The Political Economy of the World Trading System

The WTO and Beyond

Second Edition

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LIST OF ABBREVIATIONS

ACP	African, Caribbean and Pacific (Lomé convention)
ACWL	Advisory Centre on WTO Law
AD	antidumping
AMS	aggregate measure of support
APEC	Asian-Pacific Economic Cooperation
ASEAN	Association of South-East Asian Nations
ATC	Agreement on Textiles and Clothing (WTO)
Benelux	Belgium, Netherlands and Luxembourg
BIT	Bilateral Investment Treaty
BOP	balance of payments
BTN	Brussels Tariff Nomenclature
CAP	Common Agricultural Policy (EU)
CCC	Customs Cooperation Council
CCCN	Customs Cooperation Council Nomenclature
CEEC	Central and Eastern European country
CGE	computable general equilibrium (model)
c.i.f.	cost, insurance and freight
CMEA	Council of Mutual Economic Assistance
CRTA	Committee on Regional Trade Agreements (WTO)
CTE	Committee on Trade and the Environment (WTO)
CTH	change in tariff heading
COMECON	see: CMEA
CVD	countervailing duty
DSB	Dispute Settlement Body (WTO)
DSP	dispute settlement procedures (WTO)
DSU	Dispute Settlement Understanding (WTO)
ECE	Economic Commission for Europe (UN)
ECOSOC	Economic and Social Council (UN)
ECJ	European Court of Justice (EU)
EDI	electronic data interchange
EEC	European Economic Community
EFTA	European Free Trade Association
ECSC	European Coal and Steel Community
EU	European Union
FAO	Food and Agricultural Organization (United Nations)
FDI	foreign direct investment
f.o.b.	free on board
FSC	foreign sales corporation (US)

ΓA	free trade area
ΓAA	Free Trade Area of the Americas
ATS	General Agreement on Trade in Services
ATT	General Agreement on Tariffs and Trade
MO	genetically modified organism
PA	Agreement on Government Procurement
DP	gross domestic product
SP	Generalized System of Preferences
TAP	Global Trade and Analysis Project
IS	Harmonized Commodity Description and Coding System
CC	International Chamber of Commerce
CTSD	International Centre for Trade and Sustainable Development
ECC	International Express Carriers Conference
FIA	International Federation of Inspection Agencies
LO	International Labor Office
MF	International Monetary Fund
NR	initial negotiating right
PRs	intellectual property rights
TA	Information Technology Agreement (WTO)
TC	International Trade Centre (UNCTAD and WTO)
TO	International Trade Organization
ISO	International Organization for Standardization
LDC	least-developed country
MAI	Multilateral Agreement on Investment
MEA	Multilateral Environmental Agreement
MENA	Middle East and North Africa
MFA	Multifibre Arrangement
MFN	most-favored-nation
MRA	mutual recognition agreement
MTN	multilateral trade negotiation
NGO	nongovernmental organization
NTB	nontariff barrier
NTM	nontariff measure
NAFTA	North American Free Trade Agreement
NATO	North Atlantic Treaty Organization
OAU	Organization for African Unity
OECD	Organization for Economic Cooperation and Development
OMA	orderly marketing arrangement
OTC	Organization for Trade Cooperation
PPM	Production and processing method
PSI	preshipment inspection

QR	quantitative restriction
R&D	research and development
RCA	revealed comparative advantage
RIA	regional integration agreement
ROO	rules of origin
SADC	Southern African Development Community
SCM	subsidies and countervailing measures
SPS	sanitary and phytosanitary
S&D	special and differential treatment
SDR	Special Drawing Right
SGS	Société Générale de Surveillance
SITC	Standard International Trade Classification
STE	state-trading enterprise
TABD	Trans-Atlantic Business Dialogue
TBT	technical barrier to trade
TMB	Textiles Monitoring Body (WTO)
TPRB	Trade Policies Review Body (WTO)
TPRM	Trade Policies Review Mechanism (WTO)
TRIM	trade-related investment measure
TRIPs	trade-related intellectual property rights
TRQ	tariff rate quota
TRS	technical regulations and standards
UK	United Kingdom
UN	United Nations
UNCITRAL	United Nations Committee on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
USSR	Union of Soviet Socialist Republics
USTR	United States Trade Representative
VER	voluntary export restraint
VIE	voluntary import expansion
WCO	World Customs Organization
WHO	World Health Organization
WIPO	World Intellectual Property Organization
WTO	World Trade Organization
WWF	Worldwide Fund for Nature

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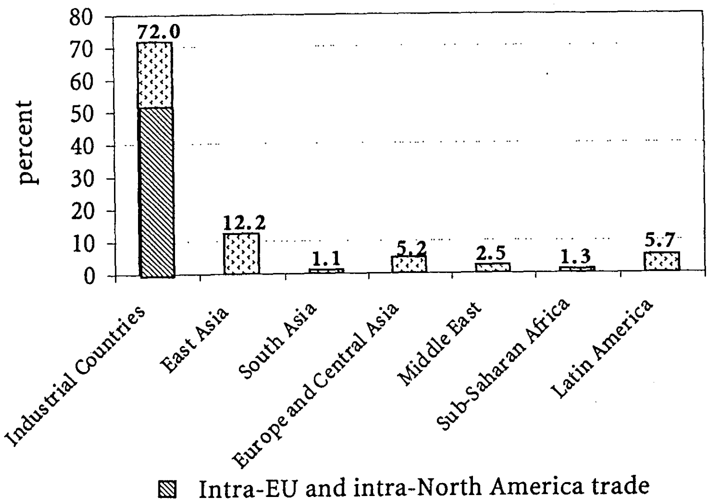
The Trading System in Perspective

