were preferable. By 2000, Members appreciated Pakistan's decision to implement its phase-out plan in spite of the fragility of the balance-of-payments situation.[124] Pakistan, in fact, completed the phase-out of its balance-of-payments restrictions ahead of schedule in 2002.[125]

117 Ibid, para 11.

118 BOP/R/108, 15 November 1979.

119 BOP/4/Rev.1.

120 BOP/R/12, 10 August 1967.

121 BOP/R/98, 13 February 1978.

122 BOP/R/181, 28 April 1989, para 8.

123 BOP/R/27, 15 July 1997.

124 BOP/R/56, 22 December 2000.

125 BOP/N/59, 17 December 2001.

(ii) Other non-tariff measures

As already mentioned, customs tariffs and quantitative restrictions under Articles XII and XVIII:B were the most important trade restrictions in place in the early days of GATT. The GATT Secretariat, however, also published some information on other duties and charges. This information illustrates the role of the GATT in improving transparency in the area of non-tariff measures. A 1953 GATT Report for instance observed an increased tendency to impose additional charges of various kinds on imported goods.[126] Among various examples of changes in supplementary charges, the Report mentions the replacement by the Dominican Republic of a complicated system of additional charges by a single tax of 23 per cent. A 1955 Report mentions, amongst others, that France increased its customs stamp tax from 2 to 3 per cent, to provide funds for family allowances for agricultural workers. In 1956, a Secretariat Report notes that in the field of import charges, changes indicated in most instances a tendency towards increased rates.

In the second half of the 1950s, a section on custom formalities was introduced in the GATT Secretariat reports on developments in commercial policy. The 1956 Report, for instance, discusses consular formalities, certificates of origin, marks of origin, temporary importation, valuation for customs purposes and special treatment of product samples. The Report notes that the Contracting Parties decided to reaffirm their recommendation that all such formalities should be suppressed but that nine Contracting Parties still normally required consular invoices or visas.

The first five Rounds of the GATT were primarily devoted to tariff reductions and dedicated very little attention to non-tariff measures. The Kennedy Round which was launched in 1963 was predominantly a tariff negotiation, but some NTMs were addressed. The inclusion of NTMs in the negotiations took place at an early stage. In an effort to identify existing NTMs, Contracting Parties shared information on the NTMs they encountered in their trade relations through a notification system. They came up with a non-exhaustive list including 18 measures: escape clauses, anti-dumping practices, customs valuation, government procurement policies, state trading, border tax adjustments, dumping and restrictive import policies on coal, bilateral quotas, residual quantitative restrictions, mixing regulations, variable levies, administrative and technical regulations, administrative guidance, subsidiaries' trading policies, import collateral, subsidies, internal fiscal charges, and the US system of wine gallon assessment on imported bottled spirits. A working group was established to deal with the items on the list and to proceed with the process of identification and the elaboration on related agreements. Overall, the Round's achievements on NTMs were limited to an optional code on anti-dumping, an agreement on the American Selling Price Procedure and provisions regarding State Trading Enterprises included in the Protocol of Accession of Poland to the GATT.[127] One of the main difficulties faced by Contracting Parties in the negotiation was to distinguish between general issues which could be disciplined through new rules and product specific or other particular measures that necessitated bilateral or multilateral negotiations.

Shortly after the Kennedy Round, an inventory of non-tariff barriers (NTBs) was drawn up on the basis of a list of measures notified by exporting countries.[128] Five working groups were established to examine problems related to the following five topics: government participation in trade, customs and administrative entry procedures, standards, specific limitations to trade and charges on import.

One of the major differences between the Kennedy Round and the Tokyo Round was the extensive negotiations on NTMs in the latter round. The progress achieved by negotiators during the Tokyo Round was considered one of the major accomplishments in trade negotiations since the creation of GATT. Identification of the NTMs to be covered in the negotiations was based on the inventory drawn up after the Kennedy Round and updated on a yearly basis. As explained in subsection 1, five main agreements, the so-called codes, pertaining to NTMs were negotiated. These codes covered respectively subsidies and countervailing duties, customs valuation, government procurement, standards and licensing procedures.

[126] See GATT (1953) International Trade, p. 89.

[127] See document LT/KR/A/1, dated 30 June 1967.

[128] This was the first published inventory of NTMs. UNCTAD later created a comprehensive database on NTMs.

In addition, the Antidumping Code which had originally been negotiated as part of the Kennedy Round was amended. Legal arrangements covering further non-tariff measures were negotiated in the context of various other agreements. Provisions on non-tariff measures were included in the Code on Civil Aircrafts, the Agricultural Agreements, the International Dairy Arrangement, and the Arrangement Regarding Bovine Meats. Only a subset of the 65 or so developing Contracting Parties signed the Codes. The number of developing country signatories in February 1982 was: 15 for the Standards Code, 8 for the Subsidies Code, 11 for the Import Licensing Code, 7 for the Customs Valuation Code, 9 for Anti-Dumping and 1 for the Procurement Code. As shown in Table 13, the number of signatories increased over the years, both because some Contracting Parties extended their participation to more Codes and because countries which acceded between the early eighties and 1995 signed some Codes. A number of countries also became observers to some of the Codes.

Table 13
Number of developing and developed Contracting Parties having signed selected Tokyo Round Agreements, 1982-1995

	Developing		Developed	
	Feb-82	Dec-95	Feb-82	Dec-95 [a]
Standards	15	24	21	21
Government Procurement	1	3	10	10
Subsidies and countervailing duties	8	16	12	10
Customs valuation	7	25	11	11
Import licensing	11	19	12	11
Anti-dumping	9	17	11	10

[a] The United States withdrew from the standards, subsidies, import licensing effect and anti-dumping Agreements on 29 February 1995, after the new corresponding WTO Committees came into effect.

Source: GATT (1982) GATT Activities in 1981 and GATT (1996) GATT Activities 1994-1995.

Part A of the Punta del Este Ministerial Declaration established as one of the objectives of the Uruguay Round negotiations the reduction and elimination of non-tariff measures and obstacles. A Negotiating Group on NTMs focused on product specific measures which were not covered in other negotiating groups but the negotiations on NTMs went much further than those encompassed by the Negotiating Group. As a whole, the Uruguay Round negotiations produced extremely broad and detailed results on NTMs. First, eleven developing-country Members made commitments on NTMs under Part III of their Schedules. Those commitments cover inter alia: the removal of import licensing requirements, elimination of quantitative restrictions, elimination of tendering requirements, reform of import licensing systems, assurance of absence of quantitative restrictions and import ban and phasing out of tariff rate quotas.[129] Second, the NTB Codes established during the Tokyo Round were revised. Third, other agreements were reached and NTMs were regulated in areas such as services and intellectual property. Fourth, a number of provisions regulating NTMs were scattered all around WTO Agreements, Ministerial and other declarations, understandings and recommendations. WTO rules addressed NTMs mainly through specific provisions regulating NTMs or transparency requirements.

Provisions addressing particular NTMs can be found in most WTO Agreements. A number of important measures were taken to discipline the use of NTMs in the agricultural and textiles and clothing sectors. The Agreement on Textiles and Clothing required the phasing out of all MFA quotas restricting imports from the most competitive producers into industrial country markets.[130] The Agreement on Agriculture required the replacement of agriculture-specific non-tariff measures with tariffs affording an equivalent level of protection and prohibited the use of agriculture-specific trade-restrictive measures except tariffs.

[129] The 11 countries are respectively Belize, Cameroon, China, Egypt, El Salvador, Indonesia, Malta, Saudi Arabia, Senegal, Chinese Taipei and Trinidad and Tobago.

[130] See Box 19.

Many countries, both developed and developing had been using NTMs, sometime in conjunction with tariffs, to limit or control imports of agricultural products. The prohibition and tariffication of NTMs represented a major change in the trade rules relating to agriculture, notably by contributing to more transparency. Whether it contributed to liberalization is a controversial question, the answer to which largely depends on one's assessment of the tariffication process. A number of experts consider that the Uruguay Round contributed little to lower the actual protection levels for agricultural products in most countries. The major exceptions were Japan and other high income Asian countries, which exhibited a consistent pattern of liberalization.[131] The Agreement on Agriculture also included provisions phasing down export subsidies and certain domestic support measures. Similarly, in this area it was more the framework for future liberalization that it created than the actual reduction of subsidies to which it contributed that was seen as the main contribution of the Agreement on Agriculture to the liberalization of agricultural markets.

Other important measures taken towards the elimination or regulation of NTMs were included in the Safeguards Agreement which prohibited voluntary export restraints, orderly marketing arrangements and any other similar measures affecting imports and exports.[132] Box 21 below discusses voluntary export restraints. As discussed in more detail below, the SPS and TBT Agreements imposed disciplines respectively on the use of sanitary and phyto-sanitary measures and technical regulations. Other WTO Agreements disciplined or improved the disciplines on the use of trade related investment measures, anti-dumping (see below), customs valuation, pre-shipment inspection, rules of origin, import licensing procedures, subsidies and countervailing measures. In addition, plurilateral agreements were signed on government procurement, trade in civil aircraft, dairy products and bovine meat.

A major change compared to the Tokyo Round, was the principle of the single undertaking whereby all signatories had to accept all the annexed agreements plus all the appended documents. Members did not have the possibility to opt out of some agreements. As discussed in subsection 4 below, a number of special and differential treatment provisions were included in the new agreements, but these provisions did not in most cases dispense developing countries from the main disciplines in the agreements. An assessment of the impact of the UR on the use of NTMs by individual Members is clearly beyond the scope of this Report. However, most experts would probably agree that compulsory adherence to all the agreements introduced tighter disciplines on the use of NTMs by most if not all of the WTO Members.

Box 21: Voluntary export restraints (VERs)

Beginning in the mid-1950s, voluntary export restraints (VERs) began to emerge as elements of some industrial countries' trade policies (McClenehan, 1991). This coincided with the reappearance of Japan as an important player in international trade. A VER is an agreement, explicit or tacit, between exporting and importing countries, where the former "voluntarily" limit the quantity or the growth of their exports. VERs are known by other names, including "orderly marketing arrangements". A VER has the same economic effect as a quota. VERs are contrary to some GATT provisions, especially Articles XI and XIII on export and import quotas.

VERs provided a convenient way of protecting low-tariff industries that were increasingly being subject to competition from low-cost countries, without a country being required to furnish proof of serious injury or to pay compensation. These would have been conditions of safeguard protection under Article XIX of the GATT. For exporting countries, the VER was often a more attractive alternative compared to other import-restricting measures at the disposal of the importing country.

[131] See for instance Hathaway and Ingco (1996).

[132] See the discussion of the safeguards agreement in subsection 2.(d).

Many of the industries where VERs became prominent restrictions were those where Japan, and subsequently the East Asian tigers and other developing countries, built-up competitiveness – textiles and clothing, footwear, iron and steel, and motor vehicles. VERs became a major feature of the international trading system, reaching their pinnacle in the decades of the 1970s and 1980s. VERs could be considered "safeguard" measures brought in through the back door, not subject to any form of international discipline or oversight. They were selective, and thus discriminatory, and since they were "voluntary", they did not require compensation.

Attempts to deal with the proliferation of VERs by negotiating an international agreement on safeguards took place during both the Tokyo and Uruguay Rounds. The negotiations in the Tokyo Round did not produce a breakthrough in the manner of a safeguards code to stand alongside those completed in the area of antidumping and subsidies and countervailing duties. The Contracting Parties were divided on a range of issues including the non-discriminatory application of safeguards, surveillance, dispute settlement, the definition of "serious injury" and issues of structural adjustment (Jackson, 1997). The Contracting Parties could only agree on continuing to negotiate. It was left to the Uruguay Round to complete the negotiations and produce the Agreement on Safeguards. The Agreement phased out existing VERs, orderly marketing arrangements and similar measures whether on exports or imports.

Why did countries find no more need for these extra-legal measures? The availability of a new multilateral agreement on safeguards was certainly a key factor. But there were a number of economic factors that contributed to the demise of VERs. In the case of footwear, industrial countries removed the restraints because they found them either superfluous (the expected employment effect failed to materialize) or ineffective (the principal exporters maintained their market share during the height of the restrictions), or else because the industry was able to adjust (see Hamilton et al. 1992). Some of these same factors accounted for the demise of United States' restraints on Japanese automobiles – the big three American automakers recovered (or adjusted successfully) after the recession of the early 1980s and Japanese manufacturers evaded the possibility of future trade restrictions by establishing their manufacturing plants in the United States. Finally, one needs to take into account the economic costs of the measures themselves. Economic research on VERs suggested that they exacted a high cost on consumers with part of the benefits being transferred to the exporters (as quota rents) and part to the import competing domestic industry (see for example Berry et al., 1999).

The multilateral trading system successfully weathered an important challenge in the form of VERs. These measures operated outside the boundaries of the rules-based multilateral trading system. They extracted a high economic cost on consumers of importing countries. And by being directed at some of the key exports of developing countries, they also had a strong anti-development effect.

Technical barriers to trade and sanitary and phytosanitary measures

If technical measures differ across countries they can represent significant barriers to trade. They may do so simply because it is costly for exporters to obtain accurate and up-to-date information on technical measures abroad and on related conformity assessment procedures. They can also hinder trade if adjusting to foreign technical measures engenders significant costs. In the latter case, technical measures – like tariffs – can result in discrimination between foreign and domestic products. But while a tariff clearly has the purpose and effect of discriminating, it can in practice be quite difficult to establish the purpose and effect of a technical measure. Indeed, technical measures may well have the aim to correct for market failures like information asymmetries or network externalities and well-designed standards can play an important role in guaranteeing the smooth functioning of markets. Technical measures, however, are also likely to affect the outcome of international transactions and thus trade. If they are designed to

do so, i.e. if technical measures are employed as a "disguised" form of protectionism, this would be in conflict with the principles of the multilateral trading system. The challenge for the system is to find ways to distinguish between legitimate and illegitimate measures.

It is difficult to measure the actual incidence of technical measures and even more difficult to measure their impact on trade. Counts of tariff lines affected by technical measures compiled for a number of markets indicate that the share of imports covered by technical measures ranges, at the high end, from about half of total imports in the case of Brazil to about a third in the case of the United States and China. By contrast, only 2 per cent of Japan's imports and less than one per cent of the EU's imports are covered by technical measures.[133]

As mentioned above, during the Uruguay Round negotiations took place on how to improve, clarify or expand agreements negotiated in the Tokyo Round and in this context negotiations also took place on the Tokyo TBT Agreement. The revamped Uruguay Round TBT Agreement was largely based on the earlier version of the Agreement, but its scope was altered.[134] The Uruguay Round TBT Agreement covers technical regulations, standards and conformity assessment and applies to a wide range of bodies and systems, local, national, regional and international, governmental and non-governmental. The TBT Agreement recognizes that governments employ technical regulations to attain legitimate objectives such as national security requirements, the prevention of deceptive practices, protection of human health or safety, animal or plant life or health, or the environment. But technical regulations must not be prepared, adopted or applied with a view to, or have the effect of, creating unnecessary obstacles to international trade. So technical regulations should not to be more trade-restrictive than necessary to fulfil a government's legitimate objective(s).

In order to enhance transparency on the use of technical measures, the TBT Agreement requires Members to notify relevant measures to the Secretariat.[135] In this particular aspect, the Uruguay Round TBT Agreement goes further than its predecessor. The role of national enquiry points on TBT-related measures has, for instance, been expanded and in cases where more than one national enquiry point exist, Members are obliged to assist other Members in finding their way through the different enquiry points. If requested, Members are required to provide documents relevant for national TBT-related measures, and the Uruguay TBT Agreement added that developed-country Members can be asked to provide English, French or Spanish translations of relevant documents.[136]

Chart 5 below shows the number of notifications received by the Secretariat since 1995 on technical barriers to trade. The number of notifications increased quite significantly after the conclusion of the Uruguay Round, decreased afterwards and appears to have been following an upward trend in recent years.

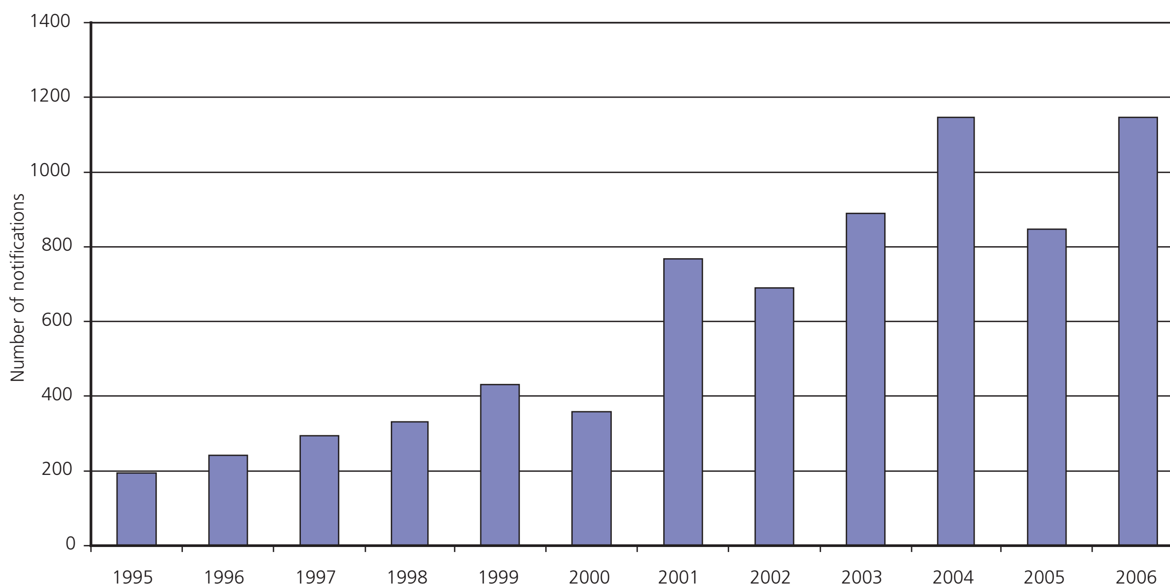
[133] This information is based on data from UNCTAD's Trade Analysis and Information System (TRAINS). See WTO (2005) for a more detailed description of the relevant data and of their limitations.

[134] See the discussion in section IVG.

[135] See TBT Articles 2.9.2, 2.10.1, 3.2, 5.7.1 and 7.2.

[136] Article 10.5 TBT Agreement.

Chart 5
Total number of circulated SPS notifications since 1995



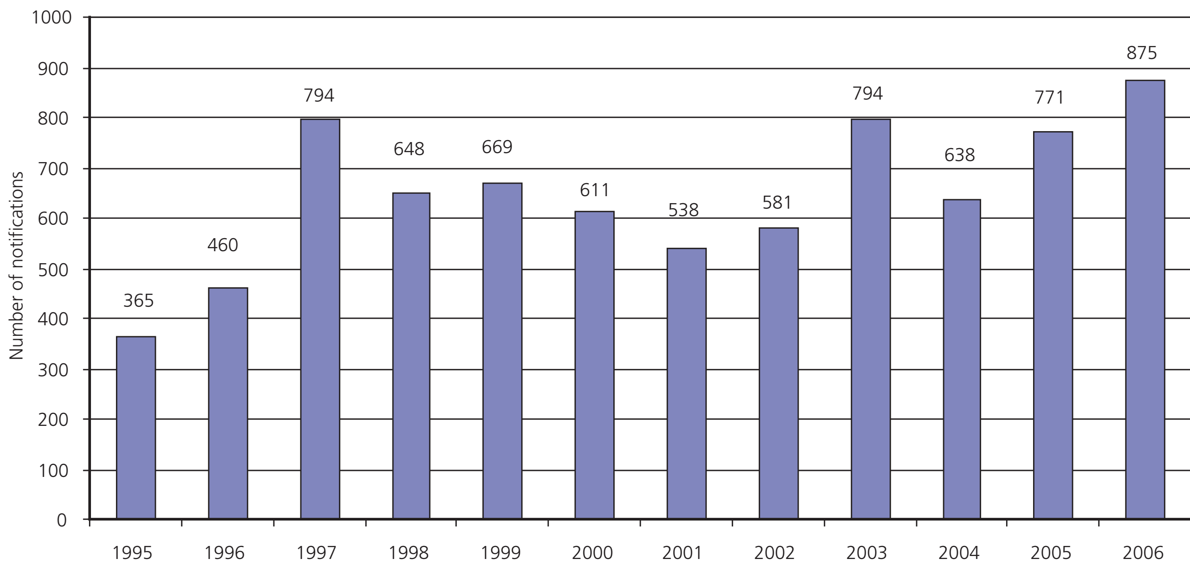
Source: WTO Secretariat.

The GATT legal texts and the Tokyo Round TBT Agreement were not considered satisfactory to deal with sanitary and phytosanitory measures and the Punta del Este Declaration asked for separate negotiations on the latter issue. The outcome was the SPS Agreement. This Agreement covers all measures whose purpose is to protect human or animal health from food-borne risks; to protect human health from animal- or plant-carried diseases; to protect animals and plants from pests or diseases or to prevent or limit other damage to a country from the entry, establishment or spread of pests. The TBT Agreement, instead, covers all technical regulations, voluntary standards and conformity assessment procedures to ensure that these are met, except when these are sanitary or phytosanitary measures as defined by the SPS Agreement. Thus it is the type of measure which determines coverage by the TBT Agreement, but the purpose of the measure which is relevant in determining whether a measure is subject to the SPS Agreement. Most labelling requirements, nutrition claims and concerns, and quality and packaging regulations are generally not considered to be sanitary or phytosanitary measures and hence are normally subject to the TBT Agreement.

The two Agreements have some common elements, such as the basic obligation of non-discrimination and similar requirements for the advance notification of proposed measures and the creation of information offices ("Enquiry Points"). Nevertheless, many of the substantive rules are different. For example, both agreements encourage the use of international standards. However, under the SPS Agreement scientific arguments resulting from an assessment of potential health risks are required to justify the choice of standards which are more stringent than those advocated by international standard-setting bodies. In addition, governments may impose SPS measures only to the extent necessary to protect human, animal or plant health, on the basis of scientific information. Under the TBT Agreement, WTO Members may derogate from international standards when they deem them to be either inappropriate or ineffective in the fulfilment of a legitimate objective, for instance, due to fundamental climatic or geographic factors, or fundamental technological problems. Scientific evidence may be relevant, depending on the specific legitimate objective pursued, and the specific reason for which a Member has derogated from an international standard.

Chart 6 reflects the evolution over time of the number of notifications circulated. Unlike the notifications under TBT, notifications under SPS have increased quite steadily over time and have reached their peak in recent years.

Chart 6
Total number of TBT notifications since 1995



Source: WTO (2007) Twelfth Annual Review of the Implementation and Operation of the TBT Agreement G/TBT/21/Rev.1.

Although notification requirements contributed to reducing information cost related to sanitary and phytosanitory measures in export markets, developing countries continued to face problems to implement relevant measures, including international standards set by bodies explicitly referred to in the SPS Agreement.[137] There was an increasing awareness that developing countries need assistance to develop the expertise and capacity to implement sanitary and phytosanitary standards, particularly for agricultural products destined for international markets.

At the WTO Ministerial Meeting in Doha in November 2001, the Executive Heads of the FAO, OIE, World Bank, WHO, and WTO issued a joint communiqué committing the institutions to explore new technical and financial mechanisms for coordination and resource mobilization to assist developing countries in the establishment and implementation of appropriate SPS measures. This led to the creation of the Standards and Trade Development Facility (STDF), a financing and a co-ordinating mechanism providing grant financing for developing countries that seek to comply with international SPS standards and hence gain or maintain market access. The STDF also provides a forum for dialogue on SPS technical assistance issues among its five partner organizations and interested donors.

Today the multilateral trading system is thus equipped with two agreements that explicitly deal with non-tariff measures of a technical nature: the TBT and the SPS Agreement. Both provide Members with legal texts that give guidance on how to distinguish between legitimate measures and those that are in conflict with the spirit of multilateral trade collaboration. The transparency requirements contained in the Agreements have contributed to lowering information costs related to technical measures with possible positive effects on trade flows. With the SDTF the system has equipped itself with a mechanism that involves collaboration among relevant international institutions and donor countries, to provide technical assistance to those WTO Members that find it difficult to implement international standards or other standards prevalent in export markets.

Antidumping

In Section C of this Report, contingency measures were described as necessary tools of temporary protection in a trade agreement to allow countries to commit to deeper liberalization. Contingency measures allow a country to trade off short-term protection for long-term commitment to market

[137] See the discussion in subsection 7.

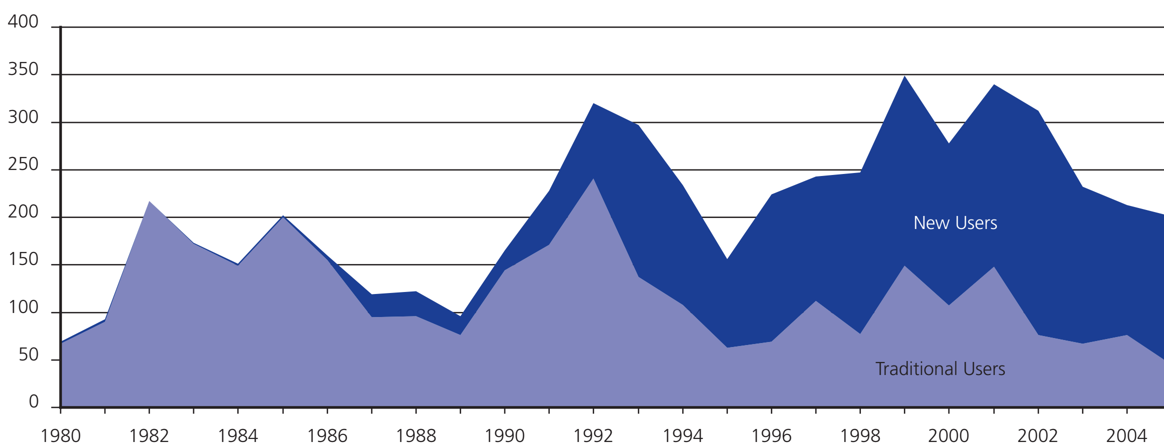
opening. To the extent that this trade-off exists, it may make sense to discuss some aspects of trade remedy used in the trading system – its growth, spread and attempts to rein these in through changes in multilateral rules – under this Section on non-tariff measures. And since, as noted in Section C of this Report, countries have a revealed preference for the use of antidumping measures, dwarfing the number of safeguards or countervailing actions, it is important not to neglect discussing those measures.

Antidumping has a far longer history than the other contingency measures. The first antidumping legislation was adopted in Canada in 1904 followed soon after by Australia in 1906. The United States enacted its antidumping legislations in 1916 and 1921.

The original multilateral rule on antidumping is contained in GATT Article VI. It allows a contracting party to levy a duty on a product that is dumped and which causes or threatens to cause material injury to an established industry. In its first 30 or 40 years of operation (or until the last two decades of the 20th century), most antidumping actions were confined to a small group of GATT Contracting Parties – the United States, Canada, Australia and the EC.

In the mid-1980s, antidumping actions began to spread beyond the traditional users and to involve many developing countries (see Miranda et al., 1998; Zanardi, 2004; Prusa, 2005). Chart 7 gives an indication of the main trends. First, total antidumping initiations have continued to rise during the two decades since 1980. The annual growth rate is 8 per cent, higher than the rate of global merchandize trade expansion of 5 per cent during the same period. Second, antidumping initiations by the historically predominant users (Australia, Canada, the EC and the United States), which made up the overwhelming part of initiations during the 1980s, has tailed off in the last decade. Third, the newcomers (primarily developing countries like Argentina, Brazil, India and Mexico) have become quite active users and have been responsible for much of the growth of antidumping activity since the mid-90s. The new users initiate antidumping cases more intensively (15 to 20 times more frequently per dollar of imports) than historically predominant users like the United States and the EC (Prusa, 2005). Lastly, antidumping actions by developing countries are increasingly directed at other developing countries. For the period 1995-2001, about two-thirds of all initiations and antidumping measures by developing countries are against other developing countries (see Zanardi, 2004).[138]

Chart 7
Count of antidumping initiations, 1980-2005
(Number of initiations)



Note: Traditional users include Australia, Canada, the EC and the United States.
Source: Prusa (2005) and WTO Secretariat.

[138] Zanardi (2004) distinguishes between "developing" countries and "transition economies". Since many countries in the latter group are usually treated or classified as developing countries in the WTO context, they have been grouped together as developing countries for the purpose of the calculation.

There is no lack of proposed explanations for this trend. Some have assigned the major role to the worldwide reduction in traditional instruments of protection (i.e. tariffs) with antidumping measures being used as a potent substitute (Tharakan, 1995). Others have looked for the explanation in the successive rounds of multilateral negotiations aimed at developing an antidumping code, culminating in the single undertaking of the Uruguay Round, which helped spread the adoption of antidumping statutes around the world (Zanardi, 2004). And there is the argument that antidumping is a necessary tool for countries undertaking trade liberalization. Finger and Nogues (2006) have pointed to the trade reform experiences in Latin America during the late 1980s and 1990s. Countries like Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, and Peru went through what was often a painful process of economic reform, which included liberalization of their trade regimes. Their governments created and managed trade contingent measures as part of this liberalization. In many cases, and not always without difficulty, these instruments allowed the countries to sustain the momentum towards openness to international trade. This period of the late 1980s and early 1990 was, not coincidentally, when these countries began to appear as new users of antidumping. This is a worthwhile reminder that these trends in antidumping initiations and measures, useful though they may be, only tell part of the story, since these measures may be part of the price to pay for a successful transition to more open trade.

The idea that contingency measures are necessary in trade agreements acknowledges that there is a trade-off being made between short-term protectionism and the longer-term benefits from mustering political support for trade liberalization. But this does not mean that these short-term costs are negligible. There is a lot of good information on the frequency of antidumping initiations and measures but much less available evidence about the economic cost of antidumping measures. Nevertheless, some studies indicate that they represent a big part of the welfare cost of trade restrictions. For example, according to one estimate, the cost of antidumping and countervailing duties for the US economy has been about $4 billion in 1993 dollars annually, a cost that is second only to that imposed by the restrictions under the Multi-fibre Agreement (Gallaway, et al, 1999).

The fundamental challenge for the international trading system is to make certain that the expected benefits from having contingency measures, such as antidumping, in trade agreements are not negated by the very real and immediate cost of the measures. If indeed short-term protectionism from contingent measures is one of the parents of a liberal trading system, one must ensure that it does not devour its young.

Thus, there have been frequent attempts at clarifying or strengthening the antidumping rules in the GATT/WTO. After the first decade of the GATT, those who were frequent targets of antidumping actions began to question whether the application of the measures were raising new barriers to trade (Jackson, 1997). This led to negotiations during the Kennedy Round to elaborate rules for the application of Article VI. The objective was "to provide greater uniformity and certainty in their implementation". Although the Round ended with a new antidumping code, continued problems or frustrations with the application of antidumping measures, and attempts to curb them through rule changes, have led all subsequent multilateral trade rounds – Tokyo Round, Uruguay Round and the Doha Round – to always include negotiations on antidumping rules. This led to a new antidumping code in the Tokyo Round and the current Antidumping Agreement (Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994) from the Uruguay Round.

Through these various rounds, the elaboration of the antidumping rules has touched on nearly all of its aspects: determination of dumping, definition of material injury and domestic industry, causality, spelling out the procedures for initiating a case, conduct of the investigation, evidence, the duration of the measure, reviews of the measures, etc.

The current Doha Round continues this process since the mandated negotiations are aimed at clarifying and improving the existing rules on antidumping. Proposals have been made on a number of specific issues: determinations of injury/causation, the lesser duty rule, public interest, transparency and due process, interim reviews, sunset, duty assessment, circumvention, the use of facts available, limited

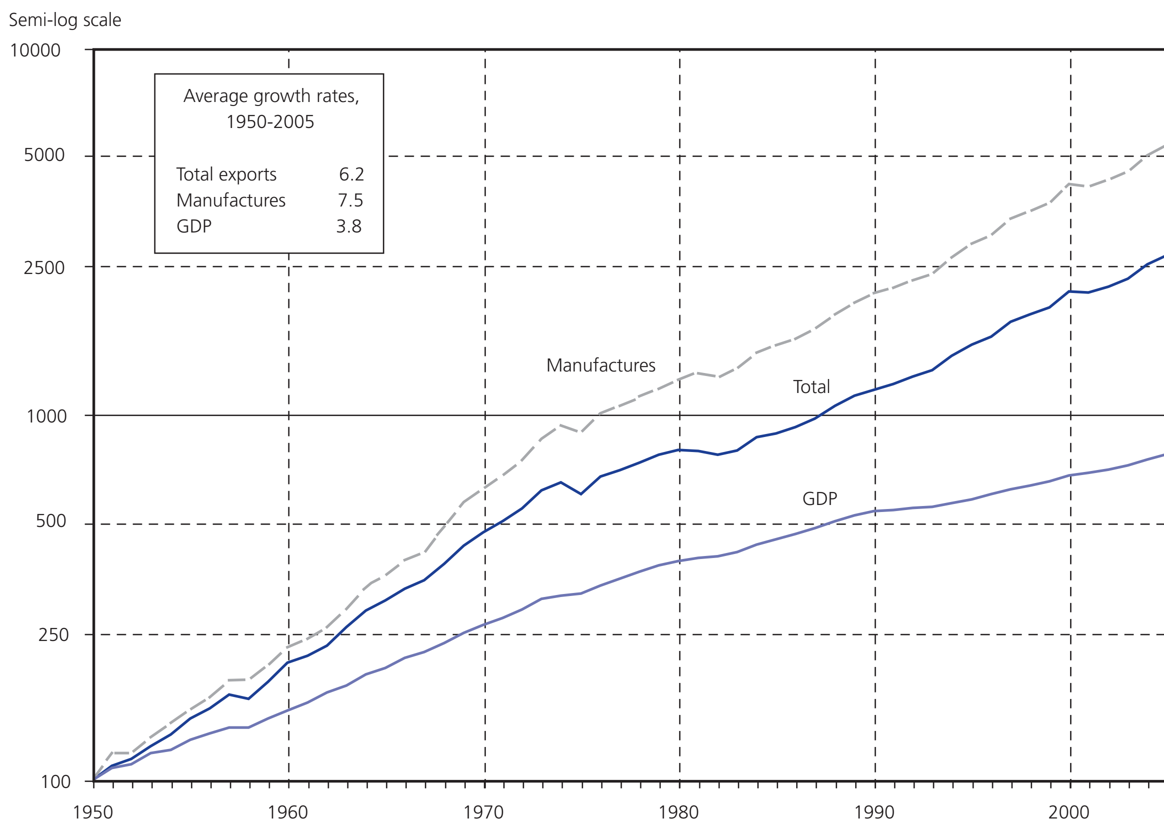
examination and all others rates, dispute settlement, the definition of dumped imports, affiliated parties, product under consideration, and the initiation and completion of investigations.

Given the enduring appeal of antidumping measures, it is unlikely that even a successful outcome to the negotiations that leads to “improved disciplines” will cause a fundamental alteration of countries’ preference for the use of antidumping measures. Deardorff and Stern (2005) have discussed various possible explanations for the strong appeal of antidumping measures. It provides a stronger and more focused means of protection against surges of imports than GATT-legal safeguards laws permit. Antidumping formalizes a meaning for “unfair trade” that strikes a chord in the public mind. For now and the foreseeable future, antidumping actions will likely remain the default trade adjustment measure of many WTO Members.

(d) GATT/WTO contribution to world trade growth

Since 1950, world trade has grown more than twenty-seven fold in volume terms (see Chart 8). This expansion has been three times faster than growth in world GDP, which expanded eight-fold during the same period.

Chart 8
World merchandise exports and GDP, 1950-2005
(Volume indices, 1950=100)



Source: WTO, International Trade Statistics.

The trade expansion was much more pronounced for manufactures than for either agricultural products or fuel and mining products (see Table 14). Trade in manufactures grew (7.5 per cent annual growth) more than twice as fast as trade in agricultural products (3.6 per cent annual growth).

Table 14
Growth of trade by sector, 1950-2005

Sector	Average annual growth (in percent)
Agricultural products	3.6
Fuels and mining products	4.2
Manufactures	7.5

Source: WTO (2006) International Trade Statistics 2006.

This increase in international trade is unprecedented in historical terms. To put it in perspective, the expansion in trade between 1870 and the start of the first World War, a period that has sometimes been described as the first wave of globalization (Baldwin and Martin, 1999), saw trade volume expand at about half the pace of the period since 1950 (see Table 15). The difference in the rate of trade expansion between the first wave of globalization and the post-war era persists even after taking into account the faster growth of GDP in the latter period. Based on Maddison's (2001) data, the trade to GDP ratio for the world rose from 4.6 per cent in 1870 to 7.9 per cent in 1913.[139] This ratio has risen far more in the second wave of globalization reaching 19.4 per cent in 2005, confirming how trade growth in this era had outstripped the expansion of the previous period of globalization.

Table 15
World exports and world GDP, 1870-2005
(In billions of constant 1990 dollars)

Item	1870	1913	Annual Growth: 1870-1913	1950	1998	2005	Annual Growth: 1950-2005
Exports	50.3	212.4	3.4%	296	5817	8043	6.2%
GDP	1,102	2,705	2.1%	5,336	33,726	41,456	3.8%
Trade/GDP	4.6%	7.9%		5.5%	17.2%	19.4%	

Note: The last two columns are not from Maddison. The figures in the last column are derived from the International Trade Statistics 2005 and were used to calculate world exports and world GDP for 2005 (in 1990 prices).
Source: Maddison (2001), Tables B-18 and F-3 and own calculations.

Several reasons are often given to explain this expansion in world trade. First is technological change, which dramatically reduced the cost of transportation and communication. A second reason is more open trade policies. A third explanation refers to the changes in economic organization, such as vertical specialization, that may have been induced by both technological change and open markets.[140] But liberalization of trade regimes can take place unilaterally, bilaterally, regionally and multilaterally. The key question that is taken up in this subsection is the link between post-war trade expansion and WTO-induced liberalization.

There is now a growing literature on the subject of the multilateral trading system's contribution to the post-war trade expansion. Two principal questions have been addressed. First, does the GATT/WTO increase trade through its rounds of negotiations or from countries becoming a Member of the organization? Second, since two of the principal roles of the GATT/WTO are to establish rules on international trade and to resolve disputes among its members, to what extent has it resulted in greater stability in the trade of its members? Several answers can be provided by this growing body of work. First, there is econometric evidence that the GATT/WTO accounted for some of this expansion in world trade. The multilateral system's impact on trade expansion was strong in the case of developed countries and in industrial goods. The GATT/WTO appeared to have also been important in helping Members, who had no previous trade relationship, to begin trading with one another. There is conflicting research on the effect of GATT/WTO membership on reducing the volatility of a country's trade.

139 Table F-5 in Maddison (2001), p. 363.

140 See Yi (2003). Vertical specialization leads to countries specializing in particular stages of a good's production. Such specialization requires much more trade of the parts and components to occur per unit of output of the final product. In effect, production becomes much more trade-intensive.

The GATT conducted the first three rounds of tariff negotiations within the relatively short period of four years, 1947-51. Irwin (1995) found that these early rounds of GATT negotiations did not produce a rapid liberalization of world trade. But he did go on to credit the GATT for securing commitments from Contracting Parties to early tariff reductions, which kept them from instituting higher tariffs as import quotas and foreign exchange controls were dismantled in the 1950s.

The paper by Andrew Rose (2004a) went considerably beyond examining the GATT's early decade. It was the first econometric study (using a gravity model) on the effects of the multilateral system on global trade. The gravity model predicts that the volume of trade between any two countries will be positively related to the size of their economies (usually measured by GDP) and inversely related to the trade costs between them.[141] These trade costs are usually represented by geographical characteristics of the countries, like the distance between them, whether they are landlocked, whether they have a common border, etc. as well as policy barriers. In the absence of any reduction in trade costs or policy barriers, the gravity model predicts that bilateral trade should grow at a rate equal to the sum of the partners' GDP growth rates. Since world trade has expanded much faster than that, this suggests that trade liberalization and cost of trade reductions mattered in the post-war period. But to much surprise, Rose's study, which covered about 178 countries and spanned the period from 1948 to 1999, concluded that there was little evidence that countries joining the GATT/WTO experienced a statistically significant increase in their trade.

A subsequent paper by Rose (2004b) argued that this was because GATT/WTO accession did not lead to significant trade liberalization by Members. However, as the discussion in subsections 2.(a) and (b) above shows, it is essential to distinguish between liberalization by developed countries and developing countries. Developed countries undertook substantive reductions in tariffs in the various multilateral rounds of negotiations: about one-fifth during the Geneva Round; a further one-third during the Kennedy Round; another one-third during the Tokyo Round; and 40 per cent in the Uruguay Round. On the other hand, there is little evidence to show that developing countries undertook as deep a commitment on trade liberalization within the GATT. Ignoring these differences and lumping together all GATT Members can lead one to the conclusion that GATT/WTO membership did not entail significant changes in trade policy.

Given the counterintuitive nature of the results, the conclusion that GATT/WTO membership had no impact on trade was quickly challenged.[142] Subramanian and Wei (2007) concluded that GATT or WTO membership had a strongly positive but uneven effect on trade. They explain this unevenness in trade effects as a reflection both of the history and design of the multilateral trading system. First, there was little or less liberalization by developing country Members compared to industrial countries because of special and differential treatment. However, the situation may be different with developing countries that have acceded to the institution since the establishment of the WTO. They have had to accept more obligations, including offering more market access. Second, some sectors – agriculture, textiles and clothing, etc. – were not subject to multilateral rules for a substantial part of the history of the institution. Third, market access commitments are granted on an MFN basis only to Members. True to these features of the organization, they found that the impact on trade was strong for the industrialized countries. They also find a significant difference in the impact of the WTO in those sectors which were covered by multilateral rules and disciplines and those sectors which, for many decades, were left outside of such rules: – agriculture, textiles and clothing. They estimated that GATT/WTO membership has resulted in a 120 per cent increase in world trade. Thus, the reason for Rose's inability to find a positive impact of WTO membership on trade was because he did not take these important institutional details into account and focused only on aggregate trade flows. This masked the positive impact on the subset of countries and sectors where multilateral liberalization took place.

141 The gravity model has proven to be popular among empirical trade economists because of the high explanatory value of the model in explaining bilateral trade flows. Besides the trade effect of WTO membership, gravity models have been used to study the impact of regionalism and currency unions.

142 See, for example, Evenett et al. (2004) as well as Goldstein et al. (2005).

A more important gap in Rose's analysis, and in most work on gravity models, was the inclusion of only positive bilateral trade flows in the sample. This means that the analysis will not be able to examine cases where a pair of countries who did not have a prior trade relationship will begin to trade. (Box 22 below examines the frequency of such cases). Accession to the GATT/WTO can make it easier for countries that did not have a prior trade relation to establish such links. This can come about because of a reduction in levels of protection or through greater policy certainty from undertaking GATT/WTO commitments. Recent studies that have included unrecorded trade flows in gravity equations have tended to find that WTO membership has a strong and significant effect on the formation of bilateral trading relationships. If the trade flows are unrecorded either because of censoring (as in Felbermayr and Kohler, 2005) or because of self-selection (as in Helpman et al., 2006).[143] In the first case (censoring), the absence of trade between two countries is a consequence of actions (or non-actions) external to the firm or trader; in the second (self-selection), the absence of trade can be traced to decisions made by the firm or trader himself. In Felbermayr and Kohler (2005), positive trade between two countries arises only if their bilateral trade potential exceeds some threshold value. Maintaining a trade relationship may require the presence of certain public infrastructure or public institutions. But governments will not spend on these institutions unless the expected size of bilateral trade justifies the cost of the investment. The self-selection in Helpman et al. (2006) comes from firms deciding whether to enter an export market or not. The selection decision depends on their underlying productivities because only firms above a threshold productivity level will be able to remain profitable after paying the fixed cost of entry. But whatever assumption is made, the end result is still the same. GATT/WTO membership has a positive and significant impact on new trade relationships. One will fail to fully capture the contribution of the multilateral trading system to world trade growth if one neglects this impact.

In the WTO, a Member's market access rights are protected by its ability to use the WTOs dispute settlement mechanism. While this cannot provide an ironclad guarantee that all Members would abide by their commitments, it does mean that a reneging Member faces the prospect of costly retaliation. This would imply greater security of a WTO Member's access to other Members' markets and, therefore, more stable trade. This has led to empirical investigations of whether membership in the GATT/WTO results in more predictable or stable trade. However, it is not clear whether this is the appropriate test to carry out since security of negotiated market access is what is desired by a WTO Member and not necessarily stability of trade volumes. It seems more reasonable, for example, to test whether WTO Members are less prone to policy reversals than non-Members. A country may in fact welcome less predictability of trade volumes if it occurs, for instance, as a result of rapid trade expansion because of negotiated market access.

So far, the evidence on the stability of a WTO Member's trade is conflicting. Using a data set covering annual bilateral trade flows between over 175 countries between 1950 and 1999, Rose (2005) estimated the effect of GATT/WTO membership on the coefficient of variation (a statistical measure of variability) in trade computed over 25-year samples. He found little evidence that membership in the GATT/WTO had a significant dampening effect on trade volatility. There is however some question whether the gravity model setup which he uses for the empirical test is the appropriate framework for assessing the effect of GATT/WTO membership on trade volatility. The gravity model is a model about bilateral trade flows or volumes and not about variability. A different result is found by Mansfield and Reinhardt (2006) who, among other approaches, use an ARCH[144] specification to directly model the variability of trade and test the impact of GATT/WTO membership on it. They found that GATT/WTO membership significantly reduced export volatility, providing in their view, evidence of the beneficial impact of the institution.

---

143 Different assumptions about the unrecorded data lead to different estimation methods. Assuming that the unrecorded data are zero trade flows (i.e. the data is censored) leads to Tobit estimation. If one assumes that the data are missing because of self-selection, the appropriate estimation technique is the Heckman 2-step procedure.

144 ARCH (Engle, 1982) stands for autoregressive conditional heteroskedasticity and is an econometric method introduced to account for a pattern of volatility, in which turbulence is concentrated at certain periods rather than being more evenly spread out. This type of turbulence is commonly found in financial prices, the area where the model was first applied. The ARCH process models the current disturbance term as a function of past disturbance terms ("autoregressive"). The modelling framework has been extended by Bollerslev (1986) into the GARCH (generalized autoregressive conditional heteroskedasticity) process. The "generalization" involves adding a moving average process to the autoregressive components of the disturbance term.

Box 22: Creating new trade relationships

Over the past 50 years, more and more countries have begun trading with one another. Global trade has grown not only through the expansion of already existing trade among partners but also through the growth of new trade among countries that had previously not had a trade relationship. New research strongly suggests that this is one avenue through which the GATT, and thereafter the WTO, has contributed to world trade growth.

Some indication of this expansion in new trading relations can be gleaned from bilateral trade data. For the year 1980, the IMF's Direction of Trade Statistics had import data for about 183 countries, 27 of them developed and the remainder developing countries. The maximum possible number of bilateral import relationships is 33,306 (183 x 182) country-pairs. But there were positive import flows for less than a third (10,087 country-pairs) of that. No one country imported from all the 182 potential partners. The median number of import sources was only 53, i.e., half of the 183 countries in the IMF database imported from less than 53 partners.

By 2005, the same database had import data for 204 countries, 32 of them developed and the remainder developing countries. The maximum possible number of bilateral import relationships is 41,412 (204 x 203) country-pairs. There were now positive imports flows for more than half (21,630 country-pairs) of that. The median number of import sources had now almost doubled to 105.

The growth in new trading relationships took place between developing and developed countries (North-South trade) and among developing countries (South-South trade). In 1980, there were positive import flows for 98 per cent of all possible developed country-pairs. In contrast, there were only positive import flows for 59 per cent of all possible North-South country pairs and just 18 per cent of all possible South-South country-pairs. By 2005, there were now positive import flows for 83 per cent of all possible North-South country pairs and 39 per cent of all possible South-South country-pairs.

Now some caution may be called for in interpreting this trend since not all empty cells in the bilateral trade matrix represent zero trade flows. They may also reflect non-availability of data. Thus part of the increase in positive trade flows would be due to better data availability.

New trading relationships, 1980 and 2005
(Percentage)

Source: IMF Direction of Trade Statistics.

(e) Future challenges

Evidence presented in this subsection indicates that since 1947 industrial countries have made use of the multilateral system to reduce their tariffs on industrial products. Developing countries on the other hand have made a more limited use of the system in the tariff area. The binding coverage of most developing countries remained very low and their tariffs very high until the second half of the 1980s when approaches towards trade and trade policies started changing and pressure for liberalization from developed countries and the international financial institutions increased. These changes translated into substantial trade liberalization and a considerable extension of binding coverage for many developing countries but the bindings in most cases did not cause the liberalization. Developing countries reduced their applied tariffs unilaterally but did not bind these reductions. Where they made commitments, they set their bound tariffs at a considerably higher level than their applied tariffs. This evidence is consistent with the results of econometric studies surveyed in subsection 4 above, which find an uneven effect of GATT/WTO participation on Members.

The evidence on participation in market access negotiations is largely consistent with the terms-of-trade approach presented in Section B, according to which small countries have an incentive to join the GATT/WTO but not to participate in market access negotiations. The fact that developing countries liberalized unilaterally without binding their tariff reductions suggests that they are not using the GATT/WTO system for commitment purposes. Bown and Hoekman (2007) link the failure of the system to play the role of a commitment mechanism to the fact that WTO Members do not challenge poor countries. They see this lack of enforcement as both a cause and a consequence of developing countries' limited market access commitments. They suggest that the failure to enforce developing-country commitments creates disincentives for those countries to negotiate additional commitments. International relations theories also shed interesting light on the evidence discussed in this subsection. Constructivist approaches can help understand the role played by changes in approaches to openness in the 1980s. Liberalist approaches, which relate changes in domestic interest patterns with changes in trade policies can help explain why developing countries liberalized but did not bind, while neorealist approaches help understand the power games behind the changes in policies.

Evidence on NTMs suggests that the GATT/WTO also helped its Members reduce or discipline other barriers to trade, such as quasi-tariffs and quantitative restrictions. GATT disciplines provided for the general elimination of quantitative restrictions with some exceptions. Developed countries kept quantitative restrictions in place in agriculture and textiles, while some developing countries maintained balance-of-payments related restrictions for several decades. The single undertaking of the Uruguay Round, however, led to a significant reduction of remaining non-tariff obstacles to trade.

The evidence discussed in this subsection sheds some light on the challenges still faced by WTO Members, and which are being taken up in the current negotiations. The post-UR tariff landscape is characterized by relatively low bound and applied tariffs in developed countries in all sectors except for agriculture and in some cases textiles, footwear, or fish and fish products. By contrast, developing countries exhibit applied tariffs that, though much lower than before, are on average higher than those of the developed countries, and, where they exist, bound tariffs that are often considerably higher than these applied rates. Issues of market access for developing countries, including access to developed markets by developing countries, access to developing markets by developed countries and access to developing markets by developing countries are all relevant in the Doha negotiations.

TECHNICAL APPENDIX TO SUBSECTION 2

Tariff nomenclatures: historical background

Efforts aimed at improving the comparability of customs tariffs led to the creation of a common framework for customs tariffs in the late thirties. In 1937, the League of Nations published its Draft Customs Nomenclature. This nomenclature, known as the "*Geneva Nomenclature*", has 991 positions grouped in 86 chapters, themselves grouped in 21 sections. The 991 positions are common to all countries that use the nomenclature but governments have some flexibility with sub positions.

The Geneva Nomenclature was only used for a short period of time, but it served as a basis for other tariff nomenclatures such as the Brussels Tariffs Nomenclature of the Customs Cooperation Council. The Brussels Tariffs Nomenclature (BTN) was established in 1955 and was widely used. It followed a logic of production process, i.e. articles were grouped according to the nature of the inputs used in their production. The BTN had 1097 positions, 99 chapters and 21 sections. The BTN differed from the Geneva Nomenclature with regard to both the number of chapters and the number of positions and the unavailability of correlation tables makes it difficult to track changes and rectifications over time.

In 1974, the Brussels Tariffs Nomenclature was renamed the Customs Cooperation Council Nomenclature (CCCN) to avoid confusion with the nomenclature of the European Community. In 1978, the CCCN was amended. The updated nomenclature had 1.011 positions, 99 chapters and 21 sections. Again, the unavailability of tables of correlation between the BTN and the CCCN makes it difficult to track changes over time.

The need to further harmonize trade related data (trade statistics, customs etc.) led the Customs Cooperation Council to the creation of the "*Harmonized Commodity Description and Coding System*". Entering into force on January 1, 1989, the new HS nomenclature progressively replaced the CCCN. The Customs Cooperation Council published correlation tables between the 1978 CCCN and the 1989 HS.

Sources for the case studies in subsection 2

Nomenclatures and data sources used in case studies

Country	Year	Nomenclature	Data Source	
			Applied tariffs	Bound tariffs
Brazil	1949-1950	National Nomenclature	ICJ	Schedule of tariff concessions, GATT 1947
	1957-1958; 1979-1980; 1986-1987	BTN/CCCN	ICJ	ICJ
	1997; 2001	HS	IDB	-
India	1948-1949	Geneva Nomenclature	ICJ	Schedule of tariff concessions, GATT 1947
	1958-1959; 1964-1965;	Geneva Nomenclature	ICJ	ICJ
	1979-1980; 1987-1988	BTN/CCCN	ICJ	ICJ
	1997; 2001	HS	IDB	-
Senegal	1969-1970; 1977-1978; 1985-1986	BTN/CCCN	ICJ	-
	2002	HS	IDB	-
Nigeria	1965-1966; 1970-1971	BTN/CCCN	ICJ	-
	1987	BTN/CCCN	BFAI	-
	2003	HS	IDB	-
Argentina	1967-1968	BTN/CCCN	ICJ	Schedule of tariff concessions, GATT 1967
	1967-1968; 1971-1972; 1987-1988	BTN/CCCN	ICJ	-
	2001	HS	IDB	-
Korea	1974	BTN/CCCN	Korean Customs Association	-
	1982-1983	BTN/CCCN	ICJ	-
	2001	HS	IDB	-

ICJ International Customs Journal.
IDB WTO Integrated Data Base.
BFAI Zoll und Handelsinformation by the Bundesstelle für Aussenhandelsinformation.

Methodology used for the case studies in subsection 2

Binding coverage

Pre-1989 binding coverage estimates were computed manually from paper sources. Post-1995 figures were computed from electronic sources.

Average applied tariff rates

For the selected product groups, pre-1989 simple averages were calculated as the sum of all tariffs in the product group divided by the total number of lines in the product group. Only *ad valorem* duties were taken into account. However, the proportion of non-*ad valorem* duties (specific, mixed, compound or other duties) is indicated in the tables.

Post-1995 averages are calculated from tariff data pre-aggregated at the HS 6 digit level. For the calculation of HS 6-digit duty averages, only *ad valorem* duties were used.

Despite the use of tables of correlation to keep a constant definition of product groups over time, the change from the CCCN to the HS tariff nomenclature in early 1989 probably affects the comparability of tariff averages over time.

Appendix Table 6
Applied tariff average rates for 13 European countries and industrial product groups, 1950

(Percentage)

Country [a]	All Groups,[b] 79 Items	Mineral Oils and Chemicals, 19 Items	Textiles, 16 Items	Apparel, 4 Items	Iron and Steel, 8 Items	Non-ferrous Metals, 10 Items	Tools,[c] 3 Items	Machinery, 13 Items	Transportation Equipment, 6 Items
Denmark	3.4	0.4	4.5	6.7	1.8	1.9	1.0	5.4	5.9
Sweden	8.5	3.2	9.2	22.7	3.0	3.4	5.7	7.9	13.0
Norway	10.8	2.3	6.9	16.2	1.5	1.7	20.0	13.5	24.0
Benelux	11.2	19.9	8.2	24.0	3.7	4.8	8.7	6.3	13.7
France	17.9	17.4	12.8	22.0	18.4	18.1	16.0	18.4	20.0
Portugal	18.0	16.7	28.6	61.0	6.1	13.6	4.8	9.3	3.9
United Kingdom	23.3	33.1	16.3	26.0	42.0	14.0	15.8	19.2	20.4
Italy	25.3	27.0	15.6	30.0	30.6	19.5	32.9	22.6	24.6
(Austria	18.0	14.1	19.0	-	37.8	19.3	18.5	16.6	18.6)
(Germany	26.4	81.6	27.9	28.2	14.9	10.8	9.0	20.3	18.2)
(Greece	39.0	53.1	55.9	92.5	24.7	25.0	26.7	19.7	14.0)

[a] Arrayed in ascending order of average duty of all groups.

[b] Unweighted average of the eight group indexes.

[c] Excludes knives.

Note: The reported average rates for Germany, Austria and Greece are upward biased as they refer to pre-WW II trade flows and not to 1950. Some calculation errors have been found which, if corrected, increase somewhat the average rates for Denmark, Sweden and Norway.

Source: Woytinsky, W.S. and Woytinsky, E.S. (1955) -'World Commerce and Governments. Trends and Outlook'.

Appendix Table 7
Applied tariff rates of selected developed GATT/WTO Members, 1952 and 2005

(All products)

	1952	2005
Austria	17	(4.2)
Benelux	9	(4.2)
Denmark	5	(4.2)
France	19	(4.2)
Germany	16	(4.2)
Italy	24	(4.2)
Sweden	6	(4.2)
United Kingdom	17	(4.2)
EU(25)	-	4.2
Canada	11	3.8
United States	16	3.7
Total (arithmetic country average)	14.0	3.9
Total (country import weighted) [a]	15.1	4.1

[a] Excluding trade with NAFTA members for the US and Canada and EU intra trade in 2004.

Note: Unweighted arithmetic average of 52 products in 1952 and of all tariff lines in 2005.

Source: GATT, International Trade 1952, WTO, Trade Profiles 2006, WTO, International Trade Statistics 2006 and IMF, IFS Statistics Yearbook 1979.

Appendix Table 8
Status of tariff bindings: developed countries and industrial products, 1972-2000
(Percentage – Coverage based on tariff lines)

	Post-Kennedy Round	Post-Tokyo Round	Post-Uruguay Round
	1972	1987	2000
Canada	74-74	98-98	99.7
United States	100-100	100-100	100.0
Japan	90-91	97-97	99.6
EU [a]	98-99	99-99	100.0
Denmark	97-91	-	-
United Kingdom	93-94	-	-
Austria	86-87	96-96	-
Finland	55-86	97-97	-
Sweden	94-95	97-97	-
Norway	79-81	95-95	100.0
Switzerland	98-98	99-99	99.7
Australia	...	11-17	96.5
New Zealand	...	39-51	99.5

[a] Refers to EEC(6) for Post-Kennedy, to EEC(9) for Post-Tokyo and to EU(15) for Post-Uruguay Round (including ITA).

Note: Lower end of binding coverage range refers to totally bound tariff lines while upper end includes partially bound tariff lines.

Source: GATT (1971) Basic Documentation for the Tariff Study. Supplementary Tables, Geneva. (Kennedy Round). GATT (1987), Importance des consolidations tarifaires établies dans le cadre de l'Accord Général, GATT document: MTN.GNG/NG1/WW/2/Rev.1*, 27 mars 1987. (Tokyo Round). WTO (2007), World Tariff Profiles. (Uruguay Round).WTO (2007), World Tariff Profiles. (Uruguay Round).

Appendix Table 9
Status of tariff bindings: developed countries and agricultural products, 1987 and 2000
(Percentage – Coverage based on tariff lines)

	Post-Tokyo Round	Post-UR Round
Canada	90-91	100.0
United States	90-93	100.0
Japan	60-63	100.0
EU [a]	63-65	100.0
Austria	55-62	-
Finland	51-56	-
Sweden	46-50	-
Norway	67-69	100.0
Switzerland	44-46	< 100.0
Australia	26-32	100.0
New Zealand	48-54	100.0

[a] Refers to EEC(9) for Post-Tokyo and to EU(15) for Post-UR Round (incl. ITA).

Note: Lower end of binding coverage range refers to totally bound tariff lines while upper end includes partially bound tariff lines.

Source: GATT (1987), Importance des consolidations tarifaires établies dans le cadre de l'Accord Général; GATT document: MTN. GNG/NG1/WW/2/Rev.1*, 27 mars 1987 (Tokyo Round); WTO (2007), World Tariff Profiles (Uruguay Round).

Appendix Table 10
Accessions and successions to GATT and accessions to the WTO[a]

Country	Date of Accession	Article of Accession
Australia	1-Jan-48	Original Contracting Party
Belgium	1-Jan-48	Original Contracting Party
Canada	1-Jan-48	Original Contracting Party
Cuba	1-Jan-48	Original Contracting Party
France	1-Jan-48	Original Contracting Party
Luxembourg	1-Jan-48	Original Contracting Party
Netherlands	1-Jan-48	Original Contracting Party
United Kingdom	1-Jan-48	Original Contracting Party
United States of America	1-Jan-48	Original Contracting Party
Czechoslovakia	20-Apr-48	Original Contracting Party
South Africa	13-Jun-48	Original Contracting Party
India	8-Jul-48	Original Contracting Party
Norway	10-Jul-48	Original Contracting Party
Zimbabwe	11-Jul-48	Original Contracting Party
Myanmar	29-Jul-48	Original Contracting Party
Sri Lanka	29-Jul-48	Original Contracting Party
Brazil	30-Jul-48	Original Contracting Party
New Zealand	30-Jul-48	Original Contracting Party
Pakistan	30-Jul-48	Original Contracting Party
Chile	16-Mar-49	Original Contracting Party
Haiti	1-Jan-50	Art XXXIII [a]
Indonesia	24-Feb-50	Art XXVI:5(C) [b]
Greece	1-Mar-50	Art XXXIII
Sweden	30-Apr-50	Art XXXIII
Dominican Republic	19-May-50	Art XXXIII
Finland	25-May-50	Art XXXIII
Denmark	28-May-50	Art XXXIII
Nicaragua	28-May-50	Art XXXIII
Italy	30-May-50	Art XXXIII
Germany	1-Oct-51	Art XXXIII
Peru	7-Oct-51	Art XXXIII
Turkey	17-Oct-51	Art XXXIII
Austria	19-Oct-51	Art XXXIII
Uruguay	6-Dec-53	Art XXXIII
Japan	10-Sep-55	Art XXXIII
Ghana	17-Oct-57	Art XXVI:5(C)
Malaysia	24-Oct-57	Art XXVI:5(C)
Nigeria	18-Nov-60	Art XXVI:5(C)
Sierra Leone	19-May-61	Art XXVI:5(C)
Tanzania	9-Dec-61	Art XXVI:5(C)
Portugal	6-May-62	Art XXXIII
Israel	5-Jul-62	Art XXXIII
Trinidad and Tobago	23-Oct-62	Art XXVI:5(C)
Uganda	23-Oct-62	Art XXVI:5(C)
Burkina Faso	3-May-63	Art XXVI:5(C)

Appendix Table 10
Accessions and successions to GATT and accessions to the WTO[a] (cont'd)

Country	Date of Accession	Article of Accession
Cameroon	3-May-63	Art XXVI:5(C)
Central African Republic	3-May-63	Art XXVI:5(C)
Congo	3-May-63	Art XXVI:5(C)
Gabon	3-May-63	Art XXVI:5(C)
Kuwait	3-May-63	Art XXVI:5(C)
Chad	12-Jul-63	Art XXVI:5(C)
Cyprus	15-Jul-63	Art XXVI:5(C)
Spain	29-Aug-63	Art XXXIII
Benin	12-Sep-63	Art XXVI:5(C)
Senegal	27-Sep-63	Art XXVI:5(C)
Madagascar	30-Sep-63	Art XXVI:5(C)
Mauritania	30-Sep-63	Art XXVI:5(C)
Côte d'Ivoire	31-Dec-63	Art XXVI:5(C)
Jamaica	31-Dec-63	Art XXVI:5(C)
Niger	31-Dec-63	Art XXVI:5(C)
Kenya	5-Feb-64	Art XXVI:5(C)
Togo	20-Mar-64	Art XXVI:5(C)
Malawi	28-Aug-64	Art XXVI:5(C)
Malta	17-Nov-64	Art XXVI:5(C)
Gambia	22-Feb-65	Art XXVI:5(C)
Burundi	13-Mar-65	Art XXVI:5(C)
Rwanda	1-Jan-66	Art XXVI:5(C)
Yugoslavia	25-Aug-66	Art XXXIII
Guyana	5-Jul-66	Art XXVI:5(C)
Switzerland	1-Aug-66	Art XXXIII
Barbados	15-Feb-67	Art XXVI:5(C)
Korea, Republic of	14-Apr-67	Art XXXIII
Argentina	11-Oct-67	Art XXXIII
Poland	18-Oct-67	Art XXXIII
Ireland	22-Dec-67	Art XXXIII
Iceland	21-Apr-68	Art XXXIII
Egypt	9-May-70	Art XXXIII
Mauritius	2-Sep-70	Art XXVI:5(C)
Democratic Republic of the Congo	11-Sep-71	Art XXXIII
Romania	14-Nov-71	Art XXXIII
Bangladesh	16-Dec-72	Art XXXIII
Singapore	20-Aug-73	Art XXVI:5(C)
Hungary	9-Sep-73	Art XXXIII
Suriname	22-Mar-78	Art XXVI:5(C)
Philippines	27-Dec-79	Art XXXIII
Columbia	3-Oct-81	Art XXXIII
Zambia	10-Feb-82	Art XXVI:5(C)
Thailand	20-Nov-82	Art XXXIII
Maldives	19-Apr-83	Art XXVI:5(C)
Belize	7-Oct-83	Art XXVI:5(C)
Hong Kong, China	23-Apr-86	Art XXVI:5(C)

Appendix Table 10
Accessions and successions to GATT and accessions to the WTO[a] (cont'd)

Country	Date of Accession	Article of Accession
Mexico	24-Aug-86	Art XXXIII
Antigua and Barbuda	30-Mar-87	Art XXVI:5(C)
Morocco	17-Jun-87	Art XXXIII
Botswana	28-Aug-87	Art XXVI:5(C)
Lesotho	8-Jan-88	Art XXVI:5(C)
Tunisia	19-Aug-90	Art XXXIII
Venezuela	31-Aug-90	Art XXXIII
Bolivia	8-Sep-90	Art XXXIII
Costa Rica	24-Nov-90	Art XXXIII
Macao, China	11-Jan-91	Art XXVI:5(C)
El Salvador	22-May-91	Art XXXIII
Guatemala	10-Oct-91	Art XXXIII
Mozambique	27-Jul-92	Art XXVI:5(C)
Namibia	15-Sep-92	Art XXVI:5(C)
Mali	11-Jan-93	Art XXVI:5(C)
Swaziland	8-Feb-93	Art XXVI:5(C)
Saint Lucia	13-Apr-93	Art XXVI:5(C)
Czech Republic	15-Apr-93	Art XXXIII
Slovak Republic	15-Apr-93	Art XXXIII
Dominica	20-Apr-93	Art XXVI:5(C)
Saint Vincent and the Grenadines	18-May-93	Art XXVI:5(C)
Fiji	16-Nov-93	Art XXVI:5(C)
Brunei Darussalam	9-Dec-93	Art XXVI:5(C)
Bahrain	13-Dec-93	Art XXVI:5(C)
Paraguay	6-Jan-94	Art XXXIII
Grenada	9-Feb-94	Art XXVI:5(C)
United Arab Emirates	8-Mar-94	Art XXVI:5(C)
Guinea Bissau	17-Mar-94	Art XXVI:5(C)
Saint Kitts and Nevis	24-Mar-94	Art XXVI:5(C)
Lichtenstein	29-Mar-94	Art XXVI:5(C)
Qatar	7-Apr-94	Art XXVI:5(C)
Angola	8-Apr-94	Art XXVI:5(C)
Honduras	10-Apr-94	Art XXXIII
Slovenia	30-Oct-94	Art XXXIII
Guinea	8-Dec-94	Art XXVI:5(C)
Djibouti	16-Dec-94	Art XXVI:5(C)
Papua New Guinea	16-Dec-94	Art XXVI:5(C)
Solomon Islands	28-Dec-94	Art XXVI:5(C)
European Communities	1-Jan-95	Art Xi [c]
Ecuador	21-Jan-96	Art XII [d]
Bulgaria	1-Dec-96	Art XII
Mongolia	29-Jan-97	Art XII
Panama	6-Sep-97	Art XII
Kyrgyz Republic	20-Dec-98	Art XII
Latvia	10-Feb-99	Art XII
Estonia	13-Nov-99	Art XII

Appendix Table 10
Accessions and successions to GATT and accessions to the WTO[a] (cont'd)

Country	Date of Accession	Article of Accession
Jordan	11-Apr-00	Art XII
Georgia	14-Jun-00	Art XII
Albania	8-Sep-00	Art XII
Oman	9-Nov-00	Art XII
Croatia	30-Nov-00	Art XII
Lithuania	31-May-01	Art XII
Moldova	26-Jul-01	Art XII
China [e]	11-Dec-01	Art XII
Chinese Taipei	1-Jan-02	Art XII
Armenia	5-Feb-03	Art XII
Former Yugoslav Republic Macedonia	4-Apr-03	Art XII
Nepal	23-Apr-04	Art XII
Cambodia	13-Oct-04	Art XII
Saudi Arabia	11-Dec-05	Art XII
Viet Nam	11-Jan-07	Art XII

Note:

[a] Of GATT 1947.

