Cordell Hull Institute

# Trade Policy Analyses

Vol. 6, No. 5 June 2004

With the multilateral trading system in crisis, following the collapse of the World Trade Organization's Ministerial Conference in Cancún in September 2003, the Cordell Hull Institute convened a series of meetings. The third one, a meeting of the Institute's Trade Policy Roundtable on June 16, 2004, addressed the need to "Pause for Reflection on the WTO System".

The meeting was held at Arnold & Porter, attorneys-at-law in Washington, DC. Pictured above is the well of the firm's building.

The meeting marked the seventieth anniversary of Cordell Hull's Reciprocal Trade Agreements Act of 1934.

Reproduced here is the paper by **Richard Eglin** (above) on "Time to Clarify the Role of the WTO

**PAUSE FOR REFLECTION…**

## Time to Clarify the Role of the WTO System

**Richard Eglin**

THE Uruguay Round negotiations of 1986-94 were critical in repairing and strengthening multilateral trade relations after they had drifted dangerously off course in the 1970s and 1980s. The results of those negotiations have allowed the World Trade Organization (WTO), created at the end of the round in 1994, to claim a good deal of success during its first decade of operation. But there have been disappointments, too, particularly the failure of WTO member governments to carry forward convincingly the momentum not only of further trade liberalization but also of extending WTO rules to maintain their relevance to international economic integration.[1]

At the fifth WTO Ministerial Conference in Cancún in September 2003, the ministers should have been able to confound the critics of "globalization" and give a ringing endorsement to the role that a well-functioning multilateral trading system plays in helping to maintain the health and vitality of the world economy. Their job was to take the decisions that are necessary to start the concluding stage of the first WTO round, launched in Doha, Qatar, in November 2001.

Instead, Cancún turned into a crisis, not as notorious as the WTO Ministerial Conference in Seattle in December 1999, but more disappointing since on this occasion the damage was largely self-inflicted. After doubts from the outset in Doha about the depth of political commitment to the launch of the new round, a string of missed deadlines to mark progress in the negotiations in Geneva in 2002-2003, and then failure to prepare a usable draft text for ministers to finalize in Cancún, it came as no real surprise when the conference collapsed.

Some commentators found virtue in this defeat. They saw it as a healthy process of bringing the WTO down to earth after it had threatened to stray beyond its Uruguay Round limits into rule-making on foreign investment and the like. Quite why that threat

System" that was presented at the meeting.

**About the Author**

Richard Eglin has been the director of the Trade and Finance Division at the World Trade Organization, Geneva, since 1998. Earlier, he headed the Development Division; and earlier still, the Trade and Environment Division (1991-96) when the Committee on Trade and Environment was first established.

After obtaining his PhD from the University of Cambridge, in England, he was on the staff of the International Monetary Fund in Washington, DC, for five years before moving to the Economic Research and Analysis Division at the GATT Secretariat, Geneva, in 1985.

**About the Meeting**

After the WTO Ministerial Conference in Cancún came to grief, the Doha Round negotiations were seen worldwide to be in deep trouble, struggling with apparently intractable issues in an atmosphere of division and distrust, unable to get any traction.

When the negotiators back in Geneva still couldn't find a basis on which to re-engage, many asked whether the negotiations were salvageable or, if that was too soon to determine, whether it wasn't time to reflect on what the negotiations and the WTO system itself were trying to achieve.

Restoring the momentum of trade liberalization in the world economy is critical – following the Iraq crisis – to strengthening multilateral cooperation in general and, more

should be taken so seriously is not obvious, when international investment and trade are clearly linked and when both are now routinely covered in economic integration agreements at the regional level. With bilateral investment treaties also proliferating (more than 2,000 and counting), it seems only a matter of time before logic dictates that investment should be covered at the multilateral level in the WTO system – the same logic that led governments almost sixty years ago to consolidate their bilateral and regional trade relations in the multilateral trading system under the General Agreement on Tariffs and Trade (GATT).

## Loss of Direction in the WTO System

If the solution in Cancún had been as simple as unloading the "Singapore issues" from the agenda,[2] the way should now be clear for progress on the rest of the Doha Round negotiations, in particular on liberalizing market access which lies at the heart of the negotiations. Is it, indeed, a case of "fix agriculture and the rest will fall into place" or are there other explanations for lack of progress? The signals are still very mixed.

One can point to a lack of political oxygen for trade negotiations when security issues dominate the international agenda, to a range of domestic concerns such as "outsourcing" and job security, food safety, environmental and social standards and, even, to the influence of anti-globalization activists.

No doubt all of these have made the trade negotiator's job more difficult. Yet most of them are not new. It is hard to credit them with having been enough to knock the WTO – the flagship of multilateral cooperation and economic globalization in 1995 – so profoundly off course that governments were unable to put together a successful ministerial conference from which the multilateral trading system could have emerged with its reputation enhanced and its mandate strengthened.

There are signs that failure to make progress in the Doha Round negotiations is symptomatic of more deep-seated problems of loss of direction in multilateral trade policy. Governments seem unable to decide whether to place their confidence in non-discrimination and multilateralism or to press ahead instead with selective bilateral and regional deals. They also seem unable to build on their decision to launch the WTO round in Doha by spelling out what a fair, reciprocal bargain from the negotiations might look like; and they are unable to agree on whether to go further in binding their trade-related economic policies under WTO rules or, for that matter, even stick to commitments they have already made.

The sense of loss of direction has shown up recently in proposals that have been made by some member governments – at authoritatively senior levels – to try to unblock the Doha Round negotiations. They have proposed launching plurilateral negotia-

particularly, in the WTO system.