Although economic theory suggests that countries should pursue liberal trade policies and exchange goods and services on the basis of their comparative advantage, in practice most nations actively intervene in international trade. Since 1947, the GATT has been the major focal point for industrialized country governments seeking to lower trade barriers. In the process, an ever more complex network of rights and obligations regulating international trade relations emerged. Progress towards liberalization of trade was fitful at times, often involving two steps forward and one step back. None the less, recurring MTNs and the positive demonstration effects of the success of outward-oriented development strategies aimed at integration into the world economy resulted in a steady decline in the average level of protection in most countries. The principles and disciplines of the GATT helped governments to liberalize trade and to resist pressures for protection. This in turn helped foster ever-greater integration of the global economy through trade.

1.1. TRADE AND GLOBAL INTEGRATION

At the beginning of the new century, the value of global trade in goods and services exceeded US$7 trillion (thousand billion). At US$6 trillion, trade in goods accounted for the lion's share of global flows, followed by trade in commercial services, which reached the US$1 trillion mark in 1992, and had grown to US$1.5 trillion in 1999 (WTO, 2000). Data on trade in knowledge, as measured by payments of royalties for use of trademarks, patents, and so forth, is incomplete, but has been estimated to account for at least US$75 billion (Karsenty, 2000).

Global trade flows are dominated by exchanges within and between the three major regions of the global economy (the so-called triad): Europe, North America, and East Asia. Trade flows involving other parts of the globe are relatively small, accounting for some 15 percent of world trade (Figure 1.1). Intra-EU and intra-North America trade accounts for 52 percent of industrial trade (shaded area, Figure 1.1). All 48 least-developed countries together accounted for only 0.5 percent of world trade, reflecting the small size of their economies and very low per capita incomes. Their share has actually fallen over time—it stood at 1.7 percent in 1970. South Asia and Sub-Saharan Africa each represent just over one percent of world trade.

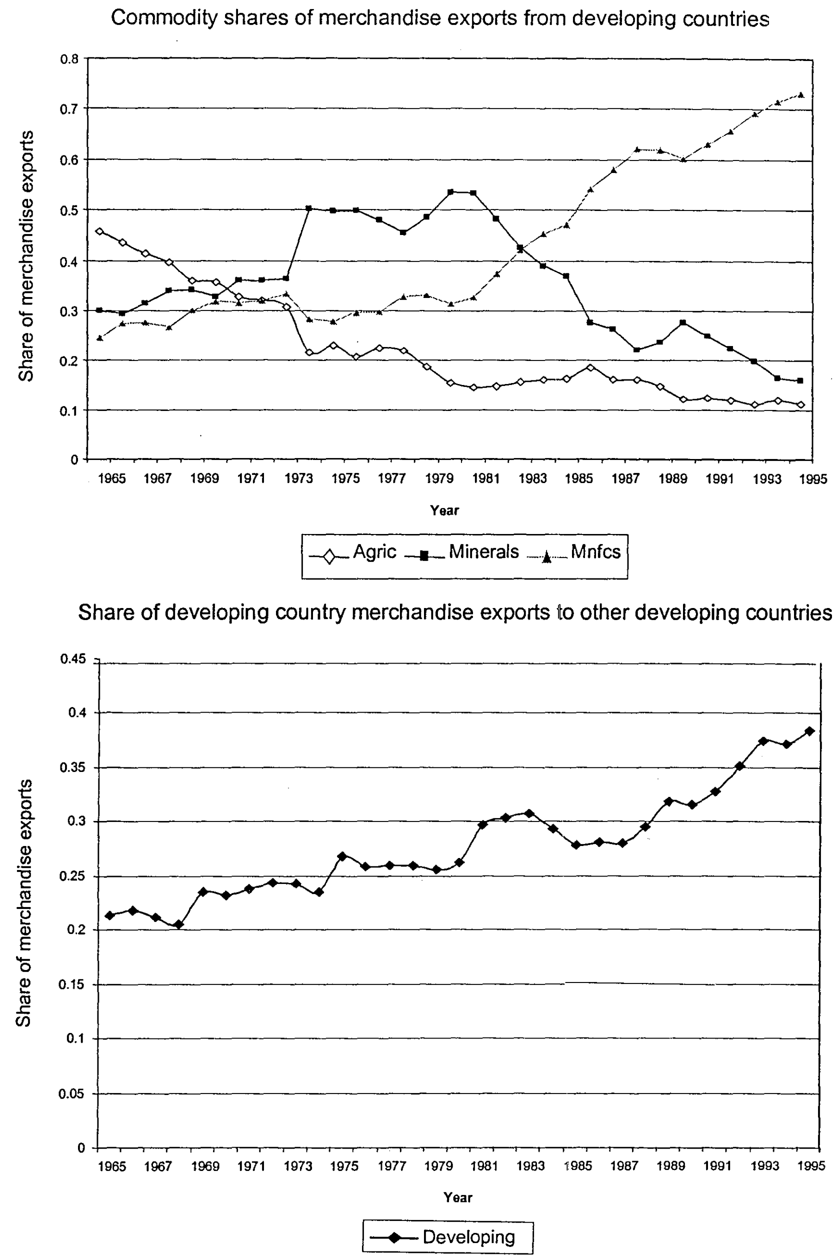


Source: Computed from UN Comtrade database.