[b] Of GATT 1947.

[c] Of the Marrakesh Agreement.

[d] Of the Marrakesh Agreement.

[e] China was an original contracting party to the GATT but withdrew in 1950. Similarly, Lebanon and Syria were original contracting parties but withdrew in 1949 and 1951 respectively. At 1 January 1995 (date of entry into force of WTO Agreement), there were 128 contracting parties to GATT (including Socialist Federal Republic of Yugoslavia). All of these, except the Socialist Federal Republic of Yugoslavia whose participation in GATT was suspended, accepted the Agreement definitively. Liberia became a contracting party in November 1949 but withdrew in 1953.

Source: WTO (1995a) Guide to GATT law and practice - Analytical index, volume 2, Geneva: WTO.

Appendix Table 11
Brazil: Binding coverage by section, 1949

Section	Description	Total Number of Lines	Number of Bound Lines	Binding Coverage in %
1	Live animals	16	2	12.5
2	Human hair-animal hair	72	5	6.9
3	Hides, skins and leather	117	14	11.9
4	Meat, fish, oleaginous substances	73	16	21.9
5	Mother-of-pearl, ivory tortoise	50	2	4.0
6	Wool	147	10	6.8
7	Silk, rayon and other similar artificial products	104	7	6.7
8	Fruits, cereals, pot herbs, vegetables thereof	69	19	27.5
9	Plants, leaves, flowers, fruits, seeds, roots, barks	106	42	39.6
10	Vegetable juices, alcoholic and fermented beverages	98	15	15.3
11	Wood	194	2	1.0
12	Indian and other cane, bamboo, rushes	48	2	4.1
13	Coir, esparto, Manila hemp, kapok and other similar vegetables	66	6	9.0
14	Cotton	273	6	2.1
15	Flax, jute, hemp and ramie	143	11	7.6
16	Paper and its applications	166	11	6.6
17	Stones, earths, ores and other minerals products	249	29	11.6
18	Earthenware and glassware	93	29	31.1
19	Aluminium, lead, tin and zinc	191	5	2.6
20	Copper and nickel	137	6	4.3
21	Iron and steel and their alloys	184	26	14.1
22	Gold, platinum and silver and their alloys	46	4	8.6
23	Metalloids and miscellaneous metals	82	16	19.5
24	Raw materials and miscellaneous preparations	239	47	19.7
25	Inorganic and organic chemical products	1177	77	6.5
26	Drugs, chemical medicines and pharmaceutical dietetic	487	36	7.3
27	Armaments and other gunsmiths' wares, ammunition and war material	71	22	31.0
28	Cutlery and accessories thereof	34	10	29.4
29	Clocks and watches	53	41	77.3
30	Physical, chemical, mathematical and optical apparatus	199	180	90.5
31	Surgical, medical, dental and veterinary apparatus	128	102	79.6
32	Musical instruments	151	13	8.6
33	Vehicles and their accessories	77	31	40.2
34	Machines, apparatus, tools and miscellaneous	389	197	50.6
35	Miscellaneous articles	207	6	2.8
	Total	5936	1047	17.6

Source: International Customs Journal, Brazil (1949); WTO estimates.

Appendix Table 12
Brazil: Binding coverage by section, selected years

Section	Description	1957 Total Number of Lines	1957 Number of Bound Lines	1957 Binding Coverage in %	1979 Total Number of Lines	1979 Number of Bound Lines	1979 Binding Coverage in %	1986 Total Number of Lines	1986 Number of Bound Lines	1986 Binding Coverage in %
1	Live animals	160	19	11.9	277	16	5.8	308	4	1.3
2	Vegetable products	603	22	3.6	498	30	6.0	586	19	3.2
3	Animal and vegetable Fats	110	1	0.9	156	2	1.3	164	2	1.2
4	Prepared foodstuffs, beverages and vinegar	132	2	0.2	398	1	0.3	452	0	0.0
5	Mineral products	93	0	0.0	468	6	1.3	325	4	1.2
6	Products of the chemical and allied industries	2335	22	0.9	2871	88	3.1	3244	55	1.7
7	Artificial resins and plastic materials	135	3	2.2	310	3	1.0	419	3	0.7
8	Raw hides and skins	73	3	4.1	90	2	2.2	116	0	0.0
9	Wood and articles of wood	81	0	0.0	144	0	0.0	175	0	0.0
10	Paper making material	102	20	19.6	145	23	15.9	181	10	5.5
11	Textiles and textile articles	458	11	2.4	975	12	1.2	588	2	0.3
12	Footwear, headgear, umbrellas	74	1	1.3	78	0	0.0	85	0	0.0
13	Articles of stones, of plaster	109	5	4.5	284	4	1.4	262	1	0.4
14	Pearls, precious and semi precious stones	33	1	3.0	116	4	3.4	127	0	0.0
15	Base metals and articles of base metals	408	26	6.3	835	42	5.0	785	29	3.7
16	Machinery and mechanical appliances	589	30	5.0	1470	193	13.1	1919	219	11.4
17	Vehicles, aircraft and associated equipment	209	0	0.0	356	24	6.7	299	4	1.3
18	Optical, photographic, cinematographic measuring	426	62	14.5	621	33	5.3	928	76	8.2
19	Arms and ammunition	14	0	0.0	18	0	0.0	18	0	0.0
20	Miscellaneous manufactured articles	153	6	3.9	191	8	4.2	271	4	1.5
21	Works of art, collectors' pieces and antiques	6	0	0.0	6	0	0.0	6	0	0.0
	Total	6303	234	3.7	10307	491	4.8	11258	432	3.8

Note: Because of changes in Nomenclature, binding coverage are not strictly comparable across years. See technical appendix for further details.

Source: International Customs Journal, Brazil (1957), Brazil (1979), Brazil (1986); WTO estimates.

Appendix Table 13
India: Binding coverage by section, selected years

Section	Description	1948		1958		1964		1979		1987-1988	
		Number of Bound Lines	Binding Coverage in %	Number of Bound Lines	Binding Coverage in %	Number of Bound Lines	Binding Coverage in %	Number of Bound Lines	Binding Coverage in %	Number of Bound Lines	Binding Coverage in %
1	Live animals	6	13.6	5	31.2	5	29.4	1	10.0	0	0.0
2	Vegetable products	10	18.9	12	13.3	16	20.8	17	45.9	142	52.2
3	Animal and vegetable Fats	6	46.2	7	50.0	6	37.5	3	42.9	25	47.2
4	Prepared foodstuffs, beverages and vinegar	22	46.8	22	31.9	19	29.2	0	0.0	0	0.0
5	Mineral products	3	12.5	4	13.3	4	13.3	3	9.1	3	2.0
6	Products of the chemical and allied industries	26	21.0	21	12.6	18	11.5	19	24.4	60	7.1
7	Artificial resins and plastic materials	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
8	Raw hides and skins	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
9	Wood and articles of wood	1	16.7	3	27.3	2	20.0	0	0.0	0	0.0
10	Paper making material	2	22.2	3	18.8	3	16.7	0	0.0	0	0.0
11	Textiles and textile articles	5	6.5	7	8.3	3	3.8	0	0.0	0	0.0
12	Footwear, headgear, umbrellas	3	60.0	3	33.3	2	25.0	0	0.0	0	0.0
13	Articles of stones, of plaster	2	11.8	3	13.6	3	14.3	0	0.0	0	0.0
14	Pearls, precious and semi precious stones	0	0.0	1	6.7	0	0.0	0	0.0	0	0.0
15	Base metals and articles of base metals	6	5.6	5	2.4	5	3.3	0	0.0	0	0.0
16	Machinery and mechanical appliances	28	84.8	28	39.4	24	30.0	0	0.0	0	0.0
17	Vehicles, aircraft and associated equipment	3	13.6	7	18.9	13	34.2	0	0.0	0	0.0
18	Optical, photographic, cinematographic, measuring	3	50.0	4	33.3	4	33.3	1	2.6	0	0.0
19	Arms and ammunition	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
20	Miscellaneous manufactured articles	0	0.0	2	10.5	2	11.8	0	0.0	0	0.0
21	Works of art, collectors' pieces and antiques	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
22	Articles not otherwise specified	1	100.0	0	0.0	1	50.0	0	0.0	0	0.0
	Total	127	20.0	137	14.9	130	15.4	44	7.9	230	4.4

Note: Because of changes in Nomenclature, binding coverages are not strictly comparable across years. See technical appendix for further details.

Source: International Customs Journal, India (1948), India (1957), India (1964), India (1979); India (1987); WTO estimates.

Appendix Table 14
Argentina: Binding coverage by section, selected years

Section	Description	1967		
		Total Number of Lines	Number of Bound Lines	Binding Coverage in %
1	Live animals	100	23	23.0
2	Vegetable products	262	11	4.2
3	Animal and vegetable Fats	42	2	4.8
4	Prepared foodstuffs, beverages and vinegar	85	9	10.6
5	Mineral products	157	8	5.1
6	Products of the chemical and allied industries	2689	82	3.1
7	Artificial resins and plastic materials	257	1	0.4
8	Raw hides and skins	26	0	0.0
9	Wood and articles of wood	155	0	0.0
10	Paper making material	110	13	11.8
11	Textiles and textile articles	244	5	2.1
12	Footwear, headgear, umbrellas	22	0	0.0
13	Articles of stones, of plaster	114	3	2.6
14	Pearls, precious and semi precious stones	35	0	0.0
15	Base metals and articles of base metals	535	34	6.4
16	Machinery and mechanical appliances	1373	124	9.0
17	Vehicles, aircraft and associated equipment	141	17	12.1
18	Optical, photographic, cinematographic, measuring	427	39	9.1
19	Arms and ammunition	12	0	0.0
20	Miscellaneous manufactured articles	59	6	10.2
21	Works of art, collectors' pieces and antiques	8	0	0.0
	Total	6853	377	5.5

Source: International Customs Journal, Argentina (1967); WTO estimates.

Appendix Table 15
Recourse to Article XVIII:B, 1959 to present

Argentina	1972 – 1978
	1986 – 1991
Bangladesh	1974 – 2008
Brazil	1962 – 1971
	1976 – 1991
Chile	1961 – 1980
Colombia	1981 – 1992
Egypt	1963 – 1995
Ghana	1959 – 1989
India	1960 – 1997
Indonesia	1960 – 1979
Korea	1969 – 1989
Nigeria	1985 – 1998
Pakistan	1960 – 2002
Philippines	1980 – 1995
Peru	1968 – 1991
Sri Lanka	1960 – 1998
Tunisia	1967 – 1997

Source: WTO Secretariat.

3. THE EVOLUTION OF DISPUTE SETTLEMENT PROCEDURES: STRENGTHENING THE RULE OF LAW

The new dispute settlement mechanism is seen by many as the crown jewel of the WTO. Plagued by an increasing incidence of procedural bottlenecks in the final years of the GATT, the GATT dispute settlement arrangements were substantially revised during the Uruguay Round and the resulting new WTO dispute settlement system has been successfully used by an increasing number of WTO Members (both developed and developing) over the past ten years. Although WTO Members have stated that they are reasonably satisfied with the operation of the WTOs dispute settlement system, they have also recognized that aspects of the new system could perhaps be clarified and improved, in such areas as developing country participation, legal procedures and enforcement. This subsection begins by discussing the evolution of GATT/WTO dispute settlement. It then analyses the performance of the WTO dispute settlement system to date. It concludes with an overview of various proposals by WTO legal scholars to improve the system.

(a) GATT/WTO dispute settlement history

Despite its lack of legal rigour, the GATT dispute settlement system actually performed rather well in the early years of the GATT. In its later years, however, GATT Contracting Parties who were subject to complaints under the system were able to use various procedural techniques arising from the positive consensus rule on which the system operated, to block the establishment of panels and/or the adoption of panel reports. This often led to long delays in complaints being heard, or, if they were heard and ruled on, to delays in the rulings being given legal effect. This unsatisfactory state of affairs led to the negotiation of the WTOs DSU, which codified and substantially improved the GATT system for settling disputes, which had oscillated between legal and diplomatic solutions. The DSU moved disputing parties from a power- to a rules-based orientation in settling their differences. In reviewing the history of GATT/WTO dispute settlement, the processes and instruments used in resolving disputes are described. Explanations are provided as to why the dispute settlement system worked better at certain times than others. The subsection also highlights the deficiencies of GATT dispute settlement system, which led to its overhaul during the Uruguay Round.

(i) Dispute settlement under the GATT 1948-94

Early GATT dispute resolution

Discussion on the use of both diplomatic and legal approaches to settling commercial disputes had begun even before the GATT was born. The first working draft of the ITO charter ("Suggested Charter") – put forward by the United States – foresaw a rigorous legal procedure that included the right to appeal before the International Court of Justice (ICJ). However, participants in the ITO negotiations were not ready to surrender all legal authority for settling disputes to independent experts. Thus, it was proposed that appeals to the ICJ would only take the form of a request by the collective ITO membership for an advisory opinion. Parties would not appear as litigants and therefore could not become subject to a decree by the Court (Jackson, 1969). There was wide consensus that, if anything, the involvement of the ICJ was to help find a diplomatic solution. Other key players, such as the United Kingdom, felt that potential disputes, rather than being defined as purely legal, also required an economic appraisal and hence should remain ultimately under the control of ITO members (Hudec, 1990). Ultimately, the formal legal structure of the Charter was considerably modified to accommodate political demands for flexibility. Its key provision on disputes, as in the GATT, was a clause on nullification and impairment.

In view of the provisional nature of the GATT (ITO negotiations were still ongoing, see subsection 4) and its small, "like-minded" membership, the rudimentary dispute procedure on nullification and impairment (copied verbatim from the draft ITO Charter) was considered more than appropriate (Jackson et al., 1995). Although vague, GATT Article XXIII allowed for formal judgements, requests for corrective action and ultimately economic countermeasures. No references were made to other dispute settlement provisions

of the draft ITO Charter owing to their character as the "legal machinery for a formal organization" (Hudec, 1990: 53).[145] The functioning of GATT dispute settlement was tested from its very beginnings. The first bilateral dispute (*Cuba–Consular Taxes*) on whether Article I applied to consular taxes was resolved by an affirmative ruling of the Chairman of the Contracting Parties. No reference to GATT Article XXIII was made.[146] This improvised procedure relying on the Chairman's personal prestige was only used once more.[147]

In the following years, complaints were referred to "working parties" consisting of parties to the dispute (who needed to consent to any decisions taken), some supporters and a number of neutral countries. A range of cases was successfully settled[148], but agreement was not always possible with the disputants participating in the proceedings and lobbying for other countries' support.[149] It was not until 1952 (after the failure of the ITO) when this procedure was modified in a subtle, but important manner. At the Seventh Session of the Contracting Parties, the Chairman proposed establishing a single working party to deal with all of the complaints on the agenda.[150] It was later referred to as the "Panel on Complaints".[151] The novelties were twofold: first, none of the parties to the various disputes were members of the Panel. In fact, in this particular case, the major powers, which had usually been present in working parties to ensure the political acceptability of the outcome, did not even take part in the proceedings. Second, while the Panel would discuss its draft report with each party, it would determine the findings itself.[152] Parties were not invited to present their arguments orally, rather these were submitted in writing and subsequently were closely examined by Panel members (and the Secretariat) as to their legal merits. At the Tenth Session of the Contracting Parties, in 1955, the panel procedure became formalized in a Secretariat document on "Consideration Concerning the Extended Use of Panels".[153] With the adoption of the new procedure, the "judicialization" of dispute settlement was well on its way (Petersmann, 1997b).[154]

Despite this change in practice, dispute settlement proceedings remained rather informal. Rulings were drafted "with an elusive diplomatic vagueness" (Hudec, 1993: 12). Mostly, they were in favour of the complainant, and despite vigorous protests by the defendants, rulings usually were accepted. The main tool to induce compliance in the early days of the GATT was peer pressure. It usually worked due to the cohesiveness and limited number of GATT Contracting Parties. The devastating experiences of commercial confrontation during the interwar period were still on everybody's mind (see Section B.1) as was the failed

145 As a reminder: GATT was an agreement between the commercial powers of the time who sought to reduce tariffs amongst themselves even before the ITO would come into force. In order to avoid lengthy ratification procedures in the United States and a number of other countries, it was important that legal obligations in the GATT were limited to trade and only accepted on a "provisional" basis and "to the fullest extent not inconsistent with existing legislation" (Hudec, 1990: 51; see particularly references in footnote 8).

146 GATT/CP.2/SR.11; see also GATT/CP.2/9. For a digital archive of GATT documents see http://www.wto.org/english/docs_e/gattdocs_e.htm.

147 GATT/CP.2/SR.11.

148 Some of them were put on the agenda before bilateral consultations were exhausted. Hudec (1990) takes this as an indication that filing disputes was seen as a normal "diplomatic" act.

149 For instance, at the Fourth Session in 1950, in a complaint by Chile, now with explicit reference to GATT Article XXIII, Australia stated its opposition to the Working Party report (prepared by the Secretariat) in writing and lobbied among Contracting Parties for its rejection. A counter-lobby was started "stressing the importance of not subjecting such decisions to political reviews before the full GATT membership" (Hudec, 1990: 79). Australia eventually gave way to the Contracting Parties' approval of the report (Jackson, 1969). With this case, while still of a diplomatic nature, GATT dispute settlement had taken a first step in the direction of third-party adjudication. See Australian Subsidy on Ammonium Sulphate (GATT/CP.3/61 and GATT/CP.4/23); see also GATT/CP.4/SR.15 and GATT/CP.4/SR.21.

150 SR.7/5.

151 SR.7/7.

152 As Hudec (1990: 86) observes, "the word 'panel' ... evoked notions of impartial and non-political decisions by individuals acting in their own capacity".

153 L/392/Rev.1.

154 In the following years, "working parties" were still created in certain cases for reasons of domestic political sensitivities of one of the parties as to the surrender of decision-making authority or simply because a country representative of the complainant was part of the Panel on Complaints. See, for instance, SR.7/10 regarding Dairy Products - United States Restrictions (complaint by the Netherlands).

effort to build a larger and more formal international organization governing trade. Despite an increasingly legalistic approach, dispute settlement did not lose its "negotiation" character and depended strongly on the cooperation of the defending party. Panel decisions essentially provided the losing government with additional arguments that could be used domestically to justify a change in policy to its constituencies.

In only one case was retaliation ever authorized.[155] The countermeasures applied were "small enough to avoid charges of overreaction and yet large enough to attract the public attention desired. ... The point was not to punish, but to get across a message." (Hudec, 1990: 195-196). Interestingly, the offending measures were not withdrawn for years to come and the complainant (Netherlands) regularly obtained extensions to keep its retaliatory quotas in place. At the time, a continued breach of obligations *cum* countermeasures was not an unusual situation (Jackson, 1967). On several occasions, countries had withdrawn concessions unilaterally in response to what they considered to be abuses of the various escape clause provisions contained in GATT Articles XIX and XXVIII[156], although it should be recognised that unlike GATT Article XXIII, unilateral rebalancing of concessions were permitted under these two articles. Rather than hostile acts to coerce a country into compliance, "sanctions" were seen as a means to restore the balance of reciprocal concessions in a diplomatic, but assertive manner.

"Anti-judicialization" – GATT dispute settlement wanes in the 1960s

The 1960s were marked by a steep decline in dispute settlement activity in the GATT. For one thing, the formation of the EEC in 1958 obliged its members – previously active users of GATT procedures (see subsection 2.(b)) – to speak with one voice in the GATT and to settle disputes amongst themselves.[157] What is more, a review of the EECs trading regime by Contracting Parties revealed a number of politically sensitive problems that could hardly be resolved by resorting to adversarial proceedings. In particular, the EC sought flexibility in dealing with its agricultural sector and in maintaining preferential relations with its former colonies, notably via the European Economic Community Association Agreement. At the Twelfth Session in 1958, it managed to convince Contracting Parties of the usefulness of further study on these issues focusing on "practical problems, leaving aside for the time being questions of law" (BISD 7th Supplement, 1959: 70).

Contracting Parties' tolerance of the new EC trading regime was put to the test when the EC introduced variable levies in the context of its Common Agricultural Policy (CAP). Since the issue of fluctuating tariffs had also arisen in the context of tariff renegotiations under GATT Article XXVIII upon formation of the EEC, the EC again offered lower tariff bindings on other products not subject to the new variable levies. However, the United States rejected any form of compensation other than ceiling bindings on the variable duty items themselves, albeit to no avail. Failure to agree on suitable compensation ultimately entitled the United States to withdraw an equivalent amount of concessions (i.e. to retaliate) without further legal examination. Disagreement on the appropriate amount finally led to the establishment of a panel, which decided on a retaliatory award in an amount that lay somewhere between the proposals advanced by the disputing parties.[158] Again, retaliation did not lead to any meaningful modification of the offending measures (Jackson, 1969). Further progress on agricultural issues was made by the EC and the US on the sidelines of the Kennedy Round when the two sides agreed on standards for surplus disposal and a set of export prices.[159] Contracting Parties thus came to tolerate the CAP without mounting any form of legal challenge as to its basic elements, notably in regard to the disputed measures of import protection (Sampson and Snape, 1980).

155 SR.7/16. Both parties provided statistics supporting their claims of the appropriate amount of damage in a highly speculative manner. The Panel agreed on a "middle ground" figure, which was readily accepted by both parties, without further justification. See L/61.

156 See for instance L/57.

157 Hudec (1990: 236) notes: "[T]he ease and legitimacy of the disputes procedure seemed to depend a good deal upon its momentum – the frequency of use, and the prior participation of litigants".

158 L/2088 "Panel on Poultry", also known as the so-called "Chicken War".

159 See, for instance, the Arrangement Concerning Certain Dairy Products (BISD 17th Supplement, 1970: 5-11.

The array of preferential agreements between the EC and its former colonies (see subsection 4) as well as the formation of further trade agreements, such as the European Free Trade Area (EFTA) and the Latin American Free Trade Association (LAFTA), gave further impetus to "anti-legalistic" tendencies. These developments also coincided with developing countries' own demands for greater freedom to deviate from their own GATT obligations. With the shifting status of many former colonies into independent nations, developing countries began to constitute a powerful force in the GATT.[160] However, their calls for special exemptions for developing countries (which went back to the ITO negotiations) were accompanied by demands for more effective enforcement of developed country obligations.

This attitude was best illustrated by Uruguay's complaint against 15 developed countries, which listed all these countries' non-tariff measures that were affecting Uruguay's exports.[161] However, rather than seeking a specific dispute settlement ruling, the Uruguayan complaint was more a political gesture, aimed at drawing public attention to developing countries' worsening trade situation (Jackson, 1969). Seeking to avoid direct confrontation with major trading partners, Uruguay abstained from making legal arguments as to the non-conformity of the measures with GATT rules and from submitting evidence of the trade damage suffered. Instead, it asked the Panel to determine whether retaliation should be authorized in an attempt "to make GATT assume the prosecutor's role" (Hudec: 1990: 242). The Panel declined to do so. During the Kennedy Round, Uruguay (together with Brazil) again pursued the idea of having the GATT itself act as a type of public prosecutor that would pursue complaints on behalf of developing countries along with the idea of strengthening available remedies (calling *inter alia* for financial compensation and the right to retaliate collectively).[162] Neither proposal met with any success.[163]

Following the Uruguayan complaint and the proposed "radical" reforms of GATT Article XXIII, GATT dispute settlement became increasingly associated with a more forceful pursuit by developing countries of their grievances with the GATT trading system. This was offset, however, by developed countries' resolve to preserve a more flexible application of GATT rules and to address their problems through diplomatic means. Rapidly developing and newer Contracting Parties, such as Japan, had further changed the composition of the GATT membership and their expanding exports began to have economic consequences, which triggered new forms of protectionism ("voluntary export restrictions", VERs) which did not appear to fall within GATT obligations. The GATT trading system thus became infused with legally doubtful trade measures. GATT Contracting Parties, in turn, when criticized for certain of these practices, were able to point to similar policies elsewhere or to tie the issue to a larger problem that needed an overall solution.[164] With this increased potential for serious economic conflict, stringent enforcement of GATT law came to be seen as an inimical act that did not take account of economic realities; instead an understanding developed that a more gradual approach towards fulfilling obligations was what was needed. Following a small number of confrontational cases (including the *US-EC "Chicken War"* and the massive Uruguayan complaint), dispute settlement activity ground to almost a complete halt between 1963 and 1969. Certainly, the two major rounds of trade negotiations in the 1960s (see subsection 1) reinforced this decline. During this period Contracting Parties preferred to address trade conflicts through negotiation, wary of antagonizing matters by engaging in formal dispute settlement.

In that spirit, other attempts by developing countries in the late 1960s to establish some type of self-initiated panel procedure also failed.[165] Instead of a public prosecutor, in 1971, Contracting Parties agreed to create a

160 Within a decade, developing country numbers more than tripled. A 21 to 16 majority of developed to developing countries in 1960 tipped over to reach a 25 to 52 ratio in 1970. See subsection 4.(a).

161 See L/1647 and L/1662 for Uruguay's submissions; see BISD 11th Supplement (1963): 95-148, for the Panel ruling; see BISD 13th Supplement (1965): 35-44, for the Panel's compliance review.

162 COM.TD/F/W.1.

163 See BISD (1966): 18-20, for the modifications of the procedures under GATT Article XXIII adopted at the end of the Kennedy Round. At least, for developing country complaints, after the exhaustion of various consultation procedures "the Council shall forthwith appoint a panel of experts" (para. 5). Hence, the possibility to block the establishment of a panel was forestalled in such cases.

164 See, for instance, SR.24/10 and SR.24/14 for a discussion of the New Zealand proposal on waivers for residual balance-on-payments restrictions.

165 COM.TD/W/68 and COM.TD/W/116.

"Group of Three" consisting of the three Chairmen of the Contracting Parties, the Council and the Committee on Trade and Development. This group was tasked to identify apparently unjustified trade restrictions affecting developing countries and make proposals for their removal.[166] Rather than triggering panel proceedings, this type of "surveillance" body was intended to expose (and embarrass) specific countries, while preserving flexibility to act as a potential mediator that could step in and broker a less confrontational solution.[167]

The revival of formal dispute settlement in the 1970s and beyond

With major supporters of a more "legalistic" approach (United States, major developing countries) having accepted the tendency towards more informal, "diplomatic" means to address trade problems in the 1960s, GATT dispute settlement was only revived due to domestic events in the United States in the early 1970s. Deteriorating economic conditions, notably the first US merchandise trade deficit since World War II in 1971 (leading also to the abandonment of the dollar's convertibility into gold), strengthened the interest of the US Congress in international economic policy, including trade. A review of foreign trade restrictions in Congress triggered widespread criticism of the GATT's "ineffectiveness" (Hudec, 1990: 251). At the same time, the US administration sought new negotiating authority in the run-up to the Tokyo Round. To show its resolve, the US administration pursued a number of complaints in the GATT and, more importantly, announced its intention to exercise its right to retaliate against French import restrictions still in place and ruled illegal by a panel in 1962.[168] Being the target in most US complaints, the EC responded by challenging income tax incentives provided under the US Domestic International Sales Corporation (DISC) legislation for alleged violation of subsidy rules under GATT Article XVI. Soon thereafter, the United States mounted its own complaint against tax measures in several EC countries. For more than two years, the two parties could not agree on the composition of the panel.[169] These events, combined with the continuing frustration of unfettered agricultural policies and the growing range of preferential agreements by the EC, led the United States to call for a strengthening of dispute settlement procedures, including improved rights to retaliate (Hudec, 1993).

However, the major impetus to rebuild the GATT's legal system came from the new "codes" on various non-tariff measures agreed during the Tokyo Round. In view of the increase of obligations and the complexity of issues, a credible enforcement mechanism was needed. As a consequence, a general overhaul of GATT dispute settlement was undertaken, and each code contained its own, more advanced set of procedures. Most importantly, under the new Subsidies Code, and in light of the experience of the DISC dispute, the establishment of a panel could no longer be blocked by the defendant.[170] The other codes contained similar, although less rigorous, language (Hudec, 1980). However, the new general framework did not provide for the right to a panel.[171] It did however confirm a number of established practices, such as third-party adjudication, and set out various procedural issues, such as rough time limits for the different phases of a dispute.

The increasing number of complaints during the 1980s, their legal complexity and the sophistication of the evidence submitted (as foreshadowed already in the DISC dispute) prompted the Secretariat to create a specialized "legal office" in 1981.[172] However, the limits of the existing procedures soon became evident, in particular, with the EC's CAP coming under increased fire. On several occasions, the panel had difficulties in interpreting legal concepts, in handling the large amount of evidence submitted by parties and, ultimately,

[166] BISD, 18th Supplement (1972): 70-87.

[167] BISD, 19th Supplement (1973): 31-47. The Group of Three operated between 1971 and 1973. In 1974, the subjects covered by it became part of the negotiating mandate for the Tokyo Round and its work was suspended. See COM.TD/W/219.

[168] L/3744.

[169] Interestingly, both parties agreed to involve outside tax experts in the panel due to the complexity of the matter, an implicit acknowledgement of the need for third-party adjudication. See Hudec (1990): 260-261.

[170] The automaticity of establishing a panel was modelled after the special 1966 procedures for developing countries. See BISD (1966). The possibility to block the establishment of a panel continues to be a feature in many bilateral or regional free trade agreement, including recent ones, such as the agreements between Australia and Singapore and Australia and Thailand (Fink and Molinuevo, 2007). Panel blockage is also foreseen in the FTA scheduled to come into force by 2010 between the European Union and Mediterranean countries (Ramírez Robles, 2006).

[171] L/4907 in BISD, 26th Supplement: 210-218, see particularly para. 6(ii).

[172] It took until 1983 before it was more or less operational. See Hudec (1993).

in reaching a decision.[173] As a consequence, on a growing number of occasions parties experienced a sense of frustration as a result of the panel process. In one instance, the United States even offered "to drop its complaint in exchange for wiping this ruling off the books" (Hudec, 1993: 136).[174] But even when the legal system, towards the latter half of the decade, managed to deal more effectively with an increasing caseload and to render more legally coherent decisions, the adoption of rulings dealing with sensitive issues continued to be blocked by the party ruled to be in violation of its obligations in a significant number of cases. At the 1982 Ministerial Meeting, the EC had stopped short of agreeing to a "consensus-minus-two" principle (Hudec, 1993). The recommendations on dispute settlement finally agreed were targeted at making the process faster and more effective, including by exhorting panels to render clear decisions and recommendations.[175] Following growing dissatisfaction with the lack of enforcement under the GATT, threats of unilateral retaliation were voiced, notably by the United States under its Section 301 procedure, which allowed private parties to file complaints on foreign trade barriers to which the administration was required to respond (Sykes, 1992). Not surprisingly, there was a risk that such non-GATT-authorized measures would spark counter-threats by equally potent players[176], but at the same time this policy proved quite effective (Hippler Bello and Holmer, 1990). It also served to remind GATT Contracting Parties of the value of a functioning dispute settlement system under the GATT, as illustrated by the increasing number of countries initiating disputes and by the decision to further strengthen dispute settlement procedures during the Uruguay Round. Indeed, in 1989, a decision was taken to improve GATT dispute settlement rules and procedures as part of an "early harvest" agreed by Ministers at the Montreal Mid-term Meeting in December 1988.[177] While procedural steps were further clarified to keep the process going (for instance, by giving the Director-General the right to appoint panellists in instances where parties could not agree), the decision did not alter the consensus required to adopt a report and only contained a rather ambiguous provision concerning a complainants' right to a panel.[178]

The continued threat of unilateral sanctions was underscored by the adoption of the Omnibus Trade and Competitiveness Act of 1988, which intensified the pressure on the United States' administration to wield its retaliatory power.[179] In order to subject such measures to multilateral control, Uruguay Round negotiators began to press for a more fundamental reform of the GATT dispute settlement system. By the time of the 1990 Brussels Ministerial meeting a draft understanding was presented that, in a further refined form, subsequently became part of the "Dunkel Draft" of December 1991.[180] The DSU adopted at the end of the Uruguay Round as part of the Single Understanding incorporated all of the earlier GATT decisions on dispute settlement but, what is more important, genuinely reformed the system.

(ii) The WTO Dispute Settlement Mechanism (DSM) – 1995 to present

Providing for a unified system of rules, the WTO Dispute Settlement Understanding (DSU) became applicable to all WTO Agreements, although some of them include special and additional dispute settlement provisions.[181] It has entailed an increasing "judicialization" and "de-politicization" of the process (Esserman and Howse,

173 For instance, in interpreting the concept of "equitable share" in subsidies disputes, it proved difficult to establish a causal chain between subsidization and increased market shares on the basis of the data available to the panel. See, for instance, *European Communities–Refunds on Exports of Sugar*, L/4833 in BISD 26th Supplement (1980): 290-319.

174 L/5142 and L/5142/Corr.1, not reprinted in BISD. The General Council merely noted the ruling rather than adopting it. See C/M/152.

175 L/5424 in BISD 26th Supplement (1983): 9-23.

176 For instance, when Portugal adopted quotas on grains and soybeans in the context of the CAP upon its accession to the EC, the US imposed a non-restrictive quota on EC exports, as long as the Portuguese restrictions did not reduce the level of US exports. In response, the EC subjected a range of US exports to special "surveillance" threatening to apply similar measures if needed. See Hudec (1993): 203-206 in particular.

177 L/6489 in BISD 36th Supplement (1990): 61-67.

178 Despite the success of its unilateral policies, the United States, a long-time supporter of a stronger legal system under the GATT, was the driving force behind more automaticity in panel proceedings and even tried to interpret the 1990 Decision to that extent. See, for instance, C/M/248 and C/M/249.

179 Public Law 100-418.

180 MTN.TNC/W/35 and MTN.TNC/W/FA: S.1-S.23.

181 See Article II.2 of the WTO Agreement and Article 1.2 of the DSU.

2003), albeit not without continuing to make use of both political and legal elements (Petersmann, 1997a). Diplomatic procedures, such as consultations, are mandated to precede the establishment of a panel, while others, such as good offices and mediation, are voluntary alternatives if the parties so agree. Judicial elements have clearly been strengthened. Notably, the right to a panel has been made explicit. Requests for the establishment of a panel before the DSB may only be blocked once, but not when the matter is raised a second time. By the same token, by virtue of DSU Article 23, all trade-related grievances must be channelled through the DSU, thus precluding the unilateral reprisals that had helped to stimulate the reforms. The DSU codifies a number of GATT practices, such as the composition of a panel, its terms of reference, time-limits, procedures for multiple complainants and the intervention of third parties, and has introduced new procedures, such as the interim review of panel reports. Some other procedures, *inter alia*, the right of panels to seek information from any relevant source in addition to the information provided by the disputing parties, including by soliciting reports from expert groups, are set out in more detail (Petersmann, 1997b).

Perhaps the most important features of the WTOs DSM are institutional, namely the quasi-automatic decision-making of the Dispute Settlement Body (DSB) ("reverse" or "negative" consensus that prevents the losing party from vetoing adoption of the report) and the establishment of the Appellate Body as a standing organ for legal review. Both innovations are connected: in exchange for giving up the power to veto rulings they consider erroneous, WTO Members have gained the possibility to appeal to a review body on matters of legal interpretation. Rulings of the Appellate Body are expected to be rendered quickly (60-90 days) and become binding unless overturned by consensus. At any time, parties may call for voluntary arbitration or settle a dispute bilaterally. However, the terms of such settlements and awards must be notified to the WTO and consistent with WTO law, and may be challenged by third Members - another confirmation of the emphasis of multilateral control.

Enforcement procedures have also been streamlined and isolated from possible blockage by the party found to be in violation. If corrective action by the responding Member has been taken, a separate ruling may be sought (to be rendered within 90 days) on whether these measures taken to comply satisfy the recommendations rendered by the panel/Appellate Body and adopted by the DSB. Failure by the Member that has been the object of an adverse ruling to come into compliance after a reasonable period of time (determined by binding arbitration if the parties cannot agree) triggers a 20-day period during which voluntary compensation can be negotiated. If no agreement is reached, with prior authorization by the DSB, retaliatory measures may be implemented 10 days later. The size of such retaliation may be settled by arbitration before the WTO and must be equivalent to the economic harm and loss in trade benefits caused. Any compensatory or retaliatory measures are considered to be temporary, pending full compliance with the ruling.

In order to evaluate the performance of reforms, Ministers in their 1994 Declaration agreed to review the DSU within the next four years. When the DSU review was initiated by the end of 1997, Members largely expressed their satisfaction with the workings of the system[182], as witnessed also by the high level of dispute activity in the first decade of its existence (see next subsection). Few suggestions for improvement were made in the early stages of the review, which at the end of 2001 became part of the Doha Round of negotiations. Zimmermann (2006) takes the initial reluctance to propose modifications not only as an indication of the smooth functioning of the DSU, but also as an expression of uncertainty about how the system would deal with the implementation of politically sensitive disputes, such as *EC-Hormones* and *EC-Bananas*.

Compliance matters ultimately became a major item under the review, in particular the question of whether a successful challenge of implementing measures pursuant to Article 21.5 of the DSU was a prerequisite for the complainant's request for authorization of countermeasures (the so-called "sequencing" issue). In 2002, the United States became the object of the biggest retaliatory award in WTO history, when its replacement legislation for the Foreign Sales Corporation (FSC) was found not to be in compliance with DSB recommendations[183] and the EC was given the right to impose import restrictions on up to $4 billion of trade from the United States. Increasingly, the United States' proposals to reform the dispute settlement system began to reflect the fact that more and more cases were successfully brought against United States, especially in the trade remedy area.

[182] WT/DSB/M/42.

[183] WT/DS108/AB/RW.

US proposals for increased flexibility and Member control were thus put forward. In addition, certain United States environmental measures (*US–Gasoline* and *US–Shrimp*) had previously been challenged, which sparked concern among various NGO environmental groups in the United States.[184] As a consequence, the WTO also came under pressure from NGOs for more transparency in regard to WTO dispute settlement proceedings. Proposals to that end continue to be opposed by some developing countries for fear of undue pressure being put on panels to consider concerns other than trade concerns. Indeed, the DSM in recent times has proved itself capable of protecting Members' rights to pursue other policy objectives e.g. in the fields of environment and health, as illustrated by the *US–Shrimp (Article 21.5 – Malaysia)* and *EC–Asbestos* cases.

With its broad-ranging coverage of policy issues, exclusive jurisdiction and virtually automatic adoption of dispute settlement reports, the WTOs DSM has been described as the most powerful international law tribunal (Jackson, 2006).[185] It has widely been hailed as a victory of the rule-of-law over bilateral power politics. Indeed, with the adoption of the DSU, rule-oriented, binding adjudication has replaced many of the "diplomatic" elements characterizing dispute settlement under the GATT, such as flexible procedures, party control over the proceedings (including the possibility to reject rulings), compromise solutions (instead of winner-loser situations) as well as the limited use of legal techniques of treaty interpretation. Of course, some observers deplore the loss or weakening of certain elements, be they substantive such as closer ties to public international law (see early references to the ICJ) or be they procedural, such as attorney functions within the institution (akin to the Group of Three mentioned above). Despite the obvious room for discussion on possible improvement[186], the DSU seemed to have served Members well over the first ten years given the over 300 requests for consultations and more than 140 reports issued, including in the new areas of services and trade-related intellectual property rights (Petersmann, 1997b). Before discussing some remaining challenges identified in the literature, the following subsection provides a more detailed overview of salient features in the use of dispute settlement procedures under the GATT and WTO along with possible explanations of the patterns observed.

(b) Utilization of GATT/WTO dispute settlement procedures and outcomes

It has often been noted that a few large countries, particularly the US and EC, have been the principal users of GATT/WTO dispute settlement. However, a more recent development has been the increasingly frequent use of the DSM by developing countries, including to solve disputes amongst themselves. This subsection provides an overview of dispute settlement activities in the GATT and WTO in terms of participation and content of disputes, settlement record (mutually agreed solutions, reports issued) and implementation of rulings/countermeasures.[187] It also cites the literature that has sought to explain various matters related to the use of GATT/WTO dispute settlement procedures, such as the decision to bring a dispute, the likelihood of obtaining concessions in early settlements, the likelihood of complainants winning their cases, the high compliance rate and the limited recourse to retaliation to date.

---

184 Ultimately, in the *US–Shrimp (Article 21.5 – Malaysia)* compliance proceedings, it was determined that the United States could maintain its environmental measure in modified form.

185 While most regional or bilateral free trade agreements contain dispute settlement procedures, often following similar steps as the WTOs DSU, only a few have put in place a comparable institutional framework. A notable exception is the ASEAN dispute settlement mechanism, which provides both an independent secretariat equipped to provide legal support and a permanent Appellate Body, closely following the WTO model (Fink and Molinuevo, 2007).

186 In fact, proposals in the DSU negotiations cover 25 out of the 27 Articles of the DSU.

187 For the WTO, the data set compiled by Horn and Mavroidis (2006b) covers all 311 WTO disputes initiated through the official filing of a request for consultations from 1 January 1995 until 31 July 2004. For these disputes, the data have been updated to include events occurring until February 2006. Given the average length of disputes (until circulation of an Appellate Body Report) of almost two years determined by Horn and Mavroidis (2006a), disputes initiated thereafter are likely to be still ongoing and hence cannot be used in much of the analysis undertaken here. For more up-to-date descriptive statistics on WTO dispute settlement (number of complaints initiated, Members bringing/subject to complaints etc.) see Leitner and Lester (2006) See also earlier papers, such as Park and Panizzon (2002). These papers only contain summary statistics. The underlying data sets are not made public, and accounting methodologies (e.g. what constitutes a "case") as well as questions of categorization (e.g. how to characterize the content of a dispute) are different. For the analytical questions addressed in this Report (e.g. concerning types of measures and dispute settlement outcomes), the Report has relied on the publicly available and well documented database prepared by Horn and Mavroidis (2006b) which enables the reader to replicate aggregate results and verify questions of classification in specific cases. The methodology is also consistent with the analysis of GATT disputes based on the equally publicly available data in Reinhardt (1996 and 2001).

(i) Participation in, and subject matter of disputes

As discussed above, dispute settlement activity had its ups and down under the GATT until it exploded in the 1980s. Heavy use of the system continued under the WTO. These changes in the volume of litigation are a reflection of the GATT's evolution as well as of broader economic circumstances. Table 16 shows that the volume of activity was reasonably strong in the first 15 years of the GATT until it bottomed out in the 1960s and early 1970s. The sharp drop in cases brought by the EC and developing countries (despite their increase in numbers) during that time period and the continued activity by the United States (responsible for 25 of 39 complaints) underscore the scepticism of the former towards formal dispute settlement and consistent support of the system by the latter.[188] Dispute settlement activity grew strongly after the Tokyo Round and further intensified during the final seven years of the GATT after the 1988 Midterm Review. Under the WTO, the annual caseload has been quite stable with a recent decrease in cases initiated by the US and the EC offset by growing developing country activity as complaining parties. Overall activity has multiplied under the WTO with almost as many cases (339) being initiated in not even ten years as were initiated (433) in the 47 years of the GATT.

Table 16
Total number of disputes over time and by country group

	GATT						
	1948-57	1958-67	1968-77	1978-87	1988-94	Total GATT 1948-94	Total WTO 1995-2004
US	13	10	25	31	37	116	81
EC15	32	8	4	32	29	105	63
IND	3	13	8	28	26	78	55
DEV	9	23	2	41	57	132	139
LDC	1	1	0	0	0	2	1
All	**58**	**55**	**39**	**132**	**149**	**433**	**339**

	WTO										
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Total
US	8	17	17	11	10	8	1	4	3	2	81
EC15	2	7	16	16	6	8	1	4	3	0	63
IND	6	8	7	7	7	3	3	10	2	2	55
DEV	14	17	10	8	12	21	19	19	18	1	139
LDC	0	0	0	0	0	0		0	0	1	1
All	**30**	**49**	**50**	**42**	**35**	**40**	**24**	**37**	**26**	**6**	**339**

Notes: Use of dyadic disputes results in more observations than requests for consultations due to multiple complaints. GATT cases resolved under the WTO DSU are counted under the WTO. Due to its evolution from six Members in 1958 to 15 Members in 1995 some cases appear as intra-EU complaints during the GATT years. Accession of ten new Members to the EC in 2004 and of an additional two Members in 2007 is not taken into account. IND: other industrialized countries, i.e. Australia, Canada, Iceland, Japan, Liechtenstein, Norway, New Zealand, Switzerland. LDC: least-developed countries in accordance with UN classification; DEV: other developing country Contracting Parties/Members.

Source: GATT: Reinhardt (1996) updated by authors; WTO: own compilation from Horn and Mavroidis (2006b); data include all disputes initiated between 1 January 1995 and 31 July 2004 (DS 1-311); for these disputes, the data have been updated to include events occuring until February 2006.

On average, given their weight in international trade, the EC and US have been involved in the majority of disputes both under the GATT and WTO (Table 2; Horn and Mavroidis, 2006b). Japan was mostly active as a defendant under the GATT, but its picture is more balanced under the WTO. Amongst developing countries, Argentina, Brazil and Chile were the most active dispute participants under the

[188] Of course, as stated in Subsection 3.(a) above, trade negotiations, in particular the Kennedy Round, also contributed to the overall decline in dispute settlement activity during that time period, since Members addressed certain issues through negotiations rather than disputes.

GATT and continue to be so in the WTO. Over the first 10 years of the WTO India, the Republic of Korea and Mexico joined their ranks in terms of frequency of participation.

While the EC continues to target the United States in about 40 per cent of cases, the share of US complaints against the EC as a percentage of overall US complaints dropped from close to 60 per cent under the GATT to about 35 per cent under the WTO. Both Members file proportionally more complaints against developing countries than under the GATT (around 12 per cent of disputes under the GATT versus 43 and 47 per cent for the EC and US respectively under the WTO). However, Horn and Mavroidis (2006a) also observe that these two Members increasingly have become the subject of complaints rather than acting primarily as complaining parties, an indication of the rise of other countries seeking to defend their export interests. Indeed, a new development over the last ten years has been the more frequent use of the DSM by developing countries. Developing countries have instigated more than 40 per cent of disputes under the WTO as compared to 30 per cent during the years of the GATT. Forty-two per cent of developing country complaints under WTO have been directed against other developing countries as opposed to merely 5 per cent under the GATT. Despite increased litigation between themselves, the US and EC also continue to be prime targets for developing countries, with 75 cases being brought against the two biggest players over the initial 10 years of the WTO compared to 106 cases during 48 years of the GATT.

Several authors have tried to identify the fundamental factors accounting for utilization of the dispute settlement system. Bütler and Hauser (2000) hold a decision to bring a case depends on the strength of the implementation mechanism and the probability of reaching a favourable decision. Both aspects were strengthened with the DSU (which removed the possibility of responding parties to block establishment of panels and adoption of reports and introduced more elaborate implementation procedures) which, helps to explain the boost in WTO dispute settlement activity relative to the GATT. Horn et al. (1999) examine which countries tend to litigate. They find that while differences in legal capacities appear to play some role, dispute patterns can fairly well be explained by the diversity and value of exports. Bown (2005a) shows that even when the size of exports at stake is controlled for, a country's retaliatory and legal capacity as well as its relationship with the defendant, for instance via preferential agreements, are important factors in a decision to initiate a formal complaint. Guzman and Simmons (2005) find that developing countries pursue complaints according to their immediate trade interests and are not deterred from filing a dispute against bigger players for fear of reprisal. However, owing to a lack of resources they face difficulties in identifying violations and building a case and, hence, are constrained in their capacity to launch disputes. Reinhardt (1999) attributes less importance to legal resources and international power relationships, but relates the likelihood to bring a dispute to the ability of domestic interest groups in a country to exert pressure on the government to defend their export interests. Interestingly, Bown (2005b) finds that the incentive to go through formal litigation is reduced, when it is easy for industries to initiate an anti-dumping/countervail investigation leading to the implementation of trade contingency measures in retaliation for an alleged breach of rules by another country.

The WTO dispute settlement system has also seen a growing participation by third parties.[189] Many observers see this as a positive development as it enlarges the circle of Members who can express their concerns (including "systemic" interests) (Lanye, 2003). Indeed, Busch and Reinhardt (2006) find that the participation of third parties, including at the consultation stage, has an impact on dispute settlement outcomes. They caution that third party participation increases the transaction costs of reaching a mutually agreed solution and may deter disputes from being filed in the first place.

[189] Third parties are Members that merely reserve their rights in a dispute (as opposed to co-complainants). The conditions for third party participation depend on the Article under which the complainant requests consultations with the defendant. "Other parties" may also request to join the consultations in advance of a panel proceeding. Article 10 of the DSU allows third parties to make written and oral submissions in the first round of litigation which are to be reflected in the final report. If a panel report is appealed, DSU Article 17 gives those third parties similar access to the proceedings before the Appellate Body.

Table 17
Most frequent complainants and defendants

	GATT		WTO	
	Complainant	Defendant	Complainant	Defendant
Argentina	13	3	10	14
Australia	24	4	7	9
Brazil	19	9	21	13
Canada	33	23	25	12
Chile	18	3	9	10
EC15	105	197	63	74
India	6	3	13	18
Japan	8	35	11	13
Korea, Rep. of	1	4	11	12
Mexico	5	3	13	11
New Zealand	9	2	6	0
Norway	4	12	1	0
US	116	116	81	92

Notes: Use of dyadic disputes results in more observations than requests for consultations due to multiple complaints. GATT cases resolved under the WTO DSU are counted under the WTO. Due to its evolution from six Members in 1958 to 15 Members in 1995 some cases appear as intra-EU complaints during the GATT years. Accession of ten new Members to the EC in 2004 and of an additional two Members in 2007 is not taken into account.

Source: GATT: Reinhardt (1996) updated by authors; WTO: own compilation from Horn and Mavroidis (2006b); data include all disputes initiated between 1 January 1995 and 31 July 2004 (DS 1-311); for these disputes, the data have been updated to include events occuring until February 2006.

Table 18
Who targets whom?

		GATT									
Complainant		US		EC15		IND		DEV		LDC	
		number	share	number	share	number	share	number	share	number	share
Defendant	US	0	0	42	40	28	35.9	43	32.8	2	100
	EC15	67	57.8	30	28.6	37	47.4	63	48.1	0	0
	IND	34	29.3	21	20	11	14.1	17	13.7	0	0
	DEV	15	12.9	12	11.4	2	2.6	8	5.4	0	0
	LDC	0	0	0	0	0	0	0	0	0	0
	Total	**116**	**100**	**105**	**100**	**78**		**131**	**100**	**2**	**100**

		WTO									
Complainant		US		EC15		IND		DEV		LDC	
		number	share	number	share	number	share	number	share	number	share
Defendant	US	0	0	26	41.3	26	47.3	40	28.8	0	0
	EC15	29	35.8	0	0	10	18.2	35	25.2	0	0
	IND	14	17.3	10	15.9	5	9.1	5	3.6	0	0
	DEV	38	46.9	27	42.8	14	25.4	59	42.4	1	100
	LDC	0	0	0	0	0	0	0	0	0	0
	Total	**81**	**100**	**63**	**100**	**55**	**100**	**139**	**100**	**1**	**100**

Notes: Use of dyadic disputes results in more observations than requests for consultations due to multiple complaints. GATT cases resolved under the WTO DSU are counted under the WTO. Due to its evolution from six Members in 1958 to 15 Members in 1995 some cases appear as intra-EU complaints during the GATT years. Accession of ten new Members to the EC in 2004 and of an additional two Members in 2007 is not taken into account. IND: other industrialized countries, i.e. Australia, Canada, Iceland, Japan, Liechtenstein, Norway, New Zealand, Switzerland. LDC: least-developed countries in accordance with UN classification; DEV: other developing country Contracting Parties/Members.

Source: GATT: Reinhardt (1996) updated by authors; WTO: own compilation from Horn and Mavroidis (2006b); data include all disputes initiated between 1 January 1995 and 31 July 2004 (DS 1-311); for these disputes, the data have been updated to include events occuring until February 2006.

Table 19 shows that non-tariff barriers (NTBs) are the type of measure most frequently complained about (more than half of all measures under the GATT and about 45 per cent under the WTO, including SPS and TBT related complaints). Hudec (1990) confirms that, as tariffs were cut, tariff related disputes revealed a constant downward trend, while NTB litigation became relatively more important. Combining the subsidy and antidumping (AD) / countervailing duty (CvD) categories, it seems remarkable that about one-quarter of GATT and WTO cases deals with "unfair" trade practices or the measures taken to offset them. United States AD/CvD measures are and historically have been a main target of trade remedy disputes (as compared to, for instance, Japan who, until recently,[190] has not been the target of any such dispute. In the GATT years, the EC frequently had to defend its subsidy regime. Under the WTO, developing countries have quickly been catching up as defendants in trade remedy disputes, notably in regard to AD as well as safeguards, while the picture is more balanced across other types of trade measures.[191] Most disputes under the WTO cover goods, with services and trade-related intellectual property rights barely accounting for 10 per cent of complaints.

Table 19
Disputes by type of measure

	GATT						
Contested Measure	Tariff	NTB	Subsidy	AD/CvD	SG	PTA	Total
number	84	267	54	54	7	47	513
share	16	52	11	11	1	9	100

	WTO										
Contested Measure	Tariff	NTB	Subsidy	AD/CvD	SG	PTA	SPS	TBT	IP	Services	Total
number	64	163	43	79	37	10	30	33	25	21	505
share	13	32	9	16	7	2	6	7	5	4	100

Notes: Use of dyadic disputes results in more observations than number of bilateral complaints and number of requests for consultations due to multiple contested measures. GATT cases resolved under the WTO DSU are counted under the WTO. GATT preferential trade agreement (PTA) disputes represents a lower bound due to missing data/conservative classification, but include disputes associated with European Economic Community (EEC). GATT count does not single out measures under the plurilateral Codes, e.g. the Tokyo Round TBT Agreement, since all relevant disputes also referred to GATT provisions. Internal money charges, such as discriminatory taxes, are categorized as NTBs, not tariffs.

Source: GATT: Reinhardt (1996) updated by authors; WTO: own compilation from Horn and Mavroidis (2006b); data include all disputes initiated between 1 January 1995 and 31 July 2004 (DS 1-311); for these disputes, the data have been updated to include events occuring until February 2006.

For the WTO, data is available on the HS classification of products categories subject to disputes. As Figure 9 illustrates, by far the largest number of disputes are in agriculture,[192] followed by base metals (Section XV), vehicles and transport equipment (Section XVII), textiles and clothing (Section XI) and machinery (Section XVI). Sections I to IV alone (agricultural products except fish) account for 45 per cent of the disputes. This is broadly consistent with the GATT, where about one-half were agricultural cases (with the exception of the 1950s when agricultural products were shielded behind quotas for balance-of-payments purposes).[193]

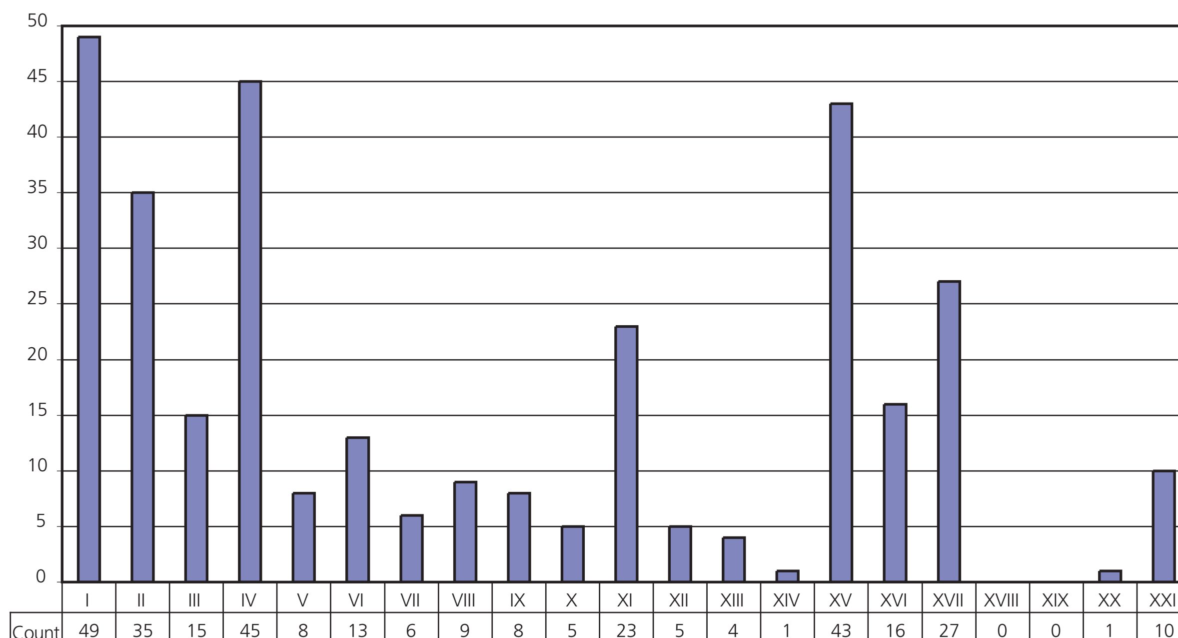
[190] In 2006, a panel has been established in *Japan–Countervailing Duties on Dynamic Random Access Memories from Korea* (WT/DS336).

[191] See, for instance, Park and Panizzon (2002): 233, Table 6 as well as Hudec (1990): 340, Table 11.38.

[192] Agricultural products under the WTO are defined as products contained in Sections I-IV, except fish and fish products, and certain products of Sections VI, VIII and XI; see Annex 1 of the Agreement on Agriculture.

[193] See Hudec, 1990: 327, Table 11.28.

Chart 9
WTO disputes by type of product



	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	XIII	XIV	XV	XVI	XVII	XVIII	XIX	XX	XXI
Count	49	35	15	45	8	13	6	9	8	5	23	5	4	1	43	16	27	0	0	1	10

Notes: Use of dyadic disputes results in more observations than requests for consultations due to multiple complaints. Products categorized by HS chapters and summarized in HS Sections I-XXI as follows: I – animals and animal products, II – vegetable products, III – animal or vegetable fats, IV – prepared foodstuffs, V – mineral products, VI – chemical products, VII – plastics and rubber, VIII - hides and skins, IX – wood and wood products, X – wood pulp products, XI – textiles and textile articles, XII – footwear, headgear, XIII – articles of stone, plaster, cement, asbestos, XIV – pearls, precious or semi-precious stones, metals, XV – base metals and articles thereof, XVI – machinery and mechanical appliances, XVII – transport equipment, XVIII – measuring and musical instruments, XIX – arms and ammunition, XX – miscellaneous, XXI – works of art.

Source: Own compilation from Horn and Mavroidis (2006b); data include all disputes initiated between 1 January 1995 and 31 July 2004 (DS 1-311); for these disputes, the data have been updated to include events occurring until February 2006.

(ii) Dispute settlement outcomes

As far as dispute settlement outcomes are concerned, Table 20 confirms a number of improvements from the GATT to the WTO. Due to the positive consensus rule under the GATT, panels were established in less than 45 per cent of complaints filed. Of the 189 complaints that went to the panel stage, another 20 per cent were dropped or mutually settled without official notice. Finally of the 151 cases in which reports were issued more than a quarter remained unadopted. In total, only 25 per cent of initial complaints ended with an adopted panel report. Under the WTO, this compares to 62 per cent of the complaints (excluding ongoing disputes) for which a panel report was issued and proved "decisive"[194] and to another 28 per cent of complaints settled according to the rules. Seventy per cent of the cases, where a panel report is issued and that are not mutually settled or ongoing, are appealed. Bütler and Hauser (2000) explain that this high rate is a result of compelling reasons on the part of the losing government to appeal. First, there is at least a small chance that a panel's findings might be reversed, even if only in part; second, the losing government is likely to be under pressure from domestic interest groups to appeal; and finally, during the appeal process a little more time is gained during which the offending measure can be maintained.