At the core of the WTO struggle are two major issues that have got harder and harder to resolve as, over the course of half a century, the major trading powers have brushed them aside as "too difficult".

• One is the liberalization of trade in temperate-zone agricultural products, important to low-cost producers not only in developing countries but also in Oceania, North America and even parts of Europe.

• The other is the liberalization of trade in labor-intensive manufactures, such as textiles and clothing, footwear, furniture and earthenware, items that developing countries produce in quantity as they industrialize and begin to export to earn the foreign exchange they need to import and grow.

Resolving the impasse in the WTO system is not only a matter of sorting out the modalities for negotiations on the different items on the Doha Round agenda. The sources of tension and suspicion run deep and, to be understood, they have to be put in historical context and clarified in a longer-term perspective.

**Other Speakers**

The roundtable meeting was attended by 55 trade policy specialists, mostly from the Washington DC area.

Besides Dr Eglin, other speakers at the meeting were **Ernesto Zedillo**, the former President of Mexico and now director of the Yale Center for the Study of Globalization, New

tions on the Singapore issues, relieving low-income developing countries (one-third of the WTO membership) of involvement in reciprocal liberalization or binding policy commitments and, from a different perspective, restricting MFN tariff liberalization so as to preserve margins of preference in favor of developing countries.[3] It is hard to reconcile proposals such as these with the core principles of the multilateral trading system.

This is not the first time that governments have struggled to mix principle with pragmatism in an effort to advance a trade negotiation. The Uruguay Round negotiations of 1986-94 had their share of pragmatism – the "peace clause", for example – although that could be viewed charitably as unfortunate slippage from what otherwise was an ambitious and principled result of the negotiations.

The current situation brings to mind a more worrying comparison with the Tokyo Round negotiations of 1973-79 and their aftermath. Then, loss of confidence in the multilateral trading system saw it fragment into plurilateral agreements on the new trade issues of that time – liberalization came to a halt, unadopted GATT dispute panel reports accumulated and quantitative restrictions and "grey area" measures proliferated. Pragmatism overwhelmed principle and pushed the GATT system towards irrelevance, to the point where, in the early 1980s, at least one-third of world trade was bypassing core GATT rules.[4]

This is not to suggest that history will repeat itself, but rather that going back to basics should be part of putting the Doha Round negotiations and the WTO system back on track. A new, broad-based political consensus on the purpose of multilateral trade policy is needed, embracing all WTO member countries and their domestic constituencies.

## Role of the Multilateral Trading System

The role of the multilateral trading system is to expand the production and trade of goods and services and allow countries to convert comparative advantage more readily and more fully into concrete economic gains. It does that by providing a legal and institutional framework that serves two purposes. One is to liberalize trade through periodic rounds of multilateral trade negotiations. The other is to lock-in the results under legally binding rules so that commerce can take place at the international level on the same secure, contractual basis as it does nationally.

Transparent, stable, predictable and progressively more liberal trade policies reduce the risk of, and obstacles to, doing business internationally and create more long-term, profitable, trade and investment opportunities worldwide. That generates economic growth, creates jobs, reduces prices – in short, it increases

Haven, CT; **Harald Malmgren**, chairman of Malmgren O'Donnell Ltd, financial advisers, London and Washington, DC; **Kenneth W. Dam**, of the University of Chicago, a former U.S. Deputy Secretary of the Treasury and earlier U.S. Deputy Secretary of State; **John M. Weekes**, former Canadian ambassador to the WTO and now senior policy adviser at Sidley Austin Brown & Wood, attorneys-at-law, Geneva; and **Ann Tutwiler**, president of the International Food & Agricultural Trade Policy Council, Washington, DC.

Others who spoke were: **Roberto Abdenur**, the Brazilian ambassador to the United States; **Anders Ahnlid**, minister at the Royal Swedish Embassy, Washington, DC; **Jagdish Bhagwati**, professor of economics at Columbia University, New York, NY; **Jean-Francois Boittin**, minister at the French Embassy, Washington, DC; **Hugh Corbet**, president of the Cordell Hull Institute; **Gary N. Horlick**, a partner at Wilmer Cutler Pickering Hale & Dorr, attorneys-at-law, Washington, DC; **Sidney Weintraub**, of the Center for Strategic and International Studies, Washington, DC; and **David Woolner**, executive director of the Franklin & Eleanor Roosevelt Institute, Hyde Park, NY. The meeting was chaired by **William D. Rogers**, vice chairman of Kissinger Associates, international consultants, New York, who recently retired as senior partner at Arnold & Porter, and **Lord Parkinson**, former British secretary of state for trade and industry.

prosperity in rich and poor countries alike. It is hard to find any other field of economic policy cooperation that offers such promise.

These days the political role and value of the trading system is referred to less often, but it was very much in the minds of the original architects sixty years ago. The "peace dividend" of the trading system was an unwavering conviction of Cordell Hull who, as the U.S. Secretary of State in 1933-44, inspired the thinking that after World War II lead to the establishment of the multilateral trading system:

> "Unhampered trade dovetailed with peace; high tariffs, high trade barriers and unfair economic competition with war... I reasoned that, if we could get a freer flow of trade – freer in the sense of fewer discriminations and obstructions – so that one country would not be deadly jealous of another and the living standards of all countries might rise, thereby eliminating the economic dissatisfaction that breeds war, we might have a reasonable chance of lasting peace".[5]

Cordell Hull's conviction is just as relevant today. With $9 trillion of trade at stake collectively, the system increases international solidarity and provides an enduring reason to remain on friendly terms with one's neighbors. Friendship is the best possible basis from which to exert moral influence and build mutual respect. Also, the resources it generates allow governments to broaden their range of policy options and tackle new political challenges, such as reducing poverty, raising social and humanitarian standards and protecting the natural environment. Obstructing the functioning of the trading system in any significant way would mean closing off opportunities to realize other shared policy objectives in a cooperative spirit.