FIG. 1.1 Regional shares in world trade, 1998

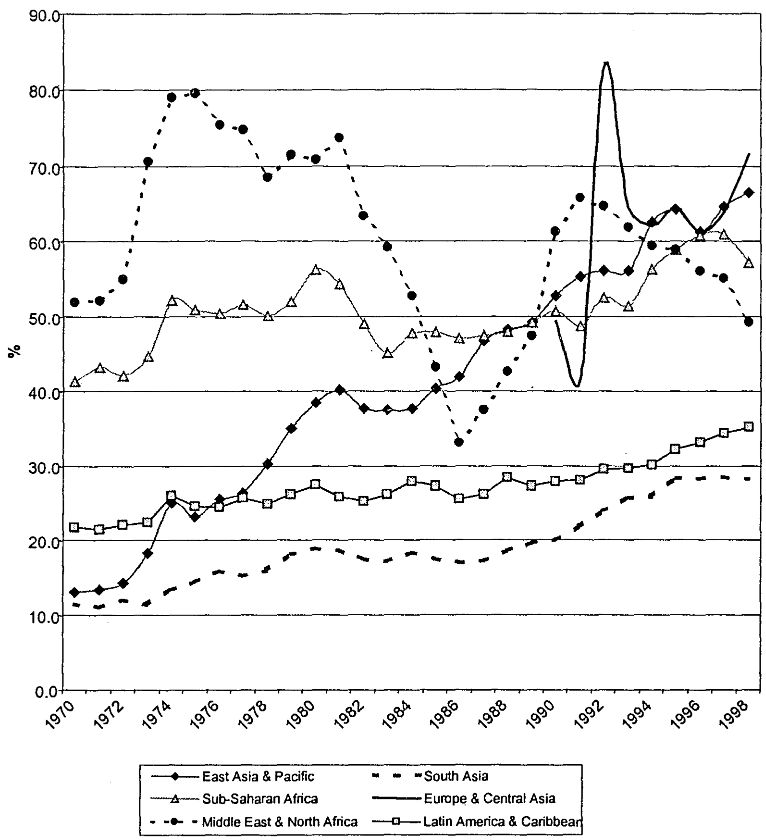
Although the trade shares and trade-output ratios of many of the poorest countries has fallen, in the last thirty years many developing countries have expanded their share of world trade. Developing countries have also shifted increasingly to becoming producers and traders of manufactures. The share of manufactures in total exports of developing countries reached 70 percent in the 1990s and is projected to rise to 80 percent in 2005. Some 40 percent of all developing country exports are destined for other developing countries (Figure 1.2).

Trade to GDP or openness ratios have also expanded rapidly for most developing countries (Figure 1.3), driven by unilateral (autonomous) economic reforms—including liberalization of trade—that were pursued during the 1980s and 1990s. These reforms were often supported by the international financial organizations, in particular the World Bank and the IMF. As discussed later in this book, the GATT played at best a marginal role in this process. Until the conclusion of the Uruguay Round, its impact was largely restricted to inducing OECD countries to reduce trade barriers.



Source: Hertel and Martin (2000).

FIG. 1.2 Developing countries in manufactures

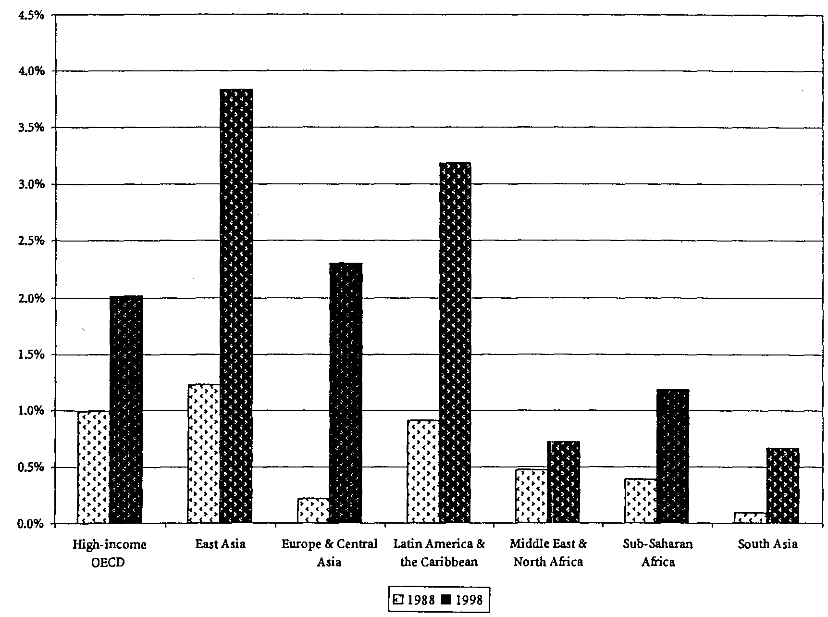


Source: World Bank SIMA database.