Indeed, both under the GATT (82 per cent) and the WTO (88 per cent) complainants have mostly won their cases (counting the ones that went through to an adopted report and "decisive" ruling respectively). More than one-third of completed cases under the WTO have been mutually settled, some of them (about 10 per cent of the total) without notifying details of a bilateral agreement to the membership as

[194] For the present statistical purposes, "Panel/AB is decisive" means that either (i) the ruling was pro-defendant; or, (ii) it was pro-complainant and defendant complies; or, (iii) it was pro-complainant and compliance was not forthcoming, but the complainant decided not to pursue the matter further.

a whole.[195] Of those, a number of cases simply were dropped. Davey (2005a) raises the question whether the contested measure was removed or not, and if not, what action, if any, by the respondent led to the dropping of the case. Bütler and Hauser (2000) demonstrate that bilateral settlements are more likely at the early stages of the dispute process; the later a mutually agreed settlement (MAS) is concluded the more likely it is to resemble to the expected ruling. Busch and Reinhardt (2000) as well as Guzman (2002) note that the complainant government may prefer to go before a panel because the political damage of giving in to foreign pressure may not be offset by the expected benefits from a negotiated settlement. Likewise, politicians in the defending country, should the case be lost, can blame the WTO for the need to repeal the disputed measure and may suffer less political harm than if they had settled for a compromise deal. This selection effect also helps to explain the high "victory" rate of complainants.[196] Guzman and Simmons (2002) further elaborate that the nature of the disputed issue has an impact on the likelihood to settle in consultations. When the subject matter of the dispute has an all-or-nothing character and leaves little room to compromise (such as a health measure), there is considerably less opportunity for a negotiated compromise than when "continuous" variables, such as tariff levels are concerned.[197] Despite the rather high quota of mutual settlements, Holmes et al. (2003) and Reinhardt (2001) do not find evidence that weaker Members, especially developing countries, come under systematic pressure to settle bilaterally instead of seeing their cases completed. To the contrary, Busch and Reinhardt (2000 and 2003) hold that early settlement offers the greatest likelihood of securing full concessions from a defendant, but that developing countries have less been able to do so.[198]

[195] Hoekman and Mavroidis (2000) contend that even the notifications received under Article 3.6 of the DSU often do not allow for a determination of whether Article 3.6 of the DSU (stipulating that any mutually agreed settlement must be consistent with the covered agreements) has been complied with.

[196] Guzman's (2002) reasoning is that unlike in domestic litigation the relative payoffs of the disputing parties are political and not symmetrical, i.e. not "zero-sum". This may be for a variety of reasons: affected interest groups in the defendant may be more powerful than their counterparts in the complainant or a higher reputation damage following a lost case may be inflicted on the complainant (seen to be bringing "meritless" lawsuits) than on the defendant (suffering little reputation loss as long as the measure ultimately is removed).

[197] When WTO Members negotiate a bilateral settlement, they typically focus on the specific measure at issue. According to the authors, it would, of course, be possible to make a "lumpy" issue (such as a safety regulation) more "continuous" by making side payments or link it to another policy matter. As a corollary, the authors find that democracies are less likely to negotiate these more complicated deals (and hence are more likely to go through the full panel process on "discontinuous" issues), since they are more concerned with the interests of other domestic groups, who might oppose the strategy of such linkage, than autocratic regimes.

[198] To recall, by virtue of Articles 3.7 and 11 of the DSU, a bilateral settlement always remains possible, i.e. also when the case has progressed to the panel stage or when a report has been issued.

Table 20
Dispute settlement outcomes and direction of ruling

GATT				WTO			
				Complaint ongoing			122
					consultation ongoing	106	
					active Panel	16	
Case dropped during panel phase			38	Settled by MAS (notified)			55
					at consultation stage	28	
					at panel stage	21	
					post-report stage	6	
Settled by MAS (not notified) or no panel established			244	Settled by MAS (not notified)			23
					at consultation stage	12	
					at panel stage	11	
				Settled for procedural reasons			4
				Settled by Art. 25 Arbitration			1
Report unadopted			42				
Report adopted			109	Panel/AB report is decisive			134
	pro-defendant	20			pro-defendant	16	
	pro-complainant	89			pro-complainant	118	
Complaints notified			433	Complaints notified			339

Notes: Use of dyadic disputes results in more observations than requests for consultations due to multiple complaints. GATT: GATT cases resolved under the WTO DSU are counted under the WTO. WTO: Cut-off date for ongoing disputes is February 2006. The number of observations in "Panel/AB is decisive" (134) is less than the number of adopted reports (141), since in 6 instances post-report MAS occurred and in 1 instance an Art. 25 arbitration was agreed upon.

Source: GATT: Reinhardt (1996) updated by authors and own compilation. WTO: own compilation from Horn and Mavroidis (2006b); data include all disputes initiated between 1 January 1995 and 31 July 2004 (DS 1-311); for these disputes, the data have been updated to include events occurring until February 2006.

Ultimately, a complaint can only be considered successful if it induces the offending Member to live up to its commitments. The clearest favourable result for the complainant is achieved when the measure at issue is withdrawn, which appears to be the case for at least 66 of 121 completed WTO cases (Table 21). By empirically analysing a large set of GATT/WTO dispute settlement outcomes Bown (2004a) finds that the potential costs of retaliation, and hence consideration of the plaintiff's power, influence a Member's decision to comply rather than concerns for its reputation. However, the statistics in Table 21 may hide the fact that a losing Member can modify the offending measure to a certain extent or replace it with a new policy that may raise WTO-consistency problems of its own. Reif and Florestal (1998) point to the problem of defining the precise nature of the losing party's obligation given that findings are mostly confined to recommendations to bring the contested measure into conformity without suggesting how this should be done. Davey (2005a) sees the increasing invocation of DSU Article 21.5 compliance panels[199] (many of which are ongoing) as an indication of the problem of modified or replacement measures. He finds evidence of the former particularly in SPS matters and of the latter in anti-dumping and countervailing cases.

From Table 21 it can also be seen that only about 20 per cent of completed cases lead to threats of retaliation, and in only one half of those instances have retaliatory measures been imposed. Another 10 per cent of completed cases are "missing" in the sense that no requests for countermeasures have been made despite the absence of a confirmed "positive" solution for the complainant. Bown (2004b) cautions against taking the low number of countermeasures as a sign of lacking effectiveness. To the

[199] DSU Article 21.5 foresees that where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings by a panel or the Appellate Body, a panel – wherever possible the original panel – can be called upon to decide on such a dispute.

contrary, he notes that concerns about retaliation affect governments' decisions in the first place of whether to protect a domestic industry via "illegal" measures and face a formal complaint or "legally" via safeguards while providing compensation.

Table 21
Compliance record in WTO disputes

Report adopted, of which:			141
Implementation (reasonable period of time) ongoing (excluding sequencing)			20
Pro-defendant, i.e. officially settled			14
MAS (prior to request for CM)			3
Compliance forthcoming			68
	undisputed compliance	66	
	prior to request for CM, 21.5 panel pro-defendant	2	
CM requested			25
	post request for CM, MAS	3	
	post request for CM, 21.5 panel pro-defendant	1	
	inactive or suspended	4	
	n/a	1	
	under Art. 25	1	
	sequencing, i.e. pending	2	
	imposed	13	
"Missing cases": compliance not forthcoming, no MAS, not ongoing, but also no CM requested			11

Notes: Use of dyadic disputes results in more observations than requests for consultations due to multiple complaints. Cut-off date for ongoing disputes is February 2006. The number of adopted reports (141) is higher than the number of observations in "Panel/AB is decisive" (134) in Table 20, since it included 6 instances in which post-report MAS occurred and 1 instance in which an Art. 25 arbitration was agreed upon. CM: counter measures.

Source: Own compilation from Horn and Mavroidis (2006b) data include all disputes initiated between 1 January 1995 and 31 July 2004 (DS 1-311); for these disputes, the data have been updated to include events occuring until February 2006.

In order to evaluate the success of the DSM, the time it takes to achieve satisfactory results from the point of view of the complainant must also be taken into account, given that any offending measure may be in force for at least the duration of the proceedings. Horn and Mavroidis (2006a) have calculated an average of just under two years (23 months) from the date of request for consultations until the date of circulation of an Appellate Body report.[200] This is longer than the sum of statutory timelines (15 months). The authors conjecture that delays may be a function of the complexity of the dispute (as measured by the number of invoked articles), the damage at stake (as claimed by the defendant) and the litigation capacity of parties (as measured by their level of development). Delays may also occur simply because parties agree to suspend the proceedings.

(c) Performance of the WTO's DSM and challenges discussed in the literature

This subsection provides an overview of the academic literature and makes no attempt to portray the whole range of proposals in the current DSU review negotiations under the Doha Development Agenda. The main topics discussed in the DSU review negotiations include sequencing, remand, post-retaliation, transparency, enhanced third party rights and improved participation of developing countries.

[200] If averages for the reasonable period of time during which implementation must occur as well as the time for a compliance panel and Appellate Body compliance report are added the total process starting from the request for consultations can take over three and a half years.

As foreshadowed in subsection 3.(a), after 12 years of operation, there is an overwhelming consensus in the literature that the WTO's DSM works well.[201] However, defining and measuring the success of the DSM is not as straightforward as it may seem. According to Article 3 of the DSU, the objective of the WTO dispute settlement is to provide security and predictability to the multilateral trading system and to preserve the rights and obligations originally negotiated among its Members. In order to measure fulfilment of the DSU's objectives, reference is commonly made to the workings of the system and its level of activity, as portrayed in the preceding Section.[202] Yet, these criteria are far from being unambiguous. For some commentators, the number of disputes is a sign of success (after all, countries utilize the system), for others it is an indication of growing discontent with the ambiguity of rules governing world trade (Reinhardt, 1999). Likewise, an extensive litigation process is tantamount to bureaucratic slack for some, and a sign of due process for others (Iida, 2004). The frequency of retaliation is evidence of a system at work for some, but a worrisome tendency for others (Schwartz and Sykes, 2002). By the same token, a high level of mutually agreed solutions may be a positive trend or a sign of power-politics and understandings that are potentially detrimental to outsiders (Busch, 2000). What all of these criteria have in common is that only disputes actually initiated are considered, while the fact that some cases are never brought may be a consequence of how the dispute settlement system is designed. Hence, the number of "missing cases" could be an indication of failure (Bown and Hoekman, 2005), but is next to impossible to measure.[203]

In light of these problems, any evaluation of the success and remaining challenges of WTO dispute settlement must be less than perfect. For the purposes of this subsection, the approach by Jackson (2005) and others is followed, who have primarily compared the WTO dispute settlement to GATT practices as well as to similar international tribunals. In a qualitative manner, it has been stated that WTO dispute settlement processes are comparatively well defined and running smoothly. A large variety of countries are using the system. The DSB's authority is accepted and its recommendations are generally complied with. The enforcement apparatus is powerful in being able to issue binding decisions, in the quasi-automaticity that exists for the adoption of reports and especially in its ability to enforce decisions against non-complying Members and has created what Jackson calls "sanctions envy" (Jackson cited in Charnovitz: 2001: 792) by other international organizations. Along similar lines, some of the challenges identified in the literature can be categorized into questions of participation, adjudication and implementation of rulings.

(i) Issues of participation

As mentioned in the preceding section, a large range of countries make use of the DSM. Yet, these statistics reveal an absence of the poorest WTO Members who fail to engage either as complainants or interested third parties (but are not challenged either). The descriptive statistics above reveal that the participation of developing countries as a group has increased under the WTO compared to the GATT. In the 47 years of the existence of the GATT, 30 developing countries filed a total of 132 complaints corresponding to an average of about 3 cases per year. In comparison, 139 cases have been initiated by 31 developing countries during the first ten years of the WTO resulting in an annual average of about 14 developing country complaints.[204] However, 57 per cent of all developing country complaints and 42 per cent of third party participation are accounted for by the most active developing countries, namely Argentina, Brazil, Chile, India, Mexico and South Korea, as well as China and Chinese Taipei as of 2001 (Horn and Mavroidis, 2006a). This means that more than 80 developing Members litigate rarely,

201 See exemplarily Davey (2005b).

202 See e.g. Jackson (2005). For a discussion of alternative indicators of the DSU's effectiveness, which are more difficult to measure, see e.g. Iida (2004).

203 The term "missing cases" in this context refers to a different phenomenon than in Table 20. Here, "missing cases" refers to the possibility that some cases are never brought before the DSB, whereas above, the term denotes litigation outcomes that cannot be accounted for. In the literature, the term "missing cases" is also used in both contexts.

204 139 of 339 complaints represent about 40 per cent of filings. In addition, developing country Members are third parties in at least 49 per cent of WTO disputes (Horn and Mavroidis, 2006a).

if ever. As shown in Table 16, least-developed country participation in dispute settlement is practically inexistent.[205]

Hence, some concern remains whether the WTO's DSM may be systematically biased against developing countries. Two explanations for the possibly disadvantageous position of economically weaker, "small" countries are commonly noted (Anderson, 2002; Mavroidis, 2000; Pauwelyn 2000). Firstly, it has been argued that small countries lack the necessary retaliatory power to enforce rulings in their favour. Anticipating the futility of their endeavours to coerce economically powerful countries into compliance, small countries abstain from engaging in costly litigation procedures in the first place or right away opt for other options to protect their interests (for instance via trade remedies or balance-of-payments restrictions). These considerations (and possible avenues of reform) are examined in detail in subsection (iii) below, which deals with issues of implementation and enforcement.

Secondly, it has been argued that resource constraints prevent poor countries from obtaining information to build their case, from taking the necessary steps to initiate a dispute and from arguing their case in the appropriate manner. Hoekman and Mavroidis (2000) contend that small countries are confronted with higher costs to collect relevant information, since there is a lack of national mechanisms as well as resourceful private groups that could monitor foreign trade practices. Once a violation of another country has been detected, many developing and least-developed countries may only have limited legal expertise at their disposal to bring or defend a case and may have to rely on (expensive) outside expertise. Horn and Mavroidis (1999) highlight disadvantages in legal capacity that may be more pronounced for poorer countries, notably in relation to non-violation complaints, monitoring and implementation of rulings.

Hoekman and Mavroidis (2000) stress the role of "surveillance", a term they use interchangeably for transparency. Important progress was made with the creation of the Trade Policy Review Mechanism (TPRM). While reviews of Members' trade policies take place in a more systematic fashion, they do not include proposals for the removal of trade barriers, like the reports by the Group of Three did in the early 1970s. Moreover, in Article A.(i) of Annex 3 of the Marrakesh Agreement establishing the WTO, it is made explicit that the TPRM is not intended "to serve as a basis for the enforcement of specific obligations ... or for dispute settlement procedures", i.e. the Secretariat is not meant to fulfil the function of a general attorney, and reports cannot be used as evidence against the Member reviewed. Hoekman and Mavroidis (2000) criticize that the TPRM process is too infrequent and that periodic surveys of a representative cross-section of companies involved in importing and exporting as well as of consumer and industry associations are needed to assess the impact of a country's trade policies on export (as well as domestic) markets. To that end, Bown and Hoekman (2005) advocate private-public partnerships (between developing country governments and private companies, NGOs and/or consumer groups) in order to raise awareness and provide legal assistance.[206] The authors make further proposals to facilitate the participation of WTO Members in dispute settlement activities, including the provision of direct financial support for litigation, increased surveillance by the WTO Secretariat as well as capacity-building.

An important initiative to support developing countries in dispute settlement activities has been the Advisory Centre on WTO Law, established in 2001 (Van der Borght, 1999). The DSU also contains special procedures and time-frames that are meant to alleviate the burden of developing countries in becoming involved in a dispute.[207] Developing countries are also entitled to legal assistance from the WTO Secretariat and other special and differential treatment in relation to dispute settlement under certain agreements (Footer, 2001). Nordstrom (2005) and Nordstrom and Shaffer (2007), while acknowledging

205 LDCs have a share of about 0.8 per cent in world trade (2005 merchandise export values) and only filed a single complaint in the WTO (which corresponds to 0.3 per cent of complaints). Furthermore, LDCs were third parties in only 1.5 per cent of disputes. See also Shaffer (2005).

206 See Shaffer (2003a; 2006) for a detailed overview over the issue of public-private-partnerships in the WTO and developing countries' challenges in establishing such mechanisms.

207 See Articles 3.12, 4.10, 8.10, 12.10, 12.11, 21.2, 21.7, 21.8 and 27.2 of the DSU. In Article 3.12, reference is also made to the special procedures agreed in 1966. See BISD, 14th Supplement (1966): 18-20.

the importance of legal aid, highlight the limitations of the WTO Secretariat in providing assistance under its current mandate for reasons of impartiality, and, as an alternative avenue, propose the introduction of simpler and less costly dispute settlement procedures for "small claims". The proposal from before the Tokyo Round to create a "federal prosecutor" or "general attorney" within the WTO Secretariat for developing countries has also been brought up on occasion by certain authors (e.g. Hoekman and Mavroidis, 2000).[208]

(ii) Issues of adjudication

Dispute panels and the Appellate Body have created a large body of WTO case law, ensuring to the maximum extent possible its internal consistency. However, in interpreting WTO law, they have at times been criticized in the literature for making law instead of administering it. "Judicial activism", the argument goes, may lead to a serious encroachment on Members' sovereignty. Along with this critique, WTO scholars have also raised the concern that the system has become too rigid, too "judicialized", over the years. Too much rigidity, it is claimed, prevents the DSB from dealing with unforeseen situations and new developments. Finally, a number of commentators have suggested that a lack of transparency in the litigation process undermines the legitimacy of rulings. Legal questions of this sort can hardly be assessed empirically. They reflect conceptual differences among WTO scholars about what the role of dispute settlement should be.

The mandate of dispute settlement bodies

According to Article 31(1) of the *Vienna Convention on the Law of Treaties*: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.". In interpreting WTO law, dispute settlement panels and the Appellate Body have, on several occasions, been accused of exceeding their mandate by adding to Members' obligations or limiting their rights, instead of merely clarifying the ambit of provisions (Davey, 2001). It has been claimed that such practice may curtail the sovereignty of WTO Members and have an impact on their right to pursue legitimate domestic policy objectives (Essermann and Howse, 2003). Interestingly, early criticisms came from environmentalists after the *US–Tuna* and the *US –Shrimp* disputes, but somewhat died down when the rulings in *EC–Asbestos*, and *US–Shrimp (Article 21.5 – Malaysia)* demonstrated the deference of WTO dispute settlement to national environmental and health policies (Petersmann, 1997b). More recently, panels and the Appellate Body have been criticized for certain rulings on trade remedies for allegedly having disregarded the standard of review under Article 17.6(ii) of the Anti-Dumping Agreement.[209] Others have criticized WTO jurisprudence for "under-reaching" by giving too much deference to measures taken by WTO Members (e.g. McRae, 2004).

These debates brought to the surface the fundamental question for WTO dispute settlement: how to deal with the existence of constructive ambiguity and loopholes in the treaty text? As stated above, adjudicators are charged with interpreting the treaty text in its context and in the light of the object and purpose of the treaty.[210] In addition, the Appellate Body has said, based on Article 31 of the *Vienna*

[208] Precedents for an independent international bureaucracy to act as a prosecutor exist. Pursuant to Article 226 of the 1957 Treaty of Rome Establishing the European Community, the European Commission, at its own initiative, can take action against member states that fail to fulfil their obligations. After having received the observations by the member state in question, it issues a "reasoned opinion". If the member state does not comply with the terms of the opinion within the specified time period, the Commission may bring the matter before the European Court of Justice.

[209] According to Article 17.6(ii) of the Anti-Dumping Agreement, where a panel finds that a provision admits of more than one "permissible" interpretation, it shall consider the national authority's determination in conformity if it rests upon one of those interpretations. There is considerable controversy among legal scholars as to whether the WTO DSM has exceeded the limits of the standard of review and the interpretative approach mandated under the Anti-Dumping Agreement. Tarullo (2002) and Greenwald (2003), for example, are affirmative, while Durling (2003) and Leibovitz (2001) do not see an excess of mandate.

[210] For a discussion of the role of various methods of treaty interpretation see e.g. Petersmann (1998).

Convention, that treaty interpretation could not occur in clinical isolation from public international law.[211] Pauwelyn (2001) acknowledges that interpretation (even within the relatively strict sense referred to in Articles 31 and 32 of the Vienna Convention) is a matter of definition. However, he emphasizes that interpretation must be limited to giving meaning to rules of law and cannot extend to creating new rules,[212] which is the prerogative of WTO Members through negotiations.

Proposals have been made by a few authors to curb the authority of panels and the Appellate Body, to do away with the reverse consensus rule of adopting reports, to increase party control over the dispute outcome as well as to introduce stronger elements of post-report diplomacy.[213] Opponents of this weakening of the judicial process fear, among other things, a loss of the public good nature of setting legal precedents and an undue encouragement of undisclosed deals with adverse effects on other Members (Holmes et al., 2003).[214] Most WTO scholars observe that there is no evidence of judicial activism and, therefore, agree with Mercurio (2004) that if proposals for increased flexibility and Member control were implemented, "the basis of dispute settlement in the WTO and the fundamental tenets upon which the DSU operates [would be eroded ... and that] the organization as we currently know it would cease to exist" (Mercurio, 2004: 818).

Has the dispute settlement system become too "judicialized"?

Some commentators have argued in favour of more diplomacy for a somewhat different reason. Recognizing that the WTO is a relational contract of trade cooperation, Guzman (2002) and others have noted that the WTO is crucially dependant on the good-will of its Members and that too much "judicialization" endangers dispute settlement.[215] These authors observe that the current trading system is becoming progressively institutionalized, legalized and formalized by virtue of institutional innovations, treaty addenda and the power of de facto precedence of WTO jurisdiction. They hold that a focus on rules creates the illusion that the WTO is a complete (unambiguous) contract, when in reality, it is not. A move towards increased "judicialization" seeks to create the appearance that WTO agreements contain the answer to all possible issues of conflict and that dispute settlement is a matter of applying the correct legal passage of the text. It is argued that a "judicialized" approach may be counterproductive

211 Pauwelyn argues that "[f]or a non-WTO rule to play a role in this process, (1) the WTO term in question must be broad and ambiguous enough to allow for input by other rules; and (2) the other rule must say something about what the WTO term should mean, i.e., there must be some connection with a WTO term for a non-WTO rule to impart meaning to the interpretive process. ... [W]ithin the process of treaty interpretation, non-WTO rules cannot add meaning to WTO rules that goes either beyond or against the 'clear meaning of the terms' of WTO covered agreements" (Pauwelyn, 2001: 572-573).

212 The Appellate Body confirmed that "[a]n interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility" (*United States-Standards for Reformulated and Conventional Gasoline*: 23). Elsewhere, the Appellate Body emphasized that "it is certainly not the task of either panels or the Appellate Body to amend the DSU. ... Only WTO Members have the authority to amend the DSU" (*United States-Import Measures on Certain Products from the European Communities*: para. 92).

213 See e.g. Hippler Bello (1996). It appears that only very few authors, such as Barfield (2001), really wish to go back to diplomatic solutions in politically difficult cases, advocating the re-introduction of a blocking mechanism by the losing party. In the current DSU negotiations, the United States and Chile have proposed, *inter alia*, to provide a mechanism for parties to delete by mutual agreement findings in a panel report that are not necessary or helpful to resolving the dispute, to make provision for some form of "partial adoption" procedure, where the DSB would decline to adopt certain parts of reports and to provide some form of additional guidance to WTO adjudicative bodies concerning (i) the nature and scope of their mandate and (ii) rules of interpretation of the WTO agreements. See TN/DS/W/82 and 82/Add.1.

214 In fact, more "bilateralism" in trade matters may even be counterproductive for the broader relationship between two countries. The possibility to "refer" bilateral trade disputes to the WTO can help to "remove" (at least to some extent and for some time) trade rows that recurrently spoil the atmosphere in bilateral diplomatic relations dealing with a wider range of policy issues. This observation is owed to WTO Deputy Director-General Alejandro Jara, who from previous experience as a trade negotiator has noted that progress on other matters became easier, once a bilateral trade dispute was addressed at the WTO. See also Guzman (2002) for related arguments on governments' preference for seeking the establishment of a panel rather than a bilaterally negotiated solution.

215 See Chayes and Chayes (1993) for the so-called managerial school of international relations. A "relational" (or "fiduciary") contract is characterized by longevity, a continuing relationship and substantial incompleteness. As a consequence, relational contracts are governed by shared norms, values and a sense of "what is right" rather than through explicit rules and elaborate provisions. These authors hold that it is often impossible (since a party cannot observe or verify implicit contract details), or at least counterproductive (since it sours the atmosphere of cooperation), to try to settle disputes in relational contracts by resorting to the letter of the contract.

for at least three reasons: First, it entails a loss of flexibility in dealing with unanticipated situations and dissatisfied parties may distance themselves from the system and turn to outside solutions (Downs et al., 1996). Second, excessive obedience to procedural, statutory and legalistic details may frustrate disputants and leave important questions unresolved.[216] Third, it may invite "trigger-happy" Members to initiate disputes that are formally correct, but against the spirit of the agreement (Klein, 1996). The result of this over-reliance on the letter of the treaty, critics maintain, is a loss of the initial spirit of the GATT and the shared sense of cooperation (Charnovitz, 2002a).

Several reform proposals have been made in favour of a multilateral soft law approach, also called "sunshine methods" (Charnovitz, 2001: 824). Taking human rights and environmental agreements as an example, a number of scholars contend that compliance in relational contracts is best promoted through more harmonious and less confrontational processes that rely on transparency and accessibility of information, increased reporting, monitoring, implementation review procedures, NGO involvement and capacity building.[217] This notion of "managing" the compliance process relies on the argument that behaviour is more easily modified through persuasion and a "normative pull" (a culture of compliance) than through coercion. In order to counter a potential trend towards excessive and "unfriendly" litigation in international trade, Charnovitz (2001) and Holmes et al. (2003) recommend a greater use of mediation, conciliation and arbitration techniques.[218] Most of these authors see their suggestions as a complement to current practice, in order to preserve the smooth functioning of the DSM.

On the other hand, a large body of literature exists on how to further strengthen the authority of panels/ Appellate Body and, more generally, the judicial elements of WTO dispute settlement in order to increase the security and predictability of the multilateral trading system. Pauwelyn (2006), for instance, proposes to allow the Appellate Body to collect factual evidence and complete the analysis itself or to remand a case to the original panel.[219] Another example is Mercurio (2004) who discusses a range of strategies that have been proposed to ensure the availability of qualified panellists and reduce delays associated with their selection.[220]

Do WTO dispute settlement procedures lack adequate transparency?

While transparency is an issue in all phases of dispute settlement, the panel phase has attracted most attention both in regard to public participation in panel hearings and the possibility of non-governmental actors to make their arguments heard.[221] Some have also noted the opacity of the deliberation process by panels and the Appellate Body, for instance in regard to the role of the WTO Secretariat, the circumstances under which panels exercise "judicial economy" or the decision to seek outside expertise (Hoekman and Mavroidis, 2000).

216 A pertinent example is the statutory prohibition for the Appellate Body to reconsider the facts established by the panel or to fill gaps in fact-finding left by the panel. However, occasionally, the Appellate Body has "completed the analysis" on the basis of factual determinations by the panel or facts undisputed between the parties in the interest of the prompt resolution of disputes.

217 See Charnovitz (2002a), Chayes and Chayes (1993) and Guzman (2002). For a critical note see Lawrence (2003), Downs et al. (1996) and Bown (2004a).

218 For an explanation of the various political vs. adjudicative models of international dispute settlement see Merrills (2005).

219 On remand authority see also, e.g., proposal by the EC (TN/DS/W/38).

220 See also proposals by the EC (TN/DS/W/1) on a permanent body of panellists and by Thailand (TN/DS/W/31) as well as Canada (TN/DS/W/41) on streamlining the panel selection process.

221 Unlike at the WTO, which is an intergovernmental body, it is possible for private parties to have a standing before international tribunals and dispute settlement mechanisms. Several free trade agreements, such as NAFTA or ASEAN, include provisions on investor-to-state arbitrations. Under most agreements, foreign investors can submit their claims either to the International Centre for the Settlement of Investment Disputes (ICSID) or to *ad hoc* arbitral tribunals established under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL). The advantage of this approach is that investors do not need to convince their home governments to challenge offending measures in the host country. At the same time, investor-to-state arbitrations offer a bilateral solution between the complainant and the host government without the obligation of the latter to bring its measures into conformity. See also Fink and Molinuevo (2007).

It has been proposed to establish operating procedures that would allow for a systematic consideration of *amicus curiae* briefs by non-state actors[222] and the explicit right to open hearings (Charnovitz, 2001).[223] In order to foster transparency during panel deliberations, guidelines for the role and competence of external experts and the Secretariat advising panels have been called for by these authors. The proposals to establish standing dispute panels or to streamline the selection process not only seek to ensure constant professional quality and legal predictability *vis-à-vis* litigating Members (Hoekman and Mavroidis, 2000), but also to address transparency concerns as to the nomination of panellists for the roster and the composition of individual panels (Davey, 2002).

(iii) Issues of implementation

Enforcement in the WTO implies that the offending measure is brought into conformity with the WTO Agreements. When a measure is successfully challenged, the defending WTO Member may comply by withdrawing the offending measure, or it may achieve compliance in other ways. It may maintain the measure on a temporary basis if it offers adequate compensation to the complainant and the offer is accepted. If the Member concerned neither complies nor provides mutually acceptable temporary compensation, the aggrieved Member may, subject to prior DSB approval, take retaliatory measures equivalent to the economic harm and loss in trade benefits caused. A number of commentators have taken issue with certain aspects of the DSU's dealing with enforcement matters. Firstly, a range of authors have questioned the DSU's insistence on compliance with WTO obligations over temporary derogation from WTO commitments. Secondly, the infrequent use of compensatory measures and the limited availability and practicality of retaliatory measures, especially for developing countries have been noted. Finally, several authors have questioned the methodologies used in the calculation of economic harm and loss in trade benefits and equivalent retaliation that has been authorized by the DSB so far. In terms of inducing compliance, the question has been raised whether the standard of equivalent damages is appropriate, or whether punitive damages are called for. Although these issues are not unrelated, each will be further discussed in turn.

What should be the objective of dispute settlement?

WTO scholars are divided as to what the aim of dispute settlement should be. Should it be to compensate the victim by "rebalancing" or to induce compliance? The latter is the principal objective enshrined in the DSU, and numerous scholars have argued that the main function of the WTO's DSM is to serve the rule of law and ensure the security and predictability of the multilateral trading system, as mandated in Article 3.2 of the DSU (Hilf, 2001). Petersmann (1997b: 57) has not tired of portraying the WTO Agreement and its "compulsory worldwide dispute settlement system" as a model for "constitutionalizing" other international organizations and of emphasizing the public good character of dispute settlement, including by creating a degree of precedent. In order to protect the integrity of the multilateral trading system, the objective of WTO dispute settlement is (and must be) to re-establish adherence to the rules (Jackson, 2006). Therefore, every WTO Member is under an unalterable international obligation to comply with DSB rulings and bring its measures into conformity. Hence, while satisfied with the current objective of the DSU, some have proposed that *extra*-contractual behaviour must be sanctioned through "punitive" damages (contrary to Article 22.4 of the DSU) above and beyond the "rebalancing level" in order to motivate a prompt return to compliance and deter deviations (Charnovitz, 2001; Mavroidis, 2000).

[222] The Appellate Body has ruled that panels have the discretion to accept *amicus curiae* briefs by non-state parties in view of their right to seek information from any source (Article 13 of the DSU). It is left to the discretion of panels whether to accept or reject those briefs. See *US-Shrimp/Turtle* (Appellate Body Report, WT/DS58/AB/R: paras. 107-108).

[223] A first experience with public hearings was made in the recent *United States/Canada–Continued suspension of obligations in the EC–Hormones* dispute (DS320 and DS321). At the request of the parties the panels agreed to open their proceedings with the parties and scientific experts on 27-28 September 2006 and with the parties on 2-3 October 2006 for observation by WTO Members and the general public via closed-circuit broadcast to a separate viewing room at WTO Headquarters in Geneva.

Other authors, who see the WTO as a web of bilateral concessions, argue in favour of returning to a more flexible dispute settlement system (Zimmermann, 2005). Rather than conceiving of WTO dispute settlement as a "supranational" compliance system, these authors stress its "transnational" character, which should allow for an orderly rebalancing of concessions between parties to the dispute. Proponents of this view, such as Hippler Bello (1996), are content with the current standard of "equivalent" damages, but hold that Members should be given the explicit right to choose between compliance with DSB rulings on the one hand and deliberately "opting out" of certain obligations on the other, as long as tariff compensation is provided or a suspension of concessions tolerated. As a consequence, Hippler Bello sees the main benefit of the WTO DSM's orientation towards the "rule of law" in the institutionalization of commensurate punishments.[224] However, Jackson (2004), Pauwelyn (2000) and Dunoff and Trachtman (1999) convincingly argue that besides being conceptually flawed for confusing enforcement provisions with temporary escape clauses, such an approach (which is mainly based on an abstract game-theoretic literature on the exchange of market access commitments between two players) is ill-suited for an international contract between multiple parties and a complex set of obligations, such as the ones covered by WTO agreements.

Compensation, retaliation and alternative remedies

If compliance is not forthcoming, the principal remedy under the DSU in order to pressure a Member to bring an offending measure into conformity with WTO law is retaliation. The option of voluntary and temporary compensation is heavily under-utilized.[225] The principal problem is that an agreement between the complainant and the respondent is required. Members in dispute would need to negotiate and agree on the scope of compensation and the way to implement it (e.g. via tariff cuts or other liberalization measures). One reason why, in reality, compensation is hardly ever offered may be that the offending Member would run into internal political difficulties if it were to expose an unrelated domestic industry to more foreign competition as a compensation for WTO-illegal protection offered to another sector (Guzman, 2002).[226] In addition, for similar reasons, the successful complainant is likely to prefer withdrawal of the inconsistent measure to compensation.

The basic idea of retaliation is that sectors not directly involved in the dispute are harmed and consequently exert pressure on the non-compliant Member to bring its measure into conformity.[227] In addition to the deterrent effect on the offending party, protection of its import-competing sectors constitutes at least a partial compensation for the complainant.[228] Retaliation can be executed by the complainant without cooperation by the defendant, but entails other disadvantages. Higher levels of protection introduce additional economic inefficiencies on both sides. In addition, it affects "innocent bystanders", such as consumers and competitive industries (Pauwelyn, 2000; Charnovitz 2001, 2002a). Hence, it runs

224 Schwartz and Sykes (2002: 26) hold that the main innovation of the DSU (*vis-à-vis* the old GATT system) was the institutionalization of the "efficient breach" principle: "[T]he innovation of the DSU was intended not so much to deter violation of most substantive rules ... What the system really adds is the opportunity for the losing disputant to 'buy out' of the violation at a price set by an arbitrator who has examined carefully the question of what sanctions are substantially equivalent to the harm done by the violation. … The new system does a better job of protecting violators from the actual or threatened imposition of excessive sanctions. In turn, it ought to perform better than the old system at ensuring that opportunities for efficient breach are not undermined."

225 Cases, in which compensation was agreed upon, are very rare. Following arbitration in *US–Section 110(5) of the US Copyright Act*, the United States paid financial damages to the European music industry until the offending law was repealed.

226 According to DSU Article 22.1, compensation is "voluntary and, if granted, shall be consistent with the covered agreements". This provision suggests that e.g. tariff compensation must be granted on an MFN-basis, which may make it less attractive to both complainant and defendant, since exporters from third countries also benefit. Monetary compensation, which is further discussed below, limits the scope for these (positive) externalities on third countries. Bagwell (2007) briefly mentions the possibility that other forms of trade compensation, such as reductions of existing anti-dumping duties, could be chosen, but may give rise to further legal questions.

227 Retaliation induces exporters in the non-compliant country to lobby their government to keep foreign markets open and act as a counterweight to the influence of import-competing industries.

228 This is so owing to either political economy consideration or positive terms-of-trade effects if the retaliating country is large enough to affect world prices.

counter to the liberalizing spirit of WTO and its objective to secure predictable business opportunities. Retaliation is also likely to lead to trade diversion, and hence economic impacts on third countries. The complainant may have no interest in applying retaliatory measures, when the costs of raising tariffs on needed imports are considered too high, both economically and politically.[229] Even larger Members may face resistance by consumers and importers of intermediate products who suffer from higher prices or disturbed relations with regular suppliers (Anderson, 2002).

However, in applying retaliatory measures, large countries can cause economic harm to the party found not to be in compliance with its obligations and even extract additional economic benefits via terms-of-trade improvements. Conversely, small countries, in view of their limited market size, are unable to exert sufficient pressure on larger Members to alter their behaviour (Anderson, 2002). Hence, retaliation fails to deter economically powerful countries from committing a violation against small countries (Mavroidis, 2000; Pauwelyn 2000). Large countries may either remain non-compliant or offer settlements at unfavourable conditions. Indeed, to date developing countries have never suspended concessions. As mentioned previously, the futility of retaliation gives rise to the suspicion of "missing cases" (Bown and Hoekman, 2005), i.e. complaints by "small" countries that are never brought, since costs of dispute settlement would be incurred on top of the costs caused by the offending Member's non-compliance, without any hope of obtaining reparation (Bronckers and van den Broek, 2005).[230] Smaller countries lacking sufficient retaliatory power may be generally less willing to make trade liberalization commitments (Bown and Hoekman, 2005). Reform proposals suggest promoting the use of compensation,[231] improving the effectiveness of tariff retaliation[232] and mechanisms that foster expeditious implementation by, *inter alia*, introducing the concept of remedies with effect as of the adoption of DSB rulings or even with retroactive effect.[233]

In order to strengthen the remedy of temporary compensation (which unlike retaliation leads to more not less trade) through tariff reductions in other sectors, a proposal has been made to make tariff compensation mandatory and automatic (Pauwelyn, 2000). It has been proposed that the WTO DSB indicate in which sectors the non-complying Member should reduce tariffs or that it authorize the winning complainant to choose sectors for compensation (Horlick, 2002). Alternatively, Lawrence (2003) proposes that Members pre-commit sectors that they promise to liberalize in case they lose a dispute. Schropp (2005) suggests the creation of an arbitration procedure for compensation and to make compensation more attractive by offering a discount as compared to the retaliation award. Several DSU review proposals suggest that the level of nullification or impairment caused by an inconsistent measure be determined earlier in the process than under existing DSU rules, either by the panel or the Appellate Body in the original proceedings or in compliance proceedings, with a view to facilitating and expediting negotiations on compensation.[234]

---

[229] It should be noted that optimal tariffs are close to zero in countries that are too small to affect world prices, and, hence, tariff increases would reduce welfare.

[230] Bown (2004a) shows that retaliatory capacity of complainants is the crucial determinant affecting the defendant governments' policy decision to comply with rulings adopted by the DSB or to remain recalcitrant *vis-à-vis* those rulings. Retaliation capacity thereby is understood as the complainant's market power *vis-à-vis* the defendant: The more the defendant's exporters depend on the market of the complainant, the more credible and deterring are the latter party's self-enforcement threats.

[231] See proposals by the EC (TN/DS/W/1), by Japan (TN/DS/W/32) and by Ecuador (TN/DS/W/33).

[232] The African group has proposed to allow collective retaliation (TN/DS/W/15 and TN/DS/W42), see also the LDC group proposal (TN/DS/W/17). A group of developing countries comprising India, Cuba, the Dominican Republic, Egypt, Honduras, Jamaica and Malaysia has proposed to ease the conditions for the use of cross-retaliation by developing countries (TN/DS/W/47).

[233] See, e.g., proposals by Mexico (TN/DS/W/23), the LDC Group (TN/DS/W/37), and the African Group (TN/DS/W/42).

[234] See, e.g., proposals by Ecuador (TN/DS/W/33), and Korea (TN/DS/W/35).

Bronckers and van den Broek (2005), among others, support financial compensation as an alternative remedy. Several WTO Members have submitted proposals to that effect in the DSU reform negotiations.[235] Payments received could be disbursed as reparation for the injury suffered by industries directly affected by the violating measure.[236] It may also be more easily applied retroactively (Davey, 2005a, 2005b). Those who advocate more flexibility to temporarily derogate from certain WTO obligations may presume that this option would be used whenever it was desirable for the offending Member from an economic efficiency or political economy perspective. Others are concerned with the determination of appropriate amounts and the possibility for rich countries to buy themselves out of their obligations "too cheaply" and on a more or less permanent basis. Bronckers and van den Broek (2005) counter that fines could increase by a certain percentage each year and that arbitrators determine trade damage already under current rules. However, following the approach of introducing an element of punishment to induce compliance would not re-establish the original balance of concessions. Another systemic concern is that equivalent monetary pay-offs may represent less of an incentive for the offender to comply, since an increased burden on the government budget (shouldered by a large number of unorganized taxpayers) triggers less domestic pressure than retaliatory trade barriers faced by export lobbies (Lawrence, 2003). In the public eye, money flows from developing countries that have lost a dispute to industrialized nations may not be perceived well either.·[237]

Even if temporary compensation became mandatory, the risk would remain that a non-compliant Member may continue to disregard its duty, whatever form compensation would take. Retaliation would remain the means of enforcement of last resort, since it is not controlled by the offender. In order to increase the incentive to comply, "stiffer" penalties have been proposed, i.e. deliberately punitive damage awards (Bown, 2002). Another idea to exert more pressure on a trading partner to comply with a WTO ruling has become known as "carousel retaliation" (Sek, 2002).[238] Furthermore, Members have proposed to facilitate developing countries' resort to cross-retaliation, that is retaliation in sectors or under agreements other than those where the violation occurred.[239] Some authors explore the idea of collective retaliation by developing countries in order to overcome the problems of limited market size (Maggi, 1999; Pauwelyn,

[235] See the proposals by Ecuador (TN/DS/W/33), China (TN/DS/W29), the LDC Group (TN/DS/W/17 and TN/DS/W/37), and the African Group (TN/DS/W/15 and TN/DS/W/42) suggesting monetary compensation for developing and/or least-developed Members affected by WTO-inconsistent measures taken by developed Members.

[236] Limão and Saggi (2006) show that monetary fines act both as a deterrent and compensation mechanism and avoid the inefficiencies introduced by tariff retaliation. Tariffs transfer income via terms-of-trade changes, but do so in an inefficient manner compared to fines due to deadweight loss. Shaffer (2003a) notes that "cash remedies" could facilitate payment of legal fees by developing countries to private law firms and, hence, may change the dynamics of litigation by alleviating an important constraint in bringing a case.

[237] There are several examples of other agreements envisaging compensation in monetary form. The free trade agreement between the United States and Chile, for instance, provides for monetary compensation, including the possibility to make annual payments at a 50 per cent discount compared to the level of damages determined by the dispute panel. See Article 22.15, para. 5. The compensation is paid to the complaining party or, if the FTA Commission so decides, into a fund to sponsor appropriate initiatives to facilitate trade between the parties. For the full text of the free trade agreement between the United States and Chile see http://www.ustr.gov/Trade_Agreements/Bilateral/Chile_FTA/Final_Texts/Section_Index.html. See also the free trade agreement between Singapore and the United States (Article 20.6, para.5) and, furthermore, the North American Free Trade Agreement (NAFTA) (Chapter 11), the Common Market for Eastern and Southern Africa (COMESA) (Articles 8, 171) and the EC Treaty (Article 171). The principle of financial liability to injured parties is also firmly established in the domestic law of many countries and exists also in international law on State responsibility.

[238] "Carousel" retaliation refers to the periodic revision of the list of targeted sectors in order to (threaten to) harm a greater number of exporters and maximize domestic pressure on the offending government. Sek (2002) notes wide criticism of this practice, including from domestic industries. Australia (TN/DS/W/49), and Thailand and the Philippines (TN/DS/W/3), for example, have proposed prohibitions of "carousel" retaliation.

[239] See footnote 232 above and. Subramanian and Watal (2000), Hudec (2002), Charnovitz (2002a). In the case of TRIPS retaliation, denying foreign IP rights, at least in the short run, results in assets being available at a lower price, i.e. has the opposite effect of a retaliatory tariff. Hudec (2002: 90) also contends that even "negligible" amounts of retaliation in the IP area could cause considerable "political discomfort". Critics of cross-retaliation raise the concern that suspending intellectual property rights, given the private nature of rights, amounts to expropriation, undermines the rule-of-law in a country and may create conflicts with other international agreements (Cottier, 1992). Nevertheless, it features in certain free trade agreements, such as the one between the European Union and Mexico. See Ramírez Robles (2006).

2000).[240] Others suggest making retaliation rights tradable, such that Members who do not find it opportune to retaliate can obtain some monetary reparation, while others would acquire the right to protect their industries, supposedly at a discount.[241] Bagwell et al. (2007) further elaborate on auction design, particularly the question whether the losing party should be allowed to bid. If it was, sellers (supposedly small developing countries) could expect higher revenues, but globally it would be more efficient if only third countries were allowed to acquire the right to retaliate.[242] Under the latter approach it is still necessary that at least one interested country is found that is large enough to credibly threaten retaliation. Retaliation as a "back-up" for monetary compensation can be avoided if, as suggested by Limão and Saggi (2006), each country has posted a bond with a neutral party (an "escrow") at the time the trade agreement is concluded.[243] When a country is found to have violated its obligations, it has to decide whether to pay the fine and recover the right to its bond or not to pay the fine and forfeit the bond, which is then disbursed to the aggrieved country as compensation.[244]

New "penalties" discussed in the literature include the suspension of membership rights, for instance to attend meetings, to participate in decision-making, to use the DSM or to exercise other WTO rights or to receive technical assistance.[245] While such proposals may not entail negative trade effects, they may alienate the penalized Member from further engaging in WTO matters and reduce its motivation to bring its measures into conformity. Moreover, it would be difficult to identify a suspension of rights that would not be out of proportion with the underlying violation. A number of scholars have come out in favour of more subtle methods, such as improved surveillance of Members' implementation of DSB rulings or attempts to rally international mobilization *vis-à-vis* non-compliant states (Charnovitz, 2001). The latter includes "home-directed mobilization", that is an increased exposure of governments to domestic stakeholders. As explained above, proposals include "sunshine methods" geared at exerting constructive influence on the compliance process.

Arbitration on the level of suspension of concessions to be authorized by the DSB

A number of authors have criticized the way in which the equivalent level of damages has been calculated pursuant to Article 22.4 of the DSU. A systematic under-compensation is said to result from the absence of retroactive damage awards. Under current DSU rules, complaining parties are not compensated for any damage suffered in the period between commencement of the breach and the authorization of retaliation by the DSB (Pauwelyn, 2000; Bronckers and van den Broek, 2005; Trachtman, 2006). According to Lawrence (2003), prospective damages coupled with weak procedural disciplines invite "foot-dragging" tactics by offending WTO Members, i.e. the swapping of one non-compliant measure

[240] India and nine other developing countries proposed a collective retaliation scheme along the lines of the "principle of collective responsibility" championed in the UN Charter, see footnote 232 above. However, Limão and Saggi (2006) point out that a "small" country may prefer that others retaliate, leading to possible collective action problems.

[241] This idea has been taken up by Mexico. See WTO document TN/DS/W/23.

[242] Bagwell et al. (2007) show that the expected benefit of acquiring the right to retaliate in a country with strong domestic political economy interests is likely to outweigh the expected cost in other countries. This has the consequence that under certain conditions a prior compensation stage (essentially the possibility for the losing party to retire retaliatory rights) can reduce overall efficiency.

[243] The authors also show that the possibility of financial compensation has an added value for the level of cooperation only if it is backed up by bonds and not by retaliatory tariffs as a supporting instrument.

[244] The authors quote an article in *Inside U.S. Trade* 13 of 11 November 2002 ("Chile Looks for Monetary Sanctions as Enforcement Mechanism"), in which Chile proposes such an "escrow" scheme for its bilateral free trade agreement with the United States. However, in the final agreement, the suspension of benefits has been chosen as a fall-back option if compensation is not forthcoming.

[245] Experiences with the suspension of membership rights have been made in the IMF, the Montreal Protocol for the Protection of the Ozone Layer or the ILO (Charnovitz, 2001; Lawrence, 2003).

with another. In addition to the introduction of retroactive damages,[246] several procedural reforms have been proposed by the above authors to speed up the dispute settlement process. These include improved rules on the reasonable period of time for implementation, a reversal of the burden of proof (the implementing Member would have to demonstrate that the measures it has taken to comply with the adverse DSB rulings fully implement those rulings), the right for panels or the Appellate Body to grant interim measures[247] and rules resolving the so-called "sequencing" problem.[248]

Another point of concern has been that arbitrators have set the level of authorized retaliation equal to the level of adverse trade effects of the inconsistent measure (Anderson, 2002).[249] In response, Breuss (2004), for instance, seeks to estimate welfare rather than trade impacts, including indirect repercussions. Along these lines, Mavroidis (2000), Schwartz and Sykes (2002) and Schropp (2005) contend that the benchmark for achieving full rebalancing must be the "expectation damage".[250] Ethier (2004) and Schwartz and Sykes (2002) argue that the WTO is a profoundly political agreement between self-interested policymakers. Given its political nature, the authors deny that awards limited to economic damage can re-establish any kind of political balance. These criticisms have not resulted in readily operational reform proposals. Even the calculation of direct trade effects, let alone welfare and other second-round effects, have posed methodological and data challenges (Bagwell, 2007; Keck, 2004). In light of the less than fully transparent methodologies used in certain past arbitration awards,[251] the modelling approach laid out in *US–Continued Dumping and Subsidy Offset Act of 2000 (CDSOA) (22.6)* illustrates the need for a more

246 The panel report on "Australia – Subsidies Provided to Producers and Exporters of Automotive Leather: Recourse to Article 21.5 of the DSU by the United States" (DS/WT126/RW) illustrates that retrospective application of remedies may not be precluded in respect of prohibited subsidies in the light of the requirement in Article 4.7 of the SCM Agreement that such subsidies be withdrawn. See in particular paragraphs 6.29-6.32. For remedies with retroactive effect, see proposal by Mexico (TN/DS/W/40); see also proposal by Japan (TN/DS/W/32) suggesting a prospective determination of the level of nullification and impairment which takes into account continued application of inconsistent measures and frequency of inconsistent administration or implementation.

247 See e.g. Jackson (1998) and Lockhart and Voon (2005). Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL) allow the arbitral tribunal to impose interim measures, which may be established in the form of an interim award. See UNCITRAL Arbitration Rules Article 26, para. 2. On similar measures taken by the International Court of Justice (ICJ) see Merrills (2005).

248 Since *EC–Bananas* it has been contested whether or not a so-called "compliance panel" (Article 21.5 of DSU) must have finished its determination of non-conformity before a request to suspend concessions can be submitted. The DSU is unclear on this question (Valles and McGivern, 2000). If a compliance panel proceeding must precede arbitration on retaliation, the implementing Member may successfully procrastinate by replacing one illegal measure with another one. Sequencing of compliance proceedings and arbitration on the level of suspension of concessions equivalent to the level of nullification or impairment caused by the inconsistent measure is the subject of a number of DSU review proposals, see, e.g., proposal by Australia (TN/DS/W/49).

249 Judging from past experience with WTO arbitrations, an estimation of the level of trade that would occur based on the counterfactual that the inconsistent measure had been brought into conformity, has become the standard in arbitration under Article 22.6 of the DSU. Of course, the equivalent value of imports does not measure the actual welfare loss caused by the inconsistent measure. Counterfactual trade effects are relevant also in a number of other applications of WTO rules. See Keck et al. (2006) for more.

250 "Expectation damages" embrace all further efficiency costs (trade opportunities foregone or losses in domestic value-added production) caused by the breach of the agreement over and above direct trade effects (Mavroidis 2000). Those efficiency losses include the present (discounted) values of profits foregone, diseconomies of scale, costs of finding new markets/partners, costs of switching production, and so forth. However, Bagwell (2007) cautions that such a system would require detailed information about a government's political-economic preferences and might increase the probability of third-party externalities. Howse and Staiger (2006) show that, for the latter reason, such remedies are likely to trigger further violations. The authors endorse the trade effects approach and liken it to a system of remedies that provides for "expectation damages" if concessions negotiated within the GATT/WTO system are considered as protected by an overarching "liability rule". In addition, the trade effects approach is attractive because the implications of breach and retaliation concern the same bilateral relationship. However, it is of course true, as Bagwell (2007) notes, that even if by virtue of retaliation commensurate to trade effects, the pre-violation terms-of-trade level is restored, retaliation results in an internal (local-price) distortion for the complainant.

251 For example, in *EC–Bananas (Article 22.6 of the DSU)*, in order to estimate the trade effect of an inconsistent measure, the value of EC imports under the banana import regime was compared to an estimated value under a counterfactual WTO-consistent regime. Arbitrators did not disclose how counterfactual scenarios were selected and defined and why the scenario on which the final award was based differed from the counterfactuals that had been proposed by the parties.

systematic approach based on economic theory.[252] Sound methodologies are all the more important if punitive elements/over-compensation are to be avoided, especially in disputes involving prohibited subsidies, where the more flexible benchmark of "appropriate" countermeasures applies.[253]

In sum, the last 60 years have seen a remarkable evolution of GATT/WTO dispute settlement. Contracting Parties/Members have managed to strengthen the rule-of-law while preserving the system's intergovernmental character, notably in the area of enforcement. This overview has concentrated on a number of key challenges and possible modifications to the current system.[254] The analysis of the various proposals by trade scholars suggests that additional progress could possibly be made at the technical level in facilitating the use of the DSM and in clarifying its procedures, and perhaps even in further strengthening its capacity to resolve disputes in a more timely and effective manner, without necessarily requiring drastic or fundamental changes to the current DSM rules. At the same time, such analysis does not nor is it intended to detract from the substantial success already achieved under the current system as it has operated since the inception of the WTO.

4. THE EXPANSION OF GATT/WTO MEMBERSHIP: ACCOMMODATING DEVELOPING COUNTRIES

This subsection focuses on the way in which the special concerns of developing countries have been incorporated into the multilateral trading system. The first part describes the evolution of special GATT/WTO disciplines as they apply to developing countries and explains how contemporaneous development thinking shaped decisions by the GATT Contracting Parties. The complexities of locating trade policy within the framework of development policy continue to be felt today, not least in the ongoing debates on implementation and S&D in the context of the Doha Round. The second part discusses the forms of S&D currently available in WTO Agreements as well as some of the empirical evidence on the use of trade policy measures for industrial development. Remaining challenges to accommodate developing country interests within the WTO are highlighted and strategies for enhanced S&D are presented.

(a) Developing countries in the GATT/WTO

The expansion of GATT/WTO membership over time is mainly due to the successive accessions of developing countries. Most of the industrialized nations were founding Members of the GATT or acceded in its early years. They have traditionally been seen as driving the extent and content of its disciplines. One or several developing countries joined the multilateral trading system in almost every year of its existence (Chart 10). The years around the Kennedy Round in the 1960s and towards the end of the Uruguay Round in the early 1990s saw particularly large increases in developing country membership. In light of these developments, the notion of increased "diversity" of GATT/WTO membership has principally been associated with fundamental differences in interest between developed and developing countries, despite the large heterogeneity within the latter group. This part describes the evolution of GATT/WTO disciplines as they apply to developing countries and explains the timing of demands and concessions made within the historical context.

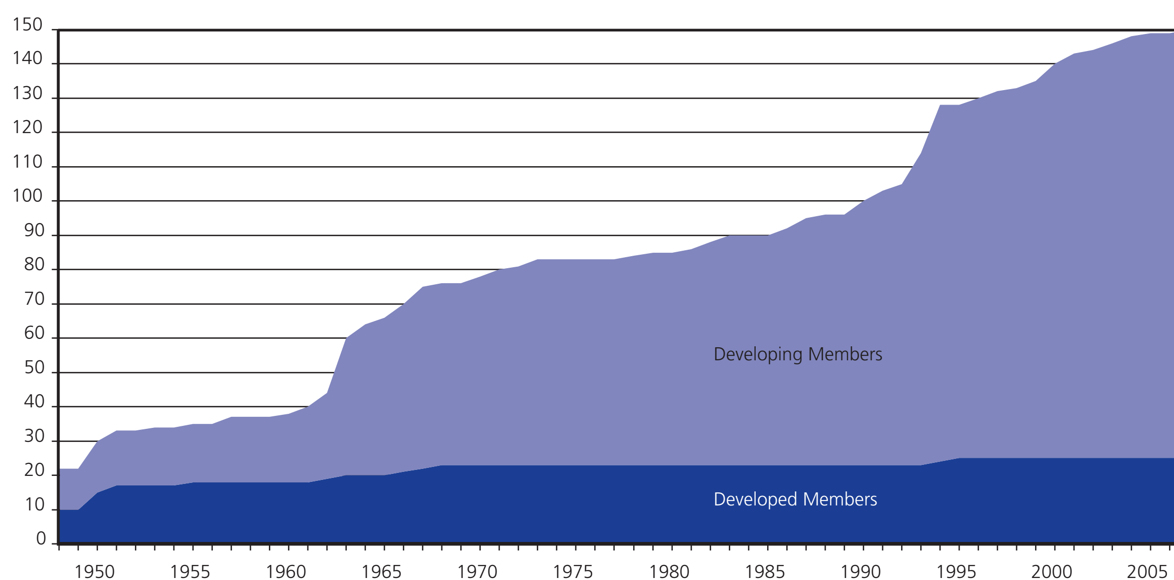
---

[252] Howse and Staiger (2006) is a recent attempt to respond on the basis of economic theory to the question of how the level of nullification or impairment should be defined and measured, using *United States-Anti-Dumping Act of 1916* case as an example. In particular, as suggested above, the authors find that arbitrators' focus on trade effects has merit from an economic perspective. They emphasize that in order to measure forgone trade flows, arbitrators must determine the extent to which the change in conditions of competition would have led to reduced export volumes at the original exporter prices.

[253] According to the special standard under Articles 4.10 and 4.11 of the SCM Agreement, countermeasures are to be "appropriate" as a response to the initial wrongful act and (according to Footnotes 9 and 10) "not disproportionate" in light of the fact that the subsidies are prohibited. This standard is different from the general standard of "equivalence" between the level of permissible retaliation and the level nullification or impairment (usually equated with the value of trade benefits foregone) under Article 22.4 of the DSU.

[254] For an overview and analysis of proposals made in the DSU negotiations see Zimmermann (2006).

Chart 10
Developing and developed country membership in the GATT/WTO, 1948-2006
(Number of members)



Notes: For the purposes of this Chart, the following 24 countries plus the European Communities in their own right as of 1995 are considered developed: Austria, Australia, Belgium, Canada, Denmark, European Communities, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Liechtenstein, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom, United States. The remaining GATT Contracting Parties/WTO Members are counted as developing/transition economies. For consistency purposes, Czechoslovakia and South Africa as original Contracting Parties are counted among the latter (although this is sometimes done differently in the literature, see e.g. Hudec, 1987). In the early days of the GATT, Greece, Spain and Portugal were considered developing, while Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovak Republic and Slovenia as well as Bulgaria and Romania are considered developed at latest since their accession to the European Union in 2004 and 2007 respectively. China, Lebanon and Syria were original Contracting Parties to the GATT but withdrew in 1950, 1949 and 1951 respectively. China acceded again in 2001. Yugoslavia, a GATT Contracting Party since 1966, did not become a WTO Member under Article XI of the Marrakesh Agreement Establishing the World Trade Agreement. The Chart shows 22 countries in 1948, as Chile, although an original Contracting Party, formally joined only in 1949.

Source: WTO (1995) and WTO website.

(i) Failure of the ITO negotiations and the early days of the GATT: limited exceptions for developing countries

Twelve of the original 23 Contracting Parties of the GATT 1947 were developing countries (see Appendix Table 10), six of which were also part of the preparatory committee to the Havana conference drawing up the draft charter of the ITO (Brazil, Chile, China, Cuba, India, Lebanon). Srinivasan (1998) recalls that India and, even more so, the Latin American countries considered the draft charter to not represent their interests. A large number of proposals were tabled calling for both a transfer of resources and deviations from the draft charter's legal obligations. These demands, notably for infant industry protection, unilateral preferences, non-reciprocity and commodity agreements, were guided by the idea that economic development could be a legitimate reason for trade-distorting policies. Hudec (1987) explains this attitude as a reflection of developing countries' colonial past, in which parent countries were seen to maximize economic benefits by controlling trade and suppressing competition from overseas suppliers. During the negotiations, developing countries were reinforced in their beliefs by the exceptions developed countries claimed for themselves, notably quantitative import restrictions on agricultural products and the right to use export subsidies.

With the demise of the ITO charter, its trade-policy rules survived in the GATT. Already early on in the drafting process of the ITO charter, the "no-exceptions" principle originally advanced by the United States was abandoned and parties adopted the basic premise that developing countries were "special" and required some dispensation from the rules. However, GATT governments could not agree on all the concessions made in the draft ITO charter regarding exceptions for "economic development". The

controversy about which exceptions to include centred on the protection of infant industries (Corden, 1974), a right that was ultimately conceded, albeit subject to prior approval by Contracting Parties.[255]

In the first seven years of operation of the GATT, developing countries appeared to cope with the few exceptions obtained. Only limited use was made of infant industry provisions. An important reason for this was the widespread existence of balance-of-payments restrictions in both developed and developing countries which obviated the need to resort to other types of restrictions. However, over time, with new geo-political realities and an increase in numbers, developing countries gradually raised their demands to obtain "more favourable" treatment and realize some of the proposals originally made at the ITO conference (Tussie, 1987). Hudec (1987) observes that, as a result, "over the next four decades the legal discipline applicable to developing countries all but disappeared" (1987: 15).

(ii) The 1955 Review Session, Haberler Report and GATT Part IV: the quest for "more favourable" treatment

The move of colonies into independence and Cold War competition for influence in the Third World played an important role in order to understand some of the decisions taken during that time period in favour of developing countries. The notion of preferential market access was omnipresent in defining the relationship between former colonizers and the newly independent territories. During the 1955 Review Session, developing countries pressed for an extensive revision of GATT Article XVIII giving them additional leeway to protect infant industries. In 1958, the Haberler Report (GATT, 1958) established a link between the insufficiency of developing country export earnings and developed country trade barriers. In the following, developing countries gradually extended their interests from securing exceptions for their own policies towards extracting broad market access concessions from developed countries (Hudec, 1987).

Developing countries' reliance on primary commodity exports and the problem of deteriorating terms of trade gained new prominence with the formulation of the Prebisch-Singer thesis,[256] which gained a high degree of popularity in the 1960s and 1970s, and the creation of the United Nations Conference on Trade and Development (UNCTAD). Both developments reinforced the intellectual foundations for an industrialization based on import substitution and the concomitant focus on domestic and regional markets in developing countries. In 1967, efforts to obtain a temporary waiver from MFN obligations and promote trade among developing countries led to the signing of the Tripartite Agreement between Egypt, India and Yugoslavia.[257] In 1973, the GATT Protocol relating to Trade Negotiations among Developing Countries, which had been negotiated under GATT auspices, entered into force (Hamza, 1981).[258] Perceived "competition" with UNCTAD (developing Contracting Parties had threatened to abandon the GATT for UNCTAD) and the creation of the Group of 77 bloc of developing countries as a counterweight to industrialized nations contributed to the formal recognition of developing country concerns in the GATT, as manifested by the inclusion of Part IV on trade and development in 1964, which, among other

[255] ITO Article 13 on "Governmental Assistance to Economic Development and Reconstruction" appears to have inspired to a large extent GATT Article XVIII. Despite the insistence by developing countries on their other principal demands, the ITO charter's chapter VI (Articles 55-70) on "Intergovernmental Commodity Agreements" ultimately did not become part of the GATT (apart from a reference in Article XX(h)) nor did ITO Article 15 on "Preferential Agreements for Economic Development and Reconstruction".

[256] The thesis concerning the declining trends of the terms-of-trade for developing countries was formulated concurrently by Singer (1950) and Prebisch (1950). The original thesis combined two complementary hypotheses. One referred to the negative effect of the income-inelasticity of demand for commodities on developing countries' terms-of-trade. The other hypothesis pointed to the asymmetries in the functioning of labour markets in the "centre" vs. the "periphery" of the world economy. In the first case, the pressure towards a deterioration in real commodity prices is generated in goods markets, in the second this pressure comes from factor markets and thus affects developing countries' terms-of-trade indirectly through the effects on production costs. Whereas the first hypothesis applies solely to commodities (more generally, to goods with a low income-elasticity), the second applies to all goods and services produced in developing countries. For more see Ocampo and Parra (2003).

[257] The first preferential scheme between developing countries raising the issue of MFN inconsistency was the Latin American Free Trade Area (LAFTA) set up in 1960. However, its goal arguably was the attainment of a free-trade area covered under GATT Article XXIV (Tussie, 1987).

[258] These countries were Brazil, Chile, Egypt, India, Israel, Korea, Mexico, Pakistan, Peru, the Philippines, Tunisia, Turkey, Uruguay and Yugoslavia, as well as Greece and Spain that were still considered developing countries at that time.

things, codified the principle of non-reciprocity (Abdel Kader, 1986). The quest for improved market access culminated with UNCTAD II in 1968 and the adoption of a "generalized system of preferences" (GSP). The United States that for long had resented the provision of special preferences by the European Community (EC) to certain Mediterranean and African countries finally abandoned its opposition in exchange for the abolition of "reverse preferences" enjoyed by the EC in these countries (Hudec, 1987). In 1971, two 10-years waivers were obtained covering both GSP schemes and preferential agreements between developing countries.