### Evolution of the GATT System

Although the multilateral trading system is based on the theory of free trade, it did not start out with a deeply *laissez faire* objective. The GATT focused almost exclusively on tariffs and non-tariff barriers applied at the border. It did not stipulate what economic or regulatory system governments had to apply domestically, although state-trading was treated suspiciously and the few centrally-planned economies that were admitted as members were subject to special obligations to guarantee and increase their market access. Of the GATT's two principles of non-discrimination, most-favored-nation (MFN) treatment was paramount, for it guaranteed non-discrimination at the border. National treatment served primarily to ensure that the liberalization of border measures was not nullified by overt discrimination against imported products once they had crossed the border and entered the domestic market.

This started to change in the Kennedy Round negotiations of 1964-67, when the trade-distorting effects of domestic subsidies were

addressed for the first time. The GATT moved further into dealing with inside-the-border measures in the Tokyo Round negotiations with agreements on government procurement and on technical barriers to trade – areas of domestic regulation that could be used to favor domestic suppliers and to restrict competition from abroad. In the process, the objective of the GATT system began to expand, from increasing cross-border market access to increasing the contestability of the domestic market for foreign products and foreign producers.

The Uruguay Round negotiations took this evolution a large step further forward, particularly in the General Agreement on Trade in Services (GATS) and the agreements on trade-related investment measures, trade-related aspects of intellectual property rights (TRIPS) and sanitary and phyto-sanitary measures. In these areas, domestic regulation can produce far more important constraints to expanding commerce than can border measures. As a result, the non-discrimination principle of national treatment became a key instrument of liberalization in its own right.

The evolution did not happen by accident. Governments were responding to demands from business that they tackle obstacles to much deeper international integration of markets. If the GATS had been negotiated using a traditional GATT blueprint, it would not have gone further than covering the cross-border supply of services ("mode 1") and consequently would have been of limited practical relevance in expanding international trade.

### Clarifying the Role of WTO Rules

The WTO's interest in its member countries having open, market-oriented domestic policies has turned a trade round into a far broader and more intrusive political event than any GATT round. Hence, the concern that is voiced today about the extra-jurisdictional reach of the WTO system; and about it being used to erode national environmental and social standards, or "space" for national development policies.

Where to draw the line between policies that it is legitimate to expect governments to discipline under WTO rules, on the one hand, and policies that should remain sovereign, on the other, is not an academic issue. It produced difficult parliamentary debates when the time came to ratify the results of the Uruguay Round negotiations. It also lay at the heart of the way in which the national-treatment principle was incorporated in the GATS in order to gain consensus support from member governments – as a negotiated concession rather than a rule of general application, as is the case in the GATT, which considerably weakened the effectiveness of the GATS in the process.

Since the Uruguay Round negotiations ended, lines of defense to protect national sovereignty over international trade and invest-

ment policies are being pushed still farther back in regional and bilateral economic integration agreements. They leave little doubt about the direction in which the WTO will eventually have to go if it is to remain as relevant as regionalism is to business interest in expanding commercial activity internationally while the world economy continues to integrate.

For the time being, however, there is no consensus on the issue of "shallow" or "deep" integration at the multilateral level. In the Doha Round negotiations, member countries are pulling in opposite directions – towards deeper integration, on the one hand, through proposals to negotiate on investment and competition policies, for example, and away from it, on the other, through the "implementation" agenda, for example, which aims to claw back flexibility for domestic development policies that was given up in the Uruguay Round agreements.

The result has been an ineffectual process of horse-trading subjects on and off the agenda of the Doha Round negotiations in an effort to get traction. Openly debating this issue in terms of the role that member governments want the WTO to play today is a surer way of moving the trade negotiations forward.

## Principles of the GATT System

Since it was established after World War II, the multilateral trading system has been based on three pillars, namely non-discrimination (unconditional MFN treatment and national treatment), reciprocal trade liberalization and legally binding trade-policy obligations. These are the same pillars on which Cordell Hull based the transformation of U.S. trade policy from its eighteenth- and nineteenth-century origins. They are not the only important principles of the trading system. But the extent to which they are accepted and applied by governments goes a long way to explaining why trade rounds succeed or fail and, moreover, it provides insight into the difficulties that have beset the Doha Round negotiations.

### *Principle of Non-discrimination*

The principle of non-discrimination is central to the economic, legal and administrative benefits that countries derive from the multilateral trading system and from participating in a round of multilateral trade negotiations.

In a market economy, leaving commercial transactions to be concluded on the basis of price competition, without reference to their origin or destination, improves the allocation of resources and generates a larger collective welfare gain. There is no systematic benefit to be had in economic terms from favoring transactions with one particular trading partner over another, or one product or service or foreign investment over another, simply on the grounds of nationality.

As trade restrictions are liberalized, unconditional MFN treatment ensures that the benefits are extended automatically to every member of the trading system. It acts like a multiplier to spread the benefits of liberalization. Non-discrimination also underwrites the process of international economic integration, particularly for countries with less individual commercial or political influence than others, since it guarantees that no one will be picked out and treated unfairly and that all can compete on an equal footing for a share in the gains from trade liberalization. In addition, transaction and administration costs are reduced (e.g., at customs) and there is an economy of rule-making when the same policy measures are applied to all commercial transactions rather than being differentiated by the origin or destination of goods and services to which they apply.