FIG. 1.3 Trade openness, 1970–97

A substantial proportion of global trade in manufactures, especially between OECD countries, comprises intra-industry trade—the exchange of similar, differentiated products. Intra-industry trade ratios are frequently above 0.6 for OECD countries, and have risen to similar levels for dynamic developing and transition economies. This is one reflection of the process of globalization, which increasingly involves the fragmentation of production of a good across many different countries.

In 1997, intra-industry trade ratios for Israel, Brazil, Korea, Chinese Taipei and the Czech Republic stood at 0.66, 0.54, 0.61, 0.60, and 0.68, respectively.[1] Much of this trade involves trade in semi-finished goods and components that are processed further after importation and re-exported subsequently. Global outsourcing practices have resulted in increasing fragmentation or splintering of the production process. So-called global production networks have expanded rapidly, in part driven by rapid growth in FDI flows (Figure 1.4). Of the US$6 trillion trade in goods, some 40 percent is intra-firm,



Source: Yeats (1997).

FIG. 1.4 Shares of FDI in GDP by region

involving exchanges between affiliated firms. An estimated 30 percent of global trade in manufactures comprises components (Yeats 1997). The rapid increase in the share of trade in manufactures that consists of components and parts is one striking illustration of the process of globalization of production.

[1] Calculated at the 3-digit SITC level, using the UN Comtrade database and the Grubel-Lloyd definition of intra-industry trade $(1- \Sigma \mid Xi - Mi \mid \; / \; \Sigma (Xi + Mi))$ where X and M are exports and imports of commodity i. This index ranges between 0 (no intra-industry trade) and 1 (all trade is intra-industry).

The factor content of trade has also changed significantly. Just a decade ɪgo, many developing country exports were predominantly natural resource ɪnd unskilled-labor intensive. In East Asia and Latin America, in particular, :he importancė of technology and human capital inputs increased rapidly, vhereas South Asia began to exploit its endowments of unskilled labor and ;hift away from natural resource intensive products (commodities) (Table l.1). The outlier, as is the case for most indicators, is Sub-Saharan Africa.

TABLE 1.1 *Factor intensity of exports, 1988 and 1998*

	Natural Resource		Unskilled Labor		Technology		Human Capital	
	1988	1998	1988	1998	1988	1998	1988	1998
Industrial Countries	22.5	17.9	9.8	9.7	39.4	45.2	28.3	27.1
Developing Countries								
East Asia	27.2	16.8	30.5	24.0	23.8	42.6	18.5	16.6
South Asia	50.2	15.9	35.9	81.2	7.9	2.2	6.1	0.6
Latin America	67.0	42.4	5.8	9.3	13.4	25.4	13.8	22.9
Sub-Saharan Africa	78.3	79.0	6.0	5.9	6.6	7.7	9.1	7.4
E. Europe & C. Asia	38.0	37.6	23.9	18.4	20.2	21.3	17.8	22.7
M. East & N. Africa	80.3	65.6	3.7	8.0	13.1	22.0	2.9	4.3

Source: UN Comtrade and The World Bank.

TABLE 1.2 *The Relative Importance of Imports of Parts and Components*

Regional and Product Group (SITC)	Share of Parts and Components In Product Group Imports (%)	
	1985	1996
East Asia		
General Industrial Machinery (74)	8.7	13.3
Office Machinery (75)	32.5	47.2
Telecommunications (76)	43.0	71.8
Electric Machinery (77)	33.3	25.2
Road Vehicles (78)	25.1	35.6
Other Transport Machinery (79)	8.4	19.3
East Asia (All Products)	19.5	25.1
OECD Europe (All Products)	21.5	23.4
North America (All Products)	23.5	22.9

Note: Totals include listed product groups and Power Generating Equipment (71), Special Industry Machinery (72) Metal Working Machinery (73) and Misc. Manufactures.
Source: Ng and Yeats (1999).

In many respects the East Asian countries took the lead in pursuing trade-driven development strategies. For example, Ng and Yeats (1999) find that

East Asian global exports of components grew at an annual rate of 15 percent during 1984–96, more than four percentage points above the growth rate for all goods, accounting for 25 percent of all exports in 1996 (Table 1.2). Moreover, exports of components to other East Asian markets grew even faster (about 20.9 percent). As a result, the share of all parts and components exports destined for regional markets almost doubled from 25 to 46 percent. (Box 1.1). This illustrates another phenomenon—the increasing pace of regionalization of the world economy. Although potentially incompatible with the process of globalization of production, it reinforces the process if driven by economic forces and regional economies maintain an open policy stance towards trade with the rest of the world.