(iii) The Tokyo Round negotiations and the Enabling Clause: the heyday of disengagement

During the 1970s, problems related to import substitution policies became evident in several parts of the developing world owing to the restrictions on competition as well as the policy bias against exports it had introduced (Nishimizu and Robinson, 1984; Bell et al., 1984). During the Tokyo Round negotiations, developing countries agreed to make limited market access commitments, although bindings were few and at relatively high ceilings. At the same time, most of them refused to participate in and sign up to the new "Codes" dealing with a variety of non-tariff measures. In order to overcome "export pessimism" owing to the uncertainty and insufficiency of market outlets for developing country products (Cline, 1982; Finger and Laird, 1987), developing countries pressed for a permanent waiver covering GSP as well as the newly created Global System of Trade Preferences among Developing Countries (GSTP). These exemptions were institutionalized in the context of the 1979 Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries, also known as the Enabling Clause.[259]

The flip-side of developing countries' increased flexibility was a lack of engagement in the rule-making process and in the exchange of reciprocal concessions (Golt, 1978; Baldwin, 2006). Amongst trade policy-makers the perception was gaining ground that the proposition of a unified group of developing countries was hardly tenable any longer, if it ever had been (Koekkoek, 1989). While the Enabling Clause agreed at the end of the Tokyo Round codified a number of exemptions, it also introduced the notion of "graduation". The exhortation contained in the Enabling Clause that developing countries were expected to make further concessions as and when their development and trade situation improved (known as "graduation") as well as the recognition of the least-developed group of countries were a clear hint at the problem of heterogeneity within that group.

(iv) The Uruguay Round and the single undertaking

The 1980s saw a radical break of the trend towards increasing disengagement by developing countries under the GATT. It culminated in first half of the 1990s with the conclusion of the Uruguay Round which dramatically widened the scope of developing countries' obligations. Several developments contributed to this reversal. First, a number of developing countries had succeeded in diversifying their economies and developed an active interest in further liberalization, notably in the heavily distorted sectors of agriculture and textiles and clothing (Page et al., 1991). Second, GSP donors extended their set of conditions defining eligibility of developing countries and began to "graduate" countries out of preferential tariffs applying to individual products for which they had become successful exporters. Moreover, prominent studies, such as Baldwin and Murray (1977), confirmed that developing countries stood more to gain from MFN tariff cuts than they would lose from preference erosion. Third, GATT Contracting Parties realized the need to discipline the increased use of "voluntary" export restraints and trade contingency measures which were increasingly used against developing exporters, particularly from Asia (Hindley, 1987). Fourth, there was a fear of unilateral retaliation absent further progress on multilateral disciplines, notably in the new areas of negotiations. According to Low (1993), the United States explicitly named India and Brazil (along with Japan) for possible action under its Omnibus Trading Act of 1988. Fifth, regional agreements appeared as an alternative to achieve more ambitious liberalization if the multilateral trading

[259] L/4903.

system was not to budge itself. Developing nations, especially smaller countries that feared exclusion from emerging regional trading blocs, appeared to be willing to accept new disciplines if this led to a strengthening of the multilateral system, where they enjoyed greater bargaining power than what they expected to have under a variety of "hub-and-spokes" regional set-ups (Whalley, 1995). Finally, research by the World Bank and International Monetary Fund (IMF), such as Krueger (1978), noted the sharp rise in private financing which removed one of the constraints – the lack of foreign exchange – that had inspired import substitution. These and other studies (e.g. Krugman, 1987) further shifted the economic thinking towards emphasizing the role of markets and argued against the distortions introduced by excessive government interventions, including export promotion measures formerly employed by East Asian countries. The "*laissez-faire*" approach gained further influence following the debt crises in various parts of the developing world in the 1980s, and even led to unilateral trade liberalization efforts, for instance in the case of Mexico.

For any combination of these reasons, a number of developing countries saw further multilateral trade liberalization and the strengthening of trade rules to be in their interest. A group of 20 developing countries (G-20) from Latin America, Africa and Asia led by Colombia at one point broke with the traditional position of the Informal Group of developing countries to block the inclusion of services in further multilateral trade negotiations, which had turned out to be a major obstacle in launching a new round. In cooperation with a group of nine smaller industrialized countries under the leadership of Switzerland, the G-20 established the "Café au Lait" Group that was instrumental in the launch of the Uruguay Round by providing a draft text that formed the basis of the Punta del Este Declaration in 1986. Various developing countries played an active role in the negotiations, not only participating in the exchange of concessions, but also advancing an offensive agenda on their own (Tussie and Lengyel, 2002). The Uruguay Round certainly marked a turning point for traditional developing country unity. Having diversified across products and markets, several developing countries were confronted with a multiplicity of domestic interests and issue areas of importance to them that made it harder for negotiators to develop a unified, well-defined position. In addition, South-South harmony suffered from an increased use of trade contingency measures amongst developing countries.

The single undertaking of the Uruguay Round meant that all WTO Members accepted all Agreements, including the ones evolving from the previous Codes of the Tokyo Round. Many developing countries significantly increased their market access commitments, especially in agriculture. In addition, they were called to observe the new Agreements on services and trade-related intellectual property. The Uruguay Round spawned a large set of studies examining its implications for developing countries, many of which criticized the unevenness of the bargain struck from the perspective of poorer nations (e.g. Finger and Schuler, 2000). Others have identified significant opportunities for the expansion of developing country trade, although some estimates turned out to be overoptimistic, for instance owing to non-consideration of the reduction in preference margins (e.g. Blackhurst et al., 1995).

(v) Implementation of WTO Agreements

The expansion and strengthening of the rules of the multilateral trading system agreed in the Uruguay Round is a reflection of both developed and developing country trade interests (and of the diversity of interests within each "group"). Sectors of particular interest to developing country exporters and characterized by pervasive distortions, such as agriculture and textiles and clothing, have been brought under multilateral disciplines. A large number of countries supported the tightening of disciplines on, for instance, contingent trade remedies. Developing Members, including small and poor countries, have benefited from the strengthening of the dispute settlement mechanism and from improved transparency, also via the trade policy review mechanism. Even in the newly included areas of services and trade-related intellectual property rights, a variety of developing countries have been active supporters, for instance in regard to the liberalization of certain services sectors and modes of supply or the protection of geographical indications.

However, in a number of developing countries, the implementation of certain obligations not only stretched their financial and human resources, but was also perceived as being inconsistent with national economic interests and development priorities. Longer transitory time periods which allowed for delayed implementation but not for differences as to the nature of obligations themselves, turned out in many instances to be ineffective as the principal tool to help developing countries adjust to the steep increase in obligations. During the preparatory process of the Third WTO Ministerial Conference in Seattle from September 1998 to November 1999, a number of developing countries put forward a wide range of proposals dealing with their perceived problems in the implementation of WTO Agreements. The over 100 proposals tabled were targeted not only at additional phase-in periods, but also at increased flexibility to deviate from substantive obligations on a more or less permanent and self-determined basis. At Doha, as part of the implementation decision and endorsed by the Ministerial Declaration, another exercise was launched, focusing specifically on making S&D provisions "more precise, effective and operational".

In the years following the conclusion of the Uruguay Round, the WTO stepped up its technical assistance and capacity-building efforts. In 1996, the Committee on Trade and Development adopted Guidelines for WTO Technical Cooperation (WT/COMTD/8) establishing objectives, principles and operational directives for technical cooperation activities administered by the Secretariat. In the run-up to the Doha Ministerial Meeting in late 2001 the Secretariat formulated a "New Strategy for WTO Technical Cooperation for Capacity Building, Growth and Integration" (WT/COMTD/W/90) consisting of ten core elements, including "mainstreaming" trade priority areas into national development strategies, increased coordination with other agencies and adequate funding. These elements have subsequently been reflected in a variety of initiatives, not least in the revamping of the Integrated Framework (IF) for LDCs, through which the IMF, ITC, UNCTAD, UNDP, the World Bank and WTO combine their efforts with those of recipients and donors to respond to the trade development needs of LDCs.

In light of the emphasis that technical cooperation and capacity building has received in the Doha Ministerial Declaration (WT/MIN(01)/DEC/1), the WTO has expanded its technical assistance efforts further. Besides its own activities,[260] which to an important extent are financed from the Doha Development Agenda Global Trust Fund (featuring an annual budget of 24 million Swiss francs), the WTO increasingly acts as a coordinator of trade-related assistance, for instance in the context of the Task Force on Aid for Trade.[261] In this respect, the WTO has a catalytic role to play – ensuring that relevant agencies and organizations understand the trade needs of WTO Members and encouraging them to work together more coherently and effectively to address these needs. The Aid for Trade initiative seeks to respond to two related concerns: one is to help WTO Members in need to implement the results of the current multilateral trade negotiations and to cope with certain economic adjustment costs that may be incurred. The second concern is the insufficiency of trade-related capacity in many WTO Members which inhibits them from taking advantage of the opportunities offered by the multilateral trading system. The latter set of concerns covers a wide range of areas, from testing facilities to transport infrastructure and trade logistics. An important element of Aid for Trade is the proposal by the WTO Director-General to establish a monitoring and evaluation function in the WTO in order to build confidence that increased Aid for Trade would be delivered and used effectively.[262] Despite their increased importance, it is clear that Aid for Trade and other technical assistance and capacity-building initiatives can only be a complement

260 For a fuller overview of WTO technical cooperation and capacity-building see http://www.wto.org/english/tratop_e/devel_e/teccop_e/tct_e.htm. The 2007 Technical Assistance and Training Plan is contained in document WT/COMTD/W/151 and Corr.1.

261 For its recommendations see WT/AFT/1. The Task Force was created pursuant to the Hong Kong Ministerial Declaration (WT/MIN(05)/DEC) and is composed of a limited range of WTO Members, both developed and developing. Relevant international organizations were invited to act in an advisory role to the Task Force on a regular basis.

262 In order to assist the development and trade policy communities to achieve higher degrees of co-ordination and coherence, avoid duplication, share information, and monitor the implementation of commitments registered in the Doha Ministerial Declaration Doha Development Agenda, the WTO and OECD Secretariats launched a Trade Capacity Building Database (TCBDB) in November 2002 . The two Secretariats also regularly produce reports to increase awareness of the multiplicity of programmes and help donors to identify where additional efforts could be applied (see http://tcbdb.wto.org). The Aid for Trade monitoring and evaluation will draw on these data for a global review of Aid for trade flows, but will also rely on donor self-assessments and recipient case studies. The various levels of monitoring will form the substance of an Annual Aid for Trade Report and Debate amongst all WTO Members.

to, and not a substitute for, ambitious liberalization outcomes and WTO rules that are responsive to development needs.

(b) S&D for developing countries in the WTO

In subsection C:2.(c).(ii) on the rationale for S&D, a range of trade-related measures were mentioned that could be employed to address specific problems in developing countries. As discussed in the previous subsection, over time the use of such policies has been accommodated to a certain extent under the multilateral trading system, usually subject to certain conditions. This subsection examines the types of S&D currently available under the WTO as well as the empirical evidence on the usefulness of the authorized trade policies for development purposes. It also portrays the claims for enhanced special and differential treatment before providing a short overview of alternative approaches on how best to accommodate special developing country interests within a multilateral system of rules.

(i) Main types of S&D in the WTO

The methodology established in subsection C.2.(iii) portrayed S&D as one of two major exceptions to the MFN principle. This is certainly true for some forms of S&D, but this statement must be further qualified. In the existing WTO agreements,[263] S&D provisions may or may not imply a violation of the MFN principle. Certain S&D provisions authorize other Members to provide more favourable treatment to developing countries, while others allow for special flexibilities that developing countries may dispose of, but that normally are to be implemented on an MFN basis.

In the first category, besides GSP schemes, there are two other forms of more favourable treatment to developing countries. These mostly come in the form of mere "exhortations". First, developed-country Members are expected to provide technical assistance under individual agreements. For instance, the TBT and SPS Agreements encourage Members to assist traditional developing country exporters who may face difficulties in complying with new measures. The best endeavour character of these provisions has been a source of long-standing controversy. While improvements on agreement-specific technical assistance continue to be made, for example with the creation of the Standards and Trade Development Facility (STDF) in the SPS area targeted at enhancing the capacity of developing countries to fulfil SPS standards, Members are unlikely to agree to legally enforceable obligations to provide technical assistance with unknown budgetary implications. Second, where possible, developed countries are encouraged to impose more lenient requirements when applying certain measures to developing-country Members, e.g. provide longer time frames to comment when a new TBT measure is enacted. Often, this type of S&D clause stipulates that developing country interests "shall be taken into account". Attempts to create mandatory exemptions have met with great resistance whenever S&D risks undermining a domestic policy objective, for example in the case of an urgent product safety standard that could not be applied with immediate effect to developing country suppliers. Nonetheless, continuing efforts are made that Members take account of developing country concerns with new regulations, for instance in the SPS area via improved notification systems allowing for consultations and information-sharing on special measures for developing country exporters.[264]

Conversely, special flexibilities available to developing countries normally do not carry MFN implications. Developing countries may be exempted from certain rules, but usually may not implement the otherwise prohibited measures in a way that discriminates among trading partners.[265] Such exemptions from market

[263] As discussed above, S&D also forms part of the current negotiations, notably in the context of non-reciprocity of concessions.

[264] See Decision by the Committee on Sanitary and Phytosanitary Measures of 27 October 2004 on a Procedure to Enhance Transparency of Special and Differential Treatment in Favour of Developing Country Members, WTO document G/SPS/33.

[265] For example, trade restrictions by developing countries for balance-of-payments purposes under GATT 1994 Article XVIII are implemented on an MFN basis. Article XVIII para.10 in Section B provides further conditions on how such restrictions are to be applied, e.g. in order to avoid unnecessary damage to the interests of individual Members.

access commitments, subsidy disciplines or other obligations usually come in the form of enforceable rights, albeit often subject to conditions or weakened by discretionary decision making.

In order to evaluate the track record of S&D to date, the empirical evidence on their use and development impact is examined. The focus is thereby on S&D in existing agreements (as opposed to e.g. differential tariff cuts or special safeguard mechanisms still to be determined in the context of the negotiations) and on "hard" rights (as opposed to "best endeavour" type promises). The most prominent S&D rights over time that have been incorporated in the GATT/WTO system relate to preferential market access, infant industry protection, export promotion as well as temporary exemptions from the rules to take account of adjustment difficulties and implementation costs. While the former two demands have formed the core of developing country demands since the beginnings of the GATT, the latter have evolved as development thinking shifted and as obligations increased, notably after the Uruguay Round, both in number and complexity.[266] For each main type of S&D[267] the experience to date is contrasted with continuing demands for more flexibility and possible alternative solutions.

Non-reciprocal preferences

As mentioned in subsection 4.(a), with decolonization, preferential access for developing countries has become a prominent issue in trade policy-making. In the 1970s, when import substitution policies increasingly came into disrepute, non-reciprocal preferences received a further boost as a tool for improving the export performance of developing countries. For both political and economic reasons, the provision of unilateral preferences to developing countries has been accommodated as a permanent exception to the MFN principle under the Enabling Clause. Preferences are to be "generalized, non-reciprocal and non-discriminatory" and "respond positively to the development, financial and trade needs of developing countries" (Enabling Clause: para.2(a) footnote 3 and para. 3(c)), thus covering GSP schemes as well as preferential agreements among developing countries, such as the Generalized System of Trade Preferences (GSTP).[268]

Empirical studies on the contribution of preferences towards export diversification and growth give a mixed picture at best. Major concerns relate to the coverage and depth of preferences schemes as well as to their structural and political economy implications. On the former issue, preferences have proven of little value when items attracting high tariff rates are excluded or when preference margins are small. Even where highly protected items are covered and margins are substantial, the size of the benefits ultimately depends on other conditions that need to be fulfilled to qualify for preferential treatment,

---

266 Another long-standing developing country issue has been the stabilization of export earnings via commodity agreements. However, with the creation of international commodity agreements based on buffer stocks following UNCTAD's Integrated Programme on Commodities (IPC) and of financing schemes, such as the International Monetary Fund's Compensatory Financing Facility (CFF), this discussion has largely taken place outside the GATT/WTO. Hermann et al. (1989) show empirically that most of these schemes have not been very successful in stabilizing developing country export earnings.

267 Essentially, the categorization chosen here comprises three principal S&D types with and three without MFN implications. The former are non-reciprocal preferences, technical assistance by Members to individual developing country Members and more lenient requirements, while the latter are flexibility to restrict imports, flexibility to promote exports and longer transition periods to implement resource-intensive agreements. The two types that usually come in a best endeavour fashion, i.e. technical assistance and more lenient requirements, are not further discussed. Kleen and Page (2005) choose a similar focus, but other classifications have been proposed in the literature (e.g. Cottier, 2006) or used in WTO discussions, depending on the context. In the Committee on Trade and Development, a six-fold typology has been proposed by the WTO Secretariat: (i) provisions aimed at increasing the trade opportunities of developing country Members; (ii) provisions under which WTO Members should safeguard the interests of developing country Members; (iii) flexibility of commitments, of action, and use of policy instruments; (iv) transitional time periods; (v) technical assistance; and (vi) provisions relating to least-developed country Members (WT/COMTD/W/77/Rev.1).

268 In 2005, 12 developed country Members made available GSP programmes. The EC is counted as one, while Bulgaria and Estonia's programmes feature separately. See UNCTAD (2005). For an in-depth discussion of certain programmes see UNCTAD (1999) and WTO (2001b). Under the Agreement on the Global System of Trade Preferences Among Developing Countries, i.e. the GSTP scheme, the concessions (contained in Annex IV of the Agreement) of 42 countries, not all of which are WTO Members, are listed on UNCTAD's website. See http://www.unctadxi.org/templates/Page____6206.aspx, visited on 25 April 2007.

notably rules of origin (Brenton, 2003; Brenton and Manchin, 2003).[269] Regarding the second concern, preferences entail inefficiencies in the allocation of resources that may make it harder to restructure the economy in the future according to a country's comparative advantage (Hoekman and Özden, 2005).[270] Moreover, Lederman and Özden (2005) find that eligibility under unilateral schemes is often tied to conditions related to other than development motives which may be costly to implement for prospective beneficiaries and lead to additional distortions. Preferences also generate interests opposed to non-discriminatory liberalization in the future (Limão, 2005; Özden and Reinhardt, 2003). Kleen and Page (2005) find that the overall impact of preferences was rather to generate rents and transfers to selected groups than to foster broad-based industrial development.[271]

Current discussions on preferences in the WTO principally pit beneficiaries against excluded developing countries. This conflict has been accentuated by the recent Appellate Body decision that GSP providers can offer higher preference margins to a specific group of developing countries that fulfil certain conditions.[272] Beneficiaries remain concerned with the erosion of preference margins following further multilateral and regional liberalization. Proposals have been made to bind existing preferences (Oyejide, 1997), i.e. to limit MFN liberalization in key sectors, such as textiles, sugar and bananas, or to set market access targets for preference beneficiaries (TN/CTD/W/3/Rev.2). Alexandraki and Lankes (2004) and IMF (2003) show that potential preference erosion is not significant for most countries, but is important for a limited number of small countries and sectors.[273] Yeats (1994), Limão and Olarreaga (2005) and Amiti and Romalis (2006) caution against slowing down MFN liberalization showing that non-discriminatory liberalization by the provider can more than offset preference erosion and lead to export increases from beneficiaries. Low et al. (2005) cast doubts as to trade solutions for preference erosion, noting the limited potential for increased utilization, alternative products and providers. As an alternative, some authors have endorsed the provision of development assistance to fund adjustment costs (Hoekman and Özden, 2005).[274]

Flexibility to restrict imports and promote exports

Despite lesser tariff reductions and fewer bindings/commitments, developing countries dispose of additional flexibilities to restrict imports, notably the right to protect infant industries (GATT Article XVIII: A and C). As discussed above, these provisions were inherited from the days of import substitution in

[269] See, for instance, Inama (2003) who attributes a utilization rate of less than 40 per cent for beneficiaries under the GSP schemes of the EC, US, Canada and Japan largely to the stringency and/or complexity of rules of origin. However, he fails to fully take account of alternative schemes. For individual markets, exporters may be able to choose between different preference schemes, and taken together, utilization rates may be higher. In the EC, for example, African LDCs may export either under the EBA initiative or the Cotonou agreement. The latter is better utilized since rules of origin are less demanding (Candau and Jean, 2005). Of course, preferences in sectors of export interest to developing countries and featuring high preference margins, such as agricultural and textile products in the EC and US, are highly utilized (Bureau and Gallezot, 2004; Candau et al., 2004).

[270] Part of the development impact of preferences depends on whether they stimulate the creation of an industry that can survive when preferences are lowered or removed (essentially an infant industry argument). Obviously, the challenge to adapt to new circumstances also depends on the time frame within which adjustments need to take place (Kleen and Page, 2005).

[271] Even if preferences do not foster sectors that, in the medium-term, become competitive, the rents they generate can still be an important source of income in poor countries, and their development impact depends on how that income is used. Mauritius, for instance, has successfully used preferential rents to diversify its economy. Nevertheless, with the reductions in the high fixed prices on sugar exports to the EU, Mauritius has had to cope with considerable adjustment difficulties faced by inefficient sugar producers who have lost their markets (Kleen and Page, 2005; Subramanian and Roy, 2001).

[272] In *European Communitie –Tariff Preferences*, the Appellate Body ruled that GSP providers could differentiate between beneficiaries who are not "similarly-situated" (para. 153). It found that development needs were not necessarily shared by all developing countries and that, therefore, beneficiaries could be treated differently (para. 162). Two conditions were attached: first, the existence of such a need had to be widely recognized, for instance, by another international organization; second, a sufficient nexus should exist between the preferential treatment and the likelihood of alleviating the relevant need (paras. 163-164).

[273] For a more complete overview of studies on the extent of preference erosion, see Hoekman et al. (2006).

[274] See, for instance, the IMF's Trade Integration Mechanism (TIM) which provides financial support for balance-of-payments difficulties arising from trade-related adjustments, for instance, due to the erosion of tariff preferences. See http://www.imf.org/external/x10/changecss/changestyle.aspx, website visited on 24 April 2007.

1950s and early 1960s. They have rarely been invoked. One reason obviously is that developing countries with unbound tariffs or high ceiling bindings can increase applied rates without recourse to S&D. Another reason is that Article XVIII:B on trade restrictions for balance-of-payments purposes is considered easier to apply and does not call for compensation. Article XVIII:B has been used by 16 developing countries to date.[275] At the end of the Uruguay Round, developing and least-developed countries (LDCs) were also given longer transition periods (five and seven years respectively) during which notified trade-related investment measures, such as local content or export-import balancing requirements, could be maintained (Agreement on Trade-Related Investment Measures (TRIMs) Article 5). Twenty-six countries, including Uganda as the only LDC, requested extensions.[276]

Inspired by the successes of export promotion in East Asia, developing countries also requested special rights to subsidize exports. These rights are frequently claimed in order to cover certain features of export-processing zones (EPZs). SCM Article 27 provides for an eight-year transition period for developing countries to phase out export subsidies and an open-ended exemption for LDCs and some poorer countries listed in SCM Annex VII, subject to certain conditions. Individual extensions are possible under SCM Article 27.4 and, in addition, a fast-track procedure was created for countries fulfilling a number of criteria (G/SCM/39). So far, the various extension procedures have been used by two dozen developing countries.[277]

Based on empirical evidence, infant industry protection for import substitution purposes was soon discarded as a development tool. It had introduced large distortions in the countries pursuing such policies by penalizing traditional sectors such as agriculture, discouraging exports and exacerbating tendencies to trade raw materials in exchange for capital goods.[278] On trade-related investment measures, Moran (1998) finds from an extensive review of empirical case studies that "[t]he imposition of domestic-content requirements in protected local markets leads to less efficient production and provides less valuable backward linkages than does allowing foreign firms to set up operations oriented toward global or regional markets" (Moran, 1998: 161).[279] Besides the impact on production structure, the overall chilling effect of trade-related investment measures on foreign direct investment (FDI) has also been found to retard technological progress (Kokko and Blomstrom, 1995; Smarzynska Javorcik, 2004).[280]

The evidence is less clear-cut for export promotion policies. The rise of the Republic of Korea and other "Asian tigers" as major traders are often quoted as examples of the importance of government involvement in establishing successful export industries (Noland and Pack, 2003). For certain followers, such as Mauritius, EPZs played an important role in the diversification of production into non-traditional sectors (Subramanian and Roy, 2001). However, other countries pursued similar strategies without

275 The Tokyo Round Declaration on Trade Measures Taken for Balance-of-Payment Purposes (BISD 26S, 1979: 205-209) requires countries in balance-of-payment difficulties to give priority to price-based measures over quantitative restrictions and to announce time-schedules for removing the measures. For an overview of the countries and time periods during which BOP measures were kept in place, see subsection 2.(c).

276 At the Hong Kong Ministerial Conference in 2005, it was decided that LDCs could notify and maintain for another seven years existing trade-related investment measures and introduce new measures subject to Members' approval and periodic review. All such measures are to be phased out by 2020 at the latest (WT/MIN(05)/DEC: F-2). However, no such notification had been received at the writing of this Report.

277 See the G/SCM/-series of WTO documents starting with G/SCM/50.

278 For two large collections of case studies see Balassa and associates (1971) and Little et al. (1970).

279 Local content schemes require firms to purchase higher cost, domestically-produced components instead of imported substitutes, thus involving higher production costs, which makes investment in the respective downstream sector less attractive. Of course, other factors in the host country, notably the level of tariff protection and fiscal or financial incentives, may outweigh the negative effect on investment of local content requirements, albeit at the cost of further distortions.

280 For a comprehensive overview of the channels through which trade-related investment measures and other performance requirements affect trade, investment and growth as well as of the empirical evidence, see WTO and UNCTAD (2002).

success.[281] Noland and Pack (2003) emphasize that horizontal factors, such as good macroeconomic policies and a highly-educated labour force, played a more important role in the East Asian experience than sector-specific interventions. In fact, the authors conclude that export incentives merely served to offset the remaining protection and that similar results could have been obtained in a less wasteful manner. Experience shows that policies of selective intervention pose important challenges of rent-seeking and long-term inefficiency (Hoekman et al., 2004). The Asian tigers were able to contain these problems owing to their stable political situation, competent bureaucracies and strict enforcement of export targets, i.e. by letting non-performing companies go out of business. By contrast, in other cases, support polices were captured by interest groups leading to corruption and continued existence of inefficient industries (Lall, 2002). Other problems relate to the fiscal implications of industrial policies and the information difficulties involved in identifying "winners" (Panagariya, 2000a).

Current S&D discussions, despite the little encouraging evidence of selective government interventions, have stressed the need for "policy space" of developing countries to protect import-competing industries and subsidize exporters.[282] It has been suggested that developing countries should be able to reject any conditions attached to infant industry protection as too cumbersome (TN/CTD/W/3/Rev.2) and not have to offer compensation (TN/CTD/W/4/Add.1). In the same vein, a number of developing countries proposed that they be free to use trade-related investment measures (TN/CTD/W/4; TN/CTD/W/3/Rev.2) and export subsidies (TN/CTD/W/3/Rev.2) as they see fit their development objectives. The underlying presumption that fewer international obligations are somehow better for development may be seen as a counter-reaction to the "Washington Consensus" advocated by the World Bank and International Monetary Fund (IMF) in the 1980s. Rodrik (1993) provides empirical support noting that the recommended strategy to minimize government intervention in the pursuit of outward-oriented development strategies met with mixed success at best.

Academic commentators in recent times have taken a more nuanced approach that foresees a role for government involvement while taking account of the experiences made to date. On the one hand, the budgetary, informational, administrative as well as political economy concerns limiting the success of active industrial policies have been acknowledged (Rodrik, 2004) as has been the importance of functioning markets and institutions.[283] On the other hand, while trade openness led to productivity improvements in previously protected markets, *laissez-faire* policies did not result in the expected improvements in economic performance either. Hausman and Rodrik (2003) hold that in order to foster structural change and growth, governments need to play a role in encouraging entrepreneurship and investment in new activities, while pushing out firms and sectors that turned out unproductive.[284] While non-trade instruments, such as time-limited public sector credits or guarantees until private financial markets are ready to step in (or declare default), in most cases may be preferable from an efficiency point of view, Melitz (2005) points out that in order to capture learning externalities, trade restrictions, albeit to be treated with great caution, under certain circumstances may be less distorting than previously thought. Panagariya (2000a) notes that the selection of first-, second or n-best policies is also a matter

---

[281] Panagariya (2000a) notes that the costs of export subsidies provided by a number of Asian and Latin American countries largely exceeded the benefits in terms of export promotion and diversification. Similarly, most case studies contained in Helleiner (2002) on a range of African countries do not find a significant impact of EPZs on exports of non-traditional commodities.

[282] Hoekman (2005) notes the widespread use and ill-defined content of the term "policy space" in current debates and proposes a more precisely defined operationalization of this concept that is further discussed below.

[283] These are important factors determining the investment climate in a country. FDI has been found to play an important role in the diversification and modernization of the industrial base in developing countries. See, in particular, Hoekman et al. (2004) for an overview of the literature on FDI and technology transfer. While the authors point to numerous case studies, where substantial technological diffusion has occurred due to FDI, they also stress that technology transfer/spillovers via FDI are not automatic and may be fostered by appropriate policies.

[284] The authors stress the need to learn what one is good at producing. They find that such discoveries are of great social value, as they determine the future pattern of specialization of the economy. Since other entrepreneurs quickly emulate what pioneers have found out, the initial entrepreneur can only internalize part of the social value generated. The authors conclude that *laissez-faire* policies lead to an under-provision of innovation. Rodriguez-Clare (2005) further elaborates that if new industries are to flourish, governments may also need to coordinate investment decisions in upstream and downstream industries that depend on each other.

of feasibility within the available time horizon. S&D discussions in this area may need to take a more detailed look at the policy instruments currently available in the WTO, including the conditions attached to their use, as well as at possible alternatives and may need to move way from a one-size-fits-all approach to better take into account the specific situation in individual countries.

Longer transition periods to implement resource-intensive obligations

The considerable increase in obligations by developing countries under the Uruguay Round soon led to complaints about the excessive costs of compliance. While under some Agreements, such as TRIMs, longer time periods were allowed to facilitate adjustment to changes in sectoral patterns and take account of political economy costs related to the phasing-out of trade distorting measures, other agreements, such as TRIPS and Customs Valuation (CV), entitled developing countries to delay implementation in order to create the required administrative environment. Presumably, it was felt that the balance between the immediate costs and the long-term benefits of an agreement would be more favourable if developing countries were required to only implement a limited number of reforms at a time and defer some of the costs to a later stage (Kleen and Page, 2005).

Under the Customs Valuation Agreement, 56 developing country Members requested the initial five years transition period under CV Article 20.1, with 32 of them applying for extensions, which essentially allowed for the continued use of minimum values. Only a limited number of developing country Members appear to have used the transition period in the sense that legislation in accordance with the Agreement was notified after its expiry. In many cases, no notifications have been received even though no further extensions were requested or no request for the initial delay was made in the first place. While use of the transaction value as the preferred methodology for customs purposes is beneficial in terms of increased transparency and objectivity, it may require reform of the customs process as a whole implying investment in institutions, equipment and training (Shin, 1999). Access to electronic information to make price comparisons is particularly important in order to avoid fraud relating to the under- (loss of tariff revenues) or over-valuation (circumvention of capital controls) of goods. The resolution of broader institutional problems, such as corruption, heavy bureaucratic procedures and weak internal auditing systems, may also be seen as a prerequisite to the use of more sophisticated valuation systems. By the same token, where customs valuation was associated with a more wide-ranging reform process, improvements in transparency, clearance times and revenue performance mostly exceeded expectations (Duran and Sokol, 2005).

Developing-country experiences with the TRIPS Agreement have revealed even more wide-ranging implementation concerns. Pursuant to TRIPS Article 65.2, apart from MFN and national treatment (TRIPS Articles 3, 4 and 5), developing countries were not required to adapt their legislation to the requirements of the Agreement for five years (eleven years for LDCs, according to TRIPS Article 66.1, with possibility of extension). Moreover, TRIPS Article 65.4 provides for a total of ten years during which product patent protection need not be extended in areas of technology where such protection did not exist before. In 2001, it was decided that LDCs could delay, with respect to pharmaceutical products, the implementation of the patent provisions and provisions in respect of the protection of undisclosed information until 1 January 2016 (WT/MIN(01)DEC/2). The general transition period for LDCs under the TRIPS Agreement was extended in 2005 until 1 July 2013 (IP/C/40). Many developing countries already had intellectual property (IP) systems in place before TRIPS, but used the transition to modernize the existing infrastructure.[285] India, for instance, further developed the Indian Patent Act (originally enacted in 1970) with a view to making it fully compatible with TRIPS through amendments in 2000, 2003 and 2005, emphasizing IP as an important tool for its commercial development in its Science and Technology Policy 2003 (Saha, 2005). A variety of developing country case studies noted that the modernization costs as well annual operational costs of IP institutions would be substantial (UNCTAD, 1996; World Bank, 2002). However, estimates varied widely, and it was often not possible to identify the

285 Developing countries also used the opportunity to obtain enhanced assistance, both bilaterally and from multilateral agencies, notably the World Intellectual Property Organization (WIPO), for the upgrading and modernization of their IP systems.

incremental costs of TRIPS obligations. In addition, in a number of developing countries revenues from registration fees, mainly of trademarks, exceeded recurring expenses (CIPR, 2002). But TRIPS was shown to have resource implications beyond operating budgets. Rightholders are disproportionately located in a few industrialized countries. In the short run, this has been estimated to result in net financial outflows from developing (and other developed) countries to technology exporters notably in the United States, Germany and Japan (World Bank, 2002; Maskus, 2000). However, some developing countries are catching up. In preparation of WTO accession China has modernized its IP authorities and, between 2001 and 2005, has registered an almost threefold increase in the number of annual patent applications for inventions received by the State Intellectual Property Office (SIPO) (2001: 63,204; 2005: 173,327). Over that time period, and in each individual year since 2003, the majority of patent applications for inventions has been submitted by domestic applicants.[286] Also on the positive side, improved IP rights have been found to increase the flow of FDI (not only in IP-sensitive sectors) and transfer of technology, including to LDCs (OECD, 2003; Smarzynska Javorcik, 2002; Lee and Mansfield, 1996). While technology transfer via imitation is constrained, FDI effects have been strongest in countries with a large capacity to reverse engineer (OECD, 2003). In addition, technology transfer via licensing agreements have increased in a range of developing countries (with positive effects depending on the size of the royalties) (Maskus and Yang, 2003).

In the current discussions on S&D, a number of developing countries have tabled proposals that transition periods under the Customs Valuation and TRIPS Agreements be extended automatically upon request (TN/CTD/W/3/Rev.2 and TN/CTD/W/4/Add.1). Opposing Members would need to demonstrate that the expiring transition period has fulfilled its purposes and resulted in the establishment of the required infrastructure (or "a viable technological base" in the case of TRIPS). While many remain sceptical as to the moral hazard[287] problems that such an approach would imply, the insight has gained some ground that the cost-benefit ratio of certain obligations may be a function of development levels. It is argued that the required investments and complementary reforms in the developing world are in competition for scarce funds and administrative capacity with other development priorities (Hoekman, 2005). At the same time, the empirical evidence has demonstrated that customs and IP modernization had positive effects on a range of development indicators, and should therefore not be neglected.[288] Effective S&D would need to be targeted at the country-specific situation, taking account of its existing infrastructure and assets, while fostering incentives for reform, but it would also need to factor in the costs of non-compliance imposed on other countries.

(ii) New approaches towards accommodating developing country interests

The current negotiations offer a good opportunity to reconsider the way in which the special interests of developing countries are accommodated within the WTO. According to the Doha mandate, all existing S&D provisions are to be reviewed with a view to making them more precise, effective and operational (WT/MIN(01)/DEC/1). Agreed S&D modalities are to be applied in the negotiations and new S&D provisions need to be conceived of in negotiating areas, such as trade facilitation. Two major challenges remain that are equally relevant to all of these forms of S&D: first, the absence of policy analysis and accountability by *demandeurs* why exemptions are needed; and second, the lack of a realistic assessment about how exemptions should be implemented without undermining the integrity of the system. These considerations are not unrelated since a justification of special development needs and of the required derogations from the rules would likely put an end to the self-selection of developing country status leaving a gap as to the appropriate selection mechanism to qualify for S&D.

[286] See http://www.sipo.gov.cn/sipo_English/statistics/200607/t20060725_104689.htm, visited on 27 April 2007. Also, other forms of protection, such as copyrights, have proven beneficial e.g. for the music industry in developing countries (Maskus, 2000).

[287] Moral hazard is defined as an insurance-induced alteration of behaviour that makes the event insured against more likely to occur.

[288] For further empirical work see also Swedish National Board of Trade (2004).

Two extreme strategies have proven particularly popular so far helping to avoid a more serious analysis: the first one has been to afford total flexibility (sometimes time-bound) to those developing countries, notably LDCs, that are too small economically to matter to the interests of other Members, without consideration of the underlying rationale or consequences. For instance, LDCs are not expected to undertake commitments in agricultural market access or in the new negotiations on trade facilitation (WT/L/579).[289] Or, they may maintain existing or new trade-related investment measures for an extended period of time, possibly until 2020 (WT/MIN(05)/DEC: F-2). While celebrated as a success, both the economic and strategic wisdom of this approach are highly doubtful. LDCs have liberalized certain sectors unilaterally and could tie in reforms under the WTO to prevent policy slippage.[290] In addition, LDCs could commit the status quo as a bargaining chip to assert their offensive interests.[291] On trade-related investment measures, as discussed above, it may not be the most cost-effective policy to foster domestic industries.

The second approach has been to focus on S&D proposals with virtually no or little intrinsic value or to make yet more pledges of "best endeavour", i.e. concede "rights" that can hardly be enforced. For example, it was agreed in principle that "the terms and conditions of the Enabling Clause shall apply when action is taken ... under the provisions of this Clause" or that in evaluating balance-of-payments measures under GATT 1994 Article XVIII:B "*full consideration shall be given* to the impact of the volatility of short-term financial flows" (Job(03)/150/Rev.2: C-2 and C-6, emphasis by author).

A number of commentators have made proposals on how to redirect S&D discussions towards a more analytical approach. They all embrace the notion of heterogeneity among developing countries if S&D is to be effective, i.e. they agree that the specific situation of individual Members should determine the eligibility and the type of S&D measure to be authorized.[292] The proposed approaches differ, however, as to the extent of differentiation among developing countries and how this is to be achieved. The two main alternatives also vary as to the exact scope of S&D and the level of detail with which the content of WTO rules and possible exemptions are examined.

Some authors have made a distinction between core obligations, such as MFN-based market access and the prohibition of highly trade-distorting measures, and obligations to implement "costly" agreements dealing with regulatory issues, such as customs valuation and TRIPS. Universal adherence to core disciplines implies that further liberalization should not be slowed down by the consideration of preference erosion

289 For new areas, such as trade facilitation and the other Singapore issues, this approach has received some academic backing. Lawrence (2005) proposes that existing WTO Agreements be supplemented with additional 'clubs' to which only members would subscribe that are willing to accept a more extensive set of commitments. In order to avoid the lack of ownership following the conversion of the plurilateral Tokyo Round Codes into universally applicable obligations, all WTO Members would participate in negotiating club rules, but would be free to join at a later stage. The author sees the WTO as a "global coordinating club" on trade that should deal with all issue linkages. Such a "club-of-clubs" would constitute a compromise in which diversity can co-exist with the establishment of a deeper integration framework. In light of fears of a "two-class society" and a further marginalization of the poorest countries, many observers (e.g. Hoekman, 2005) do not consider "plurilaterals" to be in the interest of developing countries.

290 See subsections B.2., B.5 and C.2.(c) on international commitments as a means to address domestic governance problems. If all countries generating costs of non-compliance that are too small as markets to matter to trading partners were allowed to have more or less permanent exemptions, it must be asked whether this practice, albeit not uncommon in reality, should be formalized under WTO rules, thereby putting at risk these countries' further integration into the multilateral trading system. See Kerr (2005).

291 As discussed in subsections B.2 and B.5, it is not straightforward to explain why a large country would bargain with a small country over its liberalization commitments. A plausible motivation may be the interest of the large country in cooperating on issues other than trade, such as environmental protection. Also, an LDC may not be considered a small market for certain products. Finally, since large market size *per se* provides significant bargaining power, LDCs can act as a group when negotiating with large trading partners.

292 As noted in subsections B.2, B.5 and C.2.(c), the terms-of-trade approach to trade agreements would imply that large developing countries should be accommodated in different ways than small developing countries. To recall, Staiger (2006) holds that the critical pieces of empirical evidence are the past and present degree to which developing countries are large enough in relevant markets to alter international prices with their trade policy choices. Citing two papers in support of his argument (Gros, 1987; Broda et al., 2006), he deplores the general lack of empirical studies in this regard.

and that little if any "wiggle" room be left for trade-related investment measures or export subsidization (Hoekman et al., 2004). Different strategies have been advanced to identify possible beneficiaries. Hoekman et al. (2004) advocate time-limited exemptions from "resource-intensive" agreements for an "LDC plus" group characterized by broad criteria, such as per capita income or size. It is argued that such a crude differentiation would cover practically all countries with similar implementation concerns across WTO Agreements.[293] In order to deal with complaints by individual countries not part of this group to have access to the same rights on a case-by-case basis, an appeals procedure is proposed. Wang and Winters (2000), Prowse (2002) and Hoekman (2002) hold that implementation capacity should be assessed on a country-by-country basis ("implementation audits"). The authors link the temporary exemption to the provision of technical assistance and capacity-building. Hoekman (2005) suggests that rather than creating formal exceptions to the rule, complaints against developing countries that do not implement "resource-intensive" obligations should be made conditional on prior approval by an independent oversight body that determines the likely benefits of implementation versus the costs of compliance ("development test").

While intellectually stimulating, defining S&D eligibility in one of these ways entails several shortcomings in practice: first, attempts to subdivide developing countries have proven unworkable, particularly since the same group of countries at the exclusion of other developing countries would become eligible for broad-ranging S&D. Country-by-country assessments or appeals procedures carry the disadvantage of making eligibility subject to discretionary decision-making instead of creating enforceable rights. Second, a "tailor-made" approach would require an extraordinary improvement in the coordination and provision of assistance at all levels. Finally, the involvement of external authorities to conduct "implementation audits" or "development tests" is likely to be contentious. It is unlikely that WTO Members would agree to delegate such a fundamental role to another institution, especially since the results from such an analysis could lead to enforceable rights under S&D flexibilities or determine the right to initiate panel proceedings under the dispute settlement mechanism. Also, agreement would need to be reached on who among competing groups and agencies would ultimately determine the costs of compliance and how this should be done (Keck and Priyadarshi, 2005). Nevertheless, to a certain extent, these approaches already have shaped current S&D debates. A number of institutions have stepped up their assistance and coordination efforts.[294] The modalities for the negotiations on Trade Facilitation stipulate that "the extent and the timing of entering into commitments shall be related to the implementation capacities of developing and least-developed countries ... [and that] developed-country Members will make every effort to ensure support and assistance directly related to the nature and scope of the commitments" (WT/L/579: D-1, paras. 2 and 6). While "best endeavour" elements remain, implementation is formally linked to capacity and assistance, albeit in a non-objective manner.[295]

Concerning the proposed scope of S&D, there is wide agreement in the literature that further market access liberalization constitutes a "core" activity of the multilateral trading system and that concerns over preference erosion should be dealt with by eliminating trade barriers on an MFN basis in sectors of export interest to developing countries and by providing compensation/adjustment assistance to those countries/sectors that are particularly affected. However, several commentators doubt that a clean distinction can be drawn between other "core" disciplines and more extensive obligations. For one, infrastructure-related Agreements, such as Customs Valuation, contain elements, such as publication requirements (Article 12), that have limited resource implications, but are crucial to limit *ad hoc* exceptions and maintain an equitable customs system. Furthermore, the approach does not do justice to the fact

[293] This position appears to have received some backing by an unpublished econometric analysis by the Organisation for Economic Co-operation and Development (OECD) showing that a number of developing countries were similar to LDCs for a range of key indicators while others could reasonably be grouped together with developed countries. The study was discussed during a number of meetings of the Working Party of the Trade Committee in 2002. Since no consensus could be reached on the findings of the study, it remains classified.

[294] See, for example, IMF and World Bank (2006) and WTO (2006b).

[295] Evenett (2005) mentions the idea of "pledging rounds" whereby donors would commit targeted assistance requested by a WTO Member and endorsed by a technical committee of experts. The execution of both the technical assistance and capacity-building pledges as well as of the additional trade facilitation commitments according to a management plan would constitute binding obligations.

that limited exemptions for higher tariffs or quotas may be justified when market imperfections or certain political economy considerations are involved.[296] Keck and Low (2004) argue in favour of an issue-specific approach based on economic arguments for government interventions that are otherwise prohibited by WTO rules.[297] Hence, exemptions for infant industry protection, for example, would not be excluded *a priori* as a violation of "core" disciplines, but would be made conditional on the specific situation in the *demandeur*, i.e. the existence of learning externalities, the unavailability of first-best policies and a clear timetable for removing the measures in question. The rationales for delays in dealing with export measures, trade-related investment measures or certain infrastructure matters could be tested in a similar manner.[298] The right to S&D would obviously also depend on the extent to which third interests are likely to be damaged.

Ideally, measurable criteria could be found that characterize the situation of a country and, hence, could be used to determine access to a specific S&D provision, introducing some "automaticity" or, at least, "hard" evidence into the authorization process. The range of indicators would vary depending on the circumstances and policy objective at issue. Stevens (2002) demonstrates how countries falling within a number of food security-specific thresholds could be allowed to use production subsidies for certain agricultural commodities. Keck and Low (2004) support the need for provision-specific criteria noting the difference between Stevens' (2002) hypothetical list of beneficiaries and the actual list of countries having obtained a permission to provide subsidies under certain programmes pursuant to the SCM fast track procedure (G/SCM/39). The conditions imposed on beneficiary countries, such as compensation, should also involve an economic assessment. As an example, Cottier (2006) cites the calculation methodologies of royalties in the Canadian and Swiss implementing legislations of the Declaration on the TRIPS Agreement and Public Health (WT/MIN(01)/DEC/2), which foresee the adjustment of payments on the basis of human development indicators.

The biggest advantage of such an approach would be that no *a priori* differentiation between developing country Members is necessary. In view of the differing sets of criteria for different types of S&D, target groups would match more closely with actual needs. By the same token, while qualifying for one or two "meaningful" S&D rights, not all developing countries would be able to claim all exceptions. This should lower the resistance of those who do not wish to see stronger players take advantage of flexibilities at the expense of others. However, a major challenge would be to identify and measure suitable criteria. This could not only be a lengthy undertaking, but would also strain Members' resources due to the level of detail and technical complexity involved. Even where appropriate data exist, views differ as to the quality and suitability of various sources, as witnessed by the lengthy discussion on the database to be used for the calculation of *ad valorem* equivalents in the current market access negotiations or by past complaints about the IMF's central role in supplying data for BOP consultations. Cottier (2006) rejects the idea that data problems would make a more objective and "automatic" approach unfeasible pointing to precedents in other areas, such as the criteria used to characterize a country's needs (taking account also of moral hazard risks) when determining the grant-credit mix it is entitled to under debt relief programmes (IDA, 2004). The fact that despite the data-intensity of the approach an element of "negotiation" or "decision-making" by the membership as a whole would remain, for instance, on the precise time interval during which the exemption is granted, represents an additional drawback.

Unfortunately, as this overview of the literature has shown, no silver bullet exists on how S&D in the WTO can be made more relevant to developing country needs. A number of lessons for future discussions can still be drawn from the experience to date: first, the lack of analysis of the reasons for S&D, its forms and conditions as well as its compatibility with the rules-based character of the organization needs to be addressed. This would imply a move away from broad-brushed political debates in terms

[296] See the theoretical discussion in subsection C.2.(c).(ii) and empirical evidence in part (a) of this subsection.

[297] Others have endorsed and further elaborated such an "issue"-, "provision"- or "situation"-specific approach. See, for instance, Cottier (2006), Paugam and Novel (2005) and Corrales-Leal (2005).

[298] For example, limited transition periods could be made available to bring EPZs into conformity with WTO rules if it is demonstrated that the principal role of governments has been to coordinate the establishment of an industrial cluster and provide the required infrastructure.

of "graduation" vs. "total opt-outs" towards problem-oriented discussions of market imperfections and economic instruments. Second, not all S&D demands may result in enforceable obligations, for instance, when more lenient requirements would risk undermining the policy objective pursued. Technical assistance constitutes an indispensable complement, also in regard to facilitating adjustment during times of transition. Finally, radical approaches are unlikely to meet with the required consensus. This applies to suggestions that seek to change the contractual nature of the WTO or neglect important sensitivities and capacity constraints. It seems that more technical, open-minded and incremental approaches to S&D stand the best chance to help accommodate developing country concerns within the multilateral trading system without undermining its integrity.

5. THE CHALLENGE OF REGIONALISM

In the past decade and a half, the number of regional or free trade agreements has mushroomed. Throughout its existence (1948-1994), the GATT received only 124 notifications of RTAs. But since the creation of the WTO in 1995, over 160 additional arrangements covering trade in goods or services have been notified. As of 1 March 2007, there were 194 notified RTAs in force, with 129 notified under GATT Article XXIV, 21 under the Enabling Clause and 44 under GATS Article V. With the possible exception of Mongolia, all other WTO Members are a party to at least one RTA. Asian countries, which in the past had shunned free trade agreements, are now some of the most actively involved in negotiating new agreements.

The analysis of RTAs in Section C gave valuable insights into the welfare effects of regional trade agreements and the interaction between RTAs and the multilateral trading system. One important conclusion to recall from that analysis is the ambivalence of the welfare effects of preferential trade agreements. Joining an RTA does not guarantee an increase in the RTA members' welfare. Further, RTA formation may adversely affect the welfare of non-members due to trade diversion and terms-of-trade effects. Given that WTO Members embrace both regionalism and multilateralism at the same time, it is essential to understand how the WTO has been dealing with the challenge posed by the proliferation of RTAs and what are the remaining challenges. This subsection addresses these issues.

First, it describes the way in which the multilateral system has dealt with the challenge of regionalism with a special emphasis on efforts made since the establishment of the WTO in 1995. Second, it provides an analytical account of the issues that remain to be settled and that characterize the main debate surrounding RTAs presently at WTO, with a focus on the importance of the debate from an economic point of view. Third, it provides a review of the theoretical literature on RTAs as building blocs or stumbling blocs to the multilateral trading system. It also provides anecdotal and systematic evidence on the interaction between the proliferation of RTAs and the developments in the multilateral trading system, in order to shed some light on whether RTAs have been building blocs or stumbling blocs. Finally, a number of results from the theoretical literature and empirical evidence are pulled together to discuss ways of strengthening GATT Article XXIV.

(a) Regionalism in the GATT/WTO history

How has the multilateral trading system dealt with regionalism? How have the provisions of GATT Article XXIV been implemented over the years?

There are a number of explanations about the historical origins of GATT Article XXIV, which gives exceptions from the obligation of MFN to customs unions and free trade areas that meet certain criteria. One prominent explanation for the exception given to customs unions is that it was intended to open the door for European integration, which was believed to be essential to the future peace of the Continent (Bhagwati, 1991). Another explanation for the exemption granted to customs unions is that they had received exemption from the MFN principle in bilateral trade agreements long before the GATT was created (Mathis, 2002). The United States submitted draft proposals for GATT Article XXIV that followed

its own MFN bilateral agreements formed according to the US Reciprocal Trade Agreements Act, which granted exemptions to customs unions.[299]

With respect to the exception given to free trade areas, most accounts have interpreted it as a way of hanging on to the support of developing countries for the Havana Charter, since many of them wanted the option to negotiate preferential trade arrangements in the future. GATT Article I:2 had intended to grandfather only the existing preferences at that time, such as those under the British imperial system, on the condition that no new preferences be extended. Introducing an exception to free trade areas under Article XXIV was one way of accommodating developing countries' demands (Mathis, 2002).

In most contemporary accounts of the Havana negotiations, the United States was always portrayed as standing its ground on the principle of MFN and only reluctantly acquiescing to the exception given to preferential trade agreements. However, Chase (2006) has suggested that the United States gave way to GATT Article XXIV in part to accommodate a possible US-Canada free trade agreement, which was being negotiated secretly simultaneously with the Havana Charter. Although the US-Canada FTA was eventually dropped[300] (and not successfully pursued until four decades later), the language to exempt free trade areas from the obligation of MFN was retained in the GATT.

What all these various explanations testify to is the strong interest by the countries involved in the post-war negotiations to establish the ITO to pursue preferential trade arrangements.

In 1947, there was the general belief that trade liberalization, be it regional or multilateral, was good. And regional liberalization, by providing deeper market access was complementary to the multilateral trading system. Article XXIV of GATT allowed regional arrangements as long as they satisfied three requirements: transparency, commitment to deep intra-regional liberalization and neutrality *vis-à-vis* third parties. Nearly three decades later, Paragraph 2(c) of the 1979 Decision of the GATT Council on Differential and More Favourable Treatment allowed less-developed GATT Contracting Parties to enter into regional arrangements for the mutual reduction or elimination of tariffs on less restrictive criteria than developed countries.[301] Further, the creation of the General Agreement on Trade in Services in 1995 also resulted in a sanctioned exception to MFN in preferential agreements involving trade in services (GATS Article V).

The weakness of the GATT rules on regional arrangements became first apparent with the notification of the EEC-Association of Overseas Countries and Territories. Part IV of the Treaty of Rome established an association between the EEC members and their overseas countries and territories.[302] The Treaty provided preferential treatment by the EEC members to these countries and territories in pursuit of promoting their economic development and establishing close economic relations. While it was not the first arrangement to be reviewed under Article XXIV, the examination prefigured the issues that would pre-occupy subsequent RTA examinations. Principal among the issues discussed by the working group examining the Association were the definition of "substantially all trade" and what measures were covered by "other restrictive regulations of commerce" cited in GATT Article XXIV:8. Is it possible to offer a quantitative measure of "substantially all trade"? What are the "other restrictive regulations of commerce" that must be eliminated between the members of a free trade area, e.g. should contingent measures be eliminated?[303] The Working Group responsible for the assessment of consistency of the agreement with the GATT relevant rules was not able to reach a clear-cut conclusion. Part of the reasons

299 See Mathis (2002), p. 33.

300 Notice that Canada rejected the 1948 agreement (Smith, 1988; Wonnacott, 1987).

301 The only requirements applying to RTA concluded under the Enabling Clause is a certain degree of transparency.

302 There are currently 21 overseas countries and territories scattered around the globe: 12 British overseas countries and territories: 6 French overseas territories and territorial communities (*collectivités territoriales*); 2 Dutch overseas countries; and 1 under the Danish Crown.

303 Similar opaque requirements are established in Article V of the GATS for economic integration areas in services (see next subsection for further details).

for this may be political but part is also because of the inability to substantively agree on the interpretation of these key concepts.

By the time the Uruguay Round negotiations got underway (1986-94), the so-called "second wave" of regionalism had begun. The catalytic event was the creation of the US-Canada free trade agreement (1989), prefigured nearly four decades earlier. For many, it was a momentous occasion that reflected a fundamental shift in US priorities from multilateralism to regionalism. Hence the negotiations included efforts at strengthening multilateral disciplines on RTAs.

The Uruguay Round produced the Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994. The Understanding seeks to clarify the criteria and procedures for the assessment of new or enlarged agreements and to improve the transparency of notified agreements. With respect for example to the assessment of customs unions, it provides specific guidelines on how to calculate the "general incidence of the duties and charges" that prevailed before and after the establishment of the Agreement. It establishes 10 years as the "reasonable length of time" for an RTA to be completed. With respect to transparency, it requires all notified RTAs to be examined by a WTO working party in accordance with the provisions both of the GATT and the Understanding.

After the creation of the WTO in 1995, the Committee on Regional Trade Agreements (CRTA) was established to carry out this examination function. The Committee was established with the mandate to assess the compliance of the various regional trade agreements with the relevant WTO rule and to consider the implications for the multilateral trading system. As of 1 March 2007, more than half of the 194 notified RTAs have either been examined or are in the process of being examined. Fourteen are under factual examination; the factual examination of 62 RTAs have been concluded; the reports for 5 RTAs are under consultation; and 19 RTA examination reports have been adopted. However, due to questions on the interpretation of the provisions contained in Article XXIV, Members have not reached consensus and finalized any of the examinations of the CRTA.[304]

Faced with the clear difficulties in the surveillance function of the WTO and concerned by the increasing number of RTAs, in Doha, the multilateral effort at providing some oversight of RTAs continued. WTO Members agreed on negotiations aimed at "clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements." The negotiations were pursued along two tracks: identifying the issues for negotiation, including "substantive" issues (e.g. systemic and legal issues) and holding consultations on procedural issues related to transparency of RTAs.

Negotiations over substantive issues have shown great complexity and have experienced limited progress. As far as procedural issues are concerned, on 14 December 2006, the WTO's General Council established on a provisional basis a new WTO transparency mechanism for all regional trade agreements (RTAs).[305] Members are to review, and if necessary modify, the decision, and replace it by a permanent mechanism adopted as part of the overall results of the Doha Round. The transparency mechanism requires early announcement of the RTA. This early announcement can take place after the RTA has been just signed or even as early as during the negotiation phase of the RTA. The mechanism also requires early notification of the RTA to the WTO, no later than the parties' ratification of the RTA, or application of relevant parts of the agreement, and before the application of preferential treatment between the parties. The consideration of the RTA shall be based on a report of the WTO Secretariat, which shall be "factual" and "shall refrain from any value judgement." The aim is to improve the surveillance role of the WTO. As of June 2007, factual presentations have been prepared on a total of nine RTAs in the areas of goods and services.[306]

---

304 However, during the GATT, the Working Party examining the Czech Republic-Slovak Republic Customs Union was able to conclude that the Agreement was consistent with the provisions of GATT Article XXIV.

305 WTO document WT/L/671.

306 For an example of factual presentation see WTO document WT/REG169/3.

(b) The "substantive issues" in the debate surrounding RTAs in the WTO

What are the main issues that remain open in the debate on RTAs in the WTO? And, how could this debate help to minimise the risks of distortions associated with RTAs?

All RTAs grant preferential market access to their members. However, RTAs may differ greatly as to the set of products eligible for preferential treatment, the margin of preference granted on each product, the pace of tariff reduction and the level of the MFN barrier of the RTA member-countries against third parties. All these elements are essential determinants of the overall extent of preferential market access granted by a RTA, its economic effects and the degree of compatibility with the multilateral trading system.

From a legal perspective, Article XXIV defines the market access requirements that each RTA (be it a free trade area or a customs union) should satisfy. In particular, Article XXIV allows the formation of RTAs under two key conditions. First, in order to qualify under Article XXIV, customs unions and free-trade areas are required to "eliminate" duties and "other restrictive regulation of commerce" on "substantially all trade" within a "reasonable length of time". Second, with regard to extra-regional trade barriers, Article XXIV requires that the formation of a RTA should not result in barriers toward third-parties higher than those prevailing before the formation of the RTA.

Similar requirements are established in Article V of the GATS for economic integration areas in services. In particular, Article V requires that an economic integration area must have "substantial sectoral coverage" of the trade in services among the parties and that "substantially all discrimination" has to be eliminated either at the entry into force of the agreement or on the basis of a "reasonable time-frame". Furthermore, with regard to extra-regional barriers, Article V requires that the agreement shall not raise the overall level of barriers to trade in services compared to the level before the formation of the economic integration agreement.

The main debate surrounding RTAs has focused on the interpretation of these conditions in terms of the depth and the extent of product coverage of trade liberalization, the transition period and the policy instruments on which preferential rules should be applied. To a large extent the interpretation of these provisions remains a challenge for further negotiations.

(i) The sectoral coverage

The requirement established in Article XXIV that barriers to trade should be eliminated on "substantially all trade" suggests that the sectoral coverage of the liberalization effort should be extensive. Most likely, the depth and extent of trade liberalization required was aimed at limiting the proliferation of RTAs, at avoiding RTAs that were formed with the intent to create sectorally discriminatory arrangements. The Understanding on the Interpretation of Article XXIV of GATT includes among the benefits of free-trade areas and customs unions their contribution to the expansion of world trade[307], and re-affirms how this is larger the more comprehensive is the coverage of the agreement and smaller if any major sector is excluded. But, neither Article XXIV nor the understanding defined the precise extent of the required product coverage.

Similarly, Article V of the GATS requires that an economic integration agreement must have "substantial sectoral coverage" of the trade in services among the parties. A footnote clarifies that this requirement should be "understood in terms of number of sectors, volume of trade affected and of the four modes of supply". But the extent of the sectoral coverage required remains unresolved.

[307] Note that from an economic point of view not all trade expansion generated by the formation of a RTA is desirable as some of the trade created by the RTA may simply reflect trade diversion from countries outside the agreement. See discussion in Section C on this point.

The debate

The discussions aimed at clarifying this wording have focused on whether a more precise definition of "substantially all trade" should be established in terms of trade volumes, tariff lines or sectoral coverage. This quantitative approach favours a definition of product coverage based on a statistical benchmark such as a certain percentage of tariff lines and/or trade between the parties that the agreement should cover. However, it has been objected, this criterion does not rule out the possibility that entire sectors could be excluded. Furthermore, a threshold based on trade volumes may be biased by the existence of high tariff barriers in the base year.[308] Beyond these statistical benchmarks, discussions have also touched on other considerations. For example, "substantially all trade" could imply that no sector (or at least no major sector) would be excluded from regional liberalization. In practice, this debate has revolved around whether agriculture could be excluded in the regional integration process.

A number of more specific methodological issues related to the definition of "substantially all trade" have been raised and remain under discussion. For example, one issue raised with regard to the use of tariff lines as a basis for the definition of the concept of "substantially all trade" is what threshold level should be used. Australia, for instance, has suggested using a threshold of 95 per cent of all Harmonized System (HS) tariff lines at the six-digit level. But other countries favour a lower threshold. Still other Members have objected to the setting of a numerical threshold in the first place.

A related issue is how this threshold level should be calculated. Clearly, calculations should be done on tariffs at the six-digit level as this is the maximum common level of sectoral disaggregation. But, this opens up the issue of how tariff lines below six-digit should be treated. Should a six-digit sector be counted as liberalized only if all tariff lines at a deeper level of disaggregation (10 or 12 digits) have been liberalized or would it be sufficient that just the majority of tariff lines have been liberalized? Furthermore, Article XXIV requires that duties should be "eliminated". Therefore, it is unclear whether tariff lines where duties have been reduced rather than eliminated should be included in the count of liberalized tariff lines.

Another issue is whether the requirement to liberalize should refer to each individual country in the preferential agreement or should it refer to the overall trade in the area? This is especially relevant for North-South RTAs where the required threshold level of trade liberalization may be achieved through asymmetric liberalization, whereby only the developed party liberalizes, or the developing party liberalizes but to a much lesser extent.

Regarding Article V of the GATS, despite the clarification contained in the footnote that the wording "substantial sectoral coverage" should be understood in terms of number of sectors, volume of trade affected and modes of supply, the question of the extent of liberalization needed to meet the requirement of "substantial sectoral coverage" remains unsettled. It has been argued that the flexibility allowed by the word "substantial" does not allow for the exclusion of essential services (e.g. transportation) and that no economic integration area should exclude investment and labour mobility (that is, Modes 3 and 4). Yet, a consensus on the precise interpretation has not emerged.

Another issue related to the interpretation of GATS rules is that of the adequate level of disaggregation, that is whether the examination of the extent of the coverage should take place at the level of sectors or sub-sectors and whether the requirement of substantial coverage should be defined in terms of percentage of sectors/trade excluded. It has been noted that, given the unavailability of reliable data on trade in services, it would be difficult to define a requirement in terms of percentages of trade and that a sector-by-sector examination should be favoured relative to one at the sub-sectoral level.

[308] The issue may be of relevant importance in the case of near-prohibitive initial tariffs, for example. In this case, it would be possible to exclude from the regional liberalization also a sector with a high potential for trade between the parties, on the basis that the existing trade is very low.

From an economic point of view, the definition of the required coverage and depth of integration for regional trade liberalization has important implications both in terms of welfare consequences of the formation of a RTA and its interaction with the multilateral trading system. But, economic theory does not provide a precise guide on how to evaluate Article XXIV if global welfare is the objective. For example, the requirement that RTAs eliminate protection on substantially all trade may help to avoid a proliferation of RTAs by raising the bar to their formation. If RTAs with very limited sectoral coverage were allowed, it would be possible for countries to create RTAs by simply swapping trade diverting concessions. This will increase the risk that third parties outside the agreement suffer from being discriminated and that RTAs will be stumbling blocs to the process of multilateral liberalization, as preferences granted through RTAs, especially trade diverting RTAs, may generate vested interests against MFN liberalization.[309]

On the other hand, economic theory shows that there are circumstances when the likelihood of trade diverting RTAs is higher, the deeper the level of integration within the region. Suppose, for example, that countries A and B form a RTA and that producers of good *x*, say agriculture, in country B are inefficient relative to country C (that is they produce at a price higher than producers in country C). In these circumstances, if the margin of preference[310] that A provide to B is sufficiently low, consumers in country A may still find it convenient to import from C and the RTA may not generate trade diversion. However, a large margin of preference may displace imports from C (that continues to face import barriers) in favour of imports from B (that benefit from preferential access into A).