The economic case for basing international trade relations on the principle of non-discrimination is overwhelming, yet even from the outset, when conceptual drafting of the GATT was taking place, it proved to be one of the most difficult for governments to accept in practice. An example was Britain's reluctance to accept Cordell Hull's insistence on the principle of non-discrimination in the 1942 Lend-Lease Agreement during World War II; it struck straight at the heart of the Imperial Preference, which had both political overtones for the future of the Commonwealth and economic ones in terms of Britain losing its advantage of exporting into captive markets so as to unwind the sterling balances that had built up overseas to finance the war effort.

This example illustrates the most common rationale for governments favoring a dose of discrimination. It allows them to try to influence how the benefits of trade liberalization are distributed, although usually at the cost of lower benefits overall than would accrue if the liberalization were to take place on a non-discriminatory basis.

The multilateral trading system is based on the principle of non-discrimination since its objective is to generate for its member countries the largest collective gain from reducing trade restrictions. Its objective is not to determine how the benefits should be distributed among them.

This is one of the WTO system’s most misunderstood features. And it is unfortunate when the misunderstanding is perpetuated by claims that the WTO system or a round of multilateral trade negotiations can produce a specific income-redistribution effect. The collective benefit from reducing trade restrictions is more foreign trade and investment. The extent to which any one country gains from this depends on factors related to its comparative advantage, its economic strengths and market conditions – and, not least, on the extent to which it is prepared to seize the opportunity to liberalize its own trade restrictions.

It is legitimate to target WTO negotiations at producing, for example, the greatest liberalization of trade in "products which are of particular export interest to developing countries". As long, however, as the results of the negotiations are applied on a non-discriminatory basis, it is not possible to predict with any certainty who the eventual beneficiaries might be – one country may prove more competitive than the rest and take the entire market share. It follows that claims that negotiations will generate greater benefits for a particular group of countries than for others should be avoided. Making such claims damages the trading system when expectations are raised and prove eventually to be unfounded.

### *Exceptions to the MFN Principle*

Two exceptions to the principle of unconditional MFN treatment have been institutionalized in the multilateral trading system since the beginning: trade preferences for developing countries and regional trade agreements. Both of them address the issue of how the benefits of trade liberalization are distributed. The extent to which they have affected the multilateral trade agenda has ebbed and flowed in the past sixty years, but their influence is very much in evidence in the context of the Doha Round negotiations.

### *Preferences for Developing Countries*

Trade preferences have long been a core element of the trading system's development provisions. Their justification is to reduce the margin of trade protection for domestic producers in developed country markets and so to increase market-access opportunities for developing-country exporters. To do that, one condition imposed in the 1979 Enabling Clause[6] is that preference schemes should be applied without discrimination to all developing or least-developed countries. This reflects the concern that if the preference schemes discriminate, they end up only shuffling existing market shares around from one group of developing countries to another, rather than increasing the share of imports in domestic consumption in the preference-giving country.

That, though, is very largely what has happened in practice. The value of preference schemes has been undercut over time by exclusive arrangements for certain groups of developing countries, by the graduation of some recipients out of eligibility to receive preferential treatment and by being heavily hedged around with quotas, safeguards and rules of origin, particularly on sensitive products such as agriculture and textiles and clothing in which many developing countries have a natural comparative advantage. Their value has also been undercut more recently by the spread of regional trade agreements.

Recent analysis suggests that the practical trade benefits of preferences for most developing countries have been overrated.[7] Even those which have taken the greatest advantage of preferen-

ces have suffered collateral economic damage domestically by locking-in the allocation of their resources to the preferences rather than exploiting the comparative advantage they would have in an undistorted market environment.

Nonetheless, the offer of increased trade preferences has been used on several occasions to entice developing countries to join a consensus to launch or conclude a trade-negotiating round. The Doha Round negotiations were no exception in this respect. Agreement to grant a WTO waiver for the European Union's latest preferential arrangement with developing countries in Africa, the Caribbean and the Pacific (the Cotonou Agreement) was clearly instrumental in achieving the support of those countries for a consensus to launch the negotiations.

Since then, however, the prospect of an erosion of preference through the reduction of MFN tariffs in the Doha Round negotiations has had a chilling effect on the participation of low-income (and some not so low income) developing countries. This led some of them to propose shaping the results of the market-access negotiations on agricultural and industrial products in such a way that they cause the least preference erosion possible. Doing so would significantly undermine the level of ambition in both of these areas, to the detriment of all other WTO member countries, and of the prospects for the low-income countries themselves to break out of the preference trap and expand exports in areas in which they have a genuine comparative advantage.

It is not yet clear how a solution to the problem of preference erosion can be found in the Doha Round negotiations. Proposals to deal with it outside the WTO system by providing financial compensation for preference erosion have not proved persuasive for the time being, not even the prospect of substantial additional financing from the International Monetary Fund (IMF) through its new policy (the "trade integration mechanism") to help cover temporary balance-of-payments costs of adjusting *inter alia* to preference erosion.

One lesson to be learned is that tampering with the principle of non-discrimination to try to use the WTO system to distribute benefits to particular member countries can only succeed temporarily, if at all, and it comes at a cost. It is not a meaningful substitute over the long run for working to reduce trade restrictions on a non-discriminatory basis.