Box 1.1. Changes in Global Production Sharing

The geographic fragmentation of manufacturing processes has long been a major and evolving process. One of its earlier forms involved the production of primary commodities in developing (and some developed) countries, shipment of these goods to (largely) industrial nations for further processing, and then the re-exportation (in part) of the processed product back to the primary commodity producer or third countries. As an example, tin ores might be mined in Thailand or Malaysia, shipped to Japan for refinement and further manufacture and re-export. In part, these production sharing trade flows were based on comparative advantage, but factors such as escalation of industrial country trade barriers contributed to this exchange pattern.

The magnitude of such traditional production sharing trade has been eclipsed by international exchange of manufactured parts and components. A comparison of the value of East Asian trade in traditional inputs—agricultural raw materials, ores, minerals and nonferrous metals and unprocessed foodstuffs like cocoa and coffee beans—with manufactured components reveals that in 1984, Asian imports of traditional inputs were more than double those of manufactured components. By 1996, component imports were US$67 billion higher. At 20.4 percent, the average annual growth rate for components over this period was about two and one half times greater than that for traditional products. A similar pattern is observed for Asian exports (see Box Table).

Trade Flow and Product	Value (US$bn) 1984	Value (US$bn) 1996	Growth (%) 1984–96
East Asian Imports			
Traditional Production Inputs	39.2	98.9	8.0
Manufactured Components	17.9	165.6	20.4
East Asian Exports			
Traditional Production Inputs	17.0	37.6	6.8
Manufactured Components	33.0	177.8	15.1

Source: Ng and Yeats (1999).

Trade expansion and the growth in production sharing is by no means restricted to East Asia. Processing trade played an important role in the reorientation and expansion of trade between Central and Western Europe (Hoekman and Djankov, 1997). It is also important for a number of Latin American and North African countries. Examples include the Dominican Republic (where processing trade accounts for over 80 percent of all exports), El Salvador (49 percent), and Tunisia (67 percent) (WTO, 2000). This is driven in part by autonomous reforms to facilitate trade, including the creation of export processing zones, and in part by preferential tariff treatment by major partner countries. Available data suggest there is a strong positive correlation between above average export growth and the share of processing trade in total exports.

These are just several dimensions of the multi-faceted process of global integration that has been occurring. Cross-border trade and investment flows have been a major engine of the process—'machines' that allow countries to transform one set of goods and services into another set that they value more highly. The increase in trade openness and cross-border investment is beneficial for world welfare. There is a positive relationship between openness and economic growth. In a widely cited article, Sachs and Warner (1995) conclude that open developing countries grew by an average of 3.5 percentage points faster than a comparator group of closed economies. Ben-David (2001) shows how a significant and sustained rise in post-Second World War European export-output ratios (compared to the prewar period) was associated with a sustained increase in the average growth rate. Sustained economic growth is crucial in reducing poverty. East Asia, the developing region that has relied on trade the most intensively as part of its development strategy, has seen a number of countries catch up with the industrialized nations in terms of per capita income and significantly reduce the number of people living in poverty.

However, not all countries have been successful in integrating into the world economy. Nor is openness a sufficient condition for economic growth. Ben-David and Papell (1998) examine the post-Second World War growth path of 74 countries and conclude that 46 experienced a significant slowdown in economic growth rates during the period, even though openness ratios were rising. Relatively few countries have been able to attain and sustain growth rates that were high enough to result in convergence with the per capita income levels of industrialized nations. Indeed, country groups with the largest income gaps in 1960 have not shown any 'catch-up' convergence. Income gaps between the majority of countries appear to be increasing rather than decreasing. Reasons for this are complex, but one common factor that characterizes incidences of convergence is the intensity (depth) of trade integration. Countries that trade intensively with each other tend to exhibit a relatively high incidence of income convergence (Ben-David, 2001). Of course, there is much more to the story than trade and trade policy, even though a liberal trade and investment regime is a crucial element. Very much depends on complementary policies that define the business environment—investment in human capital (education), infrastructure, and the quality of public and private sector governance. Much also depends on fundamental endowments such as location. Small land-locked countries surrounded by other low-income countries will inherently face much greater challenges than countries that are in close proximity to large industrialized economies.[2]

Although the term globalization is used incessantly, the world economy still is far from being integrated. As of the turn of the century, only 5–6 percent of the labor force in OECD countries was involved in the production of goods for developing country markets. The OECD share of the capital stock in the developing world did not exceed 11 percent, an amount that constituted less than two percent of the capital stock of the rich nations (World Bank, 1999). Truly global industries such as electronics, aerospace or some consumer good branches coexist with a much larger set of industries that retain a regional or purely national character (Dicken 1998). Moreover, the global economy remains characterized by severe restrictions on the international movement of labor. Even within the high-income country group, labor

[2] There is a vigorous academic debate on the relationship between openness and growth. For example, Dani Rodrik, a leading critic of the literature cited earlier, has argued that data and methodological weaknesses do not allow strong conclusions to be drawn (Rodrik, 1997, Rodriguez and Rodrik, 1999). Sceptics agree there is a positive association between openness and growth, but are not convinced the direction of causality is correct–it may also be that growth leads to openness. There is more agreement that a necessary condition for sustained growth is that countries have policies that allow access to technology at world market prices. This includes trade policies that encourage imports of capital equipment and knowledge, as well as establishment of conditions that are conducive to investment.

tends to be less mobile than it was in the nineteenth century.[3] There are few signs that government policies will become significantly more welcoming towards liberalization of the temporary movement of service providers, let alone reduce barriers to labor mobility more generally (Ghosh, 1997). Even abstracting from policy, country-specific business practices and technological factors (such as the need for on-site tailoring of products) continue to favor domestic trade over international transactions. Empirical evidence suggests that international borders have a much more restrictive effect on economic interaction than internal borders separating regions within a country. Among OECD nations the negative impact of international borders is in some cases twenty times higher than for intra-state borders (Helliwell, 1999).