The interpretation of the required extent of sectoral coverage in existing RTAs

How has "substantially all trade" been interpreted in RTAs? Have RTAs eliminated duties? Do RTAs allow for special treatment for developing countries?

The WTO Secretariat (2002) conducted an analysis of some 47 RTAs, mostly arrangements involving the EC, EFTA and CEFTA. It found that the agreements resulted in the elimination of most, if not all, duties on industrial goods either on the date of entry into force of the agreement or during the transition period of the agreement. The goal of free trade in industrial products appeared to be the accepted norm. However, agricultural trade remained subject to exceptions with average agricultural preferential tariffs remaining high and tariff peaks quite prominent.

A more recent study by the Inter-American Development Bank (IADB) (2006) involved 20 RTAs, primarily in Latin America and the Asia-Pacific region. The study found that most of the RTAs eliminated duties on at least 90 per cent of their imports from RTA partners by the 10th year of implementation of the agreement. The same conclusion is reached if, instead of the share of imports from RTA partners, one uses the number of tariff lines or trade-weighted tariff lines as the relevant indicator. But there are important caveats to this conclusion. Products such as agriculture and textiles and clothing, which have historically been difficult to liberalize at the multilateral level, also appeared to encounter significant problems in RTAs. In RTAs, the transition period for completely removing tariffs on these products is significantly longer (sometimes 20 years) than for other goods. And while tariffs may, at some distant point be completely eliminated on these sensitive sectors, non-tariff measures ensure an outcome that is less than free trade. These non-tariff measures include restrictive and complicated rules of origin and special safeguard measures.

The free trade commitment is also decidedly reciprocal. Even though the IADB study found that RTA partners varied markedly in the share of tariff lines subjected to liberalization in the first few years of implementation, convergence was eventually achieved so that at least 90 per cent of the tariff lines were duty free by the 10th year of implementation. There is a marked absence of the principle of "special and differential treatment" in the RTAs even though many of them have both developed and developing

309 See also subsection B.2 and Section C

310 The preference margin is defined as the difference between the MFN tariff and the preferential tariff applied within the region.

country Members. The elimination of barriers to trade is expected as much from the developing country as from the developed country member. But while the principle of special and differential treatment may not be explicitly present, there appears to be some reflection of it in the staging of the tariff reduction programmes. The IADB study found that the rate at which developing countries eliminated duties on RTA partners' trade was slower than developed countries; although the difference does not appear to be substantial (developing countries eliminated duties on 89 per cent of tariff lines by the 10th year of implementation compared to 95 per cent of tariff lines for developed countries).

As far as regional liberalization in services trade is concerned, Roy et al. (2006) reviewed the services commitments in 28 RTAs.[311] About 17 of the RTAs take a negative list approach to services liberalization. They found that the services commitments in Mode 1 and Mode 3 tended to go significantly beyond GATS bindings both in terms of coverage and improvements in the commitments, and that this was true not only in key infrastructure sectors, such as finance and telecom, but also in more traditionally difficult ones such as audiovisual or education services. In terms of coverage, they found than more than two-thirds of the countries reviewed take new or improved bindings in at least 25 per cent of services sub-sectors (their study covers 152 sub-sectors for mode 3 and 142 for mode 1). On average, the percentage of sub-sectors committed in the countries reviewed increased from about 40 per cent in GATS to over 70 per cent in RTAs for Mode 1, and from about 50 to over 80 per cent, respectively, for Mode 3.

(ii) The requirement of a "reasonable" transition period

Linked to the definition of "substantially all trade" is the debate over what constitutes "reasonable length of time". The link is determined by the fact that the length of the transition period affects when "substantially all trade" has to be calculated and how the liberalization should proceed during the transition period. The Understanding on the Interpretation of Article XXIV of GATT states that the "reasonable length of time" referred to in paragraph 5(c) of Article XXIV should exceed ten years only in "exceptional cases". But, there is no clear consensus on what constitute "exceptional cases" and what should be the pace of liberalization within the transition period.

Similarly, in GATS the wording is "reasonable time-frame". This has been argued to mean a ten-year limit (like for GATT Article XXIV), a five-year limit or any time limit to apply on a case-by-case basis. How to deal with a gradual and selected extension of certain GATS obligations (such as national treatment) is also an issue that remains to be settled.

What is the average length of the transition period in existing RTAs? The IADB (2006) study discussed above highlighted that by the 10th year of implementation of the agreement on average 90 per cent of regional trade has been liberalized, although for products such as agriculture and textiles and clothing, the transition period for the complete removal of tariffs is on average much longer, sometimes as high as 20 years.

In general, it is recognised that some flexibility should be given to RTAs involving developing countries. There is no clear consensus on what type of flexibility rules should be adopted, but it has been suggested that this may include longer transitional period for developing countries.

From an economic point of view, the need for a certain transition period finds its justification on the basis of the possible adjustment costs arising from trade liberalization. When trade is liberalized firms need to adjust to the new competitive environment. For example, they may need to invest in new technologies or higher quality products. This would require funds and time. Gradual liberalization may provide firms with the necessary time to internally finance these adjustment costs through profits. Longer implementation periods may be justified on the ground that firms face higher adjustment costs and that financial markets are inefficient in these countries.[312]

[311] As of 1 March, 2007, 44 RTAs have been notified under GATS Article V (Economic Integration).

[312] Bacchetta and Jansen (2003).

The IADB (2006) finds that on average developing countries eliminated duties on RTA partners' trade at a somewhat slower pace than developed countries. In fact, while developed countries eliminated duties on 95 per cent of tariff lines by the 10th year of implementation of the agreement, developing countries eliminated duties on 89 per cent of tariff lines by the same period.

(iii) The debate over "other restrictive regulations of commerce"

Article XXIV also requires that beside duties RTAs eliminate "other restrictive regulations of commerce". However, the GATT Agreement does not provide a definition as to which trade policy instruments should be regarded as "other restrictive regulations of commerce".

From an economic point of view, there are a number of policy instruments on which RTAs may legislate and that may qualify the depth and the extent of preferential market access provided by tariff liberalization, as well as the impact on third parties. Among these instruments there are tariff rate quotas (TRQs), safeguard and anti-dumping measures and rules of origin (RoO). TRQs can limit the extent of market access provided by the preferential arrangement, as they can limit the quantity of imports that benefit of preferential market access. The use of safeguards can also strongly limit market access.[313] For example, RTAs may define additional duties in the case their markets were disrupted by imports from their partner. Finally, RoO[314] may be designed for protection (Krueger, 1997 and Krishna and Krueger, 1995). Suppose that two countries A and B form a FTA. Suppose as well that country A is a very inefficient producer of an intermediate product *x*, say tyres, used in the production of cars that country B exports. Then, in the absence of specific constraints, country B will import tyres from the rest of the world at the MFN tariff and will export cars to A under the preferential regime. But, RoO can be designed in such as way that it may be convenient for country B to use tyres produced in country A (although it has to pay a higher price than if they were imported from the rest of the world), in order to qualify for preferential treatment in the market for cars of country A. Focusing on NAFTA, recent economic empirical studies have shown that RoO effectively limit Mexico's duty free access to Canada and the United States (Estevadeordal, 2000; Cadot et al. 2005). Focusing on the EU, Augier et al. (2005) shows that non-cumulation represents an effective barrier to trade, significantly reducing bilateral trade.

It is important to note that, like in the case of tariffs, there may be an inverse relationship between the degree of preferential liberalization provided with respect to "other regulations of commerce" and the likelihood of an adverse impact on third parties. For example, to the extent that TRQs entitlements of regional partners are provided in addition to existing entitlements (e.g. under the WTO Agreement on Agriculture), they may have a negative impact on third parties. This is because an expansion of the overall quota entitlements may reduce prices in the sector, thus eroding the quota rents for all pre-existing quota-holders. The formation of the RTA will have a negative impact on third parties, even if no more restrictive barriers are raised against them.

(iv) The requirement that RTAs should not result in higher barriers against third parties

Article XXIV allows the formation of a FTA provided that "the duties and other regulation of commerce" imposed on countries outside the agreement "shall not be higher or more restrictive than the corresponding duties and other regulations of commerce"[315] existing before the formation of the RTA. With respect to customs unions, the rules are similar but it is required that duties and other regulations imposed on countries outside the union shall not "on the whole" be higher or more restrictive than the general incidence applied before the formation of the customs union. The Understanding on the Interpretation

313 See Section C for a discussion on safeguard measures in the multilateral trading system.

314 In free trade areas, RoO are set to prevent goods that can enter the free trade area through the country imposing the lowest import tariff.

315 There is no definition of what may be meant by other regulation of commerce. And interestingly, there is no other reference to "other regulation of commerce" in the GATT.

of Article XXIV of GATT re-affirms that the purpose of customs unions and free trade agreement "should be to facilitate trade between the constituent territories and not raise barriers to trade of other Members with such territories".

Turning to GATS, Article V establishes that parties must ensure that the agreement does not "raise the overall level of barriers" to trade in services with respect to third parties. But here an important methodological problem arises which makes it difficult to apply this provision. Data limitation and differences in regulatory mechanisms across countries impede an objective assessment of the level of trade barriers both before and after the establishment of the RTA.

From an economic point of view, the simple requirement that overall barriers against third countries should not be raised does not ensure that the formation of a RTA does not have negative welfare consequences on countries outside the agreement. On the contrary, economic theory has indeed highlighted how the increase in intra-RTA may actually come at the expense of non-RTA members who lose out from trade diversion and from deterioration in their terms of trade, even when barriers against third parties remain unchanged (see Section C).

Interestingly, the Understanding on the Interpretation of Article XXIV of GATT adds that RTAs should "to the greatest possible extent avoid creating adverse effects on the trade of other Members". This requirement appears to go in the direction of considering adverse welfare consequences of the formation of free-trade areas and customs unions against third parties. Indeed, in the specific case of customs unions, economic theory has also shown that RTA partners may avoid imposing losses on third-parties outside the agreement by adopting a common external tariff that leaves the volume of trade between the non-members and the customs union members unchanged (see Box 9 in Section C for an explanation of the Kemp-Wan theorem). Given the continuing increase in the number of RTAs, reducing their adverse effects on non-RTA members will be an important challenge for the multilateral trading system (see subsection (d) below).

(c) The interaction between RTAs and progress in the multilateral trading system

The theoretical literature has provided contrasting answers to the question of whether RTAs are building blocs or stumbling blocs to the multilateral trading system.

(i) Are RTAs stumbling blocs or building blocs?

Arguments in support of the building bloc view

Several arguments have been put forward as to why regionalism can complement the multilateral trading system and be a driving force for multilateral trade liberalization.

One argument is that RTAs increase the pressure to act in the direction of further multilateral liberalization. The argument applies to both RTA members and non-RTA members. With regard to the former, the proliferation and expansion of RTAs de facto erode existing preferences, thus reducing the opposition to multilateral liberalization. With regard to the latter, it is argued that by reducing the margin of competitiveness of countries that remain outside the agreement relative to partner countries, RTAs increase these countries' incentive to move on the multilateral front to avoid trade diversion.[316] Furthermore, the formation of RTAs – especially customs unions – may prompt non-member countries to pursue more liberal multilateral trade to avoid aggressive retaliation in the future given the increased market power of the regional arrangement (Bagwell and Staiger, 1997b).

[316] An alternative way is to sign a compensatory regional trade agreement. This case is discussed below in the context of the domino theory.

Another argument in support of the complementarity between regionalism and multilateralism is that RTAs act as laboratories of international cooperation, whereby trade cooperation can be tested among a small number of countries first before being extended multilaterally. Political economic models of trade support this view. A government may lack the political support necessary to pursue a global free trade policy. But, it may be able to achieve this goal after joining a RTA. For example, Ethier (1998) argues that RTAs may help a government to mobilize domestic forces in support for the multilateral trading system through enhanced FDI. Suppose that the government of a country, which has not yet acceded to the WTO, is convinced of the need for economic reform and of joining the multilateral trading system. However, it faces political opposition to both courses of action. By initially entering into a preferential trade arrangement with a developed country, the reforming country would be able to attract FDI from its RTA partner and from other foreign investors, because of its access to the market of its RTA partner. These gains tilt the political balance within the country in favour of economic reform and accession to the WTO and subsequently allow the government to successfully proceed along both fronts.

Focusing on the impact of RTAs on enforcement, Bagwell and Staiger (1999b) show that the anticipation of an exogenous strengthening of regionalism may offer a temporary boost to multilateralism, as it may increase the perceived penalty from deflecting multilateral rules. That is, the market power effect that accompanies the formation of a customs union may temporarily work in favour of multilateralism, as it enables member countries to impose a more credible threat of punitive action against defection. Bagwell and Staiger also propose the following interpretation as to the enhanced multilateral cooperation under the GATT over the transition period corresponding to the formation and the extension of the EC. " If it is accepted that the EC customs union offered its member countries greater market power than they would have otherwise possessed, than it can be argued that the enhanced multilateral cooperation was spurred in part by the growing awareness of the United States and others that a breakdown in multilateral cooperation may have especially dire consequences in the presence of a united group of the European countries" (Bagwell and Staiger, 2002, p. 119).[317]

Recently, Baldwin (2006) has made the argument that RTAs will trigger the forces for multilateral liberalization by generating the need for "taming the tangle" of regionalism. The argument relies on the interaction between the "domino" theory of regionalism and the "juggernaut" theory. According to the domino theory, the formation of a RTA raises the value of entering into a RTA for non-members, and therefore leads to a spate of RTAs in the future (Baldwin, 1995). The domino theory starts from an initial political economy equilibrium characterised by the presence of a RTA, in which pro-membership forces (exporters that gain from preferential access) balance anti-membership forces (import-competing sector that suffer from stronger competition within the region). Then, in these circumstances, suppose that there is shock, such as deeper integration in an existing RTA or the formation of a new RTA. This will change the political equilibrium in non-member countries. The profits of the firms exporting to the region, but located in a non-member country, will suffer from their cost disadvantage. Therefore, they will turn more fiercely in favour of joining the bloc. If the government of the country was (before the shock) close to being indifferent between the option of joining the bloc or not, after the shock it will be in favour of joining. If the bloc is open, there will be an enlargement.[318] If it is closed, then the country may look for compensatory regional agreements with other excluded countries. In both cases, the new equilibrium will trigger a fourth country to join and so on. Historically, Baldwin (2006) claims that the domino effect was present in Europe during the five enlargements phases (1961, 1973, 1986, 1994, 2004).

The proliferation of RTAs predicted by the domino theory may lead to a process of gradual liberalization. To put it in Baldwin's terms, the domino effect can start the juggernaut rolling (Baldwin 1994; Baldwin and Robert-Nicoud, 2005). The argument is straightforward when RTAs are trade creating.[319] The export

317 In contrast, the formation of a FTA may temporarily enhance multilateral tensions. This is because expectations of trade diversion reduce the expected losses from deviating from multilateral rules (Bagwell and Staiger, 1997a).

318 Notice that the domino theory does not investigate whether the expansion is in the interest of the incumbent countries. It is simply assumed that the incumbent will allow new entrant countries to join.

319 See Box 8 for a definition of trade creation.

sector will expand and the import competing sector will shrink. This process will imply that when another round of reciprocal multilateral negotiations is launched, pro-liberalization political pressure will be stronger and anti-liberalization pressure weaker. Hence, RTAs are building blocs for multilateral liberalization.

The growing network of RTAs can be associated with multilateral liberalization regardless of whether RTAs are trade creating or trade diverting. The argument is as follows. If enough criss-crossing regional agreements are established and liberalize enough trade, it would only be a matter of time before increasingly incoherent and overlapping rules would induce business to pressure governments to harmonize these rules or make them multilateral. Essential elements in the political economy story behind this claim are: rules of origin (RoO) and the fragmentation of production. Since rules of origin are determined by the particular interests driving protection, they will be specific to each pair of bilateral trade relationships. Therefore, as bilateral and regional trade agreements proliferate, a "spaghetti bowl" of most likely incompatible RoOs will emerge. On the other hand, the fragmentation of production, by relocating firms that were originally in the hub-country into the spoke for example, will lower the support for existing rules of origin, while increasing the support for harmonization.

Arguments in support of the stumbling bloc view

According to the received theory of international trade cooperation, the main purpose of a trade agreement is to manage the terms of trade inefficiency that arises from a non-cooperative outcome. The multilateral trading system is able to solve this problem through reciprocal liberalization and the principle of MFN together. The principle of MFN ensures that all terms of trade externalities are channelled through the world price. Reciprocity, by neutralizing the world price implications of governments' tariff decisions, will ensure the volume of trade and welfare increases while the world price (terms of trade) remains unchanged. When MFN is violated, the principle of reciprocity is impaired. The intuition is that in a discriminatory environment governments are no longer just concerned with the total amount of imports (i.e. the world price), but also with the relative share of imports coming from each supplying country (i.e. local price abroad) as they enter under a different tariff –thus implying, for example, different tariff revenues. This generates local-price externalities that cannot be solved with reciprocity. The multilateral trading system is hampered in its ability to solve the terms of trade problem and thus regionalism (in particular free trade agreements) poses an important threat to multilateralism.[320]

Proponents of the stumbling bloc view of regionalism stress the risks that regionalism may reduce the enthusiasm or the resources to achieve further multilateral liberalization. One of their principle arguments is that preferences granted through RTAs may generate vested interests against MFN liberalization. RTAs may be trade diverting. In this case, a firm located in a country that is a member of the bloc, although inefficient, may be able to overcome the competition from a more efficient firm located in a non-member state, because it will benefit from preferential rates. Preferential rates act as a form of protection against non-members. Therefore, it is likely that an inefficient firm will lobby against the prospects of future global liberalization, because it will not want to forgo its privileged access to the regional market. Since the protection received under the regional arrangement will reinforce the inefficient firm, its lobbying power will be higher with the regional agreement than without. Consequently, a RTA that is net trade diverting, not only is welfare reducing, but might also have negative effects on further liberalization of the multilateral trading system (Grossman and Helpman, 1995 and Krishna, 1998).

A third argument is that preferential arrangements may provide members with bargaining power that governments may not be willing to give up. The argument is especially valid for large/developed countries granting unilateral preferences to small/developing countries (Limão, 2002) and explains why industrialized countries may slow down multilateral liberalization following a RTA with a small developing country.

[320] Bagwell and Staiger (1998) also show that the effects can be different between a FTA and a customs union (CU). The intuition is that, if countries that form a CU are sufficiently similar, a union will approximately behave as a single (larger) country. Therefore, as long as the common external tariff conforms to the MFN principle, the principle of reciprocity can deliver an efficient outcome.

In North-South RTAs, large countries may benefit from preferential agreements with small countries, as they may be able to engage in cooperation on non-tariff issues, such as labour market or environmental standards, migration and intellectual property. Therefore, they may have an incentive to slow down multilateral liberalization in order to maintain a certain bargaining power *vis-à-vis* the relevant partners. Recent evidence that the average extent of liberalization at the multilateral level by the US and EU is lower in products that are imported from regions (including small countries) with which these countries have regional arrangement (Limão, 2006; and Karacaovali and Limão, 2005) conforms to this prediction.[321]

Fourth, RTAs may erode the political support for multilateral liberalization. Using a political economy model based on the median voter, Levy (1997) shows that RTAs will thwart any further attempt at multilateral liberalization, if they provide higher gains than multilateral liberalization for over 50 per cent of the voting population. Levy argued that a bilateral free trade agreement can undermine support for multilateral free trade because it may offer the median voter better conditions. Suppose for example that two identical countries form a FTA. In this case the median voter will gain (as a consumer) from the access to a larger variety of goods but (as a worker) will not suffer from any price/wage change. The remaining variety gains offered by a move to a multilateral free trade agreement may be insufficient to compensate the median voter for the factor-price changes that will follow multilateral liberalization.[322] Therefore, any move to multilateralism will be blocked.

Fifth, RTAs may increase the adjustment costs associated with multilateral liberalization, thus rendering multilateral liberalization less attractive. Suppose that in order to produce, firms have to make sector-specific investments. Suppose as well that a government announcement to negotiate multilateral liberalization is not perceived by agents as a credible commitment, while they expect a particular regional trade agreement to emerge. If this region's agreements maintain high tariffs relative to the rest of the world, producers in the bloc will expect the prices of the goods produced outside the bloc to be high. Therefore, they will invest in this sector. The opposite will occur in the rest of the world. These investment decisions will create inefficient "sensitive sectors" that will lower ex-post (after the formation of the RTA) the value of multilateral liberalization. This is because multilateral liberalization will require that these sensitive sectors be compensated and the cost will be higher than had multilateral liberalization been implemented first (McLaren, 2001).

A related argument is that competing RTAs with incompatible regulatory structures and standards may lock-in its members. It is commonly argued that the maze of different regulatory regimes poses a threat to the multilateral trading system, because it undermines the principles of transparency and predictability of regulatory regimes (WTO, 2003). Furthermore, these different regulatory systems may hinder further multilateral liberalization. A recent study (Piermartini and Budetta, 2006) has found evidence of distinct "families" of RTAs with differentiated rules on technical barriers to trade (TBTs). The study shows that a number of regional arrangements that have the EU as the hub include provisions to harmonize the standards of the spoke partner country to EU standards. To the extent that the adjustment to European standards requires making investments, these provisions may lock-in a country to the regional arrangement, thus making movement towards multilateral liberalization costly.

Sixth, RTAs can affect the ability to enforce commitments at the multilateral level. In particular, in a three country model, Bagwell and Staiger (1999b) show that if two countries (A and B) are good at collaborating on a bilateral basis (so that they can achieve an agreement for free trade) and the third one (country C) is not, then RTAs may lead to an overall deterioration in multilateral tariff cooperation. A and

[321] See Section D for more details on these findings.

[322] Changes in factor prices are the consequence of liberalization between diverse countries, that is, countries with different levels of capital-labour ratios.

B will establish free trade between themselves, but they will set a tariff against country C higher than the tariff they would set were the MFN rule rigidly applied. However, the opposite can occur too.[323]

Finally, engagement in regional negotiations absorbs resources away from multilateral negotiation, thus stalling the process of multilateral liberalization.

Overall, it is possible to distinguish two schools of thought as to the dynamic impact of discriminatory liberalization: one school highlights "discrimination" and provides a pessimistic prognosis on the effects of regionalism on multilateral liberalization, thus suggesting that regionalism represents a threat to the development of a global open economy. Proponents of this view stress: (i) the risks that RTAs may promote trade diversion rather than trade creation, thus reinforcing vested interests to maintain preference margins and raising concerns against multilateral liberalization on the ground of preference erosion; (ii) that RTAs may provide a bargaining tool to exchange preferential market access with concessions on non-tariff issues (such as standards), thus reducing the enthusiasm for MFN liberalization; (iii) that the proliferation of RTAs may crowd out negotiating resources necessary to achieve further multilateral liberalization; (iv) that competing RTAs may lock-in incompatible regulatory structures and standards; (v) the fact that RTAs, by creating alternative legal systems and dispute settlement mechanisms, may weaken the enforcement system of the discipline of the multilateral trading system; (vi) that the proliferation of a maze of different regulatory systems undermines the principles of transparency and predictability of the WTO.

The other school highlights "liberalization" and predicts a benign effect of regionalism on multilateralism, reaching the conclusion that regionalism can serve as a catalyst for further liberalization. Proponents of this view have highlighted that: (i) the proliferation and expansion of RTAs de facto erode existing preferences, thus reducing the opposition to multilateral liberalization; (ii) RTAs act as laboratories of international cooperation, whereby cooperation can be tested among a small number of countries before being extended multilaterally. This helps to build up the political consensus for further liberalization and may make multilateral liberalization politically viable; and, (iii) the network of overlapping RTAs, including trade diverting RTAs, may act as a positive force for the multilateral system by generating the need of rationalizing the system (or to put in Baldwin terms "taming the tangle").[324]

What does empirical evidence show about the interaction between regionalism and the process of multilateral trading system? Have RTAs worked as building blocks or stumbling blocks in the process of multilateral liberalization?

(ii) Systematic evidence is limited

Direct systematic evidence on whether RTAs slow down or accelerate multilateral liberalization is very limited. This is probably because theoretical predictions are difficult to test for two reasons: first, most of the theoretical literature focuses on whether the formation of RTAs reduces or not the incentive for a country to sign a free trade multilateral agreement. In contrast, in practice, countries negotiate multilateral liberalization with more or less ambitious liberalization scenarios, rather than opting for full or no multilateral liberalization. Therefore, a direct test of whether RTAs decrease the likelihood to sign multilateral free trade agreements is impossible. Second, other theoretical models (e.g. Bagwell

323 In general, Bagwell and Staiger find that both a stumbling bloc and a building bloc relationship is possible between RTAs and multilateral trade liberalization. For example, on the bases of a repeated game model, Bagwell and Staiger (1997a and 1997b, 1999b) show that the impact of regionalism on multilateralism will depend: (i) on the form of RTA (free trade agreement reduce the incentive for while customs union may improve multilateral cooperation); (ii) the time period under consideration (FTA may lead to temporarily higher multilateral tariffs, but once the FTA is completed tariff rates between the home country and the non-FTA members will be no higher); and (iii) on the strength of the multilateral enforcement mechanism (RTAs are a stumbling block when multilateral enforcement mechanism is efficient, but they can be building block when the multilateral system is working poorly – anticipation of an exogenous strengthening of regionalism may offer a temporary boost to multilateralism as it may increase the perceive penalty from deflecting multilateral rules).

324 See Baldwin (2006) and Section C.

and Staiger, 1999b, Limão, 2002) do focus on the level of MFN tariff and show that it may be higher or lower in the absence of RTAs. But, it is not possible to observe the degree of multilateral liberalization to which a country that is a member of a RTA would have committed to without the regional trade agreement. Therefore, empirical analysis has to rely on differences in liberalization patterns over time, across countries or across sectors. A general problem is that there are so many factors that may affect the multilateral tariff that it is difficult to identify the role played by RTAs.

Some empirical evidence exists of a positive correlation between the presence of preferential trade agreements (PTAs), including both reciprocal and non-reciprocal preferential trade agreements, and the level of multilateral tariffs. For example, Foroutan (1998) finds lower average MFN tariffs for Latin American countries with PTAs after the Uruguay Round. But, this correlation is not tested against the possibility of reverse causation.

More robust evidence based on the econometric analysis of the differences in multilateral tariffs across sectors appears to support the view that PTAs may work as stumbling blocks. This perspective is supported by two recent papers (Limão, 2006; and Karacaovali and Limão, 2005). Both papers examine the effect of RTAs on the multilateral trading system, analysing the differences in MFN tariffs between PTA and non-PTA goods, that is goods imported by countries within a PTA and goods imported from countries outside the preferential area. The papers focus on the behaviour by the US and the EC, respectively. They find that, after controlling for product characteristics, on average the cuts in multilateral tariffs were smaller for products that were being imported under a PTA relative to similar products that did not receive preferential treatment. In particular, for the EU, Karacaovali and Limão (2005) find that multilateral tariff cuts are only about half the amount in the goods imported duty-free under a PTA than on similar non-PTA goods. Moreover, they estimate that in the absence of PTAs, the EU would have reduced its multilateral tariffs on the PTA products by 1.6 percentage points more.

To a certain extent, indirect empirical evidence on whether RTAs pose a risk for multilateral liberalization may be provided by the literature on trade creation and trade diversion.[325] One issue that proponents of the stumbling block theory have highlighted as affecting the probability that RTAs are stumbling blocks is the risk that they may promote trade diversion rather than trade creation. Recent papers by Rose (2000), Feenstra et al. (2001) and Frankel and Rose (2002) find that regional trading arrangements, in general, are trade creating rather than trade diverting. However, at the level of specific RTAs this result appears sensitive to alternative estimation procedures (Ghosh and Yamarik, 2004).[326]

(iii) Anecdotal evidence supports alternative views

Anecdotal evidence can be found in support of both views of how regional trade policy approaches impact on the multilateral system. On the one hand, there is evidence that the issue of preference erosion has contributed in stalling multilateral negotiations.[327] For example, in the context of the Doha negotiating agenda in agriculture, Paragraph 44 of Annex A of the 1 August 2004 Decision makes a cross-reference to Paragraph 16 of the Harbinson text.[328] The Harbinson text proposes an arrangement that would slow down the pace of MFN liberalization for "tariff reductions affecting long-standing preferences in respect of products which are of vital export importance for developing country beneficiaries..". Similar concerns were raised in previous Rounds. In the Tokyo Round, for example, Brazil put a proposal on the table calling

325 Aitken (1973), Bergstrand (1985), Thursby and Thursby (1987), Frankel and Wei (1993 and 1995), Frankel and Wei (1995), Frankel (1997) and Soloaga and Winters (2001). For a review see OECD (2001).

326 For example, Bayoumi and Eichengreen (1998) find a positive trade creating effect for the EU and no evidence of trade diversion from enlargement of the European Union (to include Greece, Portugal, and Spain). In contrast, Frankel (1997) found significant negative effects from membership in the EC and Frankel and Wei (1995) find significant trade diversion.

327 The example actually refers to non-reciprocal preferences. But, preference erosion is equally an issue in reciprocal preferential trade agreements.

328 WTO (2002) document TN/AG/W/1/Rev.1 of 18 March, 2003

for MFN tariff-cutting exemptions to preserve certain preferential margins - as well as arrangements for improving and extending the Generalized System of Preferences.[329]

Furthermore, there is evidence that the concern for preference erosion has actually reflected in less multilateral liberalization. For example, in the Kennedy Round, the concern about the erosion of preferences provided by the EC to African and other LDCs through the Yaoundé Convention was linked to "the difficulties of achieving expanded conditions of access to European markets for products of developing countries" (Curtis and Vestine, 1971). Another often quoted example is the case of US tariffs on low-value rum (World Bank, 2005). Rum is one of the most important export products for the Caribbean region and it enters duty free in the US market under the Caribbean Basin initiative. In 1996, in the context of WTO discussions, the United States and EC negotiated lower multilateral tariffs on white spirits, including rum. Governments of some Caribbean countries' raised concerns that this may have eroded their preferences. In response, the United States introduced four new tariff lines for rum and established a MFN duty free regime in high value rum, but maintained MFN tariff on low value rum.

Finally, there is also evidence that the engagement in regional negotiations may stall the process of multilateral liberalization by absorbing resources away from multilateral negotiation. For example, during the Kennedy Round, with regard to agriculture, the Chairman to the Meeting of the Trade Negotiations Committee pointed out to the representatives of the EEC that "all delegations were aware that in many respects there was a real dilemma for them because they were really engaged in two operations at the same time": elaborate and put into force a common agricultural policy for the Community, and participate in international negotiations covering the same field. But that at the same time, other countries "found it very difficult to move resolutely ahead without, as matters stood, any indication as to the conditions which would govern international trade in products in which the Community played an important role" as an importer or as an exporter.[330]

On the other hand, there is also anecdotal evidence in support of the view that RTAs may work as a building block toward further multilateral liberalization. For example, one of the arguments of the proponents of a building block view of RTAs is that by reducing the margin of competitiveness of countries that remain outside the agreement relative to partner countries, RTAs increase these countries' incentive to move on the multilateral front to avoid trade diversion. These predictions seem broadly compatible with historical evidence. Perhaps the most compelling example of this argument is the launch of the Kennedy Round. A number of authors (Metzger, 1964 and Winham, 1986) have argued that this was prompted by the success of the European programme of liberalization. The need to avoid US exporters being discriminated against and losing competitiveness in the EU market prompted the US President to ask the Congress for tariff bargaining authority with the objective of reducing European external protection. This triggered the launch of a new Round of multilateral negotiations. More recently, according to a WTO report the failure to conclude Uruguay Round negotiations at the Ministerial Meeting in Brussels in December 1990 together with the subsequent increase in regional initiatives were "major factors in eliciting the concessions needed to conclude the Uruguay Round" in 1994 (WTO, 1995b, p.54).

A related argument is the timing of major RTAs and multilateral trade negotiations. In particular, Baldwin (2006) points at the "coincidence" that the last three Rounds of multilateral trade negotiations have started in tandem with major moves towards regional integration as evidence of the building block relationship between the two processes. First, the period 1958-1965 saw the formation of the EEC and EFTA together with the launch of the Dillon Round and the launch of the Kennedy Round. Second, the period 1973-1979 saw the enlargement of the EEC and the signing of the EEC-EFTA FTAs, where almost all tariffs in Western Europe were eliminated and, on the multilateral side, the launch of the Tokyo Round. Third, in 1986 the Uruguay Round was launched and, on the regional side, US-Canada FTA talks started and the European Single Act was signed.

329 WTO (1973) document MTN/W/2, 26 October, 1973.

330 The Summary of the Progress Report by the Chairman to the Meeting of the Trade Negotiations Committee on 5 May 1964, WTO document TN. 64/28, p.3

Another argument in favour of the building block argument is that RTAs will trigger the forces for multilateral liberalization by generating the need for "taming the tangle". Baldwin (2006) provides two examples of how the cost from overlapping RTAs can trigger a rationalization of the system or recourse to the multilateral system. One is the Pan-European Cumulation System (PECS) and the other is the WTO Information Technology Agreement (ITA). The PECS arrangements came into being because industrial trade was almost duty-free in Europe, but trade flows were beset by complex and intertwining origin and cumulation rules. With the increasing prominence of production sharing, or geographical fragmentation of production processes, these arrangements became burdensome. A constituency grew in the business sector to get rid of these obstacles to exchange and production, which eventually gave birth to PECS. Trade in information technology products was virtually duty free, but the impediments to efficiency arising from multiple preferential arrangements built pressure on governments to simplify arrangements – hence the ITA. While motivated by the same irritation with the tangle of RTA-induced administrative paraphernalia, there was a big difference between the PECS and ITA initiatives. PECS still meant disadvantages to outsiders, even though much of the problem had been addressed within the PECS zone. The ITA, on the other hand was non-discriminatory and open-ended, intended to attract new signatories over time. With the ITA, therefore, there are no insiders and outsiders – all interested parties can benefit from the ITA's welfare-enhancing elimination of the tangle.

In conclusion, it is fair to say that empirical evidence is too limited to draw strong conclusions as to whether RTAs affect the multilateral liberalization either way. However, both theoretical arguments and empirical evidence highlight that RTAs can pose threats to the progress of the multilateral trading system and that the risk appears to be higher in the case of RTAs that penalize third parties. On the basis of the discussion above, the next subsection address the issue of whether there is scope to ensure compatibility between the current multiplicity of overlapping agreements and the multilateral trading system.

(d) WTO rules: do they ensure that RTAs are compatible with multilateral liberalization?

The discussion above showed that one way in which the GATT, and subsequently the WTO, has dealt with regionalism was to increase the level of transparency of these arrangements. The new transparency mechanism adopted in December 2006 increases the level of transparency by mandating the WTO Secretariat to prepare a report on notified RTAs. While this report on the RTA has to be "factual" and refrain from any "value judgement", the focus of the report and the analysis could still function to alert the rest of the WTO membership to some of the rules and practices in RTAs that adversely affect non-RTA members. This may induce countries entering RTAs to increasingly adopt RTA rules that lead to greater complementarity with existing multilateral agreements.

Unfortunately, transparency may not be enough to ensure complementarity between regionalism and multilateralism. What can economic theory contribute? In the light of the discussions above and in Section C, various proposals to strengthen GATT Article XXIV so as to make regionalism more compatible with multilateralism will be examined.

One of the conditions imposed by GATT Article XXIV on countries entering into a free trade agreement is that "the duties and other regulations of commerce"[331] applicable to non-members at the establishment of the free trade agreement should not be higher or more restrictive than those that prevailed prior to the FTA. But the economic literature suggests that this condition is too weak in shielding non-FTA members from the cost of trade diversion. The requirement that the duties and other regulations of commerce imposed on non-FTA partners shall not be higher or more restrictive than before is unlikely to protect the latter from a welfare loss. Based on the Kemp-Wan theorem, a sufficient condition to shield non-FTA members from a welfare loss is, for each product, to preserve the volume of trade between the FTA members and non-members that existed prior to the establishment of the agreement (see discussion

[331] See discussion in subsection b.(iv) above.

of the Kemp-Wan theorem in Section C Box 9). This suggests that the duties and other regulations of commerce imposed on non-FTA partners may actually need to fall to achieve this heightened threshold.

In line with the Kemp-Wan theorem, McMillan (1993) has proposed an amendment of GATT Article XXIV by changing the focus from "the duties and other regulations of commerce" to import volumes. The proposed change requires that the members of an RTA (whether the RTA is a customs union or a free trade agreement) to maintain their aggregate level of imports from the rest of the world at the pre-integration levels. Note that the proposal is a simplification of the Kemp-Wan conditions. The Kemp-Wan theorem requires that for each product, the trade (imports and exports) with the rest of the world be maintained at their pre-integration levels. The McMillan simplification is intended to lessen the operational burden of applying the criterion, otherwise, the Kemp-Wan conditions would require examining the RTA's trade with the rest of the world in every commodity. While the proposal simplifies the operationalization of the Kemp-Wan conditions, it does so at some cost. With aggregate imports as the indicator, one can only be certain that taken as a whole, the rest of the world is not harmed. But one cannot be certain that there are no individual losers in the countries that make up the rest of the world.

In principle, the Kemp-Wan theorem should be as applicable to trade in services as to trade in goods. One leaves the welfare of non-members unchanged if the establishment of the RTA leaves the RTA's trade in services with non-members at the pre-integration level. In practice, however, this may be more difficult to achieve than in the case of merchandise goods. In the case of a customs union, the Kemp-Wan theorem requires adjustments to the common external tariff to preserve the bloc's merchandise trade with non-partners at the pre-integration level. But even in highly integrated regions (customs unions), there may be no equivalent analogue in trade in services to a common external tariff.

Very recently, Baldwin (2006) warned that the GATT/WTO has been a passive bystander as regionalism has exploded, and that it now risks a serious erosion of its relevance. However, he argues the WTO could play a valuable role in "taming the regionalism tangle". His argument relies on claim that today we have three "fuzzy" and "leaky" trade blocs – fuzzy because sharp lines cannot be drawn around the main blocs in North America, Europe and East Asia; and leaky because of links among the "spokes" in different "hub and spoke" arrangements. In this maze, complex and costly rules of origin raise political forces to rationalize the system of trade.[332] In addition, he claims, the WTO could play an active role in multilateralizing FTAs.

In particular, Baldwin sees three roles for the WTO under the present circumstances. Firstly, to undertake analytical work to provide a deeper understanding of the attractions of multilateralizing regionalism. By providing Members with qualified and impartial information on critical issues, the WTO could alert members about the risks associated with the proliferation of RTAs. Second, to provide a negotiating forum for the coordination/standardization/harmonization of rules of origin. The process of fragmentation of production will show the importance of a coordinated set of rule of origin or cumulation. The WTO could in this field play the same role as the ISO in standards. A timing intervention could help save on large costs. Finally, the WTO can provide a forum for the spokes in hub-and-spoke regional arrangements such that the spokes would be able to identify ways of dealing with the hegemonic power of the hub. In this context, the WTO may provide legal and economic advisory services on North-South and South-South agreements.

[332] See Section C.

6. DOING BUSINESS IN THE WTO

(a) Introduction

Any healthy institution, public or private, which experiences a six-fold increase in size over six decades and expands into numerous new areas of activity would expect to face a number of institutional challenges – internally as well as externally. The WTO is no different in this respect. Since its creation little over a decade ago, the WTO's membership has grown by more than 20 per cent, adding to its coverage more than a quarter of the world's population. The combination of a growing membership and the diversification of the organization into areas beyond traditional tariff-cutting has ensured that the WTO is a very different entity compared to its predecessor, the GATT. From the small, homogenous but largely obscure club of 23 Contracting Parties in 1948 to a near universal institution with 150 Members at very different levels of development and with divergent ideological persuasions the WTO has become a more political organisation. And whereas the GATT for much of its 50 year existence rarely generated public interest beyond the trade community, the WTO is now scrutinized by a general public concerned with a long range of new issues ranging from the impact of trade and trade policy on health, the environment, food security, human rights and economic development.

With its 150 Members and a decision-making process which operates by consensus, doing business in the WTO has become increasingly prone to gridlock. Whereas negotiations under the GATT were generally led by and conducted among a small group of developed countries the growing involvement and assertiveness of multiple actors combined with a widening, deepening and, above all, inter-linked agenda has made the internal decision-making process increasingly cumbersome. In this respect, the combination of the difficulties in concluding the Doha Round, the proliferation of Preferential Trade Agreements and the relatively modest advances in multilateral trade liberalization over the past decade are all important elements in understanding why the decision-making process of the WTO has been placed under increased scrutiny by the WTO membership and by an interested public. To be sure, the focus on governance issues, including the legitimacy of decisions and processes, is not unique to the WTO, but is a central theme for most public institutions at the domestic as well as international level. However, for a Member-driven organization based on a set of legally binding rules agreed by all Members, this is particularly relevant. The legitimacy of these rules depends crucially on the extent to which all Members feel they have participated in the process that produced the rules.

The WTO has been criticized by non-governmental organizations (NGOs) and other civil society organizations for its "democratic deficit" and the lack of "legitimacy" of its decision-making process. These criticisms initially targeted the lack of external transparency of the organization and the absence of a consultative interface which would allow NGOs a more direct role into the WTO process. However, over the past few years these terms have more often been applied when criticizing the internal decision-making process of the WTO and less in the context of external transparency. This transition from a predominantly process-oriented focus on the WTO to more nuanced and substance-driven lobbying is important when evaluating the relationship between the multilateral trading system and civil society. Over the past decade NGOs have come to the gradual realization that the most efficient way to influence the WTO agenda is through individual or groups of Members, rather than through the WTO Secretariat. Whereas the member-driven nature of the WTO was poorly understood and appreciated by most of these organizations in the early years, the last few years have seen a much better understanding of the notion that it is the WTO Members that drive the multilateral trading agenda. Accordingly, the focus of most NGOs has increasingly turned to the substantive agenda of the WTO and they have often become important providers of policy input and legal advice to Members on a broad range of trade issues. The role of civil society in the way that the WTO does business today is radically different from anything which took place in the GATT and is a clear indication of how the multilateral trading system no longer operates in a vacuum.

The following chapter has two objectives. First, we shall attempt to analyse the evolution in the internal decision-making process of the WTO and demonstrate how the membership has addressed this important

institutional challenge. We shall outline the specific practices which characterize the way the WTO operates today, including the transparency guidelines which underpin the consultative processes among Members. Second, we shall take a closer look at the evolution of the way in which the WTO interacts with civil society at large, particularly with NGOs. This section will aim to illustrate the extent to which external pressure and input have contributed to important changes in the practices that guide the WTO's relationship with the outside world and the way in which the outside world views and does business with the WTO.

(b) Decision-making in the GATT and the WTO

Whereas much of the 1980's debate of international institutions focused on the need for such organizations (Keohane, 1983) and the relevancy of their mandates, an increasingly important element in the current discussion of these institutions relate to the manner in which decisions are taken in such forums. This focus is hardly surprising given that some of the most powerful international institutions of today were founded in the immediate post World War II period and reflect the ideas and ambitions of a relatively limited number of developed countries. The emergence of a number of developing countries as international powerbrokers in their own right and the increasingly multi-polar nature of international affairs have stimulated a discussion on whether existing institutional structures adequately cater to the new multiple actor power equilibrium in the international economic system. The decision-making procedures and practices of an international organization, it can be argued, represent important parameters in evaluating the extent to which the institution reflects the diversity of its membership.

This is not the place for an in-depth analysis of the decision-making rules in other international organizations. Suffice it to say that generally such organizations will use one or a combination of decision-making rules for most non-judicial action. Some organizations will apply a system of majority voting among members based on one vote per member and others will subscribe to a weighted form of voting where voting power is allocated in proportion to a members' financial contribution to the organization. Another category of organizations will offer equal representation and voting power to its members and will take decisions by consensus or unanimity. The GATT and subsequently the WTO fall under this latter category which has its roots in a notion of sovereign equality of states (Steinberg, 2002). In fact, Steinberg (2002) notes that several other organizations such as ASEAN, MERCOSUR, NATO and OECD to name a few have complex structures and mechanisms to ensure that decisions normally are taken by consensus or unanimity.

The principal objective of the following section is to examine the evolution of the decision-making process from the GATT to the WTO. For the present purposes, decision-making refers to the informal and off-the-record consultative track as well as the more formal and recorded process and we shall endeavour to analyse both. This definition deliberately seeks to identify and include those aspects of the GATT/WTO decision-making process for which the system can be held responsible, e.g. consultations organized and hosted by elected chairpersons and by the Director-General. At the same time it excludes processes which fall outside the trading system's institutional framework, e.g. bilateral or plurilateral meetings among countries. The distinction is important, but often not understood.

(i) The GATT decision-making process

Apart from its Article XXV which called for one-country one-vote and decision by a majority of votes cast unless otherwise provided, the GATT treaty contained very little concerning decision-making. However, despite this clear and formal reference to voting, the GATT decision-making practice, with the exception of accessions and waivers, generally was characterized by consensus.[333] In the early years and until the late 1950s, a practice developed whereby the Chairperson of a meeting would take sense of a meeting

[333] It is worthwhile noting that Article XXV of the GATT authorized "joint action" by GATT Contracting Parties (CPs) and had been the basis for launching most negotiations. The Article permitted decisions that were supported by two-thirds majority of the votes cast, provided that this included more than half the GATT CPs. The Article was instrumental in the US push for launching the Uruguay Round. See Croome (1995).

rather than ask for a vote. Subsequently, and until the creation of the WTO, the GATT decision-making practice was that of consensus. The development of this practice of consensus was undoubtedly related to the increasing number of developing countries that joined the GATT from the late 1950s and onwards and whose numbers could have provided them with effective control of the system to the detriment of the developed countries.

The GATT decision-making process relied heavily on informal consultations. Although the practice of the so-called Green Room meetings among a few delegations had its origins in the Tokyo Round, these informal consultations became both more frequent and involved more Contracting Parties throughout the Uruguay Round (Blackhurst and Hartridge, 2004).[334] In addition, numerous informal groups began meeting outside the GATT to discuss how to move the negotiations forward. These groups performed an important function in terms of gradually exposing ideas and proposals which required further development before being aired in meetings among all the Contracting Parties. Although the ideological homogeneity of the original Contracting Parties of the GATT notionally was diluted somewhat as more countries signed up to the Agreement, the so-called Club Model of multilateral cooperation (Keohane and Nye, 2000) in which the agenda was determined and negotiations concluded among a relatively small group of developed countries persisted until and even well into the Uruguay Round. The success and relative efficiency of the negotiating rounds under the GATT were principally down to the fact that a majority of Contracting Parties were not asked to bring anything to the negotiating table, yet received the full benefits of the outcome. In addition, the pre-Uruguay Round trade negotiations by and large focused on the traditional and relatively uncontroversial tariff-cutting on industrial products.

Although the GATT decision-making process experienced its share of problems throughout its almost 50 year existence, particularly during the Tokyo and Uruguay Rounds, many of its practices were institutionalized in the WTO[335], including the practice of taking decisions by consensus. Whereas this practice was not articulated anywhere in the GATT, Article IX of the WTO Charter states "the WTO shall continue the practice of decision-making by consensus followed under GATT 1947.". [336] The footnote to this Article defines what consensus means[337]. Articles IX and X specify when voting is possible.[338]

Despite the commitment to consensus decision-making, the issue of voting in the multilateral trading system continues to generate considerable interest. In the GATT, as in the WTO, certain decisions were required to be taken by a qualified majority of the membership. For instance, decisions on waivers and accessions in the GATT were required to be taken by two-thirds of the membership. Similar provisions have been carried over into the WTO Agreement, although waiver decisions in the WTO now require a three-fourths majority. Under the GATT, decisions requiring such qualified majorities were regularly submitted to a formal vote by the membership, either by postal ballots or by roll-call votes at meetings of the Contracting Parties to the GATT. However, in connection with such decisions that were submitted to a vote under the GATT, it is worth noting that the texts of the draft decisions and the decision to submit the draft decisions to a vote were agreed by prior consensus.

---

334 The term Green Room has been the subject of considerable speculation over the years. One theory explains the term by the colour of the walls of the Director-General's conference room at the time while another adheres to the more traditional understanding of the green room as the space where actors would gather and prepare before going on stage.

335 For a comprehensive overview of the GATT and WTO rules on decision-making see Ehlermann and Ehring (2005).

336 The Results of the Uruguay Round of Multilateral Trade Negotiations, The Legal Texts, page 11.

337 The footnote states that "The body concerned shall be deemed to have decided by consensus on a matter submitted for its consideration, if no Member, present at the meeting when the decision is taken, formally objects to the proposed decisions.".

338 Where not otherwise specified, and where a consensus cannot be established, simple majority voting is sufficient. In addition, there are three different methods of voting: (i) amendments to general principles, e.g. MFN and national treatment, require unanimity; (ii) amendments to issues other than the general principles require a two-thirds majority; and, (iii) interpretations of the provisions of the WTO agreements, including decisions on waivers, require a three-fourths majority vote.

The practice of submitting texts of draft decisions requiring qualified majorities to a vote by postal ballot, after consensus had been reached on the contents of the decisions, was initially followed in the WTO in the months immediately following its entry into force. This was the case, for example, in July 1995 when the General Council agreed to submit a draft decision on the Accession of Ecuador to a vote by postal ballot.[339] This way of proceeding reflected the old practice followed in GATT. However, the submission to a vote by postal ballot of a decision on the contents of which consensus had already been reached was soon considered unnecessarily complicated and time-consuming by Members and the General Council decided to streamline its working practice with regard to the taking of such decisions.[340] The adopted procedures make it clear that the General Council will seek a decision on a matter related to a request for a waiver or an accession by consensus and that, except as otherwise provided, a vote will be taken only where the matter cannot be decided by consensus. So far, all decisions in the WTO have been agreed by consensus and despite the amount of time and energy spent on designing WTO voting rules by Uruguay Round negotiators, both theoretical objections to voting and the practical reality ensured that the GATT tradition of consensus decision-making remained at the core of the multilateral trading system.

The agenda of the Uruguay Round complicated matters insofar as it included a number of new and sensitive issues and because it introduced the principle of a single undertaking, i.e. that the negotiated outcome would apply to all participating countries. The principle of the single undertaking and the fact that new rules would apply to all, although with varying degrees of implementation flexibility, meant that active participation in the decision-making processes mattered for all participants. The duration of the Uruguay Round and the numerous failed ministerial conferences which peppered the path to its eventual conclusion in 1994 were a genuine reflection of the complexity of the agenda as well as the fact that a much larger number of stakeholders participated in the negotiations. Nonetheless, the successful conclusion of Uruguay Round still required a bilateral agreement between the US and the EU on agriculture. The Blair House accord, incidentally, may be the last time that agreement between the two biggest traders in the multilateral trading system was enough to assure the completion of a wider negotiation. The numerous delays and the decision-making grid-lock which had characterized the Uruguay Round would foreshadow a number of institutional challenges, particularly in the area of decision-making, which would surface in the WTO.

(ii) The WTO decision-making process

Unlike the GATT, agreements reached in the WTO impose legal obligations on all Members. This places a premium on participation and the demand for active involvement in the WTO decision-making process has increased drastically among a large number of Members, particularly developing countries. It is generally accepted among the WTO membership that the extent of the WTO's legal obligations and the quasi-automatic nature of the dispute settlement mechanism are only possible because of the political participation which the consensus principle offers.

Strains in the WTO decision-making process became apparent as early as the first Ministerial Conference in 1996. Although the Singapore meeting was more of a stock-taking exercise and as such did not envisage significant trade-offs, the agenda nevertheless included a number of controversial issues which required consultation and negotiation. For a large number of developing countries the Singapore meeting was the first experience with the intense dynamic which tend to characterize WTO Ministerial Conferences and the majority of these countries came poorly prepared substantively and logistically (Pedersen, 2006). Lack of organization within individual delegations in turn made effective coordination and coalition building with other developing countries difficult. At Singapore, the core consultative process in charge of drafting the Ministerial Declaration took place among 34 countries and although the existence of this group was controversial, the antagonism it generated was neither coherent nor rebellious enough to seriously jeopardize its operation. Nevertheless, at the final informal session on 12 December 1996,

339 WT/GC/M/6.

340 On 15 November 1995, the General Council agreed on a statement by the Chairman on procedures regarding decision-making under Articles IX and XII of the WTO Agreement (WT/L/93).

designed to reach the consensus required for adoption of the Singapore Ministerial Declaration, a large number of those countries which had not been involved in the small group consultations articulated their dissatisfaction with the manner in which the text had been prepared and indicated that they were no longer willing to accept this lack of inclusiveness and transparency. However, back in Geneva these issues were placed on the back-burner and did not surface in earnest until the preparatory process for the 1999 Ministerial Conference in Seattle.

Much has been written about the comprehensive and complex substantive agenda before the WTO membership prior to Seattle and the extent to which the 14-month preparatory process became bogged down in a number of procedural issues. From a substantive as well as a pure decision-making point of view, the length and nature of the Seattle preparatory process had created a sense of expectation among delegations to see their own specific language reflected in the Chairman's text. The result became known as the "Christmas Tree" text as delegations submitted new proposals and specific wording which they expected to see in the Chairman's draft text. Little, if any, negotiation to narrow substantive differences took place and the second revision of the text ran a full 34 pages and contained some 402 square brackets. Despite a number of unsuccessful attempts to consolidate this draft through small group consultations so as to present Ministers with a manageable product the negotiation process in Geneva had clearly broken down. The issue which sparked off a procedural debate more than any other was the transfer of the ministerial text from the Geneva process to Ministers at Seattle and the extent to which the Chairman of the General Council and the Director-General could forward the draft document to Ministers or whether a consensus was required.

The key concern among many delegations was that even if it was acknowledged that the draft did not reflect agreement it would nevertheless become the basis for discussions. At previous occasions the Director-General had been given a mandate to prepare/assemble a draft declaration but forwarding the text to Ministers had always generated some controversy although never along the lines of the opposition before Seattle. Furthermore, the opposition to granting a mandate to the General Council Chairman and the Director-General to forward the text to ministers to a large extent was a reflection of the atmosphere of general distrust among WTO Members in 1999 following a rather acrimonious selection process for a new Director-General. Although it is beyond the scope of this section to analyse the substantive agenda at Seattle, it became clear even before the Ministerial Conference that outstanding differences among Members were too numerous and profound to be solved at Seattle.

The 1999 preparatory process and the Seattle meeting itself represent landmarks in terms of how the WTO operates today and in several ways set the agenda for the reforms of the practices that guide WTO decision-making. What set the Seattle preparatory process apart from previous experiences in the GATT/WTO was the active participation of a large number of developing countries and the unprecedented level of coordination which took place among a number of groups. The creation of the Like-Minded Group (LMG), the enhanced coordination of a number of developing country groups such as the African Group, the African, Caribbean and Pacific Group of States (ACP) and the Least Developed Country Group (LDC), as well as their increased use of external analytical expertise provided by a number of NGOs and international organizations, were all important elements in explaining the growing assertiveness and confidence of developing countries in the run up to Seattle. Although there is little doubt that the frustration felt by many countries at the Singapore Ministerial Conference can explain some of this improved coordination, the fact that the Seattle Ministerial Conference aimed at launching a new round of trade negotiations, including on a number of contentious issues for developing countries, provided an added incentive for these countries to cooperate.

As the conference got under way it became clear that many developing countries and the various groups to which they belonged were determined to carry over the momentum and influence which they had established in the Geneva preparatory process. This is a particularly important point because experience has demonstrated how the depth and automaticity of the Geneva coordination can be lost as the negotiating baton is handed over to capital-based officials and ministers. As the Seattle meeting entered its final days a large number of developing countries which had not been included in the small group consultations by either the facilitators or the Conference Chairperson publicly denounced the process

and, in an unprecedented move, signalled their readiness to veto any substantive outcome by the small group consultations on the basis of procedural objections. This threat was, of course, never tested as a substantive outcome from consultative processes never materialized and a draft text never appeared. However, it did send a very strong message that a large number of developing countries would no longer accept being mere spectators in the WTO and were ready to accept a larger degree of responsibility. When the meeting ended inconclusively on 3 December 1999 the issue at the forefront for a majority of WTO delegations was how to improve the internal transparency of, and participation in, the decision-making processes of the WTO.

(iii) WTO Members scrutinize decision-making process

Unlike the aftermath of Singapore, where the discussion of systemic/institutional improvements fell by the wayside, the follow-up to the flaws in the WTO decision-making process which had become apparent both before and at Seattle was immediate and represented the first time in WTO history that Members agreed to engage in a dedicated discussion at the level of the General Council of options for systemic reform. In this context it was particularly significant that a very wide spectrum of Members shared the sense that improvements to the decision-making process was required.

The consultative processes on the transparency and inclusiveness of WTO decision-making in 2000, and again in 2002, are significant from an organisational point of view.[341] The 2000 process took place against the backdrop of a failed ministerial conference which had underscored the institutional shortcomings of the consultative practices of the WTO. If anything positive came out of the Seattle meeting it was the wide-spread recognition among the membership that some sort of reform of the WTO decision-making process was necessary. The 2002 process, by contrast, did not come about as a result of a crisis or a break-down of negotiations. The successful launch of the Doha Round in late 2001 had overall seen a number of improvements in terms of the decision-making process and 2002 began with the articulation of a number of guidelines which should guide the operation of the newly established TNC and the work of the chairpersons of the negotiating groups.[342]

In the discussions on transparency in decision-making among Members two main arguments quickly crystallized. On the one hand, a number of delegations felt that the informal decision-making process lacked predictability and accountability and that a specific set of rules to guide the informal consultative processes would eliminate what they saw as sometimes arbitrary behaviour by WTO chairpersons. On the other hand, a number of countries argued that imposing specific procedures on the informal consultations would strait-jacket a process which required a maximum of flexibility to adjust to different circumstances (Pedersen, 2006). In addition, these countries argued that imposing a strict set of formal rules on the consultative process would simply ensure that the process would go outside the framework of the WTO with the negative ramifications that would entail in terms of transparency. Although the discussions were considerably more nuanced, this difference of opinion goes to the core of the trade-off between efficiency and transparency in decision-making. Following several informal and formal discussions it became clear that it would be impossible to adopt a specific set of rules on decision-making by the required consensus and that the articulation of a number of best endeavour practices remained the most realistic compromise outcome.

Although this outcome clearly fell short of what many delegations had hoped for, the principles and practices section in the Chairman's statement, which was endorsed by Members at the first meeting of the TNC on 1 February went further in articulating the role and obligations of chairpersons in ensuring inclusiveness and fair representation of different positions. While these principles were couched in best endeavour terminology and have no legal status, the context and timing of their articulation made them carry particular weight and have ensured that they remain the principal point of reference in the decision-making debate.

341 For a full overview of the discussions on internal transparency see Pedersen (2006).

342 TN/C/1.

(iv) New practices in WTO decision-making

The following will seek to provide an overview of those new practices which characterize the WTO decision-making process – in the day-to-day operation of the WTO and in relation to the conduct of Ministerial Conferences.

The WTO decision-making process, like the GATT before it, consists of formal and informal processes. In general, the former are on-the-record meetings from which minutes[343] will be available to delegations and the public within a few weeks after the meeting. The formal WTO meeting track is open to all Members of the organization[344] and the minutes provide the automatic transparency feature of this process. Whereas the formal meeting track is where WTO decisions are taken, the informal meeting track, also known as informal consultations, is where such decisions are negotiated and prepared. Such consultations aimed at building consensus among 150 Member Governments are often time-consuming, and involve discussions not only at various levels – bilateral, plurilateral and multilateral – but also in various settings, both formal and informal. The mechanics of this process is not unique to the WTO, but is a feature of most, if not all, international organizations. It remains a serious misconception that the WTO informal consultations in some strange way are different from similar processes in other international intergovernmental organizations or large non-governmental entities.

In the past, the informal consultative processes of the WTO have been the target of criticism among other things because of their exclusive nature, i.e. not all Members are invited to take part. Critics have also focused on the absence of summaries from these meetings although the entire idea behind informal gatherings is precisely that they allow participants to discuss and negotiate areas that would be impossible in a formal setting. However, informal consultations in the WTO today are subject to a much greater degree of transparency and predictability compared to the GATT and the early years of the WTO. For example, since 2000 Chairpersons of WTO bodies have followed a practice of announcing in formal meetings their intention to hold informal consultations and their intent of reporting back to the full membership on the outcome of such consultations.[345] Although a Chairperson may take the initiative to engage in such consultations, it is equally commonplace for the membership of a WTO body to request that he/she consults informally on specific issues before these are brought back to the full membership. Such requests are made by implicit recognition of the limits in terms of efficiency of open-ended meetings of all 150 Members. The Chairperson, of course, retains a large degree of autonomy in defining with whom and on what is to be consulted, but it has become increasingly customary for delegations who believe they should be consulted to contact the Chairperson or his WTO Secretariat aides directly in order to be included in a consultative process. The regular bodies of the WTO as well as the negotiating groups under the TNC have generally followed this approach and although delegations regularly articulate the need to maintain vigilance regarding transparency there is widespread recognition that the current practice as described above is striking the right balance between transparency and efficiency. The automaticity of the announcement of a consultative process and the reporting back on these discussions to the full membership has provided the WTO decision-making process with an element of predictability which did not exist previously. In addition, more countries participate more often in these consultative processes and participation in these meetings roughly reflects the proportionality between developing and developed countries in the WTO. In articulating the practices that should guide the decision-making process WTO Members also addressed the particular constraints faced by smaller delegations in the context of the ever increasing number of meetings. Specifically, the TNC has been mandated to keep the calendar of meetings under tight surveillance to avoid, as far as possible, a situation where more than one negotiating body meets at any given time.

343 Minutes of meetings are produced and translated into all three official languages of the WTO by the Secretariat. Minutes are not verbatim although they are produced from either audio tapes or written statements by delegations.

344 Exceptions are plurilateral agreements such as the Government Procurement Committee.

345 For a comprehensive overview of the role played by a WTO chairperson, see Odell (2005).

The increased transparency and predictability of the day-to-day business of the WTO decision-making process has also had a significant impact on the organization, preparation and conduct of Ministerial Conferences. In response to the confusion experienced by most delegations at the Seattle meeting, the Doha, Cancún and Hong Kong conferences introduced an increasing number of features to facilitate the work of delegations and increase transparency and predictability. At Doha the practice of setting aside two one-hour slots per day for delegations to coordinate their work and consult with others was initiated and this feature has been maintained ever since. In addition, the Doha meeting inaugurated the practice of having daily open-ended meetings to allow reports on the various consultative processes to be shared with the full membership. The rhythm of these transparency meetings mirrors the Geneva consultative practice and they have become fixed features at WTO Ministerial Conferences.

The Cancún and Hong Kong meetings represented a series of improvements over Doha. The participation of the Conference Chairpersons in the final meeting of the preparatory process represented an unprecedented commitment to ensuring continuity with the Geneva process. Similarly, the decision to announce the roster of facilitators prior to these meetings was widely welcomed by Members. At the first open-ended informal meetings at both Cancún and Hong Kong delegations were also provided with detailed and practical overview of the informal process. These new initiatives went further than what had been done previously and increased the predictability of the proceedings at Ministerial Conferences. Nevertheless, WTO Ministerial Conferences continue to represent important challenges. As the debate in 2000 demonstrated, the potential of these meetings to move forward the agenda versus the risk of provoking high profile political disasters remain real concerns among the WTO membership. Although the Hong Kong meeting was widely seen as having made important strides in terms of transparency, the substantive outcome of the meeting only just managed to keep afloat the Doha Round.

There is little doubt that adherence to these new practices constitutes an important element in the mutual trust which is often highlighted as the cornerstone of multilateral trade negotiations. The practices demonstrate how difficult it is to separate process and substance in the WTO and how important participation is to the sense of ownership of a substantive outcome.

(v) The growing importance of groups and coalitions in the WTO

One of the most significant developments within the WTO decision-making process over the past few years is the role played by different groups and coalitions of countries, particularly among developing countries. To be sure, the operation of groups and coalitions within the multilateral trading system can be traced back to the pre-Uruguay Round days, including the existence of the Informal Group of Developing Countries which opposed the attempts to bring services into the GATT. From this group emerged the so-called G10 which took an irreconcilable and hard-line approach to the services issue. Eventually, the G10 was side-lined by a coalition led by Colombia and Switzerland which brought together members of two groups known as the G9 and the G20 and whose efforts provided the basis for the Punta del Este Declaration that launched the Uruguay Round (Tussie and Lengyel, 2002, Narlikar, 2003). The success of this group, also known as the Café au Lait coalition, was founded on a common interest in a single issue which still allowed members to pursue their own agendas in other areas. Similarly, the group included a wide range of developing and developed countries and had placed a premium on research and information sharing a part of its operational characteristics. The experience and success of the Café au Lait coalition were in some ways the precursor for the creation of the Cairns Group of agricultural exporting countries in 1986. An issue and research-driven coalition of developed and developing countries, the Cairns Group positioned itself between the US and the EU and succeeded in setting the agenda on agriculture for much of the Uruguay Round. During the Round, a number of other groups, including the De La Paix Group (broad range of issues), the Morges Group (agriculture), the Pacific Group (safeguards), the Victims Group (anti-dumping) and the Rolle Group (services) brought countries together on specific issues. However, although many of these groups signalled the importance of issue-based alliances, most other issue-based initiatives during the Uruguay Round fared less well and it can be argued that only the Cairns Group managed survive the transition into the WTO.