### *Regional Trade Agreements*

The "building block or stumbling block" debate about the relationship of regional trade agreements to the WTO system and to advancing the multilateral policy agenda is familiar.[8] Casual observation would suggest that those favoring the building-block argument still have some persuading to do. The least that can be

said about the current proliferation of regional initiatives is that they are sucking oxygen away from the Doha Round negotiations. The prospect of all the current regional initiatives succeeding while the multilateral negotiations stumble to a weak conclusion would leave the WTO system's relevance to economic integration lagging far behind and most of its smaller and weaker member countries floundering in a sea of discriminatory arrangements to which they do not belong.

"Open" regionalism would considerably change the picture, through applying the results of liberalization and economic integration at the regional level to all WTO member countries on an unconditional MFN basis. Although that prospect has been considered at times, in the context of integration in the Asia-Pacific region for example, it has not so far been applied in practice.

Trade ministers have been long on statements foreseeing a harmonious relationship between regional agreements and the multilateral system, but short on facts to support their conviction. They have never succeeded in undertaking a serious examination of the consistency of regional agreements with WTO rules, despite (or perhaps because of) the fact that most agreements seem designed to ensure that liberalization of agricultural trade is blocked as conclusively at the regional level as it is multilaterally.

In the meantime, the expanding network of regional agreements builds up resistance to multilateral trade liberalization by giving the countries involved a stake in holding on to their regional privileges – the same problem, in the end, as developing countries resisting the erosion of their development preferences from MFN liberalization.

On paper, the Uruguay Round negotiations succeeded in strengthening the disciplines governing regional agreements to a certain extent. They produced an understanding on Article XXIV disciplines and launched a work program on the harmonization of rules of origin. But neither of these initiatives has proved effective in practice. WTO member countries are now making another attempt to resolve the issue in the Doha Round negotiations, but with a limited level of ambition, focusing primarily on the issue of transparency.

The multilateral trading system cannot move confidently ahead until its relationship to regional trade agreements is clarified. By and large, however, trade-negotiating rounds are not well-suited to addressing systemic issues. Since significant commercial interests are involved in regional agreements, they tend to be treated in a defensive way by those involved in them – and today that means practically all WTO members – to try to justify trade diversion rather than to exploit trade creation.

There has been little appetite for negotiating away their more trade-restricting and trade-distorting features at the multilateral

level. The systemic consideration of how regional agreements do, and ideally should, relate to the multilateral trading system then falls foul of negotiating trade-offs involved in other parts of the round. The result is at best weak, as in the Uruguay Round negotiations. At worst, it can lead to a collective whitewash through some sort of "grandfather clause" that leaves all existing regional agreements intact and untouchable, equivalent to burying the problem of trade discrimination alive instead of driving a stake through its heart.

**Principle of Reciprocity**

In a May 2004 speech in Geneva, Anne Krueger, then Acting Managing Director of the IMF, chided the free trade skeptics for indulging in "willful ignorance".[9] She pointed to overwhelming empirical evidence that countries that have liberalized their trade policies have grown faster, and increased their living standards much more, than those which have not. Dr Krueger is right, of course, but no matter how persuasive is the economic argument that it is in a country's own best interests to liberalize its international trade policies autonomously, governments are political, not economic, bodies and when left to their own instincts they generally respond more readily to sectoral interests that seek trade protection than to the principle of free trade.

Liberalizing trade multilaterally through exchanging market-access "concessions" reciprocally with trading partners is both easier and more rewarding than doing it alone. Although it is mercantilist in spirit, reciprocity has worked time and again to help both launch and conclude rounds of multilateral trade negotiations successfully. It helps to counter-balance the influence of protectionist pressure groups by giving exporters a stake in the process and politicians an ally when it comes to passing trade-liberalizing legislation. With no modern-day Richard Cobden to help repeal the European Union's common agricultural policy, the U.S. Farm Bill or Japan's rice ban, reciprocal bargaining provides a good alternative.

Reciprocal bargaining was effective in liberalizing trade in manufactured products of export interest to industrialized countries through successive GATT rounds. It was decidedly less effective in liberalizing industrialized countries' trade restrictions on products of export interest to agricultural-exporting and developing countries. Trade restricting and distorting agricultural policies – above all domestic and export subsidies – were more or less excluded from GATT rounds by the majors from the outset in order to protect their farmers; and textiles and clothing were taken out of the bargaining process through informal market-sharing agreements in 1960 and 1962 that were later extended and consolidated under the Multi-fiber Arrangement.

That state of affairs helped to discourage developing countries – few of whom qualified in any case under the GATT's "principal

supplier" rule for reciprocal bargaining[10] – from actively trying to influence the outcome of negotiations by offering to liberalize their own trade restrictions, preferring instead to wait for the results among the majors to be applied on an MFN basis. They did receive improved market access from this bargain, although often not in those areas of trade in which they are the most competitive. Meanwhile, their own import barriers remained high; and their aversion to bargaining them down was formalized in Part IV of the GATT in 1965 through the special-and-differential treatment (S&D) provision of "non-reciprocity".

The experience of both industrialized and developing countries over the past sixty years points to the fact that reciprocity does not work automatically. If it is not backed up by a clear commitment to push through domestic trade liberalization and trade-policy reform by influential players – whether individuals such as the United States, blocs such as the European Union or coalitions such as the Group of 20 – no amount of reciprocal export market-access concessions will be enough to tip the balance against entrenched protectionist interests. This goes a long way to explain, for example, the success of the Kennedy Round negotiations in the 1960s and the failure of the Tokyo Round negotiations in the 1970s.