Nevertheless, the process of global integration has progressed rapidly since the 1980s, and can be expected to continue. Science, technology and a growing component of cultural life have become genuinely borderless. Advances in telecommunications and informatics industries and steadily decreasing transportation costs reduce the tyranny of distance. English has become the first second language of the world. Globalization, like any major technological change, gives rise to adjustment costs. The process is exposing serious flaws in national systems of social assistance, environmental protection or tax laws. Interest groups have raised the alarm about negative impacts on the environment, indigenous knowledge, workers rights, national values and local communities. Global integration has cultural and social ramifications as well as economic dimensions, and these must be recognized and managed. On the other hand, there is an enormous opportunity for eliminating poverty, hunger, wars, and economic injustice. Bolstering multilateral cooperation to attenuate negative effects in instances where there are cross-border spillovers and to assist in the realization of the benefits of global integration is a major challenge for governments entering the twenty-first century. International cooperation to maintain open markets is a vital component of any strategy to raise global living standards.

[3] As is the case regarding the link between trade openness and growth, there is also a large literature investigating whether the current level of global integration is comparable to that achieved in the pre-World War One period. Space constraints prevent a discussion of this literature. See Held et al. (1999) for an overview of the debate.

1.2. TRADE AND TRADE AGREEMENTS IN HISTORY

Trade has always played an important role in economic development. The type of trade that occurs has evolved over time as technological and institutional innovations led to a decline in transaction costs. Such innovations include 'hard science' inventions such as the sailing ship, the steam engine, development of railroads, aircraft, container shipping, and refrigeration, as well as 'soft' inventions such as the creation of markets, mechanisms to extend credit to traders, and the development of contracts and procedures to enforce them.

International trade and international trade agreements have often gone hand in hand. From a historical perspective the policy stance preferred by economists—unilateral free trade—has been applied relatively rarely, most notably by Great Britain in the second half of the nineteenth century. Abstracting from instances where discriminatory trade policy was imposed by a dominant (colonial) power, the historical record illustrates that trade agreements between sovereign states have frequently been used to overcome barriers to trade. Even in the case of imperial expansion and the pursuit of formal or informal empires by metropolitan powers, trade agreements sometimes were an important instrument. Examples in the nineteenth century were trade treaties negotiated between Britain and Latin American countries such as Brazil and Argentina (Gallagher and Robinson, 1953). Sometimes trade agreements have been a key element in the process of economic integration of independent territories—a noteworthy example was the German customs union (the Zollverein), which was a key building block of what is now the Federal Republic of Germany.

A characteristic of colonial expansion was the application of metropolitan systems of law and protection of property rights to 'associated' territories—indeed, a defining characteristic of an empire is that control extends beyond foreign to domestic policy (Doyle, 1986). This was a fundamental dimension of the Roman Empire and helped create the preconditions for a single, integrated economy. Piracy was suppressed, roads built, and with sea and land substantially secure, commerce spread throughout the Mediterranean. The pottery, bronze, wine and oil of Italy were exchanged for African grain and eastern spices. Economies of scale led to large productive enterprises scattered throughout what was otherwise an overwhelmingly agricultural world (Gibbon, 1776).

The Iberian, Dutch and English empires of the sixteenth century and thereafter were of a different character in that the depth of integration was less. More important were discriminatory trade policies that sought to monopolize trade or to restrict competition. For example, not able to compete with more efficient, Dutch shipping technology and constituting a less attractive market for some colonial products, seventeenth century England imposed trade restrictions on its colonies. The trade of American colonies was often subjected to exclusivity requirements—through a ban on trade with other states or through mandatory use of metropolitan shipping services—and regulated through restrictions on colonial production. Often, regulations prohibited local processing of goods or production of goods that could compete with output produced by the colonial power (Davies, 1997).

Trade relations between European powers and Asian territories initially tended to be less dictated by the former, reflecting more powerful local states. The latter produced goods (such as spices) that were sought after in European markets, forming a natural basis for trade. Often European traders sought to obtain agreement on (or to impose) extra-territorial application of home country law to commercial transactions and the protection of property rights. Local rulers who sought to limit the impact of a foreign presence on their control of society frequently were willing to accept such extra-territoriality. One form this sometimes took was the establishment of so-called treaty ports. Examples were Macao, Nagasaki, and Goa. These served as an air lock between international commercial relations and the control of civil society more generally:

> From St. Paul's claim of civis Romanus sum against the subordinate patrimonial kingdom of Herod and the steelyard of the Hanse in London to the immunities of European settlers in Alexandria, Tunis, Constantinople and Shanghai, foreign powers have demanded extraterritorial application of their law over their nationals (both natural and legal persons). The outcome has often been the establishment of a regulated treaty port (Doyle, 1986: 202).