WTO Ministerial Conferences have played a particularly important part in the emergence and evolution of individual country groups as well as the wider cooperation among such groups. Historically, one of the most significant challenges which have faced country groups and their coordinators in the Geneva process has been how to ensure that the level of coordination achieved in the Geneva process was carried over to the ministerial level. This challenge was often made more difficult because the coordinator of a particular group was different at ministerial level compared to the ambassadorial level in Geneva. In the following we shall take a brief look at the evolution of groups in the contexts of the various WTO Ministerial Conferences and their respective preparatory processes. Subsequently, we shall endeavour to provide an overview of the multitude of groups which have emerged during the on-going negotiations in the Doha Round.

Examples of effective issue-specific group coordination in the WTO prior to the 1999 preparatory process for the Seattle Ministerial Conference were relatively scarce. Although groups such as the African Group, the ACP, the LCDs, the Small and Vulnerable Economies, (SVEs) and the Like-Minded Group (LMG)[346] revealed the general outline of some group cooperation among developing countries, even if primarily organized around the opposition to a number of "trade-and" issues, it would be wrong to label any of these groups "issue-specific". Instead, they appeared to organize their efforts according to the specific challenges faced on a day-to-day basis. However, during the Seattle preparatory process and at the conference itself several of these groups began tentative cooperation on such issues as S&D, preference erosion, implementation issues and systemic reform.[347]

Discussions on systemic reform occupied a central place on the WTO agenda following Seattle with the LMG playing a particularly active role. The initiative at Doha to maintain two meeting free slots every day to allow for delegations to coordinate was specifically introduced by the Director-General following lobbying by the coordinators of major groups. These coordination meetings also provided a facility for civil society representatives to provide input to individual and groups of delegations. Such a dialogue had taken place at Seattle, but the Doha conference took a significant step in facilitating such consultations. At Doha, as during the preparatory process, the Director-General met daily with the coordinators of the ACP, African Group and LDCs and their inclusion in the ministerial Green Rooms at Doha became automatic. In terms of the effectiveness of different groups in getting their issues onto the agenda, the Doha declaration contains several paragraphs where such influence is visible.[348] The Doha meeting also revealed the significant challenge faced by Geneva based groups in ensuring that the level of coordination achieved in the preparatory process is continued at the ministerial level.

Where the Doha meeting had illustrated the growing significance of country groups in the WTO, the Cancún meeting established these groups as power-brokers in their own right. Although the Cancún conference was envisaged as little more than a mid-term review of the Doha negotiating agenda, the absence of progress since Doha created an environment in which most delegations saw some of their specific concerns being sidelined or sacrificed. As a result, and in addition to an increasing level of coordination between existing groups, the final months before the Cancún meeting saw the emergence of several new coalitions, including the Core Group of developing countries (Singapore issues), the Cotton-Four, the G33 (agriculture) and the G20 (agriculture).[349] The emergence of these groups prior to the Cancún meeting was significant from a substantive as well as a process point of view. First, the substantive contributions of these groups, particularly the G20's proposal on agriculture, represented a serious substantive alternative to what had been placed on the table by the EU and the US. This is significant because rather than simply rejecting the transatlantic proposal, the G20 submitted its own

[346] The informal Like-Minded Group was formed in 1999 to provide a platform for a common approach on implementation-related issues.

[347] It is important to note the considerable official support that many of these groups received from international organizations such as UNCTAD, particularly prior to Seattle and to a lesser extent at subsequent ministerials.

[348] The Cotonou waiver is counted as a success for the ACP and many African countries, paragraphs 42 and 43 deal exclusively with LDCs, paragraph 35 recognises the concerns of SVEs, references to S&D are omnipresent in the text and paragraph 12 as well as a separate decision deal with implementation issues.

[349] For an overview of the agendas of each of these groups see Narlikar and Tussie (2004)

detailed proposal on agriculture and in the process established the kind of credibility which comes through research ability and substantive engagement. Second, the composition of these groups and the extensive coordination which characterized their preparations for the Ministerial Conference were unprecedented in the history of the multilateral trading system. Cancún also saw the emergence of the G20, a group of developing countries comprising the Africa Group, LDCs and ACP countries.[350] The Hong Kong Ministerial Conference as well as the preparatory process for this meeting confirmed the high degree of coordination within and among these groups, including through the use of several ministerial gatherings in preparation for Hong Kong.

The coordination within and among the three largest groups of developing countries, i.e. the African Group (45), the ACP (66) and the LDCs (34), have ensured that they play a more central role in the multilateral trading system than at anytime previously. Of course, the importance and centrality of these three groups in the WTO today can be explained by their history of increasingly active involvement in the WTO. But a number of other factors are important. First, the large numbers of Members in each group makes it impossible to overlook them in the WTO decision-making process. This is so because the groups have been active in highlighting their numbers and using their combined membership to bolster the legitimacy of their cause, as was the initiative of the Ministers representing the G-20, the G-33, the ACP Group, the LDC Group, the African Group and the Small Economies, quickly dubbed the G110, to hold a joint press conference at Hong Kong.[351] Second, the recognition in these groups that in order to participate substantively in the WTO you need to establish a reputation for detailed and technically solid research. In turning to external expertise from civil society organizations and international intergovernmental organizations to build up negotiating positions these groups have the capacity to develop and articulate a substantive agenda of their own. Third, the role of the group coordinators has changed considerably since Doha. Coordinating a large group of countries, some of whom have divergent interests, is no easy task. However, by improving internal group discipline as well as coordinating information sharing and providing the coordinator with a genuine mandate to represent its membership, each group has increased its role and importance in the WTO. Fourth, the groups – individually and in concert – have managed to ensure a much higher degree of continuity and cooperation between the Geneva process and capitals, including at ministerial level.[352]

In the context of the Doha Round negotiations the WTO has witnessed a dramatic proliferation of groups and coalitions.[353] Although this is not the place to elaborate in detail on the different groupings and coalitions it is clear that important differences exist between more structured groups, e.g. the Cairns Group or the African Group, compared to loosely organized coalitions such as the Friends of Fish or the Friends of Anti-Dumping Negotiations. The former groups will generally utilize a more formal and high-level coordination of negotiating position, including at ministerial level, while the efforts of the latter will most often evolve around Geneva-based officials and visiting senior officials. The more formal groups will often be able to draw on specialized analytical support and in some cases even established secretariats to coordinate positions and draft proposals and such groups have in the past often held their own ministerial gatherings prior to WTO Ministerial Conferences. The less organized groups and coalitions often organize their activities around specific consultative processes in Geneva at which they will attempt to present a united front. Wolfe (2006 and 2007) and Narlikar and Tussie (2004) have elaborated in more detail on the dynamics of these groups. However, what is characteristic for a number of the informal

350 See Narlikar and Odell (2006) and Odell and Sell (2006).

351 Bridges Daily Update, 17 December 2005.

352 In this context it is worth noting that in 2006 in Geneva the ACP held 46 meetings, the LDC group held 108 meetings and the African Group held 71 meetings. These figures do not include bilateral meetings of the groups. The three groups met as the G90 on four separate occasions in 2006.

353 In addition to the groups already mentioned, other groups include (non-exhaustive): G4, G6, Recently Acceded Members, Small and Vulnerable Economies (general/cross-cutting issues); Cotton-4, G10, Group on Tropical Products (agriculture), ABI group, Friends of Ambition, NAMA-11, Friends of MFN, Paragraph 6 Countries (NAMA); Mexican Group, G-7 (DSU); Friends of Anti-Dumping Negotiations, Middle Group, Friends of Fish (Rules), Friends of Environmental Goods, Group of Developing Countries (Environment); Colorado Group, Core Group (Trade Facilitation); Friends of GIs, Joint Proposal Group (TRIPS-GI-register).

coalitions in the context of the Doha Round is their organization around specific issues on which they can agree despite the fact that they have opposing interests in other areas. Some coalitions even include developed and developing countries whose agendas otherwise differ significantly. The emergence of the G20 in the run-up to Cancún represented somewhat of a watershed in the history of informal groupings within the WTO insofar as this entity, despite a number of significant internal fault-lines, has managed to maintain a central role in the Doha Round.[354]

It is difficult to generalize when it comes to the multitude of groups and coalitions which have emerged since the launch of the Doha Round. Most issues on the WTO agenda do not break along the sort of North-South fault line which existed in UNCTAD and which pre-empted the flexibility that characterizes the coalition building in the WTO today. The Doha Round negotiations have added a new dimension and a certain fluidity to the creation and abolishment of coalitions and groups within the WTO.[355]

(vi) Concluding remarks

Over the past decade issues related to internal transparency and the decision-making process of the WTO have emerged as important institutional challenges facing the multilateral trading system. This section has sought to demonstrate that, contrary to what many critics of the WTO decision-making process argue, WTO Members have been quite successful in addressing this issue. The current practices, and the guidelines within which consultations take place at the WTO, are the direct result of what a large number of Members believed was wrong with the decision-making processes. Although these practices have little legal status, their behavioural impact on the way the WTO operates is considerable. There is enough evidence in the day-to-day work of Chairpersons and the Director-General in the WTO to demonstrate adherence to a culture of increased transparency and participation and there is a general recognition among WTO Members that the current practices have improved the decision-making process.

The legitimacy of the decision-making process requires that there is an adequate degree of open-ended and inclusive activity to balance other more restrictive consultative processes. In this context, the principal challenge will always be finding the right balance between efficiency and inclusiveness. Informal and exclusive consultations will continue to play important roles in the overall WTO process since, on balance, they offer important forums for making progress. Members generally endorse this premise. Of course, the legitimacy of such consultations hinges on the ability to ensure an adequate degree of transparency and inclusiveness as well as a guarantee that such mechanisms are understood to be coalition building and not decision-making forums. It is also clear that any attempt to short-circuit or deviate from the guidelines and practices on transparency will continue to require some general acceptance among WTO Members. It may be argued that sometimes the membership may be willing to accept such a temporary deviation in return for tangible progress.[356] However, experience has also demonstrated that this is a very risky premise upon which to pursue multilateral trade negotiations.

This subsection has deliberately not engaged in a discussion of the role of bilateral and plurilateral meetings among WTO Members which take place outside the institutional framework of the WTO. While the WTO as an institution cannot be held responsible for such meetings the fact is that some of these gatherings – especially those held at ministerial level – can impact considerably on the multilateral process in Geneva. Every year a number of so-called mini-ministerial meetings are hosted by individual WTO Members, including what has become annually recurring events at Davos in January and at the

[354] See Narlikar and Tussie (2004) for a detailed account on the G20.

[355] It is probably too early to make a judgement as to the real significance of groups in facilitating consensus. In an organization of 150 Members the potential of these groups to help create consensus is clearly present. However, evidence of the ability of these groups to respond rapidly to new developments is still inconclusive.

[356] Most recent examples include the acceptance by the WTO membership to wait for consultative processes of the G6 in 2006 and the G4 in 2007. For example, the final and relatively exclusive stretch of the negotiations which resulted in the 1 August 2004 Decision was accepted without much criticism by delegations that were not in the Green Room. Another, albeit somewhat different, example was the acceptance by the membership to wait for the (inconclusive) consultative processes of the G6 in 2006.

margins of the OECD in May. These meetings are generally organized and hosted by individual countries and include on average some 30-35 WTO Members as well as the Director-General of the WTO. Such mini-ministerials can provide both direction and momentum to a multilateral process and as such they occupy a potentially decisive place in the overall decision-making process of the multilateral trading system. At the same time it is important to recall that these meetings are outside the framework of the WTO and therefore not subject to the practices of transparency and inclusiveness described earlier.

We have not discussed here the role of other international governmental organizations in the WTO decision-making process. When ministers in 1994 adopted the Marrakesh Declaration thereby founding the WTO they also articulated one of the core functions of this new organization as achieving more coherent global economic policymaking.[357] In 1996 the General Council formalized cooperation agreements with the IMF and the World Bank with the objective of further pursuing coherence in global economic policymaking. These cooperation agreements have been in operation for more than a decade and have proved to be effective platforms for the expansion of activities, programmes and initiatives of the three institutions at staff as well as management level to cover most of the issues on the WTO agenda.

At the same time it is also recognized that the WTO system is only one part of a much broader set of international rights and obligations that bind WTO Members and that issues related to global economic policymaking go much beyond the WTO's formal and specific cooperation with the Bretton Woods institutions. The WTO maintains extensive institutional relations with several other international organizations, such as UN, FAO, UNEP and UNCTAD, and there are some 140 international organizations that have observer status in WTO bodies. The WTO also participates as observer in the work of several international organizations. In all, the WTO Secretariat maintains working relations with almost 200 international organizations in activities ranging from statistics, research, standard-setting, and technical assistance and training. Although the extent of such cooperation varies, coordination and coherence between the work of the WTO and that of other international organizations continues to evolve so as to assist Members in the operation of their economic policies. Although the direct impact of other IGOs on the informal WTO decision-making process is negligible, their close substantive involvement with the WTO and its Members provide an important transparency element to the overall international economic coherence discussion.

The above does not suggest that all problems related to transparency and inclusiveness have been solved. Indeed, the informal and non-legal nature of the principles and practices which underpin the current consultative process at the WTO does not provide a guarantee against a re-emergence of the brinkmanship which has characterized WTO decision-making at various times. The end-game of a WTO negotiation will almost certainly continue to feature power based bargaining among states. The scope for short-circuiting of the decision-making process remains real and this is clearly why many countries emphasize the need to maintain vigilance regarding transparency in decision-making at the WTO. At the same time it must be reiterated that the WTO can only ever hope to regulate or impress its practices on activities which take place within its institutional framework.

(c) The GATT/WTO and civil society

The obscure and largely technical nature of the GATT did not generate much debate beyond the trade community, and the GATT agenda at least until the tuna-dolphin case in the early 1990s, failed to capture the general public. However, the deepening and widening of the WTO agenda to include issues such as environment, intellectual property and services ensured not only a growing interest among the public, but also an increasing politicization of the multilateral trading system. Of course, interest in international governance among the public had already been on display for a number of years in the mounting criticism of the World Bank and the IMF for their secrecy and weak accountability.[358] The 1998 collapse of OECD-

[357] See Article III.5 of the Marrakesh Agreement as well as the separate Ministerial Declaration adopted at the Ministerial Meeting in April 1994 to underscore this objective.

[358] See Danahar (1994).

based negotiations on a multilateral agreement on investment (MAI) owed much to a collaborative effort among at least 600 non-governmental entities in over 70 countries. This episode sent a strong signal of the extent to which international organizations were attracting the interest of a wider general public concerned with the implications of globalization. The anti-MAI network, and its unprecedented use of the internet, subsequently became a central coordination mechanism for various NGO networks prior to and at the Seattle Ministerial Conference in late 1999. These are only a few examples of the increasing external scrutiny under which international institutions find themselves today.

The objective of the following section is to provide a short overview of the evolution of the relationship between the GATT/WTO and civil society, in particular NGOs. We shall specifically seek to explain how the actions and input of these organizations have influenced the manner in which the multilateral trading system operates. The use of the term NGO in the present WTO context encompasses public action NGOs, labour unions, industry associations, but not individual companies.[359] The somewhat wider concept of civil society, while still excluding firms, also includes parliamentarians and the general public, including associations and citizens' networks.

(i) Early considerations on NGOs

Although the relationship between the GATT and non-governmental actors was virtually non-existent, the agenda on the creation of the International Trade Organization included deliberations on "[...] suitable arrangements for consultation and cooperation with non-governmental organizations concerned with matters within the scope of this Charter...".[360] In assessing the merits of institutionalizing a structured mechanism for interacting with such organizations the Secretariat of the Interim Commission for the International Trade Organization (ICITO) provided the Executive Committee with a note on existing arrangements made by the United Nations and the UN specialized agencies. In addition to this *tour d'horizon,* the note included a set of recommendations and conclusions on how the procedures regarding NGOs could be adapted to suit the ITO[361] as well as an annex with a provisional list of NGOs which might be consulted. Although these recommendations never materialized into a concrete set of procedures for dealing with NGOs within the context of the multilateral trading system (particularly as the ITO was never established), they nevertheless reflect the importance which was attached to defining a policy that would allow the trading system to interact with the outside world and benefit from external technical expertise.[362] In addition, the thrust behind these recommendations, in particular the inherent vagueness which was adopted in dealing with NGOs, clearly provide the basis for the current WTO provisions for dealing with NGOs today.[363]

(ii) From the GATT to the WTO

Despite the early attempts to institutionalize the interaction of NGOs with the multilateral trading system, no provisions were included in the GATT to allow for their involvement or participation. To be sure, a number of business organizations, most notably the International Chamber of Commerce, pursued informal and ad hoc contacts with both the GATT and its Secretariat, but were denied any formal accreditation and access (Marceau and Pedersen, 1999). Some observers of the GATT foresaw the need for the system to address the issue of civil society involvement at some juncture (Jackson, 1969), but it was not until the late 1980s and early 1990s as the Uruguay Round negotiations were intensifying that a number of NGOs concerned with issues related to environment, agriculture and sustainable development began a closer

[359] The WTO does not have a formal definition of what constitutes an NGO. Public action NGOs, labour unions, industry associations are accredited to attend Ministerial Conferences. Individual companies are not eligible for WTO accreditation to Ministerial Conferences. Generally, NGOs have to demonstrate that their activities are concerned with matters related to those of the WTO.

[360] Havana Charter, Art. 87, paragraph 2.

[361] ICITO EC2/11, 15 July 1948 (note by the Secretariat).

[362] ICITO EC2/11, 15 July 1948.

[363] Art. V:2 of the Marrakesh Agreement and WT/L/162. For a complete overview of the early considerations regarding the ITO and NGOs see Marceau and Pedersen (1999).

monitoring of the GATT. In addition to the substantive concerns which the emerging agreements raised, the inability to directly access the negotiators resulted in further frustration among these organizations and the Ministerial meeting in Brussels in December 1990 witnessed the first coordinated denouncement of the trade talks as a *"GATTastrophe"* by a number of NGOs (Croome, 1995).

In the summer of 1991, after the GATT dispute settlement panel in the case United States - Restrictions on Imports of Tuna ("Tuna-Dolphin") issued its decision – ruling that a US conservation law violated GATT rules – environmentalists across the globe began scrutinizing the GATT more closely.[364] The initial conclusion was that GATT panels remained secretive and closed to the public and that decisions about the environment were made without adequate input. At the time the calls for greater transparency and openness of the GATT received relatively little attention and the 1994 Marrakesh Ministerial Conference did not make any specific arrangements for accommodating NGOs.[365] However, the draft text adopted by Ministers at Marrakesh included a significant transparency provision on arrangements for consultation and cooperation with NGOs, which resembled the original text considered for the Charter of the ITO in 1948. Article V:2 of the Marrakesh Agreement states that "the General Council may make appropriate arrangements for consultation and cooperation with non-governmental organizations concerned with matters related to those of the WTO.".[366] The inclusion of this provision and the subsequent adoption by WTO Members in July 1996 of a set of Guidelines[367] for relations with NGOs clearly acknowledged the importance of NGOs in the public debate on trade and recognized that the multilateral trading system did no longer exist in the vacuum which had characterized its predecessor. In addition, WTO Members also adopted a first Decision on De-restriction of documents which would make documents available to the public more systematically and promptly than in the past.[368]

Article V:2 of the Marrakesh Agreement and the 1996 Guidelines provided the WTO Secretariat with a much-needed platform for dealing with civil society and increasing the transparency of WTO operations.[369] Although the Guidelines were a significant step forwards in terms of the WTO's relationship with NGOs they nevertheless fell short of providing these organizations with any direct and formal role in the work of the WTO. The informal and "arms-length" nature of the Guidelines which applied mostly to the Secretariat's interaction with civil society reflected the sensitivity and even hostility which characterized the relationship between a large number of WTO Members and NGOs at the time. This sensitivity became particularly evident in the discussions to ensure NGO attendance at the first WTO Ministerial Conference in Singapore in 1996 during which a number of Members expressed concern at the prospect of accrediting NGOs to attend the meeting. A number of Members argued in favour of a system whereby each NGO requesting accreditation would have to be approved by the WTO membership. Clearly, such a system would have been both extremely cumbersome and potentially very damaging to the Organization's image. In the end, the WTO Secretariat played a crucial role in brokering a compromise which made clear that NGO attendance at the conference would not create a precedent for subsequent meetings of the organization.

The early implementation of Article V:2 and the Guidelines were particularly challenging for the WTO Secretariat because the bulk of NGOs following WTO affairs were from developed countries and generally pushed issues with which developing countries felt uncomfortable, e.g. environment and labour. This sensitivity was principally exposed when the Secretariat sought to organize a series of symposia designed to provide a forum for WTO Members and representatives of NGOs to exchange views. However, it was characteristic for the period between 1996 and 1999 that the main preoccupations of the NGO community *vis-à-vis* the multilateral trading system concerned transparency and access to information rather than specific substantive matters.

[364] United States - Restrictions on Imports of Tuna, GATT BISD 39S/155 (Sept. 3, 1991). A number of NGOs subsequently began referring to this case as "Gattzilla Ate Flipper".

[365] NGO representatives present at the Marrakesh meeting were accredited as journalists.

[366] The Results of the Uruguay Round of Multilateral Trade Negotiations, The Legal Texts, p.9.

[367] WT/L/162.

[368] WT/L/160.Rev1.

[369] For a full overview of the Guidelines see Marceau and Pedersen (1999).

Although a number of NGOs had already attempted to provide substantive input to WTO dispute settlement panels, the academic debate at the time focused on the merit of opening the WTO processes to NGOs so as to enhance the legitimacy of its decisions. This external push for increased transparency and openness guided, to a large extent, the approach adopted by the WTO Secretariat in applying the provisions for dealing with an increasingly interested public. In July 1998, then Director-General Renato Ruggiero announced a set of initiatives for engaging more actively, though still informally with civil society, including separate Secretariat briefings for NGOs, regular circulation of a list of NGO publications received by the Secretariat and regular informal meetings between the Director-General and NGOs.

Given the novelty of interacting with NGOs in the context of the multilateral trading system the initial objective of these measures was to establish an informal confidence-building dialogue with these organizations. Although the external pressure to increase overall transparency was a significant element in the Secretariat's decision to pursue these initiatives, it was also considered to be a worthwhile two-way educational exercise which would benefit the WTO as well as the NGOs. The informal meetings which took place throughout 1998 paved the way for the organization of the first large-scale WTO Symposia in April 1999.[370] Although these early initiatives appear relatively timid, they served the dual purpose of sensitizing the WTO membership (and the WTO Secretariat) to the various NGO agendas as well as de-mystifying the operation of the multilateral trading system as perceived by civil society. Similarly, the above initiatives to increase transparency, while highly controversial at the time, remain the foundation upon which WTO structures its interaction with NGOs today and is perhaps the first clear example of how external pressure has led to a change in the way the WTO does business.

(iii) The NGO accreditation debate

Since 1996 NGOs have argued in favour of a permanent accreditation status to the WTO. However, to date, WTO accreditation has only been granted for Ministerial Conferences as well as specific events, such as the annual Public Fora. The accreditation process is administered by the WTO Secretariat and based on the mandate provided by Members in Article V:2 as well as the previously mentioned Guidelines. Historically, the principal criteria for accrediting non-profit NGOs to a WTO Ministerial Conference or a Symposia has been their ability to demonstrate "activities related to those of the WTO" and this fairly broad definition has ensured that only very few organizations have ever been refused such ad-hoc accreditation. In general, this system of accreditation has worked well over the past decade and Members seem to be very comfortable with the Secretariat's administration of its mandate. At the same time it should be emphasized that the original reservation expressed by Members in the 1996 Guidelines, namely that "there is currently a broadly held view that it would not be possible for NGOs to be directly involved in the work of the WTO or its meetings" remains valid. Similarly, the notion that closer consultation and cooperation with NGOs can be met constructively through appropriate processes at the national level still represents the general feeling among Members when it comes to NGOs. These elements of the Guidelines continue to constitute the core reasons of why a permanent formal accreditation mechanism for NGOs does not exist at the WTO. At the same time, the past decade has witnessed a growing tendency among WTO Members to accredit NGO representatives as part of their delegation to attend various WTO meetings.

In recent years, the NGO demand for permanent accreditation to the WTO has become less frequent. However, since 2001 a group of Geneva-based NGOs have pursued a campaign to obtain an annual, renewable badge that will allow access to the WTO along the lines of the accreditation system that exists for Geneva-based journalists. Within this scheme, NGOs would be granted access to the public parts of the WTO headquarters. The granting of badges would be subject to strict criteria and conditions, and limited in time. At present around 25-30 Geneva-based NGOs actively follow the work of the WTO.

---

370 A number of smaller and single-issue symposia had been held previously. In 1994 a symposium on trade and environment had taken place and in 1997 a meeting of NGOs was organized to mirror the agenda of the High Level Meeting on Trade Related Issues Affecting Least-Developed Countries. However, both symposia had seen only sporadic participation by Member countries. In March 1998 a symposium on trade facilitation took place at the WTO headquarters and involved a large number of industry associations.

(iv) NGOs at Ministerial Conferences: from Seattle to Hong Kong

The attendance of NGOs at WTO Ministerial Conferences is arguably one of the most visible manifestations of the evolving relationship between the Organization and civil society. Following the first timid steps to ensure NGO attendance at the WTO Ministerial Conferences in 1996 and 1998, the 1999 Seattle meeting in many ways took this relationship to a new level. First, the period leading up to and including the Seattle meeting saw a dramatic increase in the number and diversity of NGOs interested in the WTO agenda. Second, the reluctance of many WTO Members in dealing with NGOs was replaced by growing cooperation and information sharing, including those among the membership that had been the most reluctant to welcome these actors to previous WTO meetings. Third, from having focused primarily on process issues such as external transparency and participation NGOs slowly began turning their attention to the substantive agenda of the WTO.

The Seattle meeting was a watershed in attracting the attendance by NGOs beyond the traditional fields of business, environment, development and labour groups. The most significant newcomers included representatives from health groups, religious groups, human rights activists, consumer groups and a variety of think-tanks. In addition, Seattle saw a significant increase in the number of NGOs from developing countries as well as a large contingent of parliamentarians from Member countries. The meeting was also unique in terms of the number of NGO representatives accredited as members of individual country delegations.[371]

The increasing sophistication among Members for dealing with NGOs was evident throughout the preparatory process for Seattle. Whereas consultative processes with NGOs on trade policy matters have a long history in many developed countries, such mechanisms existed only sporadically among developing countries. However, in addition to regularly participating in WTO Secretariat briefings for NGOs, a growing number of developing country delegates began meeting with NGO representatives with expertise in areas related to development as well as more generally. This interaction continued at the conference and to some extent confirmed that NGOs were increasingly seen as having an intellectual contribution to make.

Overall, however, the chaotic street demonstrations and the eventual collapse of the Seattle Ministerial Conference had a brief negative impact on the way WTO Members perceived the NGO community. Those NGOs that had come to Seattle with the objective of lobbying delegations as well as bringing awareness to specific issues were, to a large extent, crowded out by the down-town mayhem caused primarily by unaccredited fringe groups with little understanding of the multilateral trading system. However, a number of NGOs were quick to pick up on the transparency and process difficulties which had played a significant part in the collapse of the conference. As this issue gained prominence in 2000 these organizations were well placed to provide delegations with input and advice on how to make the WTO more responsive to the need for inclusiveness and participation of all Members. Although the transparency discussions in 2000 were a purely internal affair and did not *per se* relate to any direct improvement in terms of access and consultation for the NGOs, the fact is that their changing relationship with delegations would mean that these organizations would benefit from a higher degree of transparency as well.

Despite the experiences in Seattle, the procedural and practical arrangements for NGO attendance at subsequent Ministerial Conferences were not changed. The Ministerial Conference in Doha (2001) confirmed automaticity in allowing NGOs to attend such meetings. Arguably, the physical constraints of the Doha meeting saw the imposition of a numerical limit on the size of each NGO delegation and the overall number of accredited organization fell compared to Seattle.[372] However, the parameters for the NGO attendance, including the WTO Secretariat's control of the accreditation process as well as the arrangements in Doha meant that these organizations enjoyed the same rights and facilities as at other WTO conferences. The Table below outlines NGO attendance at WTO Ministerial Conferences.

[371] It is at the discretion of each WTO Member who they include in their delegation. Although Singapore had seen the accreditation of a number of business representatives (companies as well as associations) to individual delegations, similar accreditation of other NGOs was extremely rare.

[372] Given the physical limits at Doha, each NGO was allowed to accredit one representative.

Table 22
NGO attendance at WTO Ministerial Conferences

Ministerial Conference	Number of eligible NGOs	Number of NGOs attending	Number of Participants
Singapore 1996	159	108	235
Geneva 1998	153	128	362
Seattle 1999	776	686	1500
Doha 2001	651	370	370
Cancún 2003	961	795	1578
Hong Kong 2005	1065	812	1596

Particularly since Seattle, WTO Ministerial Conferences have provided civil society organizations with excellent opportunities to rally their constituencies around specific causes. Given the fact that it generally takes in excess of 12 months to organize such a conference, civil society organizations have often managed to orchestrate campaigns which culminate at these meetings, including through the submission of signed petitions to the Director-General.[373] The media coverage that these campaigns generate represents a clear sign of the significance of a civil society presence at WTO Ministerial Conferences.

(v) WTO Symposia and Outreach Activities

In terms of direct interaction between the WTO membership and civil society, the annual WTO Symposium, now called WTO Public Forum, represents the most substantive example of a fundamental and continuously evolving commitment to transparency, dialogue and outreach. Compared to the first large-scale symposia in 1999, the format of the current annual forum has evolved considerably to allow for a broader agenda and a more interactive dialogue with NGOs. The fine-tuning of the format from large open-ended plenary sessions to a focus on individual and more interactive working sessions owes much to the constructive input of participants who both felt that the large-scale plenary sessions offered little opportunity for direct interaction and were often counterproductive. In 2006, the WTO hosted the seventh large-scale symposium during which more than 36 individual working sessions took place. Of these, some 30 were organized by participants themselves. The summaries of the discussions were subsequently made available on the WTO website. Compared to the inaugural symposia held in 1999 which were subject to considerable interference by WTO Members, the organization and format of the Public Forums over the past couple of years have been left to the WTO Secretariat. The improvement of the event over the years and its increasing visibility as the WTO's biggest and most critical outreach event are undisputable. Both in terms of numbers and composition, participation has grown to more than 1000 people, which nowadays include academics, journalists, parliamentarians, business people as well as NGOs in the traditional sense of the word. However, it remains an ad hoc exercise which falls outside the formal structure of the WTO, partly because of the lack of regular budgetary means.

The quality and interactive nature of the discussions at the Public Forum depends crucially on the organizers and participants. In other words, these meetings do not represent a magic bullet in terms of transparency and dialogue and they do not provide NGOs with a formalized and direct access to the WTO agenda. However, these meetings are now a recurrent annual feature on the WTO calendar and are embraced as such by the WTO membership. This should be the real yard-stick by which their success is measured. This, in turn, is in no small part due to the persistent pressure by a large and cross-cutting segment of the NGO community to maintain a platform for the exchange of ideas with WTO Members. The idea of having thousands of NGOs roaming the halls of the WTO Headquarters for two days every year would have been unthinkable only a few years back – today this sensitivity among Members is gone.[374]

373 The submission of Oxfam's "Big Noise" petition with 17.8 million signatures to the Director-General represents the most recent example.

374 A summary of the 2006 Public Forum was published by the WTO Secretariat in April 2007.

More recently, the WTO Secretariat has developed an outreach strategy encompassing a number of activities aimed at providing information, engaging into dialogue, and listening to civil society representatives' expectations and concerns. Regular briefings for NGOs are now held at the WTO Headquarters and not as previously outside the organization, the availability of GATT and WTO documents on-line is automatic and the NGO section of the WTO web site continues to provide statistics and information of particular interest to these organizations. The Director-General regularly briefs and interacts with NGOs, both in Geneva and abroad, and engages in on-line web chats with the public. In recent years, the WTO Secretariat has initiated a regional outreach programme for civil society representatives in developing countries. It also has started to involve Chairpersons of WTO bodies as well as other experts in issue-specific and more technical briefings.

In recent years, the Secretariat has pursued a broad and proactive approach to keep parliamentarians informed and involved in the WTO's work. This recognizes the important role they play in the multilateral trading system. As the legitimate and accountable representatives of the people who elect them they can play a crucial role in bringing greater awareness and informed debate on international trade issues. The outreach programme towards parliamentarians also encompasses regional events to further the understanding of the multilateral trading system among this important group.

In general, these and other measures, including the holding of smaller symposia and seminars, permeate the day-to-day business of the WTO. While the gradual, but consistent commitment to transparency since 1995 has made the WTO more accessible, recent initiatives place an increasing emphasis on outreach and dialogue. The results from this strategy may not be immediate, but they will eventually elevate the WTO - civil society relationship to a new and more productive level.

(vi) Amicus Curae Briefs and Dispute Settlement

The WTO DSU does not contain any explicit provisions for the submission of briefs by NGOs although panels are allowed "to seek information and technical advice from any individual or body which it deems appropriate"[375] to a particular case.

In the following paragraphs we shall focus on a couple of examples where NGOs have attempted to influence the dispute settlement process and the extent to which their efforts may have led to a change in the way the process operates. In addition, we shall outline some of the more recent initiatives to provide some transparency to the dispute settlement process.

As was mentioned previously, the 1991 ruling in the *United States–Restrictions on Imports of Tuna* case placed the GATT on the radar screen for a number of environmental NGOs. In mid-1997, two NGOs sent *amicus curiae* briefs to the WTO panel considering *United States-Import Prohibitions of Certain Shrimp and Shrimp Products* ("Shrimp-Turtle").[376] Two months later, in September 1997, the panel informed the parties that it would not consider the briefs because it did not have authority to do so under the WTO DSU rules. When the US government subsequently appealed the panel's decision regarding the scope of GATT's General Exceptions, it also appealed the panel's finding that it did not have authority to consider the NGO briefs. In addition, the NGOs sought to introduce their legal arguments on the case by attaching their briefs to the US submission. In August 1998, the Appellate Body made a preliminary ruling that it would accept the NGO briefs attached to the US submission, and that it had accepted a revised version of one of those briefs directly from one of the NGOs. During the case, it was made clear that the briefs had been read by the Appellate Body Members, although the Appellate Body ultimately stated that it focused on the arguments made by the US in the main part of its submission. In addition, in October 1998, the Appellate Body reversed the lower-level ruling on whether a panel had the authority to consider amicus

375 Art. 13.1 of the DSU.

376 *United States-Import Prohibitions of Certain Shrimp and Shrimp Products*, Report of the Panel, WT/DS58/R (May 15, 1998). This case involved a complaint by India, Malaysia, Pakistan, and Thailand about a US import ban on shrimp from countries that the US had not certified as doing enough to safeguard endangered sea turtles from being killed during shrimp trawling.

briefs. The Appellate Body said that while NGOs do not have the "right" to have their briefs considered, a panel's authority, under the DSU, "to seek information and technical advice from any individual or body which it deems appropriate"[377] includes the authority to receive unsolicited NGO briefs. Thus, the decision was significant because it established that both panels and the Appellate Body have the authority to accept *amicus curiae* briefs. The decision was controversial with many governments which felt that that it was not in conformity with the WTO Agreement, that it undermined the government-to-government nature of the WTO and provided NGOs with greater rights than WTO Members that were not party to the dispute.

In 2000, in the case involving the *European Communities-Measures Affecting Asbestos and Asbestos-Containing Products*, four NGOs submitted briefs early in the panel process.[378] Subsequently, the defendant EC attached two of the briefs to its submission. Thereafter, the panel, without providing any reason, announced that it would consider the two attached briefs, but not the other briefs. At the outset of the subsequent appeal by Canada, the Appellate Body recognized that it was likely to receive NGO briefs and, after consulting with the parties, established an *ad hoc* procedure for considering briefs by private individuals or groups. This procedure required applicants to file for leave to submit a brief. The application had to respond to a number of questions, including the objectives and financing of the applicant and how the proposed brief would not be repetitive to what the governments had already articulated. The Appellate Body's adoption of this procedure surprised governments and, at a special session of the WTO General Council convened to deal with this issue, many Members criticized the Appellate Body for undermining the governmental role in legislating dispute procedures and against the idea of amicus briefs. Shortly thereafter, the Appellate Body rejected all 17 of the applications for permission to submit a brief. In response to this rejection, several NGOs put out a critical press statement[379] complaining no reason for the rejection had been given.

By January 2006, 53 amicus briefs had been submitted to panels, the Appellate Body and Compliance Panels under Art. 21.5 of the DSU. As the two examples demonstrate, NGO activism has, at least to some extent, been instrumental in clarifying that *amicus curiae* briefs are not legally excluded in WTO dispute settlement. Of course, this is not equivalent to a right to have NGO arguments taken into account, yet several NGOs have decided to submit amicus briefs anyway, sometimes with the encouragement of the WTO Members that are parties in a case. At the same time Durling and Harbin (2005) argue that the first decade of the WTO indicates that *amicus curiae* briefs have not emerged as a prominent feature of the WTO dispute settlement system and that initial fears regarding the likely proliferation and influence of such briefs have not been realized. At this stage there is little evidence to suggest that the WTO membership would be able to agree on a specific rule amendment which would incorporate such practice into WTO law, but it is similarly clear that the past experience has established an important precedent for the submission of *amicus curiae* briefs in the future.[380]

As has been mentioned previously, a number of external observers as well as WTO Members have called for greater transparency of the dispute settlement process, including the possibility of opening up panel proceedings to other WTO Members and the general public. At the request of the parties in the disputes "Continued suspension of obligations in the *EC-hormones dispute*" (*US-Continued suspension of obligations in the EC-hormones dispute*, DS320; *Canada-Continued suspension of obligations in the EC-hormones dispute*, DS321) the panels agreed to open their proceedings with the parties and scientific experts on 27-28 September 2006, and with the parties on 2-3 October 2006 for observation by WTO

[377] Art. 13.1 of the DSU.

[378] *European Communities-Measures Affecting Asbestos and Asbestos-Containing Products*, Report of the Panel, WT/DS135/R (Sept. 18, 2000).

[379] Press Release, The Center for International Environmental Law, A Court without Friends? One Year After Seattle, the WTO Slams the Door on NGOs (Nov. 22, 2000).

[380] In the ongoing DSU negotiations, the US has submitted two proposals on *amicus curae* briefs. See TN/DS/W/13 (22 August 2002) and TN/DS/W/46 (11 February 2003).

Members and the general public.[381] A special viewing room was established and some 200 seats were made available for the general public, including journalists, NGOs and WTO observers. These individuals were able to watch the live proceedings of the "hormones" dispute-settlement panels at the WTO headquarters in Geneva via closed-circuit broadcast. Although this experiment did not create any precedent for other panels and remained a decision by the Panel at the joint request of the Parties, it nevertheless represents an important initiative towards increasing transparency at the WTO. However, despite the quite significant organizational and logistical arrangements which were required for this initiative, at no point during these closed-circuit broadcasts did the total number of representatives from the general public exceed 33 and the majority of these represented universities and schools.

(vii) NGO influence on the WTO Legislative Process

We previously mentioned the growing confidence among NGOs with respect to providing Members of the WTO with technical and political advice. Of course, lobbying is not a new phenomenon in the context of the multilateral trading system as has been demonstrated through the early involvement of the ICC in the GATT and the role of the service industries in the Uruguay Round. Similarly, other business organizations have been closely associated with the negotiating positions of their respective host countries and have played important roles in the design of the substantive outcomes in the WTO. However, whereas the private sector has often been able to influence negotiating positions at the domestic level or even as members of developed country delegations, the influence of most other NGOs had until recently been only sporadic. Over the past decade, an increasing number of countries, often as a result of a genuine lack of resources, have been turning to specialized NGOs for assistance in undertaking research and preparing negotiating positions on issues of particular concern to them. In the context of the multilateral trading system three examples in the areas of intellectual property, cotton and fisheries subsidies deserve mention.

Access to medicines

On 14 November 2001, WTO Members adopted a Declaration on the TRIPS Agreement and Public Health which contained important clarifications about the flexibilities in the TRIPS Agreement to promote public health, in particular access to medicines. The Declaration also identified one issue on which the TRIPS Agreement did not provide sufficient flexibility and called for a solution. On 6 December 2005, WTO Members approved changes to the TRIPS Agreement that provide additional flexibilities on this point. The Decision directly transforms an earlier, 30 August 2003, "waiver" into a permanent amendment of the TRIPS Agreement. That waiver makes it easier for poorer countries to obtain cheaper generic versions of patented medicines by setting aside a provision of the TRIPS Agreement that could hinder exports of pharmaceuticals manufactured under compulsory licences to countries that are unable to produce them. It is beyond the scope of this section to more closely analyse the mechanism enshrined in the above Decision. The point to make here is that the access to medicines debate illustrates a rather successful alliance of a large group of developing countries and certain civil society groups in terms of bringing an issue to the centre of the WTO agenda.

While developing countries did not always follow the advice of civil society groups, these groups did provide technical expertise, including specific drafting of proposals, as well as expert legal advice to a number of them while simultaneously designing a public campaign which is widely recognized as having generated important momentum in public opinion and among political decision-makers on this issue. This combination, and the fact that the alliance between developing countries and NGOs had to contend with a serious opponent insofar as the research-based pharmaceutical industry was concerned, made the adoption of the 2001 Declaration and the 2003 and 2005 Decisions all the more remarkable and stands testimony to the substantive support of a number of civil society groups in a specific area.

[381] This was the second time that public hearings were organized in this case. The first time was in September 2005, for the joint first substantive meeting of the panels with the parties.

Cotton Subsidies

The second issue which has illustrated the increasingly close relationship between WTO delegations and NGOs relates to cotton. In 2003, four poor cotton-exporting Central and West African countries (Benin, Burkina Faso, Chad and Mali) demanded that cotton subsidy removal be part of the WTO agriculture negotiations. The issue gained prominence at the Cancún Ministerial Conference in September 2003 with a number of NGOs conducting a high-profile campaign to bring attention to the difficulties faced by cotton producing developing countries.[382] Not unlike access to medicines, a number of NGOs had been assisting the *demandeurs* with technical expertise and policy advice, including drafting specific proposals in the agriculture negotiations and managed to maintain a public campaign which has kept the issue very much on the forefront of the Doha Round. And, as with access to medicines, the NGOs have found a specific niche in terms of substantive research input and policy advice which these developing countries would have struggled to muster independently.

Fisheries subsidies

The contribution of NGOs in the context of the discussions on fisheries subsidies at the WTO is somewhat different compared to the previous two examples for a number of reasons. First, the contribution of the most actively involved NGOs has taken the form of analytical papers and proposals presented via public symposia and similar open-ended fora, (some co-sponsored by international intergovernmental organizations). These NGOs thus have not worked through any specific country or countries. Instead they have taken a proactive role as interested stakeholders seeking, through the provision of intellectual input and ideas to the fisheries subsidies debate, to influence the negotiations to reach what in their own view would be an environmentally positive outcome. Second, the fisheries subsidies debate is not a North-South issue in the same sense as access to medicines and cotton were, as there are developed and developing countries represented on all sides of the debate. Third, environmental NGOs have considerable experience in fisheries issues, having long been active around the world in promoting environmentally-friendly fishing policies and practices. In respect of fisheries subsidies in particular, they have been working with governments, international organizations, and others for almost a decade to encourage WTO Members to adopt binding new international rules on fishing subsidies, with a focus on eliminating those that contribute to over fishing.

All of the above issues provide examples of how external input can in fact have an impact on the WTO legislative agenda. In the two first cases NGOs provided developing country governments with intellectual resources and policy advice not otherwise available to them and assisted the countries in conducting highly efficient public campaigns to raise awareness among a wider public. An important explanation for the success of the relationship between the NGOs and the developing countries in both contexts is undoubtedly the commitment of the former to remain deeply involved and dedicate significant resources over an extended period of time. It can be argued that at least for the issues of access to medicines and cotton the involvement of NGOs helped developing countries defend, and perhaps even enlarge, their policy space. In the case of fisheries subsidies, the long involvement of environmental NGOs in technical fisheries issues has led these groups to take a proactive role in directly providing intellectual input to the debate through parallel fora, without working through any particular country or countries.

Other areas such as agriculture and food security, genetic resources and traditional knowledge have seen NGOs provide background information, organize seminars and other forms of support to a number of developing country delegations

(viii) Concluding remarks

The past decade has seen a change in the way in which the WTO interacts with civil society. This relates not only to the practical interaction between the WTO Secretariat and WTO Members on the one hand and the NGOs on the other, but also in terms of how the NGOs view themselves *vis-à-vis* the multilateral trading system.

[382] See Baffes (2005).

From a sensitive, one-dimensional and mostly process-oriented relationship which primarily evolved around access to information, the WTO – NGO interaction has matured into a more substance-based one. In addition, it is an indication of the growing confidence in the working relation that exists between interested stakeholders. Although the WTO remains an intergovernmental organization, some NGOs have identified a particular advocacy role that they pursue with a view to influence the agenda. The original hesitation and suspicion among a majority of Members with respect to the role of NGOs has been replaced by a more constructive relationship which often manifests itself through increased substantive cooperation. It can be argued that through closer bilateral cooperation with delegations, NGOs have succeeded in influencing the WTO's substantive agenda more effectively than would have been possible through established institutional channels, notably through the WTO Secretariat.

This section has primarily focused on the interaction with and contributions from those civil society organizations which have opted for a constructive approach towards the WTO. Many of these, for example, industry and business associations, are usually supportive of the multilateral trading system. They recognize the objectives and activities of the WTO and generally favour an ambitious result in the ongoing trade negotiations. Others remain critical of the multilateral trading system, but have opted for substantive engagement in order to modify the system. A number of organizations continue to call for the abolition of the multilateral trading system and have generally refused dialogue. Although all of these organizations are regularly accredited to WTO Ministerial Conferences, the WTO Secretariat as well as Members work with the first two categories of NGOs on a regular basis.

From an institutional point of view the commitment to continue working towards a more constructive dialogue with civil society remains strong. As illustrated earlier the evolution of this relationship is a result of practice rather than procedural changes and the granting of specific rights. From the point of view of those NGOs that would like a more formal status within the WTO this is disappointing. However, for most NGOs that deal with the WTO and its Members on a regular basis it is doubtful that a formal role inside the WTO would enhance their advocacy role compared to the level of influence some enjoy through other channels. However, it is clear that current WTO practices for interacting with NGOs go far beyond anything that Members would be able to formally agree upon by consensus. These practices are solidly anchored in the culture of the WTO and it would be highly controversial to envisage a roll back. The challenge from an organizational perspective is to ensure that the relationship continues to evolve in an atmosphere of mutual trust. This will require vision and responsibility on all sides.

7. DEEPENING THE MULTILATERAL TRADE AGENDA

A core issue that has confronted the multilateral trading system down the years is the extent of its competence. Questions concerning the appropriate reach of the multilateral rules and whether or not particular rule areas should be covered at all have often raised sharp differences among governments. The issue has sometimes been drawn in terms of a distinction between "border" and "behind-the-border" policies. Behind the border policies or internal measures (as they are referred to here) are different from border measures in that they are applied internally rather than at the frontier. But in reality, both border and internal measures affect in some degree the conditions of competition between domestic and foreign supplies and suppliers and therefore affect trade. The discussion that follows centres on what can be said from a conceptual and systemic perspective about the inclusion or exclusion of particular subject areas from the GATT/WTO agenda.

The shape of the multilateral trade agenda has potentially important systemic consequences, as it determines perceptions about the legitimacy of the multilateral trading system, as well as the system's efficiency and viability. A lack of coherence between international cooperation on trade matters and cooperation in other policy domains may lead to inefficiencies in all areas. On the other hand, a further deepening of the multilateral trade agenda through the inclusion of many different kinds of internal measures may overburden the system and challenge its capacity to accomplish its mandate. The multilateral trading system does not stand alone and cannot be seen apart from other policy areas. Yet a single, all-embracing forum for international cooperation on all policy matters is hard to imagine.

The exact shape and scope of the multilateral trading system is the outcome of a political process. Moreover, no well-defined conceptual or theoretical framework exists for analysing the advantages or disadvantages of a given agenda. These two reasons – the play of politics and the absence of a comprehensive analytical frame of reference – render it impossible to predict how the agenda will or should evolve. This section will consider a number of factors that may have affected the development of the agenda in the past and possibly affect its future evolution. While contemplating such factors may temper views on the desirable dimensions of an agenda, they cannot provide a blueprint for future agenda formation. This agnosticism about the feasibility of prediction or prescription is consistent with much of the relevant literature in this area.[383]

(a) Thinking about internal measures in the context of trade cooperation

Internal measures initially figured on the GATT agenda because of concerns that such measures may be used to circumvent concessions made in market access negotiations. Trade negotiations in the early GATT days were about the reduction of barriers to trade in the form of border measures like tariffs. Article III (national treatment) and Article XX (general exceptions) were the main provisions in the original GATT text that served this purpose.[384] Over the years, the GATT and now the WTO have become progressively more concerned with internal measures that can affect the conditions of competition between foreign and domestic supplies and suppliers of goods and services. Consequently, internal measures have increasingly entered the multilateral trade agenda.

One reason for this evolution is that Members considered Article III and Article XX insufficient to control the circumvention of market access commitments – in other words, with preserving the value of existing market access commitments. More stringent and/or more clearly specified provisions were drawn up in order to protect those commitments. This motivation finds its clearest reflection in some of the Tokyo Round Agreements, particularly the Agreement on Technical Barriers to Trade and parts of the Agreement on Interpretation and Application of Articles VI, XVI and XXIII,[385] and in the Uruguay Round Agreement on Sanitary and Phytosanitary Measures.

Internal measures aimed at preserving acquired market access rights may focus on avoiding explicit discrimination, as would be the case with subsidy or government procurement provisions. Alternatively, they may concern measures that embody elements of de facto discrimination, where the underlying putative objective of a measure is not directly to discriminate, but rather to secure a particular public policy objective. Examples of internal measures falling into this category include those pursuing the objectives covered by Article XX of GATT or Article XIV of GATS.

A second factor explaining a broader and deeper agenda on internal measures relates to the notion that market access is inherently linked to the conditions of competition prevailing in the relevant markets. A focus on measures whose effect is to modify the conditions of competition has increasingly played a role in shaping the multilateral trading system. The motivation here is not to protect existing levels of market access, but rather to promote further market opportunities. Aspects of the General Agreement on Trade in Services are clearly an example of such a focus. The same may be said of the TRIPS Agreement, and would apply, for example, to rules on competition.

Apart from the distinction between preserving *acquis* – that is, protecting acquired rights in a market – and seeking to advance those rights, the two taxonomical categories defined above have much in common and certainly overlap. Both categories also encompass measures involving *de jure* and de facto discrimination. The reason for the overlap is that any internal measure, whatever its motivation, will

[383] See, for instance, Howse (2002) and Jackson (2002).

[384] See the discussion in Section C.

[385] It is noteworthy that similar anti-circumvention concerns prompted agreements that applied to border measures, such as those on customs valuation, import licensing and anti-dumping and countervailing duties.

affect to some degree the conditions of competition in a market. It will affect the kinds of access and/or operating environment encountered by suppliers and supplies of goods and services.

In light of this reality, some have suggested that notions of "trade-relatedness" or "specificity" may be useful in identifying which internal measures should be subject to negotiation within the WTO. The more an internal measure is able to affect the relative competitive positions of foreign and domestic suppliers and supplies of goods and services, the argument would go, the stronger the case for subjecting that measure to WTO discipline. Maskus (2002) surveys related empirical work and based on this evidence suggests a ranking of internal measures according to their trade impact.[386] But the individual studies surveyed do not directly compare the trade impact of different types of internal measures and such a direct comparison may not be possible with existing methodologies and data. Economists can therefore only provide a rather imperfect idea of the relative "trade relatedness" of different internal measures. More fundamentally, the concept of trade-relatedness only indicates the extent to which internal measures may affect trade flows and does not give any indications as to the relevance of the measures for domestic policy objectives and thus welfare maximization. It is clearly for governments to determine whether trade-relatedness is a useful consideration in choosing among internal measures that might be negotiated in the WTO.

As far as specificity is concerned, measures that target a particular group of suppliers or consumers may be considered more distorting than measures of general application and therefore more deserving of attention in the WTO. The Spaak Report, the precursor of the Treaty of Rome establishing the European Economic Community, for example, made a distinction between "specific distortions" and "general distortions" and argued in favour of concerted action to address the former (Sapir, 1995). In the Spaak Report specific measures were those that were advantageous or disadvantageous to particular branches of activity. Along similar lines, the WTO Agreement on Subsidies and Countervailing Measures develops subsidy disciplines that rely on a specificity criterion. Once again, however, specificity as a criterion for determining proximity to trade has not been subject to systematic empirical or theoretical investigation. Economic analysis does not yield clear guidance.

The difficulty of establishing clear *ex ante,* objective criteria for harnessing the multilateral trading system for negotiations on internal measures is compounded by another consideration – governments may seek linkages between issues that are entirely unrelated to market access or competitive considerations. International relations involve multiple dimensions of interaction. Even when these dimensions are not directly interdependent – for example, trade policy and security concerns – the possibility of cross-issue negotiation linkage exists. By exchanging concessions across different policy dimensions, two countries may be able to achieve cooperation in situations where scope would not otherwise exist for the attainment of mutual gains. The possibility of cross-issue linkage has, for instance, been raised with respect to global environmental problems and trade, as indicated below.

A possible drawback of combining negotiations on border and (unrelated) internal measures is that as the negotiations become more complex, the calculus of costs and benefits from international cooperation for individual parties also becomes more multi-dimensional and less certain. This is the case in part because negotiations on internal measures often go in the direction of harmonizing relevant rules at the international level. Harmonization may facilitate international transactions and understandings, but may also have disadvantages when policy objectives and appropriate measures to pursue them differ across countries. Country-specific factors such as cultural heritage, climate, ideology, regulatory traditions and the level of development will become more relevant.[387] Distributional issues across jurisdictions are more likely to arise in the context of negotiations on internal measures since the adoption and/or harmonization

[386] Maskus concludes that the empirical evidence on the existence of a positive trade impact is stronger for the case of intellectual property rights than for the case of environmental measures.

[387] See also Howse (2002) on this point.

of rules may represent a cost for some parties.[388] If international cooperation is intended to eliminate prisoners' dilemmas and to facilitate win-win outcomes – in other words, to improve global welfare – then where the commitments involved in rule-setting carry negative inter-jurisdictional implications for some parties in distributional terms, something else is required in order to ensure the viability of cooperation. Win-win situations at the global level that entail win-loss relationships at the level of individual parties, may be made viable if the latter are compensated in some fashion. Such compensation could comprise a transfer, elements not related directly to trade, or a balance might be found directly within a package emerging from trade negotiations.

More generally, the welfare effects of negotiations on internal measures may not be as straightforward as in the case of negotiations on border measures. In particular, it is not necessarily the case that positions defended by export industries are optimal for the exporting country itself.[389] It has, for instance, been shown that in the case of standards intended to overcome information asymmetries in a certain product category, these standards are likely to be too lax in the country that produces and exports the good.[390]

One risk of pursuing a complex set of negotiations is that some negotiating partners may be disappointed with the negotiation outcome once they are in a position to evaluate it fully, including in terms of revealed outcomes. Future negotiations may then become even more complex because some participants may want to recover what they believe they did not receive in previous negotiations. On the other hand, the value of negotiated outcomes is also likely to change over time. With economic growth and changes in competitive positions, the benefits countries draw from certain international rules may change. The benefits of international rules on intellectual property would, for instance, increase for a country when it changed from being a net importer to a net exporter of R&D intensive goods, or when it enjoyed enhanced prospects of attracting investments intensive in high technology.

The question whether or not to embrace international negotiations on internal measures is, of course, separate from the choice of forum. The discussion above has implicitly assumed that such negotiations would be considered in the WTO. But numerous kinds of internal measures are negotiated in different international fora, often – but not always – within a specialized international organization. Food safety standards are negotiated at the Codex Alimentarius Commission, labour standards at the International Labour Organization and environmental standards in the context of multilateral environmental agreements (MEAs). Bringing internal measures into the multilateral trading system therefore also calls for a definition of the relationship between the WTO Agreement and other relevant standard-setting bodies or agreements. Once again, no conceptual framework exists for determining an optimal international architecture or desirable distribution of subject matter among institutions. As shown in the discussion below, many considerations are at play in relation to this question.

In what follows, a number of policy areas in respect of which a debate has actually taken place in the context of the GATT or the WTO are discussed in more detail. These include competition policy, labour standards, product standards, sanitary and phytosanitary measures, intellectual property rights and environmental protection. The choice of internal measures discussed here is by no means comprehensive, but rather illustrative of how negotiations on internal measures have evolved within the multilateral trading system and how the different factors raised in this introductory discussion may have affected outcomes.

[388] Costs are here referring to reductions in economic welfare. See Bagwell and Staiger (2004) for an analysis of costs in terms of national sovereignty being compromised by international agreements.

[389] See Howse (2002) on the role of export interests in the stance of the United States during the Uruguay Round negotiations, Hoekman and Saggi (2004) on the role of export promotion policies in the attempts to put competition policy on the WTO agenda and Maskus (2002) on the relevance of US export interests for negotiations on intellectual property rights.

[390] See Sturm (2006).

(b) An evolving trade agenda: from ITO to WTO

(i) Competition and labour policy in the Havana Charter

Over time the issues of environment, labour, competition policy and intellectual property protection have played different roles in trade negotiations and trade cooperation. The Havana Charter conceived in the 1940s made explicit reference to both labour and competition policy. With respect to the former the Havana Charter stipulated in Article 7:

> "(1) The Members recognize that measures relating to employment must take fully into account the rights of workers under inter-governmental declarations, conventions and agreements. They recognize that all countries have a common interest in the achievement and maintenance of fair labour standards related to productivity, and thus in the improvement of wages and working conditions as productivity may permit. The Members recognize that unfair labour conditions, particularly in production for export, create difficulties in international trade, and, accordingly, each Member shall take whatever action may be appropriate and feasible to eliminate such conditions within its territory.
>
> (2) Members which are also members of the International Labour Organization shall co-operate with that organization in giving effect to this undertaking."

The Havana Charter also contained an entire chapter, Chapter V, on the subject of restrictive business practices, including a requirement for members to police anti-competitive practices of an international nature.[391] The Charter would have required its members to act against anti-competitive behaviour affecting trade, although it contained no general obligation to adopt a competition law. The Havana Charter also provided for intergovernmental cooperation on competition policy issues.

But as discussed earlier in this study, ratification of the 1947 Havana Charter proved difficult in some national legislatures and was never adopted. What survived of the Charter was Chapter IV, the chapter on trade in goods that became known as the GATT.

References to intellectual property rights and to the environment were limited in the Havana Charter. Article 21 provided that Members should not prevent the importation of such minimum quantities of a product as may be necessary to obtain and maintain patent, trade mark, copyright or similar rights under industrial or intellectual property laws. Article 70 foresaw flexibilities for commodity control agreements that relate solely to the conservation of exhaustible natural resources, and Article 45 made reference to exhaustible natural resources. Provisions similar to these all found their way into the general exceptions rules contained in GATT Article XX,

Indeed, the approach taken in the GATT text to disciplining the use of internal measures reflects the approach taken in Chapter IV of the Havana Charter. Like Article 18 of the Havana Charter, GATT Article III imposes restrictions on the discriminatory use of internal measures by Members.[392] GATT Article XX gives some flexibility in the use of domestic policies as long as they are used to pursue specific policy objectives that are listed in the Article, and are not unjustifiably discriminatory or restrictive of trade. See Box 23 for the relevant legal text.

---

[391] See, for instance, Anderson and Holmes (2002).

[392] The national treatment provisions of the GATS are more complicated, since they contemplate formally identical and formally different treatment.

Box 23: GATT Article XX

Article XX

General Exceptions

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

(*a*) necessary to protect public morals;

(*b*) necessary to protect human, animal or plant life or health;

(*c*) relating to the importations or exportations of gold or silver;

(*d*) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trade marks and copyrights, and the prevention of deceptive practices;

(*e*) relating to the products of prison labour;

(*f*) imposed for the protection of national treasures of artistic, historic or archaeological value;

(*g*) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;

(*h*) undertaken in pursuance of obligations under any intergovernmental commodity agreement which conforms to criteria submitted to the CONTRACTING PARTIES and not disapproved by them or which is itself so submitted and not so disapproved;*

(*i*) involving restrictions on exports of domestic materials necessary to ensure essential quantities of such materials to a domestic processing industry during periods when the domestic price of such materials is held below the world price as part of a governmental stabilization plan; *Provided* that such restrictions shall not operate to increase the exports of or the protection afforded to such domestic industry, and shall not depart from the provisions of this Agreement relating to non-discrimination;

(*j*) essential to the acquisition or distribution of products in general or local short supply; *Provided* that any such measures shall be consistent with the principle that all contracting parties are entitled to an equitable share of the international supply of such products, and that any such measures, which are inconsistent with the other provisions of the Agreement shall be discontinued as soon as the conditions giving rise to them have ceased to exist. The CONTRACTING PARTIES shall review the need for this sub-paragraph not later than 30 June 1960.

(ii) The Agreement on Technical Barriers to Trade (TBT) and the Agreement on Sanitary and Phytosanitary Measures (SPS)

As tariffs came down through a succession of multilateral trade rounds, attention shifted to non-tariff measures. In the Tokyo Round, discussions were launched on a Code of Standard Practices. One aspect of these discussions concerned the need for rules to ensure that packaging and labelling requirements did not act as unnecessary barriers to trade. In this context it was argued that GATT Article III and IX (on marks of origin) were not sufficient to achieve an appropriate outcome.[393]

The plurilateral TBT Agreement[394] was signed at the end of the Tokyo Round and entered into force on 1 January 1980. It laid down rules for the preparation, adoption and application of technical regulations, standards and conformity assessment procedures. By the mid-nineties, when a revised standards agreement emerged from the Uruguay Round negotiations, the Tokyo Round Agreement had attracted 46 signatories.[395] Technical regulations and standards regarding products can often be controlled at the border. From an inspection and enforcement point of view, such measures therefore come close to border measures, even though definitionally they are generally treated as falling within the rubric of internal measures.

The WTO TBT Agreement strengthened and clarified the provisions of the Tokyo Round TBT Agreement and broadened its coverage to certain provisions on process and production methods. In addition, the Uruguay Round SPS Agreement dealt with measures to protect human and animal health from food-borne risks, human health from animal- or plant-carried diseases, animals and plants from pests or diseases, and measures for the prevention of other damage from pests. As more stringent rules were introduced in the agricultural sector during the Uruguay Round, Members wanted to ensure that the market access gained in that sector through the conversion of non-tariff measures into ordinary customs duties, would not be undermined by product regulations. Thus, disciplines tailored for agricultural product regulations were effectively separated from the TBT Agreement.[396]

GATT Article XX (b) had been designed to allow Members to deviate from GATT rules if this was necessary to protect human, animal or plant life or health. Some countries proposed to make it more difficult to invoke this exception by allowing derogation from the rules only for measures based on international norms.[397] Indeed, the United States suggested amendments to Article XX (b) to incorporate a harmonization principle.[398] Ultimately, it was decided to leave Article XX (b) unaltered and to enshrine the concept of harmonization in the newly negotiated SPS Agreement. The European Communities argued that Members which had achieved high health standards would find it difficult to accept moving to lower standards and that such countries should, therefore, be allowed to apply SPS standards more stringent than those agreed internationally. In other words, the notion that international standards may not achieve the level of protection sought by some countries was explicitly raised during the SPS negotiations.

An agreement emerged with a requirement that deviations from international standards should be justifiable through scientific evidence. It was mainly the Cairns group of agricultural producers that had insisted on placing the burden of proof regarding scientific evidence on importing countries. In other words, suggestions were rejected that exporters would have to justify that their products were "safe" and instead importers had to justify standards that were more stringent than international standards. The SPS Agreement specifies in Annex A that international standards are those developed by the Codex

---

393 See European News Agency (1975).

394 BISD 26S/8 (1980). This agreement is also referred to as the Standards Code.

395 See WTO (2007).

396 See Abdel Motaal (2004), Croome (1995).

397 See discussion in Abdel Motaal (2004).

398 MTN.GNG/NG5/W118.

Alimentarius Commission for food safety issues, the International Office of Epizootics – now called the World Organization for Animal Health (OIE) – for animal health and zoonoses and the Secretariat of the International Plant Protection Convention (IPPC) for issues concerning plant health.[399]

All three standardizing bodies were established prior to the adoption of the SPS Agreement. Although the WTO and the international standardizing bodies remain separate institutions, the reference to standardizing bodies in WTO legal texts appears to have affected their way of working.[400] Stewart and Johanson (1998), for instance, argue that activities of the three standardizing bodies tended to receive little attention outside the scientific community, because the standards they promulgated were not legally binding. Their standards continue to be of a voluntary nature, but as a result of the SPS Agreement, the stakes for WTO Members in international SPS standards became higher, and all three organizations were increasingly politicized. Interaction between cooperation on international standards and trade cooperation is thus likely to take place even if negotiations on both issues are not explicitly linked and do not take place within the same institution.