In the Uruguay Round negotiations, reciprocity was used to great effect, not only to negotiate the reduction of border protection but also to help tie together trade liberalization, rule-making and the coverage of the new issues of services and TRIPS into a "single undertaking". In the United States and the European Union, support for the round from services exporters and the pharmaceutical and entertainment industries helped break down resistance to traditional GATT trade liberalization from their farm lobbies and textiles and clothing producers.

Developing countries accepted to liberalize and bind their tariffs, most of them for the first time in a round of multilateral trade negotiations.[11] An important reason behind the success of the Uruguay Round negotiations in this respect was that the main developing-country caucus at that time – the newly industrializing economies (NIEs) – had persuaded themselves of the need to liberalize their own trade policies after experiments with import-substituting industrialization policies had run out of steam. They calculated that, through reciprocal bargaining in the multilateral trade negotiations, they stood to make important commercial gains from trade liberalization and trade-policy reforms by industrialized countries. In exchange, they bought into the overall Uruguay Round package.

The prospects for the success of a reciprocal bargain from the Doha Round negotiations are still hard to foresee, some years after they were launched. The attempt in the original Doha Round mandate to reproduce the Uruguay Round's single-undertaking

formula and generate reciprocal trade-offs between market access, rule-making and new issues did not take root. It seems clear, therefore, that reciprocal bargaining is going to have to play out very largely in terms of traditional market-access negotiations.

The majors – both industrialized and developing countries – have not yet made an unambiguous commitment that they are prepared to place the liberalization and reform of their domestic trade policies on the negotiating table. With a few exceptions, most of their political declarations have seemed to highlight what is not on the table, rather than what is, with the result that no one seems convinced that the overall stakes add up to enough to justify launching a political effort domestically to press for trade-policy reform. Until the major agricultural protectionists, in particular, are willing to break this chicken-and-egg cycle, the scope for serious reciprocal bargaining on market access is unlikely to come into focus.

One difficulty has arisen already, however. The low-income developing countries, who are proving to be an influential caucus in the Doha Round negotiations, seem to see little advantage in reciprocal bargaining because most of them already have highly liberal access to markets for their exports through various preference schemes. Preferences – both development and regional – weaken the prospects for an ambitious reciprocal deal on liberalization at the multilateral level. This points to the importance of respect for the principle of non-discrimination in the multilateral trading system if the principle of reciprocity is to work effectively – the two are linked.

Has reciprocity outlived its usefulness for those developing countries that benefit most heavily from trade preferences? Not necessarily, since there are still big market-access gains to be had from liberalizing South-South trade, where few preferences apply. One result of developing countries standing back from reciprocal bargaining in previous GATT rounds, and of the effects of certain regional trade agreements, is that on average developing-country tariffs are higher on imports from other developing countries than on imports from industrialized countries. That, with tariff peaks and tariff escalation in industrialized countries, still offers a basis for meaningful reciprocal bargains to be reached. Rather than pleading the case of non-reciprocity, or accepting offers of having "the round for free", these countries can derive value from playing the reciprocity card in the negotiations and provide their politicians with leverage domestically to liberalize their own trade policies.

**Rule of Law**

The rule of law, with impartial courts upholding private property rights and contracts, is critical to the functioning of market economies. The binding nature of the multilateral trading system's policy obligations makes the process of trade liberalization and

trade-policy reform permanent and prevents it from rolling backwards. For the private sector, this is what produces the system's essential value of reducing risk. Preventing governments from unpredictably changing their economic policies in ways that restrict and distort markets helps to lower the commercial risk of doing business and, other things being equal, encourages more international trade and foreign investment to take place.

The rule of law was the third pillar of Cordell Hull's conception of the post-World War II trading system – the creation of treaty-bound, international rules for the conduct of trade policy that would be incorporated in the national laws of all member countries. His aim was to establish effective legislative control of trade policy-making powers delegated to the executive branch of the U.S. government – to reduce the temptation for the executive to cave in to protectionist interest groups so as to make trade policy and trade liberalization more stable, commercially and politically.

The GATT fell short of that conception. Its protocol of provisional application only required compliance with its provisions to the extent that they were not inconsistent with domestic law. Nonetheless, the system worked remarkably well until the 1970s, although due more to political commitment on the part of the major powers, particularly the United States, than to the effectiveness of legal enforcement of the trade rules through the GATT dispute-settlement mechanism. The consensus rule for the adoption of reports of GATT dispute-settlement panels ensured that, whatever legal judgment was handed down, they could easily be rejected by the losing party.

In the late 1970s and early 1980s, however, the political commitment to the rules-based multilateral trading system was challenged and found wanting as the United States and the European Union looked for culprits abroad for their domestic problems of "stagflation" and internal/external macro-economic imbalance. The costs of discrediting the dispute-settlement process by blocking panel reports or failing to implement their findings then became apparent for the GATT membership as a whole.

### *Strengthening Policy Discipline*

Governments agreed to fix this problem during the Uruguay Round negotiations. The WTO requires each member country to "ensure the conformity of its laws, regulations and administrative procedures with its [WTO] obligations"; and its dispute-settlement mechanism enforces this treaty obligation on the basis of the reformulated reverse-consensus rule for adopting the results of dispute settlement.

Confirming member governments' commitment to the rule of law has been the most valuable accomplishment of the WTO over the past ten years. Notwithstanding a few notorious instances where

the trans-Atlantic relationship has stumbled, as over bananas, the trade rules and dispute-settlement results have been widely respected by WTO members, at times in the face of considerable domestic political pressure to flout them. This though is an area in which continued vigilance is called for. The threat of protectionism remains a danger for the global economy and any serious outbreak is quite capable of pushing the WTO system beyond its political limits.