Trade cannot prosper without legal security of property rights and mechanisms to enforce contracts. One lesson from international trade relations between states throughout history is that traders will seek to ensure that such mechanisms are applied. This can be achieved through a variety of means—full-fledged integration into a formal empire being the most far-reaching one; and free trade agreements and treaty ports being less far-reaching solutions.[4]

[4] An interesting literature has emerged in the last decade exploring the emergence and maintenance of legal norms in the absence of central authority. A conclusion that emerges from these studies is that the threat of ostracising a member of a club who is reliant on repeated interaction with other members can have a powerful impact as an enforcement device. Government involvement in contract enforcement is not necessarily required. See Benson (1989), Milgrom, North and Weingast (1990), Greif (1993), and Greif, Milgrom and Weingast (1994).

Trade Policy and Trade Agreements

In general, motivations for activist trade policy can be divided into a number of types. First, revenue—governments need income, and taxing trade is often the easiest method of collecting revenue. Taxation of trade for revenue purposes has been a hardy perennial throughout recorded history, and remains important for many developing countries. Of course, those who are subject to the tax have an incentive to lobby for exemptions and invest resources to induce the authorities to lower the tax burden. Taxes imposed by rulers and governments can constitute an important motivation for conquest or the negotiation of tax treaties. Tax policy can have important effects on trade patterns. For example, in the fourth century BC, Rhodes was a key commercial power in the Eastern Mediterranean, controlling the neighboring seas and with a vibrant port. Rhodes charged a two percent tax on the value of cargo carried on all ships entering its harbor, including transit cargo. To divert shipping, Roman traders lobbied for the creation of a free port in Delos. Once established, trade rapidly shifted away from Rhodes, and the port lost most of its harbor tax revenues. This tax competition proved very costly from a social welfare point-of-view: Rhodes used part of its tax proceeds to police the sea-lanes and prevent piracy. Without the revenue, these activities declined, piracy increased significantly, and trade became more costly (Adams, 1993: 83–4).

A second motivation is mercantilist—a belief that imports are bad and exports are good. This belief is generally based on the observation that imports require the transfer of foreign exchange abroad (historically specie—gold or silver), whereas exports bring in foreign exchange. The objective of mercantilist policy is a trade surplus—ensuring that the value of exports exceeds the value of imports. Mercantilism is often driven by nationalism, the perception being that trade surpluses and political power are closely linked. Mercantilist policy therefore tends to favor direct promotion of exports and restrictions on imports through tariffs, quotas, prohibitions, and state monopolies. The policy makes no economic sense. Starting with philosophers and economic thinkers such as David Hume, Adam Smith, John Stuart Mill and David Ricardo, it has been pointed out that imports are desirable and that exports are simply a way to pay for imports. Moreover, a trade surplus will have macroeconomic effects that will act to push the balance of payments into equilibrium.[5] The theory of comparative advantage

[5] The fallacy of mercantilist thought regarding the need for a positive balance of trade inspired David Hume to develop his famous 'price-specie flow' mechanism. This illustrated the point

and free trade was developed largely in reaction to mercantilist thought and practice.

Third, trade barriers frequently have been used as instruments for agricultural and industrial development. This was an important factor in the latter part of the nineteenth century, with France, the United States and Germany protecting infant industries behind high tariff walls. After 1870, continental European powers and the United States pursued activist trade policies, including imposition of tariffs, to protect infant industries. French colonies relied heavily on discriminatory trade policies such as tariff walls against the rest of the world, keeping British goods out of these markets. With France, Germany and the United States becoming increasingly industrialized, British trade dominance was eroded and British goods came to be diverted away from traditional export markets, initially the newly industrializing markets, and subsequently rest-of-the-world colonial territories. As a result, Britain also began to pursue preferential trade regimes and became more reliant on its own territories. Eventually this led to the adoption of a system of imperial preferences.

Finally, trade policy is an instrument to redistribute income. By imposing barriers to trade, some segments of society gain at the expense of other groups. Protectionism can constitute good politics. It is a mechanism through which interest groups that support political parties or candidates can be compensated in relatively non-transparent ways. Groups seeking protection will offer political support to the government (or to challengers in elections) as a quid pro quo.

It is often difficult to distinguish between these motivations for restrictive trade policies. Revenue considerations prevail almost universally—even free-trade Britain imposed significant revenue tariffs. The implication of this is that one cannot necessarily determine from the average tariff or the magnitude of tariff revenue collections how high trade barriers are. What matters is the difference in the extent to which domestic and foreign products are taxed. If this difference is small, a country can be characterized as maintaining a liberal trade policy, even if tariffs are imposed. The connection between mercantilism and infant industry protection is very strong—both have strong nationalistic connotations, and both rest on very weak economic foundations (the economics of infant industry protection is discussed further in chapters 5 and 9).