The WTO TBT Agreement and the SPS Agreement brought an important new element into the multilateral legal system – the explicit reference to process and production methods (PPMs). As opposed to product characteristics, PPMs cannot necessarily be controlled at the border. A distinction is sometimes made between incorporated and non-incorporated PPMs, where the latter do not leave traces in the products that can easily be detected.[401] Fishing methods, for instance, do not necessarily have an impact on the characteristics of the fish that are caught. Working hours or safety regulations at the workplace do not necessarily affect the goods that are produced. Inspection and enforcement in respect of rules related to non-incorporated PPMs at the international level is therefore less straightforward.

(iii) The TRIPS Agreement

International cooperation on intellectual property issues has existed for a long time. The Paris Convention for the Protection of Industrial Property was signed as early as 1883, after the need for international protection of intellectual property had become evident when foreign exhibitors refused to attend the International Exhibition of Inventions in Vienna in 1873 out of fear that their ideas would be stolen and exploited commercially in other countries. Brazil, Tunisia, the United States and a number of European countries were among the first countries to ratify the Convention. Today the Convention is administered by the World Intellectual Property Organization (WIPO), which was established in 1970. The Convention has 171 contracting parties, 74 of whom ratified it after 1990. The Berne Convention in the field of copyright, also administered by WIPO, dates from 1886.

The Paris Convention requires that members do not discriminate against foreign industrial property owners – that is, it contains a national treatment provision. The Convention also contains a number of important minimum standards, but leaves members free to determine the main standards that regulate the level of protection given to patents. Over time, business people and policy makers in the industrialized world increasingly considered that the standards of the Paris Convention were too weak to provide adequate international patent protection. In the late 1970s a number of pharmaceutical companies and representatives from the US Patent and Trademark Office took their case for minimum standards of patent protection to WIPO.[402] But developing countries vehemently opposed changes to the Convention. The Advisory Committee on Trade Policy Negotiation, a US body created to provide business advice on trade matters to the President, consequently suggested placing the issue on the GATT agenda.

399 The TBT Agreement also encourages Members to base their internal measures on international standards and urges Members to play an active role in the development of such standards. Contrary to the SPS Agreement, the TBT Agreement does not make explicit reference to any particular international standard setting body.

400 See Abdel Motaal (2004).

401 See, for instance, Abdel Motaal (1999).

402 See Ryan (1998).

Underlying the inclusion of intellectual property as a topic for negotiation in the Uruguay Round and the subsequent negotiation of the TRIPS Agreement was a growing perception on the part of a number of WTO Members that their comparative advantage in international trade lay not in raw materials or in standard technology manufactured products, but in goods and services that were intensive in technology and creativity and/or characterized by high quality and reputation. These Members believed that they would not be able to realize their comparative advantage without a functioning worldwide set of minimum standards for the protection of intellectual property. The United States initially took the lead in seeking broad-ranging negotiations on intellectual property in the GATT framework and was subsequently joined by most other developed countries, in particular the European Communities, Japan and Switzerland.

The Uruguay Round mandate on TRIPS that was agreed at Punta del Este in September 1986, contained a commitment to negotiate a multilateral framework dealing with trade in counterfeit goods and contained a provision to "clarify GATT provisions and elaborate as appropriate new rules and disciplines" with a view to reducing distortions and impediments to international trade, and taking into account the need to promote effective and adequate protection of IPRs, and to ensure that measures and procedures to enforce them did not themselves become barriers to legitimate trade.

During the first two years of the negotiations, the meaning of this mandate was the subject of extensive discussion. Many developed countries argued that new rules for IPR protection and enforcement were needed in order to ensure that trade was not distorted and to promote the effective and adequate protection of IPRs. Most developing countries argued that such matters were outside both the mandate given at Punta del Este and the competence of the GATT.[403] They maintained that WIPO was the appropriate forum.

In a number of submissions to the Negotiating Group in 1987, developed countries made their case by emphasizing the trade problems they encountered in connection with intellectual property rights. The US submission, for instance, referred to estimates produced by industry bodies on losses faced due to limited patent terms and practices like unauthorized copying.[404] The importance of the possible impact of IPRs on trade flows was later confirmed by academic studies[405], which showed that the estimated changes in imports of manufacturing goods and high-technology manufactures induced by stronger patent rights could be substantial.

Differences regarding the negotiating mandate were essentially resolved as part of the package of the Uruguay Round mid-term review agreed in April 1989. Participants agreed that a successful outcome to the negotiations would need to include a comprehensive agreement on intellectual property, covering the following five elements: basic principles of IP protection; adequate substantive standards of protection; effective and appropriate means for their enforcement; procedures for the multilateral settlement of disputes between governments; and transitional arrangements. Agreement on these points was subject to three important understandings: in the negotiations appropriate consideration would be given to the underlying public policy objectives of national IP systems, including developmental and technological objectives; on the importance of strengthened commitments to resolve disputes on trade-related IP issues through multilateral procedures so as to reduce tensions in this area; and the negotiations would be undertaken without prejudice to whether the results would be implemented in the GATT or some other framework.[406]

---

403 See Croome (1995).

404 The submission referred to estimates provided by the International Intellectual Property Alliance and the National Agricultural Chemicals Association on the losses faced by industries due to unauthorized copying or use of copyrighted works. It also made reference to estimates provided by US pharmaceutical companies of losses due to limited patent terms together with the lack of product protection for pharmaceuticals. See MTN.GNG/NG11/W/7.

405 See Maskus and Penubarti (1995) and Maskus (2002). Maskus (2002) also makes the point that inclusion of IPRs in the multilateral trading system is facilitated by the fact that enforcement of TRIPS through dispute resolution is, in principle, a manageable task. Indeed, the assignment of commercial damages appears to be relatively straightforward in the case of IPRs, where copying is aimed at particular products and technology that may be identified through court proceedings

406 MTN.TNC/11.

Substantive work moved ahead rapidly thereafter, with the submission of a large number of proposals by developed and developing countries.[407] Intensive negotiations on the basis of draft legal texts submitted by the European Community, United States, a group of 14 developing countries, Switzerland and Japan followed [408], and the text negotiated by the end of 1991 was very close to the one that was finally approved and adopted at Marrakesh in April 1994.

This text built upon the international framework for IPRs that existed at the time and incorporated by reference many of the provisions of the then existing international agreements on IPRs, notably the Paris Convention and the Berne Convention. In addition, the TRIPS Agreement set out some substantial new international standards for the protection and enforcement of intellectual property rights. The Preamble to the Agreement calls for a mutually supportive relationship between the WTO and WIPO. International agreements established after the TRIPS Agreement, like the WIPO Copyright Treaty, are not automatically incorporated in the TRIPS Agreement, and WTO Members are under no obligation to adhere to them.

The inclusion of the TRIPS Agreement in the multilateral trading framework has given rise to a good deal of debate. Much of this has focussed on the implications of the Agreement for developing countries. Some observers have argued that the area of IPRs is one where a harmonized set of international rules has significant distributional consequences because countries at different stages of development have very different needs for IPR, and in particular, patent protection.[409] Developed countries with important R&D intensive and export-oriented industries are likely to gain from increased patent protection, while many developing countries that are net importers of IPR-embodied production, and have limited prospects of attracting high-technology industries, are likely to lose from an international IPR regime, at least in the short-run.[410]

A full analysis of these implications is beyond the scope of this discussion and in any event would entail making an assessment of the counterfactual, namely what would have been the situation in the absence of TRIPS. However, four considerations that may have played a role in the decision by developing countries to accept the TRIPS Agreement are set out below.

First, in the latter phases of the Uruguay Round negotiations, it became accepted that the TRIPS Agreement was an essential part of a broader package of results of the Uruguay Round negotiations, from which developing countries hoped to gain advantages in other areas – in particular agriculture and textiles. In other words, cross-issue linkages seem to have been important for the conclusion of the Uruguay Round.

Second, the Agreement contained elements of balance and flexibility which allowed developing country Members to fine-tune their intellectual property systems in the light of their development, public health and other public policy objectives. Some important clarifications of TRIPS flexibilities have resulted from the operation of the WTO dispute settlement system, and also from the Doha Declaration on the TRIPS Agreement and Public Health.

Third, developing countries' acceptance of the TRIPS Agreement may reflect a preference for the multilateral rule of law, including the multilateral resolution of disputes, in the area of intellectual property. It was clear at the time of the Uruguay Round negotiations that there was no longer a functioning international

[407] Summarized in documents MTN.GNG/NG11/W/32/Rev.2 and 33/Rev.2. In the context of the discussion in this section, the submission by Chile is of interest (MTN.GNG/NG11/W/61). Chile suggested forwarding the proposals on standards made in the Negotiating Group to WIPO, in order that the latter would administer the new standards. Chile also suggested that WIPO be given the responsibility of determining cases of non-application of internationally-accepted intellectual property standards. In cases of non-application, GATT panels would, upon request, determine whether or not there had been "trade-related effects". Although Chile's suggestions were not accepted, they are interesting because of their similarities to the approach taken in the SPS Agreement.

[408] MTN.GNG/NG11/W/68, 70, 71, 73, 74 respectively.

[409] For example Deardorff (1998) and Howse (2002).

[410] See Deardorff (1998).

consensus about the extent to which trading partners should provide for the protection of each other's intellectual property, and this was giving rise to widespread trade tensions, including unilateral trade measures.

Finally, another factor may have been the belief that enhanced IP protection could promote domestic creativity and inventiveness as well as the transfer of technology and FDI, within the context of the more market-oriented reforms that were being undertaken at the time. In some developing countries, especially in East and South Asia, there is evidence of large increases in the use of the patent system by domestic firms and residents, as well as increased in investment in R&D. However, for many developing countries, what is more important is the impact on the transfer of technology, including through FDI. Overall, the empirical literature appears to point to a positive role for IPRs in this regard, although perhaps the strongest conclusion that can be drawn from it is that more research and analysis is necessary.[411]

(iv) *Changing approaches towards the limits of trade cooperation*

This short summary of the role of internal measures in trade negotiations illustrates distinct approaches towards different types of domestic policies. Labour standards and competition policy were explicitly included in the original Havana Charter. The GATT legal texts incorporated into the WTO legal system do not contain any specific disciplines on harmonization of internal measures, and merely stipulate general disciplines as to which domestic policies would be in conflict with the GATT and which would not.

With the introduction of the Tokyo Round TBT Agreement, trade cooperation went in the direction of a partially more inclusive approach to harmonization of national regulation, but this happened only at the plurilateral level. The Agreement dealt with product characteristics that can often be controlled at the border and can therefore be considered a natural candidate for the inclusion of internal measures in the international trade framework. The Agreement made explicit reference to international standards, encouraging Members to apply relevant international standards where they exist and to collaborate to the extent possible in the preparation of international standards.

The Uruguay Round Agreements went several steps further and gave the multilateral trading system a significantly different character. First, the SPS Agreement and the TRIPS Agreement both brought increased harmonization of policies at the global level. The SPS Agreement does this by making explicit reference to international standard setting bodies like the Codex Alimentarius Commission and the World Organization for Animal Health. The TRIPS Agreement itself contains such international "minimum standards", as it defines, for example, the number of years for which protection will be granted for intellectual property rights related to trademarks and patents. Second, both the SPS Agreement and the TBT Agreement are applicable to process and production methods, implying that WTO provisions deal with internal measures whose implementation can potentially only be verified on production sites within the territory of exporting Members. Third, given its explicit reference to IPR rules, the TRIPS Agreement requires some Members to adapt domestic institutions in order to comply with WTO provisions.

(c) What role for domestic policies dealing with competition, environment and labour?

(i) *Competition Policy*

Competition (antitrust) policy deals with the behaviour of enterprises and, specifically, the regulation of anti-competitive practices such as cartels, abuses of a dominant position and anti-competitive mergers. As previously indicated, the still-born International Trade Organization (ITO) contained provisions on competition policy in a chapter that was not carried over into the GATT. While there is as yet no equivalent dedicated agreement on competition policy in the WTO, the subject is pertinent to a number of WTO agreements and related instruments in a number of specific ways. First, under each of the three main

411 See Fink and Maskus (2005).

agreements that make up the WTO system – the GATT, the GATS and the TRIPS Agreement – there are procedures for consultations and cooperation on anti-competitive practices.[412] Second, each of these three Agreements also contains broad rules on non-discrimination, transparency and procedural fairness which may relate, at least in some measure, to national competition policies that affect trade.[413] Third, minimum standards relating to specific anti-competitive practices are contained in certain of the WTO Agreements and related instruments – notably the GATS (Article VIII) and the commitments entered into by a large number of WTO Members in regard to basic telecommunications services in the form of the "Reference Paper" which contains competition safeguards and regulatory principles in this sector. Fourth, a number of WTO agreements contain provisions authorizing particular remedies in cases of enterprise behaviour that impacts adversely on trade and/or competition. These include the Anti-dumping Agreement, the plurilateral Agreement on Government Procurement and the TRIPS Agreement.[414] Fifth, the WTO Dispute Settlement Understanding is potentially applicable to measures attributable to governments and affecting trade which in certain situations may involve anti-competitive practices.[415] The need to ensure that anti-competitive practices do not impede or negate the realization of the benefits that should flow from the reduction of tariffs and the liberalization of non-tariff measures affecting international trade is also at the heart of the United Nations Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices ("the Set") adopted in 1980.[416]

The general question of the treatment of competition policy in the WTO was raised at the Singapore Ministerial Conference in December 1996, in response to an initiative of the European Communities. A Working Group on the Interaction between Trade and Competition Policy (WGCTP) was established with the mandate to consider issues raised by Members relating to the interaction of the two policy fields and to identify any areas that might merit further consideration in the WTO framework.[417] Pursuant to this mandate, in the first two years of its work, the Working Group focused on the following five specific dimensions of the interaction between trade and competition policy: (i) the impact of anti-competitive practices of enterprises and associations on international trade; (ii) the impact of state monopolies, exclusive rights, and regulatory policies on competition and international trade; (iii) the relationship between the trade-related aspects of intellectual property rights and competition policy; (iv) the relationship between investment and competition policy; and, (v) the impact of trade policy on competition.[418]

The first point – the impact of anti-competitive practices on trade – is the most interesting one with respect to the discussion in this section.[419] In the discussions on this item, particular attention was given to the impact of international cartels (i.e. price-fixing and similar arrangements). Note was taken of the extent and effects of such arrangements in the globalizing economic environment. The costs imposed by such cartels on the world economy and, specifically on developing countries, have been shown

412 See, respectively, *Decision on Arrangements for Consultations on Restrictive Business Practices*, BISD 9S/28-29 (with respect to the GATT); GATS, Article IX; and the TRIPS Agreement, Article 40.

413 World Trade Organization (1997). See, for pertinent commentary, Ehlermann and Ehring (2002).

414 See, for details, World Trade Organization (1997).

415 For example, in cases of a failure to adhere either to the above-noted broad rules on non-discrimination or to the minimum standards with respect to the treatment of anti-competitive practices which are embodied in the GATS and the Reference Paper. See, in this connection, the report of the panel in *Mexico: Measures Affecting Telecommunications Services*, WT/DS204/R, adopted 1 June 2004.

416 United Nations, 'The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices', http://r0.unctad.org/en/subsites/cpolicy/docs/CPSet/cpset.htm.

417 Singapore Ministerial Declaration, Paragraph 20.

418 See "Checklist of issues suggested for study," reprinted in Report (1998) of the Working Group on the Interaction between Trade and Competition Policy (WT/WGTCP/2, 8 December 1998), Annex 1.

419 With regard to the third item it is worth noting that the TRIPS Agreement specifically recognizes that competition policy has an important role to play in protecting against anti-competitive abuses of intellectual property licensing and other practices.

to involve billions of dollars annually.[420] Furthermore, in many such cases cartels are known to have operated extensively throughout the developing world, substantially raising the costs of developing country imports of affected products. Given that such cartels operate in multiple markets it is difficult, if not impossible, for national competition authorities – in particular in developing countries – to discipline possible anticompetitive abuse. In the academic literature it has been argued that increased cooperation among national competition authorities or the establishment of a *supra*-national competition authority could go some way in solving this problem.

Attention was also given to the issue of export cartels – that is, price-fixing arrangements that focus solely on export markets. It was felt by some parties that such practices result in "beggar thy neighbour" effects as their negative impact is mainly felt in the importing country while the relevant cartels in exporting countries register gains. Although they do not represent a classical example of commitment circumvention, the activities of export cartels are often seen as violating the spirit of trade cooperation. In the Working Group, some countries expressed interest in the possibility of eliminating existing exemptions for such arrangements under national competition laws, but others questioned whether the national authorities of the exporting countries would have jurisdiction to prosecute such arrangements.[421]

In the discussions under item (i) mentioned above, attention was also given to the impact on trade of anti-competitive abuses of a dominant position and vertical market restraints in importing countries.[422] If national antitrust laws tolerate such practices this can frustrate effective market entry by foreign suppliers.[423] GATT Article XXIII could be interpreted to provide some protection against these practices and has indeed been invoked – albeit unsuccessfully – in this context in the *Japan-Film* dispute, as mentioned in Section C. Yet, as with all the topics discussed in this section, the question arises whether additional specific rules should be negotiated in order to protect negotiated commitments.

In Doha, Members agreed that negotiations on competition issues would take place after the next Ministerial Conference on the basis of a decision to be taken at that session on modalities of negotiations.[424] But at the subsequent WTO Ministerial Conference in Cancun, Mexico, in September 2003, no consensus was reached on negotiations on a "multilateral framework on competition policy". Subsequently, the General Council of the WTO decided, as part of the so-called 'July package' of 2004, that no further work would be undertaken towards negotiations on competition policy (nor on the issues of investment and transparency in government procurement) in the WTO for the duration of the Doha Round.[425]

The lack of consensus on launching negotiations on competition policy at Cancun merits careful reflection. In addition to possible tactical considerations, the reasons underlying this rejection included concerns about a lack of negotiating capacity in this area, a perception by some that the proposals might intrude on developing countries' "policy space"[426], and, for some, a sense that the proponents' proposals might not be sufficiently strong to yield tangible benefits in the form of cooperation for developing countries.[427]

---

420 See, for details and relevant discussion, Levenstein and Suslow (2001), Evenett et al. (2001) and Bhattacharjea (2006).

421 Given that negotiations on export cartels are likely to result in win-lose outcomes, the question of issue-linkage arises and has, indeed, been analysedd in the economic literature. Hoekman and Saggi (2003) investigate the feasibility of a deal involving linkage between specific antitrust disciplines of interest to poor countries – a ban on export cartels enforced by high-income countries – and market access commitments.

422 See, generally, Report (1998) of the Working Group on the Interaction between Trade and Competition Policy (WT/WGTCP/2, 8 December 1998), paragraphs 81-96.

423 See Hoekman and Saggi (2004).

424 Doha Ministerial Declaration paragraph 23.

425 WT/L/579, 2 August 2004.

426 Policy space that might be used, for example, to promote national champions.

427 See Bhattacharjea (2006). For some, a further concern was the direct financial cost of setting up a national competition agency. The evidence suggests, however, that the annual costs of such agencies pale by comparison to the benefits to public treasuries that can accrue from just one or two successful prosecutions of major cartels or bid-rigging cases (Clarke and Evenett 2003).

Another factor, highlighted in the Working Group also as affecting national competition policies, may have been the public good character of competition law and the related absence of producer lobbies. It is interesting to contrast this absence of producer lobbies in the case of competition policy with the relative active role producer lobbies have played in the context of other internal measures or certain border measures. The observation has also been made that it would be difficult to reach agreement on sound competition rules within the multilateral trading framework as any negotiation on competition issues would probably be affected by progress in trade negotiations in other sectors or on other topics.[428] In other words, cross-sector linkages or cross-issues linkages of negotiations were seen as adding an undesired complexity to negotiations.

This decision in the WTO has not meant an end to international deliberations on competition policy. Work has continued on a number of fronts, including in the OECD and UNCTAD. In addition, even prior to Cancun, an "International Competition Network" (ICN) was founded, on the basis of a US proposal. The ICN is an informal network of antitrust agencies which is open to both developed and developing countries. It focuses on improving worldwide cooperation and enhancing convergence through dialogue, and does not exercise any rule-making or dispute settlement functions.[429]

In any case, the longstanding recognition of the important interdependence of trade and competition policy, reflected in the Havana Charter, the UN Set and the various above-noted WTO provisions, has not been called into question. The work of the Working Group on the Interaction between Trade and Competition Policy has served to elaborate on these relationships. In addition, recently-concluded regional free trade or similar agreements involving both developed and developing countries increasingly contain provisions relating to laws or policies dealing with anti-competitive practices and/or cooperation among relevant agencies of the participating countries.[430] The question is not whether competition policy and trade liberalization can or will be linked but whether and how far the potential synergies will be harnessed in the WTO framework.

(ii) Environment

When the multilateral trading system was established after the Second World War, the environmental consequences of economic integration were not a primary concern for policy makers. This may explain why references to issues of environmental protection in the GATT were basically restricted to Article XX, which provides that policies may under certain conditions entail elements of discrimination if they are necessary to "protect human, animal or plant life or health" or if they are related to "the conservation of exhaustible natural resources ..."

Over time, the impression arose that more clarification was needed on the relationship between trade and environment and in 1971 a Group of Environmental Measures and International Trade was established for this purpose. A request to activate this group was made for the first time in 1990 by the countries from the European Free Trade Association (EFTA).[431] The debate on trade and environment was further institutionalised within the WTO through the Marrakesh Decision on Trade and Environment. In this decision Members noted that safeguarding the multilateral trading system and protecting the environment and promoting sustainable development should be mutually supportive. They further noted

---

428 Klein, J.I. (1996), page 14: "A WTO competition policy debate would have to balance many (often diverse) national interests, with the possibility of positions shifting in response to trade-offs in other trade negotiations related to agriculture, services, intellectual property, or any of the myriad fields currently covered by WTO agreements."

429 See "About the ICN" (http://www.internationalcompetitionnetwork.org/index.php/en/about-icn).

430 See, for documentation and analysis of such arrangements, Anderson and Evenett (2006) and other sources cited therein.

431 They expressed the concern that the approach to environmental policy making varied considerably from country to country due to differing geographical settings, economic conditions, stages of development and environmental problems. EFTA countries expressed concern that the resulting policy differences could potentially set the stage for trade disputes and they therefore wished to ensure that GATT's framework of rules provided clear guidance to policy makers and that its dispute settlement system was not faced with issues it was not equipped to tackle. See Annex 1 of Nordström and Vaughan (1999) for more detail.

their desire to coordinate policies in the field of trade and environment, "but without exceeding the competence of the multilateral trading system, which is limited to trade policies and those trade-related aspects of environmental policies which may result in significant trade effects". The Marrakesh Decision also foresaw the establishment of the Committee on Trade and Environment (CTE), which took place in January 1995.

The 1994 Marrakesh Agreement Establishing the World Trade Organization (the "WTO Agreement") also introduced new elements in the legal texts that are relevant to the trade and environment debate. The Preamble to the WTO Agreement includes reference to the objective of sustainable development and to the need to protect and preserve the environment. During the Uruguay Round negotiations, a proposal was made to alter GATT Article XX and explicitly mentions the protection of the environment as a legitimate reason for Members to depart under certain conditions from their obligations. Although no consensus was attained on this proposal, Article XX is of relevance for any legal disputes concerning the compatibility of environmental policies with the multilateral trading system.

Protection of the environment also receives specific mention in the TBT Agreement. Article 2.2 of the Agreement refers to protection of the environment as a legitimate objective for a technical regulation.[432] As noted earlier, the Agreement also encourages Members to use relevant international standards as a basis for their technical regulations, although it does not make reference to any particular international standard setting. One may note the contrast between the treatment of environmental questions in the WTO texts with the approach of the SPS Agreement. The latter is a separate, explicit agreement on a set of public policy objectives – that is, measures to protect human, animal or plant life or health – while in the case of environmental protection (in a broader sense), no such specificity has been introduced.

One of the particularities of the relationship between trade and environment is the existence of a large number of multilateral environmental agreements (MEA). In 2005, the UNEP Register mentions over 200 international treaties and other agreements on the state of the environment.[433] A number of these agreements contain explicit trade provisions. The 2001 Doha Declaration refers to the relationship between WTO Agreements and MEAs. Members are called upon "to negotiate on the relationship between existing WTO rules and specific trade obligations set out in multilateral environmental agreements (MEAs) with a view to enhancing the mutual supportiveness of trade and environment".[434]

The current situation, then, is that governments negotiate international environmental standards in multiple fora, separate from multilateral negotiations on trade cooperation. Some co-ordination between the trade and environment community exists and in negotiations in the context of the Doha Round possible procedures for regular information exchange between MEA Secretariats and the relevant WTO Committees are discussed.[435] But international environmental standards largely remain the domain of MEAs.

There have been calls in the public debate for closer international cooperation on trade and environmental issues – making, for instance, trade cooperation conditional on cooperation on environmental matters. The economic literature has analysed two possible reasons for such proposals. The first argument is based on a concern that different rules on environmental measures are needed within the WTO in order to avoid regulatory "chill" or a "race-to-the-bottom" in standard-setting at the national level.[436] The argument is that governments will be increasingly hesitant to increase environmental standards or will even tend to lower their standards in order to remain competitive in global markets. Economists

---

432 Other "legitimate objectives" referred to in TBT Article 2.2 are national security requirements, the prevention of deceptive practices, protection of human health or safety and animal or plant life or health.

433 United Nations Environment Programme, Register of International and Other Agreements in the Field of the Environment, Nairobi: 2005.

434 Paragraph 31 of the Doha Ministerial Declaration.

435 Doha Ministerial Declaration paragraph 31 (ii).

436 See Bagwell and Staiger (2002), Bagwell et al. (2002).

have examined the validity of this concern by analysing whether environmental regulation indeed has a substantive impact on competitiveness. If this were the case, one would observe changes in the pattern of trade as a result of changes in environmental policies. An early study on the trade effects of environmental regulations (Jaffe et al., 1995) found that environmental regulations on US manufacturing had not affected patterns of international trade. A more recent study by Copeland and Taylor (2003) found that differences in pollution regulation do affect trade flows, but their effect is much weaker than the effect of factor endowment differences on trade flows.[437] So far, there is thus no strong evidence that environmental standards have significant effects on trade or that the risk of a race to the bottom or regulatory chill is acute.

The second argument analysed in the economic literature for tying negotiations on trade and environmental standards closer together is that this would increase the probability of negotiations on environmental matters being successful. As mentioned before, cross-issue linkage in negotiations can allow negotiating partners to exchange concessions across different policy dimensions. For example, a country may be willing to accept environmental standards that it considers very costly for its economy if in turn it obtains worthwhile gains from trade negotiations. Conconi and Perroni (2002) have analysed negotiation tie-in for environmental and trade matters in a theoretical framework and find that in some cases, negotiation tie-in could play a positive role, but that in other cases it could become a hurdle to multilateral cooperation in both fields. Their results suggest that making trade cooperation conditional on environmental cooperation and vice-versa, could play a facilitating role in the case of "small" environmental problems.[438] But such conditionality is more likely to be an impediment to cooperation for broader environmental issues such as climate change. Abrego et al. (2001) use a numerical simulation model to compute bargaining outcomes from linked trade and environmental negotiations. Results indicate joint gains from expanding the trade bargaining set to include the environment. But the authors also analyse a third scenario – that of offering cash side-payments to countries that expect to lose from international environmental standards. They find that this approach leads to significantly better negotiation outcomes than making trade cooperation conditional on environmental cooperation.

(iii) Labour

The WTO's official position on labour standards is reflected in the 1996 Singapore Ministerial Declaration that stipulates::

> "We renew our commitment to the observance of internationally recognized core labour standards. The International Labour Organization (ILO) is the competent body to set and deal with these standards, and we affirm our support for its work in promoting them. We believe that economic growth and development fostered by increased trade and further trade liberalization contribute to the promotion of these standards. We reject the use of labour standards for protectionist purposes, and agree that the comparative advantage of countries, particularly low-wage developing countries, must in no way be put into question. In this regard, we note that the WTO and ILO Secretariats will continue their existing collaboration."

This declaration, reaffirmed in Doha in 2001, emphasizes the importance WTO Members attach to core labour standards. It also *inter alia* articulates the view of Members that the ILO is the competent body to set, deal with, and promote these standards.

From past discussions, it is clear that some WTO Members would like to see the issue further explored in the WTO, including the possibility of an explicit reference to labour standards in the Agreements. WTO rules and disciplines, they argued, would provide a powerful incentive for Member nations to improve

---

[437] See WTO (2005) for references to empirical studies analysing the effect of environmental measures on FDI decisions.

[438] Small, that is, in terms of the associated welfare costs and benefits in comparison with the costs and benefits of trade policies.

workplace conditions and advance "international coherence" – that is, they would support efforts to ensure policies developed in different multilateral settings are consistent and mutually supportive.

Other WTO Members believe the issue has no place in the WTO framework. In this context, some developing countries argue that the suggestion to bring labour issues into the WTO is actually a bid by industrial nations to undermine the comparative advantage of lower wage trading partners and could undermine their ability to raise standards through trade and economic development. They also fear that proposed standards could be too high for them to meet at their level of development. These countries further contend that efforts to bring labour standards into the arena of multilateral trade negotiations are little more than a smokescreen for protectionism. They hold strongly to the pronouncement in Singapore that the comparative advantage of countries, particularly low-wage developing countries, must in no way be put into question.

In accordance with the position decided at the Singapore Ministerial Conference, there is currently no work on the subject of trade and labour in the WTO's councils and committees. In line with the Singapore Declaration, the WTO and ILO Secretariats continue existing collaboration and exchange of information. This includes participation by the WTO in meetings of ILO bodies, exchange of documentation, joint research and informal cooperation between the two Secretariats. In 2007, for instance, the two Secretariats launched a joint study on the relationship between trade and employment.[439]

Beyond the discussion among WTO Members on the topic of trade and labour, some interesting dimensions of debate have emerged in the academic literature. Theoretical and empirical economic analyses of the relationship between trade and labour standards have paid particular attention to "race to the bottom" and "regulatory chill" arguments. As in the case of the literature on trade and environment, the relevant studies analyse whether it is indeed the case that changes in labour standards affect competitiveness and thus trade flows. The relevant research has tended to make a distinction between core labour standards and other labour standards.

The term core labour standards refers to ILO Conventions dealing with four areas – freedom of association and bargaining, elimination of forced and compulsory labour, elimination of discrimination in respect of employment and occupation and the abolition of child labour.[440] Maskus (1997) analyses links between core labour standards and international trade policy. He develops a series of simple models to see whether limiting core labour standards in export sectors of developing countries can improve their price competitiveness in export markets. He concludes that deficient provision of core labour standards generally diminishes export competitiveness rather than improving it because of the distortionary effects of those deficiencies. In other words, implementing core labour standards increases workers' productivity and lowers their real costs, rather than the opposite. The author concludes that concerns about the negative impact on industrial countries of limited wage, employment, and labour standards in developing countries are largely misplaced, with one exception – the exploitation of child labour through an expansion of labour supply could expand exports in highly labour-intensive sectors.

Empirical research is not entirely conclusive, but seems to confirm that trade effects are different for core labour standards related to child labour than for core labour standards related to freedom of association and bargaining. Early studies showed the absence of a correlation between labour standards in general and the volume of trade, but those studies did not use reliable indicators of real compliance with labour standards.[441] More recently, Rodrik (1998) found that timework and child labour contribute to a higher share of labour-intensive exports in total exports. Kucera and Sarna (2006) find a robust relationship between stronger freedom of association and collective bargaining (FACB) rights and higher

[439] See ILO and WTO (2007).

[440] Originally the term "core labour standards" referred to six ILO conventions falling under the above-mentioned four headings: Convention 29, 87, 98, 105, 111 and 138 (see for instance Maskus, 1997). Today the term is used to refer to eight ILO conventions: the six conventions mentioned before, convention 100 and convention 182.

[441] See Granger and Siroën (2006) for an overview.

total manufacturing exports. They find no robust relationship between FACB rights and labour-intensive manufacturing exports. These findings are confirmed by Neumayer and de Soysa (2006), who use the measure for FACB rights constructed by Kucera and Sarna (2006) and do not find evidence of a race to the bottom in FACB rights. Instead, they find that countries that are more open to trade have fewer rights violations than more closed ones. Taken together, the evidence of these last three papers appears to confirm the findings by Maskus (1997) that with respect to their effect on trade, it may make sense to distinguish between the core labour standards related to child labour and those related to FACB. While the former could be used to circumvent market access, this would – from an efficiency point of view – not make sense for the other types of core labour standards. But empirical evidence so far is too scarce to allow for a firm conclusion in this respect.

Labour standards also differ among industrialized countries although these differences are stronger with respect to standards not considered core labour standards. As to the existence of evidence of those differences influencing trade flows, Van Beers (1998) analyses the effect of labour standards on trade flows among 18 OECD countries. His measure of labour standards is based on national legislation and goes beyond the so-called core labour standards. The author finds that labour standards do influence trade, thus confirming that the range of labour standards potentially relevant for market access concerns in the context of trade agreements is not necessarily restricted to core labour standards.[442] Blanchard (2005) contends that a trade-off between efficiency and insurance exists and thus hints at a possible trade-relevance of labour standards aimed at insuring workers against adverse professional events.

In the public debate the argument has also been made that trade agreements should make explicit links to labour standards on humanitarian grounds rather than for reasons related to market access concerns, as discussed in the previous paragraphs. Brown (2001) surveys the economic literature that analysess whether trade sanctions actually help those who are the focus of humanitarian concerns and comes to the conclusion that trade sanctions levelled against countries with poor labour practices may well hurt the very workers who are the intended beneficiaries.

(d) Conclusions and challenges ahead

Since the inception of the multilateral trading system there have been calls for more explicit disciplines on certain types of internal measures. In this section a number of policy areas have been considered on which discussions or negotiations have taken place in the context of the GATT or the WTO. The outcome of these discussions or negotiations have differed significantly across policy areas. Separate agreements have been dedicated to some internal measures, like sanitary and phytosanitary measures and intellectual property rights. Other measures, like those targeting environmental protection, are not governed by separate agreements but are explicitly entrenched in legal texts. Yet another set of internal measures receive no mention in the legal texts, but may nevertheless be subject to dispute settlement should a Member see fit to bring a complaint under GATT Articles III, XX or XXIII. There are examples of the WTO setting international minimum "standards", like in the case of TRIPS, and examples of legal texts referring to international standards set by other international bodies, like Codex in the case of SPS.

Other WTO Agreements not explicitly discussed in this section have taken different approaches to disciplining internal measures, like the Agreement on Subsidies and Countervailing measures, the Agreement on Agriculture and the General Agreement on Trade in Services. All this illustrates the broad variety of ways in which disciplines on internal measures can be explicitly linked to the multilateral trading framework. But it is not possible on the basis of this discussion, and nor for that matter on the basis of established theoretical or proven empirical propositions, to conclude whether one approach is better than another.

[442] This may explain why also in the context of regional agreements among industrialized countries, like the European Union, discussions have taken place on the harmonization of social policies. See Sapir (1995) for an extensive discussion.

The analysis here does not allow for general conclusions on whether some internal measures deserve different treatment than others from a welfare perspective. Nor does it reveal whether some internal measures are more deserving of inclusion on the WTO agenda than others, or for that matter what the optimal institutional shape for international cooperation might look like. The discussion does, however, highlight one concern that has received attention in the economic literature. This relates to the possible distributional consequences of multilateral rules on internal measures, in particular if they involve harmonization at the global level. Trade liberalization through tariff reductions is expected, in general, to lead to gains for every trading partner involved, but this is not necessarily the case for multilaterally agreed policy harmonization.

On the other hand, distributional concerns cannot serve as a reason for disregarding the possible benefits from multilateral cooperation on trade and internal measures. Trade-offs and linkages can improve overall welfare, leaving the distributional issue as a challenge to be managed as part of a package. It is a fact that in all the areas discussed in this section some level of policy harmonization is taking place at the international level, either in international institutions, specialized international standard setting bodies, or in the context of international agreements.

The choice of domestic policy issues discussed in this section was intended to be illustrative, in part to address the underlying question whether some form of pre-committed understanding of how the WTO agenda should be shaped could itself be the subject of an agreement. Were this to be possible, a set of accepted criteria would underlie any determination of what to include on the WTO agenda. The complexities and uncertainties surrounding the policy issues discussed in this section provide one good reason why efforts in this direction would be a fool's errand. We have already seen in other parts of this study that governments have very different motivations and priorities when they engage in international trade cooperation. Moreover, an effort to pre-determine agenda formation would need to recognize uncertainty about the future. In sum, this report offers no prescriptions for what ought to be done by way of defining the WTO's agenda as the multilateral trading system moves into the seventh decade of its existence. The best that this report can do is to point to some of the questions that might be asked and issues that might be relevant when governments take up the thorny issue of what, and what not, to negotiate.

E CONCLUSION: PRESENT AND FUTURE CHALLENGES

The World Trade Report 2007 has traced sixty years of multilateral trade co-operation, starting with the birth of the GATT on 1 January, 1948. The world has changed a good deal over those six decades and so too has the multilateral trading system. Globalization has brought economic interaction among nations closer than ever before, thanks in no small part to revolutions in information and transport technology and growing openness in government policy. The trend towards increased inter-dependency has rendered international economic co-operation more complex and multi-faceted. Co-operation among nations has become harder to manage and more influential in shaping the circumstances in which people live. The subject matter covered by the system has expanded significantly and many more players are involved in shaping the system. The 23 original signatories of the GATT have now become the 151 Members of the WTO.

This report has attempted to provide a better understanding of why countries have chosen to cooperate with one another in trade matters down the years. This may seem a simple question, but it turns out to have several answers. Governments embrace varying objectives at different times, reflecting, among other things, the relative standing of their economies in the international order, and the priorities imposed by their level of economic development. By demonstrating the sheer heterogeneity of interests at stake, the report highlights the fragile and incomplete nature of cooperative endeavours in a changing and uncertain world – in other words, the continuing challenge of shaping and maintaining mutually advantageous co-operative arrangements. Effective co-operation among diverse economies with differing priorities requires clarity of thought and foresight, as well as a willingness to seek accommodation. A failure to secure co-operative outcomes may well disadvantage all parties to a potential agreement in one way or another, but deals can nevertheless prove elusive. An additional requirement for sustainable and stable co-operation is that governments find ways of addressing adjustment costs and the re-distributional impact of change – in other words, of managing the challenges of globalization. Adjustment and income distribution have not been explored here, and they pose challenges that go well beyond the impact of trade policy changes in an economy.

An historical review of trade relations prior to the establishment of the GATT/WTO strongly points to the importance of building and sustaining institutional arrangements to underwrite international trade relations. International institutions can become moribund, with shrinking relevance, if governments do not take care of them, and institutional decline will likely be harder to reverse the further it goes. At the same time, it has been repeatedly demonstrated that if institutions do not adapt to change, they will wither, becoming increasingly regarded as vestiges of an older world driven by different interests than those that shape the present.

Even when governments show willing to adapt and refashion their co-operative arrangements in recognition of changing circumstances, there will always be a sense in which trade agreements remain incomplete. Agreements cannot foresee every eventuality. So while institutions and contractual provisions can mitigate the uncertainties connected with contractual incompleteness, they can hardly eliminate them. This brings with it two implications. One is that disputes are a natural outflow of contractual incompleteness. The other is that dealing with incompleteness requires a delicate balance between flexibility and adaptation on the one hand, and the preservation of predictability and stability on the other.

The report has reviewed a rich history of change and institutional adaptation in the multilateral trading system. It has identified lessons from past experience as well as a number of challenges to come. History shows how the multilateral trading system's focus of purpose proved to be its strength in the early years. The system expanded inexorably over the decades, in terms of membership, issue coverage and institutional purpose, culminating in the establishment of the WTO in 1995. A rather uniform set of issues has tended to dominate the multilateral trading agenda over the life of the institution. Sometimes the idiom has changed and the details may differ through time, but many of the essential challenges involved in searching out mutually beneficial cooperative arrangements remain much the same.

Moving beyond the general requirements of successful cooperation – adaptability and flexibility in the face of change, effective management of increasingly complex agendas among ever more numerous and diverse economies, and an ability to manage the effects of change on domestic populations – mention may be made of specific challenges that are still with us and others that may emerge. Among the greatest challenges that the multilateral trading system faces is how to integrate developing economies into the system in a manner that contributes to their growth and development aspirations. Managing the relationship between the multilateral trading system and regional/bilateral trade agreements is another continuing challenge. Thirdly, over at least the last thirty years governments have had to manage a continuing debate on the shape and content of the multilateral trading rules, especially around the question of whether and how to bring new topics onto the agenda. The world changes and institutions have to find new accommodations within this shifting environment. Fourth, the system has had to manage trade disputes among parties that centre on their perceptions of acquired rights and obligations. Notwithstanding a continuing interest among some parties in modifying the GATT/WTO dispute settlement system, it has done an impressive job of this over the years. These are all issues we have taken up and analyzed at some length in the report.

But what of future challenges, of issues that are beginning to emerge and that call for new co-operative efforts? These are not issues we have explored in this retrospective on the trading system, and any listing of future challenges is inevitably speculative and incomplete. It is nevertheless interesting to consider briefly what might demand the attention of the international trading community in the years to come. Multilateral, plurilateral and unilateral actions to reduce tariffs have raised the profile of other measures that determine trade flows, the conditions of competition and opportunities to gain from trade. Often referred to generically as non-tariff measures, these cover a wide range of interventions. They have long been a GATT/WTO concern and the subject of negotiated agreements. These concerns will probably assume greater prominence in the future. More generally, there is the whole question of how regulation affects economic conditions and what challenges are implied in regulatory co-operation internationally, not least in terms of minimizing discrimination among countries.

Another issue bound to increase in prominence is trade in services. Indeed, the WTO's efforts to provide a framework for co-operation in the services area since 1995 – which we have dealt with only scantily in this report – provides a good example of creative international co-operation in a new field, but also a stark illustration of how much remains to be done. The complexity of services transactions complicates the architecture of institutional arrangements for co-operation. But there is growing realization of how vital services are in the workings of all economies, and what the role of trade might be in providing opportunities to benefit from an efficient and well priced supply of services. Trade in services has become even more important in recent years in light of evolving business practices, including growing trends in production sharing and off-shoring.

A final issue that might be mentioned here is not a new one, but one that will almost certainly assume greater prominence. We refer to environmental issues and their relationship to trade. While we arguably understand better today than we did two or three decades ago how environment and trade interact, many new and more intensified environmental concerns, such as global warming, are assuming greater prominence in the public mind and in policy circles. How trade and the multilateral trading system will contribute to managing environmental challenges is doubtless an issues about which we shall hear a lot more.

Continuing and future challenges notwithstanding, the shared international experience of sixty years of the GATT/WTO is a positive story. Plenty of governments, non-state actors, commentators and critics want to improve the system, but very few would gainsay its core contribution to a more stable and prosperous world. An unvarnished look at the less than fully resolved issues of the past, the outstanding challenges, and the successes – as attempted in this report – will, we hope, stimulate thought on how best to manage the future.

BIBLIOGRAPHY

Abdel Kader, M. R. (1986) 'Multilateral Trade Negotiations: The Developing Countries and the GATT Secretariat', Doctoral thesis, University of Geneva, Institut Universitaire de Hautes Études Internationales: Geneva.

Abdel Motaal, D. (1999) 'Eco-labeling and the World Trade Organization', in Sampson, G. and Chambers, W. (eds) *Trade, Environment and the Millennium*, New York: UN Press.

— (2004) 'The "Multilateral Scientific Consensus" and the World Trade Organization' *Journal of World Trade* 38, 5: 855-876.

Abrego, L., Perroni, C., Whalley J. and Wigle, R. M. (2001) 'Trade and Environment: Bargaining Outcomes from Linked Negotiations', *Review of International Economics* 9, 3: 414-428.

Adlung, R. (2006) 'Public Services and the GATS', *Journal of International Economic Law* 9, 2: 455-485.

Aitken, N.D. (1973) 'The effects of the EEC and EFTA on European trade: a temporal cross-section analysis', *American Economic Review* 63, 5: 881-892.

Alexandraki, K. and Lankes, H.-P. (2004) 'Estimating the Impact of Preference Erosion on Middle-Income Countries', *IMF Working Paper* No. 04/169, Washington, D.C: IMF.

Amiti, M. and Romalis, J. (2006) 'Will the Doha Round Lead to Preference Erosion?', *IMF Working Paper* WP/06/10, Washington, D.C.: IMF.

Anderson, K. (2002) 'Pecularities of Retaliation in WTO Dispute Settlement', *World Trade Review* 1, 2: 123-134.

Anderson, R. and Jenny, F. (2005) 'Competition Policy, Economic Development and the Possible Role of a Multilateral Framework on Competition Policy: Insights from the WTO Working Group on Trade and Competition Policy', in E. Medalla (ed) *Competition Policy in East Asia*, Routledge/Curzon.

Anderson, R. D. and Evenett, S. (2006) *Incorporating Competition Elements into Regional Trade Agreements: Characterization and Analysis*. Available at http://www.evenett.com/working/CompPrincInRTAs.pdf. Accessed 31/05/2007.

Anderson, R. D. and Holmes P. (2002) 'Competition Policy and the Future of the Multilateral Trading System', *Journal of International Economic Law* 5, 2: 531-563.

Augier, P., Gasiorek, M. and Lai Tong, C. (2005) 'The impact of rules of origin on trade flows' *Economic Policy* 20, 43: 567-624.

Bacchetta, M. and Jansen, M. (2003) 'Adjusting to Trade Liberalization', *WTO Special Study* N. 7, Geneva: WTO.

Baffes, J. (2005) 'The Cotton Problem', *World Bank Research Observer* 20, 1: 109-144.

Bagwell, K. (2007) 'Remedies in the WTO: An Economic Perspective', mimeo. Available at http://www.columbia.edu/%7Ekwb8/Remedies%20in%20the%20WTO%20010907.pdf). Accessed 26/04/2007.

Bagwell, K. and Staiger, R. (1997a) 'Multilateral tariff cooperation during the formation of Free Trade Areas', *International Economic Review* 38, 2: 291-319.

— (1997b) 'Multilateral tariff cooperation during the formation of Customs Unions', *Journal of International Economics* 42: 91-123.

— (1998) 'Will Preferential Agreements Undermine the Multilateral Trading System?', *The Economic Journal* 108, 449: 1162-1182.

— (1999a) 'An Economic Theory of GATT', *American Economic Review* 89, 1: 215-248.

— (1999b) 'Regionalism and Multilateral Tariff Cooperation', in Piggot, J. and Woodland, A. (eds) *International Trade Policy and Pacific Rim*, London: MacMillan.

— (2002) *The Economics of the World Trading System*, Cambridge, Mass.: MIT Press.

— (2004) 'National Sovereignty in an Interdependent World', *NBER Working Paper* 10249.

Bagwell, K., Mavroidis, P. C. and Staiger, R. (2002) 'It's A Question of Market Access', *The American Journal of International Law* 96: 56-76.

— (2007) 'Auctioning Countermeasures in the WTO' *Journal of International Economics*, forthcoming.

Bairoch, P. (1989) 'European trade policy, 1815-1914', in Mathias, P. and S. Pollard (eds) *The Cambridge economic history of Europe*, vol. VIII, The industrial economies: the development of economic and social policies, Cambridge: Cambridge University Press.

Balassa, B. (1980) 'The Tokyo Round and the Developing Countries', *World Bank Staff Working Paper 370*, Washington, DC: World Bank.

Balassa, B. and associates (1971) *The structure of protection in developing countries*, Baltimore: Johns Hopkins University Press for the World Bank and the Inter-American Development Bank.

Baldwin, R. and Martin, P. (1999) 'Two waves of globalization: superficial similarities, fundamental differences' in Sieber, H. (ed) *Globalisation and Labour* Tubingen: J.C.B. Mohr for Kiel Institute of World Economics.

Baldwin, R. E. (1994) 'Toward an Integrated Europe', London: CEPR.

— (1995) 'A Domino Theory of Regionalism' in Baldwin, R., Haaparanta, P. and Kiander, J. (eds) *Expanding Membership of the EU*, Cambridge: Cambridge University Press. pp. 25-48.

— (2006) 'Multilateralising Regionalism: Spaghetti bowls as building bloc on the path to global free trade', *World Economy* 29, 11: 1451-1518.

Baldwin, R. E. and Baldwin, R. E. (1996) 'Alternative approaches to the political economy of endogenous trade liberalization', *European Economic Review* 40: 775-782.

Baldwin, R. E. and Murray, T. (1977) 'MFN Tariff Reductions and Developing Country Trade Benefits under the GSP', *Economic Journal* 87, 345: 30-46.

Baldwin, R. and Robert-Nicoud, F. (2005) 'Juggernaut Model – The Lego Version', mimeo, GIIS.

Barfield, C. E. (2001) *Free Trade, Sovereignty, Democracy: The Future of the World Trade Organization*, Washington, D.C.: AEI Press.

Barth, J., Marchetti, J. A., Nolle, D. E., and Sawangngoenyuang, W. (2006) 'Foreign Banking: Do Countries' WTO Commitments Match Actual Practices?', *WTO Staff Working Paper* ERSD-2006-11, 20 October 2006.

Barton, J. H., Goldstein, J. L., Josling, T. E. and Steinberg, R. H. (2006) *The Evolution of the Trade Regime*, Princeton: Princeton University Press.

Bayoumi, T. and Eichengreen, B. (1998) 'Is Regionalism Simply a Diversion? Evidence From the Evolution of the EC and EFTA', in Takatoshi, I. and Kruger, A. (eds) *Regionalism Versus Multilateral Trade Arrangements*, Chicago: University of Chicago Press.

Bell, M., Ross-Larson, B. and Westphal, L. E. (1984) 'Assessing the Performance of Infant Industries', *Journal of Development Economics* 16: 101-128.

Bergstrand, J. H. (1985) 'The gravity equation in international trade: some microeconomic foundations and empirical evidence', *The Review of Economics and Statistics* 67, 3: 474-481.

Berry, S., Levinsohn, J. and Pakes, A. (1999) 'Voluntary Export Restraints on automobiles: evaluating a trade policy', *American Economic Review* 89, 3: 400-430.

Bhagwati, J. (1991) *The World Trading System at Risk*, Cambridge, MA: MIT Press.

Bhattacharjea, A. (2006) 'The Case for a Multilateral Agreement on Competition Policy: A Developing Country Perspective', *Journal of International Economic Law* 9, 2: 293-323.

Blackhurst, R. and Hartridge, D. (2004) 'Improving the capacity of WTO institutions to fulfill their mandate,' *Journal of International Economic Law* 7, 3: 705-716.

Blackhurst, R., Enders, A. and Francois, J. F. (1995) 'The Uruguay Round and Market Access: Opportunities and Challenges for Developing Countries', in Martin, W. and Winters, L. A. (eds) *The Uruguay Round and the Developing Economies*, World Bank Discussion Paper No. 307, Washington, D.C.: World Bank. pp. 97-116.

Blanchard, O. (2005) 'European Unemployment: the Evolution of Facts and Ideas', *NBER Working Paper* 11750, Cambridge, MA: National Bureau of Economic Research.

Bode, M. and Budzinski, O. (2005) 'Competing Ways Towards International Antitrust: the WTO versus the ICN', *Marburg Papers on Economics* 03-2005, Philipps-University Marburg.

Bollerslev, T. (1986) 'Generalized autoregressive conditional heteroskedasticity', *Journal of Econometrics* 31, 3: 307–327.

Bown, C. P. (2002) 'The Economics of Trade Disputes, the GATT's Article XXIII, and the WTO's Dispute Settlement Understanding', *Economics and Politics* 14, 3: 283-322.

— (2004a) 'On the Economic Success of GATT/WTO Dispute Settlement', *Review of Economics and Statistics* 86, 3: 811-823.

— (2004b) 'Trade disputes and the implementation of protection under the GATT: an empirical assessment', *Journal of International Economics* 62: 263-294.

— (2005a) 'Participation in WTO Dispute Settlement: Complainants, Interested Parties, and Free Riders', *World Bank Economic Review* 19, 2: 287-310.

— (2005b) 'Trade Remedies and World Trade Organization Dispute Settlement: Why Are So Few Challenged?', *World Bank Policy Research Working Paper* No. 3540, Washington, D.C.: World Bank.

Bown, C. P. and Hoekman, B. M. (2005) 'WTO Dispute Settlement and the Missing Developing Country Cases: Engaging the Private Sector', *Journal of International Economic Law* 8, 4: 861-890.

— (2007) 'Making trade agreements relevant for poor countries: why dispute settlement is not enough', *Brookings Institution Working Paper 2007-05*, Washington DC: The Brookings Institution.

Breda dos Santos, N., Farias, R. and Cunha, R. (2005) 'Generalized System of Preferences in General Agreement on Tariffs and Trade/World Trade Organization: History and Current Issues', *Journal of World Trade* 39, 4: 637-670.

Brenton, P. (2003) 'Integrating the Least Developed Countries into the World Trading System: The Current Impact of European Union Preferences under "Everything But Arms"', *Journal of World Trade* 37, 3: 623-646.

Brenton, P. and Manchin, M. (2003) 'Making EU Trade Agreements Work: The Role of Rules of Origin', *World Economy* 26, 5: 755-769.

Breuss, F. (2004) 'WTO Dispute Settlement: An Economic Analysis of Four EU-US Mine Trade Wars', *Journal of Industry, Competition and Trade* 4, 4: 275-315.

Broda, C., Limão, N. and Weinstein, D. (2006) 'Optimal tariffs: the evidence', *NBER Working Paper* No 12033, Washington, DC: National Bureau of Economic Research.

Bronckers, M. and van den Broek, N. (2005) 'Financial Compensation in the WTO: Improving the Remedies of WTO Dispute Settlement', *Journal of International Economic Law* 8, 1: 101-126.

Brown, D. K. (2001) 'Labor Standards: Where Do They Belong on the International Trade Agenda?', *Journal of Economic Perspectives* 15, 3: 89-112.

Brown, W. (1950) *The United States and the Restoration of World Trade*, Washington, DC: The Brookings Institutions.

Bureau, J.-C. and Gallezot, J. (2004) 'Assessment of Utilization and Motives for Under-Utilization of Preferences in Selected Least Developed Countries, Paper presented to the OECD 53rd Joint Working Party on Agriculture and Trade, COM/AGR/TD/WP(2004)12/REV2, 21-22 October 2004, Paris: OECD.

Busch, M. L. (2000) 'Democracy, Consultation, and the Paneling of Disputes under GATT', *Journal of Conflict Resolution* 44, 4: 425-446.

Busch, M. L. and Reinhardt, E. (2000) 'Bargaining in the Shadow of the Law: Early Settlement in GATT/WTO Disputes', *Fordham International Law Journal* 24, 1-2: 158-172.

— (2003) 'Developing Countries and General Agreement on Tariffs and Trade/World Trade Organization Dispute Settlement', *Journal of World Trade* 37, 4: 719-735.

— (2006) 'Three's a Crowd: Third Parties and WTO Dispute Settlement', *World Politics*: forthcoming.

Bütler, M. and Hauser, H. (2000) 'The WTO Dispute Settlement Mechanism: A First Assessment from an Economic Perspective', *Journal of Law, Economics, & Organization* 16, 2: 503-533.

Cadot, O., Esteovadeordal, A. and Eisenmann, A. S. (2005) 'Rules of Origin as Export Subsidies', *CEPR Discussion Paper* N° 4999.

Cameron, R. E. (1993) *A Concise Economic History of the World: From Paleolithic Times to the Present*, 2nd ed., New York, NY: Oxford University Press.

Candau F. and Jean, S. (2005) 'What Are EU Trade Preferences Worth for Sub-Saharan Africa and Other Developing Countries?', CEPII, *Working Paper* No 2005-19, Paris: CEPII.

Candau F., Fontagné, L. and Jean, S. (2004) 'The utilisation rate of preferences in the EU', Paper presented at the 7th Global Economic Analysis Conference, 17-19 June 2004, Washington D.C.

Charnovitz, S. (2001) 'Rethinking WTO Trade Sanctions', *American Journal of International Law* 95, 4: 792-831.

— (2002a) 'Triangulating the World Trade Organization', *American Journal of International Law* 96, 1: 28-55.

— (2002b) 'The WTO's Problematic "Last Resort" against Non-Compliance', *Aussenwirtschaft*, 57, 4: 409-440.

Chase, K. (2006) 'Multilateralism Compromised: the Mysterious Origin of GATT Article XXIV' *World Trade Review* 5, 1: 1-30.

Chayes, A. and Chayes, A. H. (1993) *The New Sovereignty*, Cambridge, Mass.: Harvard University Press.

Checkel, J. (ed) (2007) *International Institutions and Socialization in Europe,* Cambridge, U.K.: Cambridge University Press.

Clarke, J. and Evenett, S. J. (2003) 'A multilateral framework for competition policy?' in Switzerland, State Secretariat of Economic Affairs and Simon Evenett, *The Singapore Issues and the World Trading System: the Road to Cancun and Beyond*, Bern: State Secretariat for Economic Affairs.

Clemens, M. A. and Williamson, J. G. (2001) 'Why the tariff-growth correlation changed after 1950', manuscript, Harvard: Harvard University.

Cline, W. R. (1982) 'Can the East Asian Model of Development Be Generalized?', *World Development* 10, 2: 81-90.

Collier, P. (2006) 'Why the WTO is Deadlocked: And What Can Be Done About It', *The World Economy*: 1423-1449.

Commission on Intellectual Property Rights (CIPR) (2002) *Integrating Intellectual Property Rights and Development Policy*, London: CIPR.

Commonwealth Secretariat (1978) *Multilateral Trade Negotiations and Relevant Trends in International Trade Policy*, London.

Conconi, P. and Perroni, C. (2002) 'Issue Linkage and Issue Tie-in in Multilateral Negotiations', *Journal of International Economics* 57: 423-447.

— (2005) 'Special and Differential Trade Regimes', mimeo.

Cooper, R. N. (1972) 'The European Community's System of Generalized Tariff Preferences: A Critique', *Journal of Development Studies* 8, 4: 79-94.

Copeland, B. R. and Taylor, M.S. (2003) *Trade and the Environment: Theory and Evidence*, Princeton and Oxford: Princeton University Press.

Corden, W. M. (1974) *Trade policy and economic welfare*, Oxford: Clarendon Press.

Corrales-Leal, W. (2005) 'A Situational Approach to the Doha-Mandated Negotiations on Special and Differential Treatment', mimeo, Geneva: International Centre for Trade and Sustainable Development (ICTSD).

Cottier, T. (1992) 'Intellectual Property in International Trade Law and Policy: The GATT Connection', *Aussenwirtschaft* 47, 1: 79-105.

— (2006) 'From Progressive Liberalization to Progressive Regulation in WTO Law', *Journal of International Economic Law* 9, 4: 779-821.

Cox, R. and Jacobson, H. (1973) *The Anatomy of Influence: Decision-making in International Organization,* New Haven, NJ: Yale University Press.

Croome, J. (1995) *Reshaping the World Trading System*, Geneva: World Trade Organization.

Curtis, T. B. and Vastine, J. R. (1971) *The Kennedy Round and the Future of American Trade*, New York: Praeger Publishers.

Curzon, G. (1965) *Multilateral Trade Diplomacy*, London: Michael Joseph.

Danahar, K. (ed) (1994) *50 Years is Enough – The case against the World Bank and the International Monetary Fund*, Washington, D.C.: South End Press.

Davey, W. J. (2001) 'Has the WTO Dispute Settlement System Exceeded Its Authority? A Consideration of Deference Shown by the System to Member Government Decisions and Its Use of Issue-Avoidance Techniques', *Journal of International Economic Law* 4, 1: 79-110.

— (2002) 'A Permanent Panel Body for WTO Dispute Settlement: Desirable or Practical?', in Kennedy, D. L. M. and Southwick, J. D. (eds) (2002) *The Political Economy of International Trade Law: Essays in Honour of Professor Robert E. Hudec*, Cambridge: Cambridge University Press. pp. 496-527.

— (2005a) 'Evaluating WTO Dispute Settlement: What Results Have Been Achieved through Consultations and Implementation of Panel Reports?', Paper presented at the Conference on "WTO at 10", Tokyo, Japan, 25 October 2005.

— (2005b) 'The Sutherland Report on Dispute Settlement: A Comment', *Journal of International Economic Law* 8, 2: 321-328.

De Ferranti, D., Perry, P., Lederman, D. and Maloney, W. (2002) *From natural resources to the knowledge economy – trade and job quality*, Washington, D.C.: World Bank.

Deardorff, A. (1998) 'Should Patent Protection Be Extended to All Developing Countries?' *The World Economy* 13, December 1990, pp. 497-507; reprinted in Stern, M. R. (ed) *The Multilateral Trading System: Analysis and Options for Change*, Ann Arbor: The University of Michigan Press, 1993; reprinted in Robert Howse (ed) *The World Trading System*, Routledge Press.

Deardorff, A. and Stern, R. (1982) 'Economic Effects of the Tokyo Round', *Southern Economic Journal*, January.

— (2005) 'A centennial of anti-dumping legislation and implementation: introduction and overview', *The World Economy* 28, 5: 633-640.

Destler, I. M. (1996) *American Trade Politics*, Washington, DC: Institute for International Economics.

Diebold, W. (1952) *The End of the ITO*, Princeton: Princeton University Press.

Dobson, W. and Jacquet, P. (1998) *Financial services liberalization in the WTO*, Washington, DC: Institute for International Economics.

Documentation Française (1948) 'La France et les accords tarifaires de Genève', *Notes Documentaires et Études* No.780, (13.12.1947), p.12.

Downs, G. W., Rocke, D. M. and Barsoom, P. N. (1996) 'Is the Good News About Compliance Good News About Cooperation?', *International Organization* 50, 3: 379-406.

Dunoff, J. L. and Trachtman, J. P. (1999) 'Economic Analysis of International Law', *Yale Journal of International Law* 24, 1: 1-59.

Duran, P. and Sokol, J. B. (2005) 'Policy and Operational Lessons Learned from Eight Country Case Studies', in De Wulf, L. and Sokol, J. B. (eds) (2005) *Customs Modernization Handbook*, Washington D.C.: World Bank.

Durling, J. and Hardin, D. (2005) 'Amicus curiae participation in WTO dispute settlement: reflections on the past decade', in: Yerxa, R. and Wilson, B. (eds) *Key Issues in WTO Dispute Settlement – The first ten years*, Cambridge: Cambridge University Press. pp. 221-231.

Durling, J. P. (2003) 'Deference, But Only When Due: WTO Review of Anti-Dumping Measures' *Journal of International Economic Law* 6, 1: 125-153.

Ehlermann, C. and Ehring, L. (2002) 'WTO Dispute Settlement and Competition Law', European University Institute Florence, *Policy Paper* 02/12.

— (2005) 'Decision Making in the World Trade Organization: Is the Consensus Practice of the World Trade Organization Adequate for Making, Revising and Implementing Rules on International Trade?', *Journal of International Economic Law* 8, 1: 51-75.

Elsig, M. (2007) 'The World Trade Organization's Legitimacy Crisis: What Does The Beast Look Like?', *Journal of World Trade*, forthcoming.

Engle, R. (1982) 'Autoregressive conditional heteroskedasticity with estimates of the variance of United Kingdom inflation', *Econometrica,* 50, 4: 987–1007.

Essermann, S. and Howse, R. (2003) 'The WTO on Trial', *Foreign Affairs* 82, 1: 130-140.

Estevadeordal, A. (2000) 'Negotiating preferential market access: the case of the North American Free Trade Agreement', *Journal of World Trade* 34, 1: 141-166.

Ethier, W. J. (1998) 'Regionalism in a Multilateral World', *Journal of Political Economy* 106: 1214-45.

— (2001) 'Punishments and Dispute Settlement in Trade Agreement', Penn Institute for Economic Research (PIER) *Working Paper* 01-021, Philadelphia, PA: University of Pennsylvania.

— (2004) 'Trade Policies Based on Political Externalities: An Exploration', Penn Institute for Economic Research (PIER) *Working Paper* 04-006, Philadelphia, PA: University of Pennsylvania.

European News Agency (1975) *The Tokyo-Round: Trade Issues at Stake*, Volume II, Brussels: European News Agency.

— (1979) *The Tokyo-Round: Trade Issues at Stake*, Brussels: European News Agency.

— (1986) *Reagan Round: Issues at Stake*, Brussels: European News Agency.

Evenett, S. J. (2005) 'Special and Differential Treatment: Thinking Outside the Box', Report on the OECD Global Forum on Trade held in Bridgetown, Barbados, 28-29 June 2005.