Strengthening the rule of law has improved the way in which governments conduct business in the WTO system. A weakness of the GATT was its over-reliance on consultation and negotiation to solve problems in the absence of a reliable dispute-settlement mechanism to back these up. Some commentators feel that under the WTO the pendulum may have swung too far in the other direction. Litigation has become the instrument of choice to solve problems when they arise, pushing trade diplomacy into the back seat. Member governments have turned to the WTO's dispute-settlement mechanism to liberalize trade, for example, by challenging agricultural trade restrictions in the form of U.S. cotton subsidies, EU sugar export subsidies and the activities of the Canadian Wheat Board.

As long as the Doha Round negotiations continue to drift, this can give the appearance of systemic imbalance between litigation and negotiation. But it correctly reflects the dual purposes of the trading system that were described above – to enforce existing trade rules and market-access commitments, and to strengthen and deepen those rules and commitments over time through periodic rounds of multilateral trade negotiations. The failure to advance in the Doha Round negotiations can hardly be explained away by the success of the WTO's dispute-settlement mechanism, although the prospect of litigation sometime in the future may make governments more reluctant to commit themselves now to additional binding rules.

***Sovereignty and Fairness***

The rule of law in the multilateral trading system is vulnerable to erosion on two particular counts.

> First, the system derives its legitimacy from deliberate steps by states to exercise, as opposed to surrender, national sovereignty in trade policy-making. This implies willingness to separate international trade relations from shifts in other domestic and foreign policy priorities. Mixing the two can be difficult to avoid at times, and can cause resentment when WTO rules stand in the way of meeting other policy priorities.
>
> Second, the contract must be generally accepted as "fair" by all if it is to be effective and if the consensus principle of decision-making is to work in practice. Even a mistaken

belief by a participant, or group of participants, that the contract distributes the costs and benefits unfairly will weaken it and interfere with its proper functioning.

A topical example where both of these factors come together in industrialized countries to create tension over WTO rules is the protection of job security and social standards.[12] Extending the reach of WTO rules to inside-the-border measures, that was noted earlier, has been met at times by calls to slow down, or even reverse, the process of deregulation and liberalization that is called for under WTO agreements so as to protect domestic social standards. In addition, low wage rates and weak labor standards in many developing countries create fears of an unfair international "race to the bottom" in search of greater global competitiveness; and they generate political demands in industrialized countries to restrict imports of goods and services (or looked at more parochially to stop the export of jobs) in ways that run afoul of WTO rules. This becomes more worrying still when it develops into pressure to resort to unilateral trade action, the antithesis of multilateral policy cooperation, to try to impose national standards on an international scale.

The claim that the multilateral trading system ignores, and even aggravates, social injustice is probably the most difficult issue that has confronted the WTO since its inception. The 1996 Singapore Ministerial Declaration contained a negotiated response to proposals by the United States and a few European countries that the WTO should play a more direct role in commanding support for core ILO labor standards. At the time, the protagonists claimed success in raising the profile of core labor standards and having them endorsed by the international trade community. Most WTO member countries, who prior to the Singapore Conference had staunchly resisted any mention of the issue in the ministerial declaration, welcomed the result as providing guarantees that if it were ever raised again in the WTO the ensuing debate would have to be confined within narrow parameters that excluded a "social clause" allowing trade sanctions to be used to penalize countries whose enforcement of labor standards is deemed unsatisfactory.

The victory in Singapore was short-lived. At the WTO Ministerial Conference in Seattle in 1999, fresh proposals were tabled by the United States and the European Union to initiate a WTO work program to examine the social dimension of the liberalization and expansion of world trade; and statements by President Clinton at that time managed to dispel any notion of the "social clause" having been laid to rest, playing a part in the collapse of the conference.

Whatever one might think about the intrinsic merits of the trade-and-labor issue, it is understandable that developing countries (and some developed countries, too) oppose its inclusion in multilateral trade negotiations, even if some of them seem

prepared to accept it in agreements reached at the bilateral or regional level. It is not clear, however, that absolute opposition to the WTO having anything to do with the issue is viable. That attitude makes the WTO look unnecessarily defensive, even guilty, and it alienates a political constituency of socially-concerned citizens in industrialized countries, and in some developing countries too, which on many other counts is an influential supporter of the trading system. The risk of doing nothing is that the politics involved may overpower the ability of some governments to defend the WTO principle of the rule of law and to resist resorting to WTO-inconsistent measures, or that the Appellate Body might be encouraged to think too creatively.

***Flexibility for Development***

In developing countries, the threat to the principle of the rule of law is not one of stopping or reversing the process of economic liberalization and deregulation in any major way. Rather, the problem appears to be their growing resistance to further locking in policy change under WTO rules and, also, them questioning whether they were wise to have done so under some of the existing WTO agreements, for example the TRIMs and TRIPS accords. The sense is one of "rules-fatigue" rather than "liberalization-fatigue", although clearly those two overlap to some extent. It has surfaced in two items on the agenda of the Doha Round negotiations – the "implementation" of existing WTO rules by developing countries and provisions allowing them special-and-differential treatment under the rules.

The **mockingbird** is the state bird of Tennessee. Cordell Hull represented a district of Tennessee in the Congress of the United States, and was elected a senator from there, before becoming U.S. Secretary of State (1933-44).

"The mockingbird is known for fighting for the protection of his home – falling, if need be, in its defense. Mockingbirds are not intimidated by animals larger than themselves and have been known to attack eagles"

– Diana Wells, *100 Birds and How They Got*

Flexibility for developing countries under the rules has been considered an important part of the S&D provisions, along with non-reciprocity and trade preferences. Many developing countries took advantage of these provisions in heavy measure during the GATT period. Few of them bound their tariffs in the course of successive GATT rounds; and some ran their trade policy largely on the basis of GATT Article XVIII:B, which allowed them to maintain quantitative import restrictions across-the-board with the avowed purpose of compensating for weakness in their balance-of-payments situation. Part of the *quid pro quo* with industrialized countries at the time was to accept the lack of liberalization of trade in agriculture and in textiles and clothing, a bargain that on balance was surely disadvantageous to developing countries' trade interests.

The Uruguay Round negotiations curtailed this flexibility to a large extent and, in addition, killed off the possibility for developing countries to pick and choose the rules they wished to sign onto, as had happened in the Tokyo Round negotiations. Soon after the WTO's entry into force, however, often in conjunction with the ending of transition periods for developing countries to begin implementing the Uruguay Round agreements, concerns began to be voiced about the "unfairness" of the results for developing

*Their Names* (Chapel Hill, NC: Algonquin, 2002)

***Trade Policy Analyses***

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countries and about the extent to which subjecting their trade policies to binding rules deprived them of the "policy space" needed to pursue their national development programs.[13]

The result was the initiation after the Seattle ministerial meeting in 2000 of the "implementation work program", covering proposals for some Uruguay Round agreements to be renegotiated to introduce more policy flexibility for developing countries and, also, for some other agreements to be renegotiated to curtail the flexibility that they allow the developed countries. Subsequently, this was picked up in the mandate for the Doha Round negotiations, along with an agenda to make S&D provisions more substantively meaningful and legally binding. Although neither of these has so far progressed any further than other parts of the round, they are still regarded by developing countries as core parts of the negotiations.

Whether or not some WTO rules are "unfair" to developing countries' trade interests, or do constrain their "policy space for development", instilling trade-policy discipline is a valuable function of the multilateral trading system for developing countries; and flexibility needs to be constructed to operate alongside it, not as a replacement for it. It can be tempting to see the benefit of the rules-based trading system purely from the point of view of disciplines that are enforced on the policies of other WTO member countries. This is undoubtedly of great importance, but no more so that the complementary benefit of using the trading system to liberalize and discipline domestic trade policies. One central purpose of the system is to provide governments with the advantage of an external, constitutional barrier against pressures to reverse the direction of liberal trade policy-making. They need to be reminded of that and provided with fresh, up-to-date arguments they can use to convey the message of the benefits of open trade to their domestic constituents.

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[1] The paper on which this essay is based was presented at a roundtable meeting, "Pause for Reflection on the WTO System", convened by the Cordell Hull Institute in Washington, DC, on June 16, 2004, to mark the seventieth anniversary of the Reciprocal Trade Agreements Act of 1934.

[2] The Singapore issues are trade facilitation, transparency in government procurement, the relationship between trade and investment and the interaction between trade and competition policy. These were added to the WTO work programme at the first WTO Ministerial Conference held in Singapore in December 1996. At the Ministerial Conference in Doha, Qatar, ministers agreed that negotiations on all four issues should start, subject to their being a consensus two years later in Cancún on the "modalities" for the negotiations.

[3] Most-favored-nation (MFN) tariffs apply unconditionally on a non-discriminatory basis to all WTO member governments.

[4] Industries that had come under the most severe protectionist pressures, apart from agriculture, were electronics, footwear, shipbuilding, steel, textiles and clothing and motor vehicles. For a detailed description, see S.J. Anjaria, Z. Iqbal, L.L. Perez, and W.S. Tseng, *Trade Policy Developments in Industrial Countries*, IMF Occasional Paper No. 5 (Washington DC: International Monetary Fund, 1981).

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[5] Cordell Hull, *The Memoirs of Cordell Hull* (New York: Macmillan Company, 1948).

[6] "Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries", Decision of November 28, 1979, by the GATT Contracting Parties, GATT Document L/4903, GATT Secretariat, Geneva.

[7] Bernard Hoekman *et al*, "Development and More Favourable and Differential Treatment of Developing Countries", mimeograph, World Bank, Washington DC, 2003.

[8] Jagdish Bhagwati and Avind Panagariya, "Preferential Trading Areas and Multilateralism: Strangers, Friends or Foes", in Bhagwati *et al*. (eds), *The Economics of Preferential Trade Agreements* (Washington DC: AEI Press, 1996).

[99] Anne O. Krueger, "Wilful Ignorance: the Struggle to Persuade the Free Trade Sceptics", address at the International Centre for Monetary and Banking Studies, Geneva, on May 18, 2004.

[10] GATT Article XXVIII

[11] Even though developing countries' bound rates were still higher at the end of the Uruguay Round negotiations than those of the industrialized countries (25 percent compared with 4 percent on average across all products), and in most cases were still higher than their own applied tariff rates (13 percent), their tariff cuts were more than twice as deep, in aggregate, as those of the industrialized countries.

[12] Other examples are environmental protection, food safety, animal welfare and cultural identity.

[13] For recent claims about the "unfairness" of trade negotiations and the WTO system for developing countries, see Joseph E. Stiglitz and Andrew Charlton, *An Agenda for the Development Round of Trade Negotiations in the Aftermath of Cancún*, Report by the Initiative for Policy Dialogue (London: Commonwealth Secretariat, 2004).