Evenett, S. J., Gage, J. and Kennett, M. (2004) 'WTO membership and market access: evidence from the accessions of Bulgaria and Ecuador', mimeo.

Evenett, S. J., Levenstein, M. and Suslow, V. (2001) 'International cartel enforcement: lessons from the 1990s', *The World Economy* 24, 9: 1221-45.

Feenstra, R., Markusen, J. and Rose, A. K., (2001) 'Using the gravity model equation to differentiate among alternative theories of trade', *Canadian Journal of Economics* 34, 2: 430–447.

Felbermayr, G. J. and Kohler, W. (2005) 'Exploring the intensive and extensive margins of world trade', Tübingen University, unpublished manuscript.

Finger, J. M. and Laird, S. (1987) 'Protection in Developed and Developing Countries – An Overview', *Journal of World Trade Law* 21, 6: 9-23.

Finger, J. M. and Nogués, J. J. (2006) *Safeguards and Antidumping in Latin American Trade Liberalization: Fighting Fire with Fire,* Palgrave MacMillan.

Finger, J. M. and Schuler, P. (2000) 'Implementation of Uruguay Round Commitments: The Development Challenge', *World Economy* 23, 4: 511-525.

Fink, C. and Maskus, K. E. (2005) 'Why We Study Intellectual Property Rights and What We Have Learned' in Fink, C. and Maskus, K. (eds) *Intellectual Property and Development – Lessons from Recent Economic Research,* Washington D. C: The World Bank.

Fink, C. and Molinuevo, M. (2007) 'East Asian Free Trade Agreements in Services: Roaring Tigers or Timid Pandas?', mimeo, Washington, D. C.: World Bank.

Footer, M. E. (2001) 'Developing Country Practice in the Matter of WTO Dispute Settlement', *Journal of World Trade* 35, 1: 55-98.

Foreman-Peck, J. (1995) *A History of the World Economy: International Economic Relations Since 1850*, 2nd ed., New York, NY: Harvester Wheatsheaf..

Foroutan, F. (1998) 'Does Membership in a Regional Preferential Trade Arrangement Make a Country More or Less Protectionist?', *World-Economy* 21, 3: 305-35.

Frank, I. (1987) 'Import quotas, the balance-of-payments and the GATT', *The World Economy* 10: 3, 307-317.

Frankel, J. A. and Wei, S. J. (1993) 'Trading Blocs and Currency Blocs', *NBER Working Paper* No. 4335.

— (1995) 'Open Regionalism in a World of Continental Trading Blocs' *NBER Working Paper* No. 5272, Cambridge MA: National Bureau of Economic Research.

Frankel, J. and Rose, A. K. (2002) 'An estimate of the effect of common currencies on trade and income', *The Quarterly Journal of Economics* 117, 2: 437–466.

Frankel, J. A. (1997) *Regional Trading Blocs in the World Economic System,* Washington, D.C.: Institute for International Economics.

Gallaway, M. P., Blonigen, B. A. and Flynn, J. E. (1999) 'Welfare costs of US antidumping and countervailing duty laws', *Journal of International Economics* 49, 2: 211-244.

Gardner, R. N. (1969) *Sterling -Dollar Diplomacy*, Oxford: Oxford University Press. pp. 348-361.

GATT (1947) 'Schedules of Tariff Concessions (in two volumes)', Copy No 503, October, Geneva: GATT.

— (1950) 'The attack on trade barriers, A progress report on the operation of the GATT from January 1948 to August 1949', Geneva: GATT.

— (1954) *International Trade 1954*, General Annual Report, Geneva: GATT.

— (1956) *International Trade 1956*, Geneva: GATT.

— (1958) 'Trends in international trade : a report by a panel of experts / presided by Gottfried Haberler', Geneva : GATT.

— (1962) 'Protocol to the GATT embodying the results of the 1960-61 tariff conference', 16 July 1962, Geneva: GATT.

— (1967) 'GATT Trade Negotiations. Brief Summary of Results', Press Release GATT/992, 30 June 1967, Geneva: GATT.

— (1979) 'Thirty-fifth Session of the Contracting Parties', summary record of the third meeting, held on 28 November, SR.35/3 and Corr. 1 and 2, Geneva: GATT.

— (1980) 'The Tokyo Round of Multilateral Trade Negotiations', volume II, Geneva: GATT.

— (1994) 'The results of the Uruguay Round of multilateral trade negotiations, market access for goods and services: overview of the results', Geneva: GATT.

Ghosh, S. and Yamarik, S. (2004) 'Are Regional Trading Arrangements Trade Creating?: An Application of Extreme Bounds Analysis', *Journal of International Economics* 63, 2 (July 2004): 369-395.

Goldstein, J. (1993) 'Creating the GATT Rules: Politics, Institutions and American Policy', in Ruggie, J. (ed) *Multilateralism Matters: The Theory and Praxis of an Institutional Form*, New York: Columbia University.

Goldstein, J., Rivers, D. and Tomz, M. (2005) 'Membership has Its privileges: the impact of GATT on international trade', mimeo. Department of Political Science. Stanford University.

Golt, S. (1978) *Developing Countries in the GATT System*, London: Trade Policy Research Centre.

Granger, C. and Siroën, J.-M. (2006) 'Core Labour Standards in Trade Agreements: From Multilateralism to Bilateralism', *Journal of World Trade* 40, 5: 813-836.

Greenaway D. and Kneller, R. (2004) 'Industry Differences in the Effect of Export Market Entry: Learning by Exporting?', *University of Nottingham Working Paper* No. 2004/33.

Greenwald, J. (2003) 'WTO Dispute Settlement: An Exercise in Trade Law Legislation?', *Journal of International Economic Law* 6, 1: 113-124.

Gros, D. (1987) 'A Note on the Optimal Tariff, Retaliation and the Welfare Loss from Tariff Wars in a Framework with Intra-industry Trade', *Journal of International Economics* 23, 3-4: 357-367.

Grossman, G. (1990) 'Promoting new industrial activities: A survey of recent arguments and evidence', *OECD Economic Studies* No. 14, Paris: OECD.

Grossman, G. M. and Helpman, E. (1995) 'The Politics of Free Trade Agreements', *American Economic Review* 85, 4: 667-690.

Guzman, A. T. (2002) 'The Political Economy of Litigation and Settlement at the WTO', *Public Law Research Paper* No. 98, Berkeley, California: University of California at Berkeley.

Guzman, A. T. and Simmons, B. A. (2002) 'To Settle or Empanel? An Empirical Analysis of Litigation and Settlement at the World Trade Organization', *Journal of Legal Studies* 31, 1: S205-S235.

— (2005) 'Power Plays and Capacity Constraints: The Selection of Defendants in World Trade Organization Disputes', *Journal of Legal Studies* 34, 2: 557-598.

Hamilton, C. B., de Melo, J. and Winters, L. A. (1992) 'Who wins and who loses from Voluntary Export Restraints? The case of footwear', *The World Bank Research Observer* 7, 1: 17-33.

Hamza, M. A.-B. (1981) 'Review of the preferential arrangements established under the GATT Protocol relating to Trade Negotiations among Developing Countries', United Nations Conference on Trade and Development (UNCTAD) document TD/B/C.7/49, Committee on Economic Co-operation among Developing Countries, Geneva: UNCTAD.

Hathaway, D. E. and Ingco, M. D. (1996) Agricultural liberalization and the Uruguay Round, in Martin, W. and Winters, L.A. (1996) (eds) *The Uruguay Round and the developing countries*, Washington, DC: World Bank, published by Cambridge University Press.

Hausman, R. and Rodrik, D. (2003) 'Economic development as self-discovery', *Journal of Development Economics* 72, 2: 603-633.

Hawkins, D. G., Lake, D., Nielson, D. L. and Tierney, M. J. (eds) (2006) *Delegation and Agency in International Organizations,* Cambridge, U.K. Cambridge University Press.

Helleiner, G. K. (ed) (2002) *Non-Traditional Export Promotion in Africa – Experience and Issues*, The United Nations University World Institute for Development Economics Research (UNU/WIDER) Helsinki, New York: Palgrave.

Helpman, E., Melitz, M. and Rubinstein, Y. (2006) 'Trading partners and trading volumes' unpublished manuscript.

Hemming, M. F. W., Miles, C. M. and Ray, G. F. (1959) 'A Statistical Summary of the Extent of Import Control in the United Kingdom Since the War', *The Review of Economic Studies* 26, 2: 75-109.

Hermann, R., Burger, K. and Smit, H. P. (1989) 'Commodity Policy: Price Stabilization Versus Financing', in Winters, L. A. and Sapsford, D. (eds) (1989) *Primary Commodity Prices: Economic Models and Policy*, Cambridge: Cambridge University Press. pp 240-290.

Hilf, M. (2001) 'Power, Rules and Principles Which Orientation for WTO/GATT Law?', *Journal of International Economic Law* 4, 1: 111-130.

Hindley, B. (1987) 'GATT Safeguards and Voluntary Export Restraints: What Are the Interests of Developing Countries?', *World Bank Economic Review* 1, 4: 689-705.

Hippler Bello, J. (1996) 'The WTO Dispute Settlement Understanding: Less is More', *American Journal of International Law* 90, 3: 416-418.

Hippler Bello, J. and Holmer, A. F. (1990) 'The Heart of the 1988 Trade Act: A Legislative History of the Amendments to Section 301', in Bhagwati, J. and Patrick, H. T. (eds) (1990) *Aggressive Unilateralism: America's 301 Trade Policy and the World Trading System*, Ann Arbor: University of Michigan Press. pp. 49-89.

Hoda, A. (2001) *Tariff negotiations and renegotiations under the GATT and the WTO, procedures and practices*, Geneva: World Trade Organization, published by Cambridge University Press.

Hoekman, B. (1996) 'Assessing the General Agreement on Trade in Services', in Martin, W. and L.A. Winters (1996) (eds) *The Uruguay Round and the developing countries*, Washington, DC: World Bank, published by Cambridge University Press.

— (2002) 'Strengthening the Global Trade Architecture for Development: The Post-Doha Agenda', *World Trade Review* 1, 1: 23-45.

— (2005) 'Operationalizing the Concept of Policy Space in the WTO: Beyond Special and Differential Treatment', *Journal of International Economic Law* 8, 2: 405-424.

Hoekman, B. and Kosteki, M. (2001) *The Political Economy of The World Trading System*, Oxford University Press.

Hoekman, B. and Özden, C. (2005) 'Trade Preferences and Differential Treatment of Developing Countries: A Selective Survey', *World Bank Policy Research Working Paper* No. 3566, Washington, D.C.: World Bank.

Hoekman, B. and Saggi, K. (2003) 'Trading Market Access for Competition Policy Enforcement', *CEPR Discussion Paper* No. 4110.

— (2004) 'International Co-operation on Domestic Policies: Lessons From the WTO Competition Debate', *CEPR Discussion Paper* No. 4693.

Hoekman, B. M. and Mavroidis, P. C. (2000) 'WTO Dispute Settlement, Transparency and Surveillance', *World Economy* 23, 4: 527-542.

Hoekman, B. M., Maskus, K. E. and Saggi, K. (2004) 'Transfer of Technology to Developing Countries: Unilateral and Multilateral Policy Options', *World Bank Policy Research Working Paper* No. 3332, Washington, D.C.: World Bank.

Hoekman, B., Martin, W. and Primo Braga, C. A. (2006) 'Preference Erosion: The Terms of the Debate', in Newfarmer, R. (ed) (2006) *Trade, Doha, and Development: A Window into the Issues*, Washington, D.C.: World Bank. pp. 333-343.

Hoekman, B., Michalopoulos, C. and Winters, L. A. (2004) 'Special and Differential Treatment of Developing Countries in the WTO: Moving Forward after Cancún', *The World Economy* 27, 4: 481-506.

Holmes, P., Rollo, J. and Young, A. R. (2003) 'Emerging Trends in WTO Dispute Settlement: Back to the GATT?', *World Bank Policy Research Working Paper* No. 3133, Washington, D. C.: World Bank.

Horlick, G. (2002) 'Problems with the Compliance Structure of the WTO Dispute Resolution Process', in Kennedy, D. and Southwick, J. (eds) (2002) *The Political Economy of International Trade Law – Essays in Honour of Robert E. Hudec*, Cambridge: Cambridge University Press. pp. 636-645.

Horn, H. and Mavroidis, P. C. (1999) 'Remedies in the WTO Dispute Settlement System and Developing Country Interests', mimeo.

— (2006a) 'The WTO Dispute Settlement System 1995-2004: Some descriptive statistics', mimeo.

— (2006b) 'The WTO Dispute Settlement Data Set: User's Guide Version 1.0', mimeo.

Horn, H., Maggi, G. and Staiger, R. W. (2006) 'The GATT/WTO as an Incomplete Contract', *NBER Working Paper No. W12745*.

Horn, H., Nordström, H. and Mavroidis, P. C. (1999) 'Is the Use of the WTO Dispute Settlement System Biased?', *CEPR Discussion Paper* 2340, London: Centre for Economic Policy Research.

Howse, R. (2002) 'From Politics to Technocracy – and Back Again: the Fate of the Multilateral Trading System', *American Journal of International Law* 96, 1: 94-117.

Howse, R. and Staiger, R. W. (2006) 'United States - Anti-Dumping Act of 1916 (Original Complaint by the European Communities) - Recourse to Arbitration by the United States under 22.6 of the DSU, WT/DS136/ARB, 24 February 2004: A Legal and Economic Analysis', in Horn and Mavroidis (2006) (eds) *The WTO Case Law of 2003*, The American Law Institute Reporters' Studies, Cambridge: Cambridge University Press. pp. 254-279.

Hudec, R. E. (1975) *The GATT legal system and world trade diplomacy*, New-York: Praeger.

— (1980) 'GATT Dispute Settlement after the Tokyo Round: An Unfinished Business', *Cornell International Law Journal* 13: 145-204.

— (1987) *Developing Countries in the GATT Legal System*, Aldershot, Hampshire: Gower Publishing.

— (1990) *The GATT Legal System and World Trade Diplomacy*, 2nd edition, Salem, New Hampshire: Butterworth Legal Publishers.

— (1993) *Enforcing International Trade Law: The Evolution of the Modern GATT Legal System*, Salem, New Hampshire: Butterworth Legal Publishers.

— (2002) 'The Adequacy of WTO Dispute Settlement Remedies: A Developing Country Perspective', in Hoekman, B., Mattoo, A. and English, P. (2002) *Development, Trade, and the WTO*, Washington, D.C.: World Bank: 81-91.

Iida, K. (2004) 'Is WTO Dispute Settlement Effective?', *Global Governance* 10: 207-225.

Inama, S. (2003) 'Trade Preferences and the World Trade Organization Negotiations on Market Access', *Journal of World Trade* 37, 5: 959-976.

Inter-American Development Bank (IADB) (2006) 'Mapping Market Access Provisions in Regional Trade Agreements: A Preliminary Assessment', paper presented at the workshops on "Regional Rules and the Global Trading System" held on 26-27 July 2006 in Washington D.C.

Interim Commission for the International Trade Organization (ICITO) (1952) *Liberating World Trade.*

— (1957) *International Trade 1956.*

International Development Association (IDA) (2004) 'Debt Sustainability and Financing Terms in IDA 14: Further Considerations on Issues and Options', November 2004, Washington D.C.: World Bank.

International Federation of Pharmaceutical Manufacturers Association (IFPMA) (2003) 'Accelerating innovative pharmaceutical research and development in China: A case study', Geneva: IFPMA.

International Labour Office (ILO) and World Trade Organization (WTO) (2007) *Trade and Employment: Challenges for Policy Research*, Geneva: WTO.

International Monetary Fund (2003) 'Financing of Losses from Preference Erosion - Note on Issues raised by Developing Countries in the Doha Round', Communication to the WTO from the International Monetary Fund, WTO Document WT/TF/COH/14, Geneva: WTO.

International Monetary Fund (IMF) and the World Bank (2006) 'Doha Development Report and Aid for Trade', Progress report for the Development Committee (Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries) Meeting of 18 September 2006, Document DC2006-0013, Washington D.C.: IMF and World Bank.

Irwin, D. (1993) 'Multilateral and Bilateral Trade Policies in the Word Trading System: An Historical Perspective', in de Melo, J. and Panagariya, A. (eds) *New Dimensions in Regional Integration*, London, CEPR.

— (1994) 'The GATT's Contribution to Economic Recovery in Post-War Western Europe', *NBER Working Paper* 4944.

— (1995) 'The GATT's contribution to economic recovery in post-war Western Europe' in Eichengreen, B (ed) *Europe's Postwar Recovery,* Cambridge: Cambridge University Press.

— (1996) *Against the Tide: An Intellectual History of Free Trade*, Princeton: University Press.

Jackson, J. (1967) 'The Puzzle of GATT', *Journal of World Trade Law* 1, 2: 131-161.

— (1969) *World Trade and the Law of GATT*, Indianapolis, Kansas City and New York: The Bobby-Merrill Company.

— (1997) *The world trading system, law and policy of international economic relations*, 2nd edition, Cambridge, Mass.: MIT Press.

— (1998) 'Dispute Settlement in the WTO: Policy and Jurisprudential Considerations', University of Michigan Research Seminar in International Economics (RSIE) *Discussion Paper* No. 419, Ann Arbor, Michigan: University of Michigan. Available at http://www.spp.umich.edu/rsie/workingpapers/wp.html

— (2002) 'Afterword: The Linkage Problem – Comments on Five Texts', *The American Journal of International Law* 96,1: 118-125.

— (2004) 'International Law Status of WTO Dispute Settlement Reports: Obligation to Comply or Option to "Buy out"?', *American Journal of International Law* 98, 1: 109-125.

— (2005) 'The Changing Fundamentals of International Law and Ten Years of the WTO', *Journal of International Economic Law* 8, 1: 3-15.

— (2006) *Sovereignty, the WTO, and Changing Fundamentals of International Law*, Cambridge: Cambridge University Press.

Jackson, J. H., Davey, W. J and Sykes, A. O. (1995) *Legal Problems of International Economic Relations: Cases, Materials and Text on the National and International Regulation of Transnational Economic Relations*, 3rd edition, St. Paul, Minn.: West Publishing.

Jaffe, A. B., Peterson, S. R., Portney, P. R. and Stavins, R. (1995) 'Environmental Regulation and the Competitiveness of U.S. Manufacturing: What Does the Evidence Tell Us?', *Journal of Economic Literature* 33, 1: 132-163.

Johnson, H. G. (1967) *Economic policies towards less developed countries*, New York: Praeger.

Karacaovali, B. and Limão, N. (2005) 'The Clash of Liberalization: Preferential versus Multilateral Trade Liberalization in the European Union', *The World Bank, Policy Research Working Papers* Series, N. 3493.

Keck, A. (2004) 'WTO Dispute Settlement: What Role for Economic Analysis?', *Journal of Industry, Competition and Trade* 4, 4: 365-371.

Keck, A. and Low, P. (2004) 'Special and Differential Treatment in the WTO: Why, When and How?', *Staff Working Paper ERSD*-2004-03, World Trade Organization (WTO), Geneva; also published in: Evenett, S. and Hoekman, B. (eds) (2005) *Economic Development and Multilateral Trade Co-operation*, Palgrave/ McMillan and World Bank, Washington, D.C. pp 147-188.

Keck, A. and Priyadarshi, S. (2005) 'Special and Differential Treatment: Options for Reform', in Fortescue, D., Fraser, M. and Robinson, S. (ed) (2005) *The World Trade Brief: The 6th WTO Ministerial Conference*, Haymarket Publishing, London. pp. 55-57.

Keck, A., Malashevich, B. and Gray, I. (2006) 'A "Probabilistic" Approach to the Use of Econometric Models in Sunset Reviews', *Staff Working Paper* ERSD-2006-01, Geneva: WTO.

Kemp, M. C. and Wan, H. (1976) 'An Elementary Proposition Concerning the Formation of Customs Unions', *Journal of International Economics* 6, 1: 95.98.

— (1986) 'The Comparison of Second-Best Equilibria: the Case of Customs Unions', *Zeitschrift für Nationalökonomie* Supplement 5, pp. 161-167.

Kemper, R. (1980) 'The Tokyo Round: Results and Implications for Developing Countries', *World Bank Staff Working Paper 372*, Washington, DC: World Bank.

Keohane, R. O. (1983) 'The Demand for International Regimes' in Krasner, S. D. (ed) *International Regimes*, Stanford, Cornell University Press. pp. 141-172.

Keohane, R. O. and Nye, J.S. Jr. (2000) 'The Club Model of Multilateral Cooperation and the World Trade Organization: Problems of Democratic Legitimacy', paper prepared for "Efficiency, Equity and Legitimacy: The Multilateral Trading System at the Millennium" John F. Kennedy School of Government, Harvard University, 1-2 June 2000.

Kerr, W. A. (2005) 'Special and Differential Treatment: A Mechanism to Promote Development?', *The Estey Centre Journal of International Law and Trade Policy* 6, 2: 84-94.

Khanna, R. (1991) *International trade in textiles: MFA quotas and a developing exporting country,* London: Sage Publications.

Kleen, P. and Page, S. (2005) 'Special and Differential Treatment of Developing Countries in the World Trade Organization', *Global Development Studies* No. 2, Stockholm: Ministry of Foreign Affairs, Sweden.

Klein, B. (1996) 'Why Hold-Ups Occur: The Self-Enforcing Range of Contractual Relationships' *Economic Inquiry* 34, 3: 444-463.

Klein, J. I. (1996) 'A Note of Caution With Respect to A WTO Agenda on Competition Policy' presented at the Royal Institute of International Affairs, Chatham House, London, November 18, 1996.

Kock, K. (1969) *International Trade Policy and the GATT 1947-1967,* Stockholm: Almqvist & Wiksell.

Koekkoek, A. (1989) *Developing Countries and the Uruguay Round : Some Aspects*, Rotterdam: Erasmus Universiteits Drukkerij.

Kokko, A. and Blomstrom, M. (1995) 'Policies to Encourage Inflows of Technology through Foreign Multinationals', *World Development* 23, 3: 459-468.

Kosteki, M. (1980) 'State Trading by the Advanced and Developing Countries: The Background', *Les Cahiers du CETAI n*o 80-04, HEC.

Krishna, K. and Krueger, A. O. (1995) 'Implementing free trade areas: rules of origin and hidden protection', in J. Levinsohn, A. Deardorff and R. Stern (eds) *New Directions in Trade Theory*, Ann Arbor: University of Michigan Press.

Krishna, P. (1998) 'Regionalism and Multilateralism: A Political Economy Approach', *Quarterly Journal of Economics* 113, 1: 227-51.

Krueger, A. O. (1978) *Foreign trade regimes and economic development: liberalization attempts and consequences*, Cambridge, Mass.: Ballinger.

— (1997) 'Free trade agreements versus customs unions', *Journal of Development Economics* 54, 1: 169-187.

Krugman, P. R. (1987) 'Is Free Trade Passé?', *Journal of Economic Perspectives* 1, 2: 131-144.

— (1991) 'The Move to Free Trade Zones', paper presented at the symposium sponsored by the Federal Reserve Bank of Kansas City, Policy Implications of Trade and Currency Zones, Jackson Hole, Wyoming, 22-24 August, pp. 7-41.

Kucera, D. and Sarna, R. (2006) 'Trade Union Rights, Democracy, and Exports: A Gravity Model Approach', *Review of International Economics* 14, 5: 859-882.

Kucik, J. and Reinhardt, E. (2007) 'Does Flexibility Promote Cooperation? 'Efficient Breach' in the Global Trade Regime', mimeo.

Lall, S. (2002) 'Selective policies for export promotion: lessons from the Asian Tigers', in Helleiner, G. K. (ed) *Non-traditional export promotion in Africa: Experiences and issues*, Helsinki: United Nations University [published by Palgrave]. pp. 23-71.

Langhammer, R. and Sapir, A. (1987) *Economic Impact of Generalized Tariff Preferences*, London: Trade Policy Research Centre.

Langhammer, R.J. and Lücke, M. (1999) 'WTO accession issues', *The World Economy* 22, 6: 837-873.

Lanye, Z. (2003) 'The Effects of the WTO Dispute Settlement Panel and Appellate Body Reports', *Temple International & Comparative Law Journal* 17, 1: 221-236.

Lawrence, R. (2003) *Crimes and Punishments? Retaliation under the WTO*, Washington, D.C.: Institute of International Economics (IIE).

— (2005) 'Rulemaking Amidst Growing Diversity: A Club-of-Clubs Approach to WTO Reform and New Issue Selection', *Journal of International Economic Law* 9, 4: 823-835.

Lederman, D. and Özden, C. (2005) 'Geopolitical Interests and Preferential Access to U.S. Markets', *World Bank Policy Research Working Paper* No. 3531, Washington, D.C: World Bank.

Lee, J.-Y and Mansfield, E. (1996) 'Intellectual Property Protection and U.S. Foreign Direct Investment', *Review of Economics and Statistics* 78, 2: 181-86.

Leibowitz, L. E. (2001) 'Safety Valve or Flash Point? The Worsening Conflict Between U.S. Trade Laws and WTO Rules', *Briefing Paper* No.17. Washington, D.C.: Cato Institute.

Leitner, K. and Lester, S. (2006) 'WTO dispute settlement from 1995 to 2005 - a statistical analysis', *Journal of International Economic Law* 9, 1: 219-231.

Lepan, H.E (1988) 'The Optimal Tariff, Production Lags and Time Consistency', *American Economic Review* 78, 3: 395-401.

Levenstein, M. and Suslow, V. (2001) 'Private international cartels and their effect on developing countries', Background paper for the World Bank's World Development Report 2001, 9 January 2001. Available at http://www-unix.oit.umass.edu/~maggiel /WDR2001.pdf. Accessed 18/05/2007.

Levy, P. I. (1997) 'A Political Economy Analysis of Free trade Agreements', *American Economic Review* 87: 4: 506-19.

Limão, N. (2002) 'Are preferential trade agreements with Non-trade Objectives a stumbling block for Multilateral liberalization?', University of Maryland, Center for international economics, *Working Paper* N. 02-02.

— (2005) 'Preferential Trade Agreements as Stumbling Blocks for Multilateral Trade Liberalization: Evidence for the U.S', Centre for Economic Policy Research (CEPR) *Discussion Paper* No. 4884, London: CEPR.

— (2006) 'Preferential Trade Agreements as Stumbling Blocks for Multilateral Trade liberalization: Evidence for the United State', *American Economic Review* 96, 3: 896-914.

Limão, N. and Olarreaga, M. (2005) 'Trade Preferences to Small Countries and the Welfare Costs of Lost Multilateral Liberalization', *World Bank Policy Research Working Paper* No. 3565, Washington D.C: World Bank.

Limão, N. and Saggi, K. (2006) 'Tariff Retaliation versus Financial Compensation in the Enforcement of International Trade Agreements', *World Bank Policy Research Working Paper* No. 3873, Washington, D.C.: World Bank.

Limão, N. and Venables, A. J. (2001) 'Infrastructure, Geographical Disadvantage, Transport Costs, and Trade', *World Bank Economic Review* 15, 3: 451-479.

Lipsey, R. G. (1957) 'The Theory of Customs Unions : Trade Diversion and Welfare', *Economica* 24, 1: 40-46.

Little, I., Scitovsky, T. and Scott, M. (1970) *Industry and trade in some developing* countries, London: Oxford University Press for the OECD.

Lloyd, P. J. (1979) 'State Trading and the Theory of International Trade', *Les Cahiers du CETAI* no 79-08, HEC.

Lockhart, J. and Voon, T. (2005) 'Reviewing Appellate Review in the WTO Dispute Settlement System', *Melbourne Journal of International Law* 6, 2: 474-484.

Low, P. (1993) *Trading free : the GATT and U.S. trade policy*, New York: Twentieth Century Fund Press.

Low, P., Piermartini, R. and Richtering, J. (2005) 'Multilateral Solutions to the Erosion of Non-Reciprocal Preferences in NAMA', *WTO Staff Working Paper* No. ERSD-2005-05, Geneva: WTO.

Ludema, R. (1991) 'International Trade Bargaining and the Most-Favoured-Nation Clause', *Economics and Politics*, 3: 1-20.

Macdougall, D., and Hutt, R.(1954) 'Imperial Preferences: A quantitative analysis', *The Economic Journal* 64, 254 (June): 233-257.

Maddison, A. (2001) *The World Economy: A Millennial Perspective*, Paris: OECD.

Maggi, G. (1999) 'The Role of Multilateral Institutions in International Trade Co-operation', *American Economic Review* 89, 1: 190-214.

Mansfield, E. D. and Reinhardt, E. (2006) 'International institutions and the volatility of international trade', unpublished manuscript.

Marceau, G. and Pedersen, P. (1999) 'Is the WTO Open and Transparent', *Journal of World Trade* 33, 1: 1-49.

Martin, W. and Winters, L.A. (1996) (eds) *The Uruguay Round and the developing countries*, Washington, DC: World Bank, published by Cambridge University Press.

Maskus, K. E. (1997) ‘Should core labour standards be imposed through international trade policy?’ *Policy Research Working Paper* 1817, Washington, D.C.: World Bank.

— (2000) *Intellectual Property Rights in the Global Economy*, Washington D.C.: Institute for International Economics (IIE).

— (2002) ‘Regulatory Standards in the WTO: Comparing Intellectual Property Rights with Competition Policy, Environmental Protection and Core Labour Standards’, *World Trade Review* 1, 2: 135-152.

Maskus, K. E. and Yang, G. (2003) ‘Intellectual Property Rights, Licensing, and Innovation’, *World Bank Policy Research Working Paper* No. 2973, Washington D.C.: World Bank.

Maskus, K.E. and Penubarti, M. (1995) ‘How Trade-Related are Intellectual Property Rights?’, *Journal of International Economics* 39: 227-248.

Mathis, J. H. (2002) *Regional Trade Agreements in the GATT/WTO : Article XXIV and the Internal Trade Requirement,* The Hague : T.M.C. Asser Press.

Mattoo, A. (2000) ‘Financial Services and the WTO: Liberalization Commitments of the Developing and Transition Economies’, *World Economy* 351-86.

Mavroidis, P. C. (2000) ‘Remedies in the WTO Legal System: Between a Rock and a Hard Place’, *European Journal of International Law* 11, 4: 763-813.

Mc Laren (2001) ‘A theory of Insidious Regionalism’, University of Virginia, mimeo.

McClenehan, G. (1991) ‘The growth of voluntary export restraints and American foreign economic policy’, *Business And Economic History*, Second Series 20: 180-190.

McCorriston, S. and Maclaren, D. (2002) ‘State Trading, the WTO and GATT Article XVII’, *The World Economy* 25: 107-135.

McMillan, J. (1993) ‘Does Regional Integration Foster Open Trade? Economic Theory And GATT’s Article XXIV’, in Anderson, K. and Blackhurst, R. (eds) *Regional Integration and the Global Trading System*, London: Harvester Wheatsheaf.

McRae, D. (2004) ‘What is the Future of WTO Dispute Settlement?’, *Journal of International Economic Law* 7, 1: 3-21.

Melitz, M. J. (2005) ‘When and how should infant industries be protected?’, *Journal of International Economics* 66, 1: 177-196.

Mercurio, B. (2004) ‘Improving Dispute Settlement in the World Trade Organization: The Dispute Settlement Understanding Review - Making it Work?’, *Journal of World Trade* 38, 5: 795-854.

Merrills, J. G. (2005) *International Dispute Settlement*, Cambridge: Cambridge University Press.

Metzger, S. D. (1964) *Trade Agreements and the Kennedy Round: An Analysis of the Economic, Legal and Political Aspects of the Trade Expansion Act of 1962 and the Prospects for the Kennedy Round of Tariff Negotiations*, Fairfax, Va.: Coiner Publications.

Milthorp, P. (1997) ‘Integration of FSU/economies in transition into the World Trade Organization’, *Economics in Transition* 5, 1: 215-223.

Miranda, J. R., Torres, A. and Ruiz, M. (1998) ‘The international use of antidumping: 1987–1997’, *Journal of World Trade* 32, 5: 5–71.

Moran, T. (1998) *Foreign Direct Investment and Development*, Washington, D.C.: Institute for International Economics.

Murray, T. (1973) ‘How Helpful is the Generalised System of Preferences to Developing Countries?’, *Economic Journal* 83 ,330: 449-55.

Narlikar, A. (2003) *International Trade and Developing Countries: Bargaining Coalitions in the GATT and WTO*, London: Routledge. pp. 83-103.

Narlikar, A. and Odell, J. S. (2006) 'The strict distributive strategy for a bargaining coalition: The Like Minded Group in the World Trade Organization, 1998-2001' in Odell, J.S. (ed) *Negotiating Trade: Developing Countries in the WTO and NAFTA*, Cambridge: Cambridge University Press. pp. 115-144.

Narlikar, A. and Tussie, D. (2004) 'The G20 at the Cancún Ministerial: Developing Countries and Their Evolving Coalitions in the WTO', *World Economy* 27, 7: 947-966.

Neumayer, E. and de Soysa, I. (2006) 'Globalization and the Right to Free Association and Collective Bargaining: An Empirical Analysis', *World Development* 34, 1: 31-49.

Nishimizu, M and Robinson, S. (1984) 'Trade Policies and Productivity Change in Semi-Industrialized Countries', *Journal of Development Economics* 16: 177-206.

Nogues, J., Olechowski, A., and Winters, A. L. (1986) 'The Extent of Non-tariff Barriers to Industrial Countries Exports', *World Bank Economic Review* 1: 181-99.

Noland, M. and Pack, H. (2003) *Industrial Policy in an Era of Globalization: Lessons from Asia*, Washington D.C.: Institute for International Economics (IIE).

Nordström, H. (2005) 'The cost of WTO litigation, legal aid and small claim procedures', mimeo.

Nordström, H. and Shaffer, G. (2007) 'Access to Justice in the WTO: The Case for a Small Claims Procedure', forthcoming: ICTSD.

Nordström, H. and Vaughan, S. (1999) 'Trade and Environment', *Special Studies* 4, Geneva: WTO.

Ocampo, J. A. and Parra, M. A. (2003)'The terms of trade for commodities in the twentieth century', *CEPAL Review* 79: 7-35.

Odell, J. and Eichengreen, B. (1998) 'The United States, the ITO and the WTO: Exit Options, Agent Slack and Presidential Leadership', in Kruger, A. O. (ed) *The WTO as an International Organization*, Chicago: University of Chicago Press.

Odell, J. S. (2005) 'Chairing a WTO Negotiation', *Journal of International Economic Law* 8, 2: 425-448.

Odell, J. S. (2006) (ed) *Negotiating Trade: Developing Countries in the WTO and NAFTA, Cambridge University Press:* chapters 3 and 4.

Odell, J. S. and Sell, S. K. (2006) 'Reframing the Issue: The WTO coalition on intellectual property and public health, 2001', in Odell, J. S. (ed) *Negotiating Trade: Developing Countries in the WTO and NAFTA*, Cambridge: Cambridge University Press. pp. 85-114.

Organization for Economic Cooperation and Development (OECD) (1999) *Post Uruguay Round tariff regimes, achievements and outlook*, Paris: OECD.

— (2001) 'Regional Integration: Observed Trade and Other Economic Effects', Working Party of Trade Committee, TD/TC/WP(2001)19/Rev.1, Paris: OECD.

— (2003) 'The Impact of Trade-Related Intellectual Property Rights on Trade and Foreign Direct Investment in Developing Countries', TD/TC/WP(2002)42/FINAL, Paris: OECD.

Organization for European Economic Cooperation (OEEC) (1958) 'European Payments Union. Eighth Annual Report of the Managing Board. Financial year 1957-58', Paris: OEEC.

Ostry, S. (1997) *The Post-Cold War Trading System*, Chicago: The University of Chicago Press.

Ouin, M. (1959) 'State Trading in Western Europe', *Law and Contemporary Problems* 24, No. 3. State Trading: Part 2, pp. 398-419.

Oyejide, T. A. (1997) 'Africa's Participation in the Post-Uruguay Round World Trading System', *Program for the Study of International Organization(s) (PSIO) Occasional Paper*, WTO Series Number 6, Geneva: PSIO.

Özden, C. and Reinhardt, E. (2003) 'The Perversity of Preferences: GSP and Developing Country Trade Policies, 1976-2000', *World Bank Policy Research Working Paper* No. 2955, Washington D.C.: World Bank.

Page, S. (2001) 'Country Classifications and Trade', Report prepared for the Department for International Development, London: Overseas Development Institute (ODI).

Page, S., Davenport, M. and Hewitt, A. (1991) *The GATT Uruguay Round: Effects on Developing Countries*, London: Overseas Development Institute.

Panagariya, A. (2000a) 'Evaluating the Case for Export Subsidies', *Policy Research Working Paper* No. 2276, Washington D.C.: World Bank.

— (2000b) 'Preferential Trade Liberalization: The Traditional Theory and New Developments', *Journal of Economic Literature* 38: 287-331.

Park, Y. D. and Panizzon, M. (2002) 'WTO Dispute Settlement 1995-2001: A Statistical Analysis', *Journal of International Economic Law* 5, 1: 221-244.

Paugam, J.-M. and Novel, A.-S. (2005) 'Why and How Differentiate Developing Countries in the WTO? – Theoretical Options and Negotiating Solutions', mimeo, Paris: Institut français des relations internationales (Ifri).

Pauwelyn, J. (2000) 'Enforcement and Countermeasures in the WTO: Rules Are Rules - Toward a More Collective Approach', *American Journal of International Law* 94, 2: 335-347.

— (2001) 'The Role of Public International Law in the WTO: How Far Can We Go?', *American Journal of International Law 95*, 3: 535-78.

— (2006) 'Options for Implementing a Remand Process in WTO Dispute Settlement', mimeo.

Pedersen, P. (2006) 'WTO Decision-Making and Internal Transparency', *World Trade Review* 5, 1: 103-132.

Petersmann, E.-U. (1997a) 'International Trade Law and the GATT/WTO Dispute Settlement System 1948-1996: An Introduction', in Petersmann, E.-U. (1997) (ed) *International Trade Law and the GATT/WTO Dispute Settlement System*, London: Kluwer. pp. 3-122.

— (1997b) *The GATT/WTO Dispute Settlement System: International Law, International Organizations and Dispute Settlement*, London: Kluwer.

— (1998) 'From the Hobbesian International Law of Coexistence to Modern Integration Law: The WTO Dispute Settlement System', *Journal of International Economic Law* 1, 2: 175-198.

Piermartini, R. and Budetta, M. (2006) 'A Mapping of Regional Rules on Technical Barriers to Trade', paper presented at the workshops on "Regional Rules and the Global Trading System" held on 26-27 July 2006 in Washington D.C.

Prebisch, R. (1950) 'Crecimiento, desequilibrio y disparidades: interpretación del proceso de desarrollo', Estudio Económico de América Latina 1949, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC).

Preeg, E. H. (1970) *Traders and diplomats; an analysis of the Kennedy round of negotiations under the General Agreement on Tariffs and Trade*, Washington, DC: Brookings Institution.

Prowse, S. (2002) 'The Role of International and National Agencies in Trade-related Capacity Building', *The World Economy* 25, 9: 1235-1261.

Prusa, T. (2005) 'Antidumping: a growing problem in international trade', *The World Economy* 28, 5: 683-700.

Puga, D. and Venables A. J. (1998) 'Agglomeration and Economic Development: Import Substitution Vs. Trade Liberalization', Centre for Economic Policy Research (CEPR) *Discussion Paper* No. 1782, London: CEPR.

Qian, Y. (2000) 'Financial Service liberalization and GATS', in Claesens, C. and Jansen, M. (eds) *The Internationalization of Financial Services*, The World Bank and WTO.

Ramírez Robles, E. (2006) 'Political & quasi-adjudicative dispute settlement models in European Union Free Trade Agreements: Is the quasi-adjudicative model a trend or is it just another model?, *WTO Staff Working Paper* No. ERSD-2006-09, Geneva: WTO.

Ravenhill, J. (2005) 'The New Regionalism', in Ravenhill, J. (ed) *Global Political Economy* Oxford: Oxford University Press.

Rawls, J. (1971) *A Theory of Justice,* Cambridge, Mass.: Harvard University Press.

Reif, T. M. and Florestal, M. (1998) 'Revenge of the *Push-Me, Pull-You*: The Implementation Process Under the WTO Dispute Settlement Understanding', *International Lawyer* 32, 3: 755-788.

Reinhardt, E. (1996) *Posturing Parliaments: Ratification, Uncertainty, and International Bargaining*, PhD dissertation, New York: Columbia University.

— (1999) 'Aggressive Multilateralism: The Determinants of GATT/WTO Dispute Initiation, 1948-1998', prepared for delivery at the 1999 Annual Meeting of the International Studies Association, 17-20 February 1999, Washington, D.C.

— (2001) 'Adjudication without Enforcement in GATT Disputes', *Journal of Conflict Resolution* 45, 2: 174-195.

Rodriguez-Clare, A. (2005) 'Coordination Failures, Clusters and Microeconomic Interventions', Inter-American Development Bank (IADB) *Working Paper* No. 544 Washington, D.C.: IADB.

Rodrik, D. (1993) 'Taking Trade Policy Seriously: Export Subsidization as a Case Study in Policy Effectiveness', *National Bureau of Economic Research (NBER) Working Paper* No. 4567, Cambridge, Mass.: NBER.

— (1998) 'Globalization and Labour, or: If Globalizatino is a Bowl of Cherries, Why are there so many glum faces around the Table?' in Cohen, D., Venables, A.J., Sapir, A. and Baldwin, R. (eds) *Market Integration, Regionalism and the Global Economy*, Cambridge: Cambridge University Press.

— (2004) 'Industrial Policy for the Twenty-First Century', *Centre for Economic Policy Research (CEPR) Discussion Paper* No. 4767, London: CEPR.

Rose, A. K. (2000) 'One money, one market? the effects of common currencies on international trade', *Economic Policy* 15: 7–46.

— (2004a) 'Do we really know that the WTO increases trade?', *American Economic Review* 94, 1: 98-114.

— (2004b) 'Do WTO members have more liberal trade policy?', *Journal of International Economics* 63, 2: 209-235.

— (2005) 'Does the WTO make trade more stable?', *Open Economies Review* 16, 1: 7-22.

Roy, M., Marchetti, J. and Lim, H. (2006) 'Services liberalization in the new generation of Preferential Trade Agreements (PTAs): How much further than the GATS?', *WTO Staff Working Paper* ERSD-2006-07.

Ryan, M.P. (1998) *Knowledge Diplomacy: Global Competition and the Politics of Intellectual Property*, Washington DC: Brookings Institution Press.

Saha, R. (2005) 'Management of Intellectual Property Rights in India', Patent Facilitating Centre (PFC), New Delhi: PFC. Available at http://www.pfc.org.in/workshop/workshop.pdf. Accessed 06/02/2007.

Sampson, G. P. and Snape, R. H. (1980) 'Effects of the EEC's Variable Import Levies', *Journal of Political Economy* 88, 5: 1026-1040.

Santana, R. (2005) 'Challenges to the NAMA Negotiations: Finding New Solutions to Old Problems', *Intereconomics* 40, 6: 311-316.

Sapir, A. (1995) 'Trade Liberalization and the Harmonization of Social Policies: Lessons from European Integration', in Bhagwati, J. and Hudec, R. (eds) *Fair Trade and Harmonization: Prerequisites for Free Trade?*, Vol. 1 Economic Analysis, Cambridge, Massachusetts: The MIT Press.

Schmitz, J. (1996) 'The Role Played by Public Enterprises: How Much Does it Differ Across Countries?', *Federal Reserve Bank of Minneapolis Quarterly Review* 20, 2-15.

Schropp, S. A. B. (2005) 'The Case for Tariff Compensation in WTO Dispute Settlement', *Aussenwirtschaft* 60, 4: 485-530.

Schwartz, W. F. and Sykes, A. O. (2002) 'The Economic Structure of Renegotiation and Dispute Resolution in the WTO/GATT System', *John M. Olin Law & Economics Working Paper* No. 143, Law School, University of Chicago.

Sek, L. (2002) 'Trade Retaliation: The "Carousel" Approach', US Congressional Research Service (CRS) Report for Congress, Order Code RS20715, 5 March 2002, Washington, D.C.: CRS.

Setear, J. K. (1997) 'Responses to Breach of a Treaty and Rationalist International Relations Theory: The Rules of Release and Remediation in the Law of Treaties and the Law of State Responsibility' *Virginia Law Review* 83, 1: 1-126.

Shaffer, G. (2003a) *Defending Interests: Public-Private Partnerships in WTO Litigation,* Washington, D.C. Brookings Institution Press.

— (2003b) 'How to Make the WTO Dispute Settlement System Work for Developing Countries: Some Proactive Developing Country Strategies', *ICTSD Resource paper* 5: 1-65, Geneva. Available at http://www.ictsd.org/pubs/ictsd_series/resource_papers/DSU_2003.pdf. Accessed 31/05/2007.

— (2005) 'Weaknesses and Proposed Improvements to the WTO Dispute Settlement System: An Economic and Market-Oriented View', Paper prepared for the Conference "The WTO at Ten: A Look at the Appellate Body", Sao Paulo, Brazil, 16-17 May 2005.

— (2006) 'The Challenges of WTO Law: Strategies for Developing Country Adaptation', *World Trade Review* 5, 2: 177-198.

Sherman, L.B. (1998) 'Wildly enthusiastic" about the first multilateral agreement on trade in telecommunications services, *Federal communications Law Journal* 51: 1, 61-110.

Shin, Y. (1999) 'Implementation of the WTO Customs Valuation Agreement in Developing Countries: Issues and Recommendations', *Journal of World Trade* 33, 1: 125-143.

Singer, H. W. (1950) 'U.S. foreign investment in undeveloped areas, the distribution of gains between investing and borrowing countries', *American Economic Review*, Papers and Proceedings No. 40.

Smarzynska Javorcik, B. (2002) 'Composition of Foreign Direct Investment and Protection of Intellectual Property Rights: Evidence from Transition Economies', *World Bank Policy Research Working Paper* No. 2786, Washington D.C.: World Bank.

— (2004) 'Does Foreign Direct Investment Increase the Productivity of Domestic Firms? In Search of Spillovers Through Backward Linkages', *American Economic Review* 94, 3: 605-626.

Smith, M. (1988) 'The free trade agreement in context: A Canadian perspective' in *The Canada-United States free trade agreement: The global impact,* Washington, DC: Institute for International Economics.

Soloaga, I. and Winters, A. (2001) 'Regionalism in the Nineties: What effect on trade?', *North American Journal of Economics and Finance* 12: 1-29.

Sorsa, P. (1997) 'The GATS Agreement on Financial Services – A Modest Start to Multilateral Liberalization', *IMF Working Paper* WP/97/55, FMI, Washington, D.C.

Srinivasan, T. N. (1998) *Developing Countries and the Multilateral Trading System: From the GATT to the Uruguay Round and the Future*, Boulder, Colorado: Westview Press.

Staiger, R. W. (1995) 'International Rules and Institutions for Trade Policy', in Grossman G. and K. Rogoff (eds) *Handbook of International Economics*, vol. III. Amsterdam: North Holland.

— (2006) 'Review of Behind the Scenes at the WTO: the Real World of International Trade Negotiations: Lessons of Cancun', *Journal of Economic Literature* XLIV: 428-442.

Staiger, R. W. and Tabellini, G. (1987) 'Discretionary Trade Policy and Excessive Protection' *American Economic Review* 77, 5: 823-837.

Steinberg, R. H. (2002) 'In the Shadow of Law or Power? Consensus-Based Bargaining and Outcomes in the GATT/WTO', in *International Organization* 56, 2: 339-374.

Stevens, C. (2002) 'The future of Special and Differential Treatment (SDT) for Developing Countries in the WTO', Institute of Development Studies (IDS) *Working Paper* No. 163, Brighton, Sussex: IDS.

Stewart, T. and Johanson D. (1998) 'The SPS Agreement of the World Trade Organization and International Organizations: The Roles of the Codex Alimentarius Commission, the International Plant Convention, and the International Office for Epizootics', *Syracuse Journal of International Law and Commerce*, pp. 27-54.

Sturm, D. M. (2006) 'Product Standards, Trade Disputes and Protectionism', *Canadian Journal of Economics* 39, 2: 564-581.

Subramanian, A. and Wei, S. J. (2007) 'The WTO promotes trade, strongly but unevenly', *Journal of International Economics* 72: 151–175.

Subramanian, A. and Watal, J. (2000) 'Can TRIPS Serve as an Enforcement Device for Developing Countries in the WTO?', *Journal of International Economic Law* 3, 3: 403-416.

Subramanian, A. and Roy, D. (2001) 'Who Can Explain the Mauritian Miracle: Meade, Romer, Sachs, or Rodrik?', International Monetary Fund (IMF) *Working Paper* WP/01/116, Washington D.C.: IMF.

Swedish National Board of Trade (2004) *Consequences of the WTO-agreements for the Developing Countries*, Stockholm: National Board of Trade.

Sykes, A. O. (1992) 'Constructive Unilateral Threats in International Commercial Relations: The Limit Case for Section 301', *Law and Policy in International Business* 23: 263-330.

— (2003) 'The safeguards mess: a critique of WTO jurisprudence', *World Trade Review* 2, 3: 261–295.

Tarullo, D. K. (2002) 'The Hidden Costs of International Dispute Settlement: WTO Review of Domestic Anti-Dumping Decisions', *Law and Policy in International Business* 34, 1: 109-181.

Terrence, S and Johanson, D. (1998) 'The SPS Agreement of the World Trade Organization and International Organizations: The Roles of the Codex Alimentarius Commission, the International Plant Protection Convention, and the International Office for Epizootics', *Syracuse Journal of International Law and Commerce*: 27-54.

Tharakan, P. K. M. (1995) 'Political Economy and Contingent Protection', *Economic Journal* 105, 433: 1550-1564.

Thorbecke, E. (1960) *The Tendency towards Regionalization in International Trade, 1928-1956*. The Hague: Martinus Nijhoff.

Thursby, J. G. and Thursby, M. C. (1987) 'Bilateral Trade Flows, the Lindner Hypothesis, and Exchange Risk', *The Review of Economics and Statistics* 69: 488-495.

Trachtmann, J. P. (2006) 'Building the WTO Cathedral', mimeo.

Tussie, D. (1987) *The Less Developed Countries and the World Trading System: A Challenge to the GATT*, London: Frances Pinter Publishers.

Tussie, D. and Lengyel, M. F. (2002) 'Developing Countries: Turning Participation into Influence', in: Hoekman, B., Mattoo, A. and English, P. (2002) *Development, Trade, and the WTO*, Washington, D.C.: World Bank. pp. 485-492.

United Kingdom (UK) (1947) Board of Trade, Report of the President of the Board of Trade to Parliament by Command of His Majesty, *Report on the Geneva Tariff Negotiations*. Cmd 7258, London, November 1947.

— (1979) *General Agreement on Tariffs and Trade: The Multilateral Trade Negotiations 1973-79*, London: Her Majesty's Stationery Office.

United Nations Conference on Trade and Development (UNCTAD) (1968) *The Kennedy Round estimated effects on tariff barriers*, Geneva: UNCTAD.

— (1982) *Assessment of the results of the multilateral trade negotiations*, Geneva: UNCTAD.

— (1996) *The TRIPS Agreement and Developing Nations*, Geneva: UNCTAD.

— (1999) 'Quantifying the benefits obtained by developing countries from the Generalized System of Preferences', Note by the UNCTAD secretariat UNCTAD/ITCD/TSB/Misc.52, Geneva: UNCTAD.

— (2005) 'Generalized System of Preferences: List of Beneficiaries', UNCTAD/ITCD/TSB/Misc.62/Rev.1, Geneva: UNCTAD.

United States Department of Commerce (1958) 'The role of the United States Tariff and the effects of changes in duty rates', Foreign Trade Policy. Compendium of papers on United States foreign trade policy. Collected by the staff for the Subcommittee on foreign Trade Policy of the Committee on Ways and Means, Washington, DC. p. 216.

— (1982) *The Tokyo Round Results: A Descriptive Summary*, Washington, DC.

United States Department of State (1948) ''The United States reciprocal trade agreements program and the proposed International Trade Organization", Department of State Bulletin, Vol. XVIII *No455,. Publication 3094*, March 21, 1948.

United States Tariff Commission (1948) 'United States Import Duties(1948)', *Miscellaneous Series* TC1.10: Im7/4/1948, Washington, DC.

— (1949) 'Operation of the Trade Agreements Program, June 1934 to April 1948, Report No 160', Washington, DC.

— (1953) 'Effect of the Trade Agreement Concessions on United States Tariff Levels based on Imports in 1952', Washington, DC.

United States Treasury (1960) '1959 Report of the Secretary of the Treasury', Washington, DC.

Valles, C. M. and McGivern, B. P. (2000) 'The Right to Retaliate under the WTO Agreement: The "Sequencing" Problem', *Journal of World Trade* 34, 2: 63-84.

Van Beers, C. (1998) 'Labour Standards and Trade Flows of OECD Countries', *World Economy* 21, 1: 57-73.

Van der Borght, K. (1999) 'The Advisory Center on WTO Law: Advancing Equity and Fairness', *Journal of International Economic Law* 2, 4: 723-728.

Viner, J. (1950) *The Customs Union Issue*, New York: Carnegie Endowment for International Peace.

Wang, Z. K. and Winters, L. A. (2000) 'Putting 'Humpty' Together Again: Including Developing Countries in a Consensus for the WTO', Centre for Economic Policy Research (CEPR) *Policy Paper* 4, London: CEPR.

Whalley, J. (1995) 'Developing Countries and System Strengthening in the Uruguay Round', in Martin, W. and Winters, L. A. (1995) (eds): 305-326.

Winham, G. (1986) *International trade and the Tokyo Round negotiation*, Princeton, N.J.: Princeton University Press.

— (1990) 'GATT and the International Trade Regime', *International Journal* 15: 786-822.

Winters, L. A. (1999) 'Regionalism vs Multilateralism', in Baldwin, R., Cohen, D., Sapir, A. and Venables, A. (eds) *Market Integration, Regionalism and the Global Economy Cambridge*, Cambridge University Press.

— (2000) 'Trade policy as development policy: building on fifty years' experience', paper presented at the UNCTAD X High-level Round Table on Trade and Development: Directions for the Twenty-first century, Bangkok, 12 February 2000.

Wolfe, R. (2006) 'New Groups in the WTO Agricultural Trade Negotiations: Power, Learning and Institutional Design' Canadian Agricultural Trade Policy Research Network, Commissioned Paper CP 2006-2, 1-25.

— (2007) 'Can the trading system be governed? Institutional Implications of the WTO's suspended animation', *Centre for International Governance Innovation Working Paper*, forthcoming.

Wonnacott, P. (1987) *The United States and Canada: The quest for free trade*, Washington, DC: Institute for International Economics.

Woodrow, B. (2000) 'The 1997 World Trade Organization accord on financial services : its impact on and implications for the world insurance industry', *Geneva papers on risk and insurance* 25, 1 (January 2000): 78-103.

— (2001) '*Domestic/International Regulation and Trade in Insurance Services: Implications for the Services 2000 Negotiations*', in Stern, R. (ed) *Services in the International Economy*, Ann Arbor: University of Michigan Press. pp. 369-393.

World Bank (2002) *Global Economic Prospects and the Developing Countries*, Washington D.C: World Bank.

— (2005) *Global Economic Prospects*, Washington, DC: The World Bank.

— (2006) *Assessing World Bank Support for Trade, 1987-2004, An IEG Evaluation*, Washington, DC: The World Bank.

World Trade Organization (WTO) (1995a) *Guide to GATT Law and Practice – Analytical Index, Volume 2*, Geneva: WTO.

— (1995b) 'Regionalism and the World Trading System', Geneva: WTO.

— (1997) 'Special Study on Trade and Competition Policy', *Annual Report of the WTO 1997*, chapter IV, Geneva: WTO.

— (1998) 'Japan – Measures Affecting Consumer Photographic Film and Paper', Report of the Panel, WT/DS44/R.

— (2000) 'Synopsis of 'Systemic' Issues related to regional Trade Agreements', Note by the Secretariat, document WT/REG/W/37.

— (2001a) 'Market access: unfinished business, post-Uruguay Round inventory and issues', *Special Study* No 6, Geneva: WTO.

— (2001b) 'The Generalised System of Preferences: A preliminary analysis of the GSP schemes in the Quad – Note by the Secretariat', WTO document WT/COMTD/W/93, Geneva: WTO.

— (2002) 'Compendium of Issues Related to Regional Trade Agreements', Background Note of the Secretariat, document TN/RL/W/8/Rev.1.

— (2003) *World Trade Report 2003,* Geneva: WTO.

— (2005) *World Trade Report 2005*, Geneva: WTO.

— (2006a) *International Trade Statistics 2006*, Geneva: WTO.

— (2006b) 'Recommendations of the Task Force on Aid for Trade', WTO document WT/AFT/1, Geneva: WTO.

— (2007) *A Handbook on the TBT Agreement*, Environment Division, Geneva: WTO.

World Trade Organization (WTO) and United Nations Conference on Trade and Development (UNCTAD) (2002) 'Trade-Related Investment Measures and Other Performance Requirements: Joint Study by the WTO and UNCTAD Secretariats', WTO documents G/C/W/307 and G/C/W/307/Add.1, Geneva: WTO.

Woytinski, W. S. and Woytinski, E. S. (1955) *World Commerce and Governments. Trends and Outlook*, New York: The Twentieth Century Fund.

Yeats, A. (1994) 'What are OECD Trade Preferences Worth to Sub-Saharan Africa?', *World Bank Research Policy Paper* No. 1254, Washington, D.C: World Bank.

Yi, K. (2003) 'Can vertical specialization explain the growth of world trade?', *Journal of Political Economy* 111, 1: 52-102.

Zanardi, M. A. (2004) 'Anti-dumping: what are the numbers to discuss at Doha?', *The World Economy* 27, 3: 403-433.

Zeiler, T.(1997) 'GATT fifty years ago: U.S. trade policy and imperial preferences', *Business and Economic History*, Volume Twenty six, no 2, Winter 1997.

Zimmermann, T. A. (2005) 'WTO Dispute Settlement at Ten: Evolution, Experiences, and Evaluation', *Swiss Review of International Economic Relations* ("*Aussenwirtschaft*") 60, 1: 27-61.

— (2006) *Negotiating the Review of the WTO Dispute Settlement Understanding*, London: Cameron May.

TECHNICAL NOTES

1. COMPOSITION OF GEOGRAPHICAL AND OTHER GROUPS

(a) Regions

North America: Bermuda, Canada, Mexico, United States of America, and territories in North America n.e.s.

South and Central America and the Caribbean: Antigua and Barbuda, Argentina, Bahamas, Barbados, Belize, Bolivarian Republic of Venezuela, Bolivia, Brazil, Chile, Colombia, Costa Rica, Cuba, Dominica, Dominican Republic, Ecuador, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Netherlands Antilles, Nicaragua, Panama, Paraguay, Peru, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, Trinidad and Tobago, Uruguay, and other countries and territories in South and Central America and the Caribbean, n.e.s.

Europe: of which European Union (25): Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia and Slovak Republic and Other Europe, of which Other Western Europe: Iceland, Norway, Switzerland and Liechtenstein, and Western Europe n.e.s.; and Other South-Eastern Europe: Albania, Bosnia and Herzegovina, Bulgaria, Romania, Croatia, former Yugoslav Republic of Macedonia, Serbia, Montenegro, and Turkey; and territories in Europe n.e.s.

The Commonwealth of Independent States (CIS): Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russian Federation, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

Africa, of which *North Africa*: Algeria, Egypt, Libyan Arab Jamahiriya, Morocco and Tunisia; and *Sub-Saharan Africa comprising*: *Western Africa*: Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone and Togo; *Central Africa*: Burundi, Cameroon, Central African Republic, Chad, Congo, Democratic Republic of the Congo, Equatorial Guinea, Gabon, Rwanda, and Sao Tome and Principe; *Eastern Africa*: Comoros, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Mauritius, Seychelles, Somalia, Sudan, United Republic of Tanzania and Uganda; and *Southern Africa*: Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, South Africa, Swaziland, Zambia, Zimbabwe; and territories in Africa n.e.s.

The Middle East: Bahrain, Iraq, Islamic Republic of Iran, Israel, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, Syrian Arab Republic, United Arab Emirates, Yemen, and other countries and territories in the Middle East n.e.s.

Asia, of which *West Asia*: Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka; and *East Asia (including Oceania)*: Australia; Brunei Darussalam; Cambodia; China; Fiji; Hong Kong Special Administrative Region of China (Hong Kong, China); Indonesia; Japan; Kiribati; Lao People's Democratic Republic; Macao, China; Malaysia; Mongolia; Myanmar; New Zealand; Papua New Guinea; Philippines; Republic of Korea; Samoa; Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu (Taipei, Chinese); Singapore; Solomon Islands; Thailand; Tonga; Tuvalu; Vanuatu; Viet Nam, and other countries and territories in Asia and the Pacific n.e.s.

(b) Other groups

ACP: Angola, Antigua and Barbuda, Bahamas, Barbados, Belize, Benin, Botswana, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Comoros, Congo, Democratic Republic of the Congo, Cook Islands, Côte d'Ivoire, Cuba, Djibouti, Dominica, Dominican Republic, Equatorial Guinea, Eritrea, Ethiopia, Fiji, Gabon, Gambia, Ghana, Grenada, Guinea, Guinea-Bissau, Guyana, Haiti, Jamaica, Kenya, Kiribati, Lesotho, Liberia, Madagascar, Malawi, Mali, Marshall Islands, Mauritania, Mauritius, Micronesia, Mozambique, Namibia, Nauru, Niger, Nigeria, Niue, Palau, Papua New Guinea, Rwanda, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Samoa, Sao Tome and Principe, Senegal, Seychelles, Sierra Leone, Solomon Islands, Somalia, South Africa, Sudan, Suriname, Swaziland, Timor Leste, Togo, Tonga, Trinidad and Tobago, Tuvalu, Uganda, United Republic of Tanzania, Vanuatu, Zambia and Zimbabwe.

Least-developed countries: Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, Cape Verde, Central African Republic, Chad, Comoros, Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, Lao People's Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Maldives, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Samoa, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, Sudan, Timor Leste, Togo, Tuvalu, Uganda, United Republic of Tanzania, Vanuatu, Yemen and Zambia.

WTO members are frequently referred to as "country", although some members are not countries in the usual sense of the word but are officially "customs territories". The definition of geographical and other groupings in this report does not imply an expression of opinion by the Secretariat concerning the status of any country or territory, the delimitation of its frontiers, nor on the rights and obligations of any WTO Member in respect of WTO Agreements. The colours, boundaries, denominations, and classifications in the maps of this publication do not imply, on the part of the WTO, any judgement on the legal or other status of any territory, or any endorsement or acceptance of any boundary.

PREVIOUS ISSUES OF THE WORLD TRADE REPORT

2006 – Exploring the links between subsidies, trade and the WTO

The annual World Trade Report focuses on trade policy issues – the core topic addressed in 2006 is subsidies. The Report also takes a look at recent trade developments and examines a range of trade topics, including trade in textiles and clothing, flows of international receipts and payments of royalties and license fees, trends in the trade of least-developed countries, and the impact of natural disasters and terrorist acts on international trade flows. The World Trade Report is useful for policymakers and for any individuals or groups interested in global trade policy.

Thematic Essays:

- Trade in textiles and clothing
- International payments and receipts of royalties and licence fees, 1995-2004
- Developments in LDC trade
- The impact of natural disasters international trade flows

ISBN 92-870-3352-8

2005 – Exploring the links between trade, standards and the WTO

The core topic addressed in the 2005 Report is the relationship between standards and trade. The Report also contains three shorter essays on the use of quantitative economic analysis in WTO dispute settlement proceedings, trade in air transport services, and offshoring services. The Report also reviews trends in international trade.

Thematic Essays:

- Quantitative economics in WTO Dispute Settlement
- International trade in air transport: recent developments and policy issues
- Offshoring services: recent developments and prospects

ISBN 92-870-3310-2

2004 – Exploring the linkage between the domestic policy environment and international trade

The 2004 edition reviews recent trade developments and examines issues including coherence in trade and macroeconomic policies, geographical indications, and the liberalization of trade in services through the temporary movement of natural persons.

Thematic Essays:

- Non-reciprocal preferences and the multilateral trading system
- The liberalization of services trade through the temporary movement of natural persons
- Geographical indications

ISBN 92-870-1240-7

2003 – Trade and Development

The World Trade Report is a new annual publication produced by the WTO Secretariat. Each year, the WTR will explore trends in world trade and highlight important issues in the world trading system. In addition to monitoring and interpreting trade developments, the Report seeks to deepen public understanding of pressing policy issues. The 2003 edition examines developments in South-South trade, trends in commodity markets, and the growth of Regional Trade Agreements.

Thematic Essays:

- Selected features of South-South trade developments in the 1990-2001 period
- Non-fuel commodity prices
- Regional Trade Agreements

ISBN 92-870-1230-X

ISBN 978-92-870-3401-4