Formal trade agreements generally are concluded among countries seeking to obtain preferential access to markets. They go beyond establishing the 'rules of the game' in areas such as contract enforcement and the like to address barriers to trade. Trade restrictions have been a perennial feature of international relations throughout history. One of the few exceptions was Great Britain. After the repeal of the Corn Laws (which restricted imports of wheat and other grains) and the conclusion of the Cobden-Chevalier Treaty between Britain and France in 1860 (which greatly reduced tariffs), Britain maintained a free trade stance at home and in the overseas territories it controlled. This free trade policy applied to all sources of supply, not just British goods.[6] Other major powers also liberalized trade. During 1862–7, France concluded a range of commercial treaties with virtually every major trading power in Europe (with the exception of Russia) as well as with the United States. These treaties included a most-favored-nation clause. As in each case the countries involved also negotiated treaties with each other and Great Britain, the trade concessions granted were multilateralized. As of the late 1860s, France was at the center of an impressive network of trade agreements which substantially reduced protectionist trade barriers throughout Europe (Curzon, 1965).

The major exception during this period was the United States, which maintained high tariffs on manufactures to support its industry. Much of this industry was located in the North of the country, which implied that the agricultural sector—concentrated in the South—effectively was obliged to transfer a share of its income to the North as it was forced to pay more for machinery and consumer goods. This is an example of trade diversion that can be associated with the formation of a customs union—see chapter 10 and annex 2. A doubling of average tariffs in 1861 to 47 percent helped set off the civil war: an objective of the South was to escape tariffs through secession from the Union (Adams, 1993: 330).

The nineteenth century was the period during which much of the intellectual debate about free trade emerged. There were two clear camps. Those in favor of free trade included Adam Smith (*The Wealth of Nations*, 1776) and David Ricardo (*On the Principles of Political Economy and Taxation*, 1817). Others argued trade barriers were required to support infant industries. Influential contributions here were Alexander Hamilton's *Report on the Subject of Manufactures* (1791) and Friedrich List's *National System of Political Economy* (1841). The ideas of Smith and Ricardo on the benefits of free trade and the principle of comparative advantage provided the intellectual support for the free trade movement in Europe—both on the European

that trade surpluses and associated inflow of specie would drive up prices and result in a loss of export competitiveness.

[6] British industry helped enforce this free trade stance. For example, when the British government in India attempted to impose a small revenue tariff in 1853-54, the British textile industry ensured that an equivalent excise tax was levied on Indian textiles (Doyle, 1986, p. 264).

continent and in Britain. Writings by Hamilton and List constituted a source of inspiration for those who favored protection of infant manufacturing industry in the United States and Germany, respectively. As is often the case, there was a time lag between the development of the theories and government action inspired by them. The British free trade movement emerged half a century after the publication of Smith's works. US infant industry protectionism materialized a quarter of a century after the publication of Hamilton's Report.

Despite the rise of infant industry protection in the major powers during the latter part of the nineteenth century, the global economy became significantly more integrated. Global trade expanded much faster than global output. After the First World War, however, countries imposed more restrictive trade policies. To some extent this was in response to the United States, which was unwilling to participate in efforts during the 1920s to reestablish a more open global economy following the disruption to trade that had been caused by the war and war-time policies. As the US economy moved from recession to depression following the 1929 stock market crash, the US Congress adopted the infamous Smoot-Hawley Tariff Act, raising average US tariffs on dutiable imports from 38 to 52 percent. This led US trading partners to impose retaliatory trade restrictions and engage in rounds of competitive devaluation of their currencies. A domino effect resulted, as trade flows were diverted to relatively unprotected markets, forcing down prices, giving rise to protectionist pressures there, and thus leading to higher trade barriers.

At the end of the Second World War, decision-makers were deeply influenced by the lessons of the post First World War period. They perceived the need for establishing mechanisms to avoid both competitive devaluation and the excessive use of trade barriers to guarantee the national market to domestic producers (Gardner, 1969). The negative consequences of the beggar-thy-neighbor policies of the early 1930s were still very vivid in 1945. They inspired the US willingness to pursue the type of international cooperation it had spurned in the 1920s and early 1930s and actively support multilateral liberalization efforts, including efforts to negotiate the International Trade Organization (ITO) and the GATT. In the Anglo-American view, the postwar international economic system was to be constructed in such a way as to remove the economic causes of friction which were believed to have been at the origin of the Second World War. An important element in this vision was the establishment of a stable world economy that would provide all trading nations with nondiscriminatory access to markets, supplies and investment opportunities. There was a strong perception that there was a positive correlation between trade and peace, and, as important, between nondiscrimination and good foreign relations (Bailey, 1932).[7] In the US, the Reciprocal Trade Agreements Act of 1934 had already initiated a shift to a more liberal trade policy stance through the adoption of the unconditional MFN principle, albeit firmly grounded in the principle of reciprocity. This policy was extended after the Second World War and incorporated into the draft charter of the ITO and the GATT.

1.3. FUNCTIONS OF THE MULTILATERAL TRADING SYSTEM

Multilateral cooperation among sovereign nations often occurs through the creation of institutions. Because a central authority is absent in international relations, political scientists have developed the concept of a regime, defined as 'sets of implicit or explicit principles, norms, rules, and decision-making procedures around which expectations converge in a given area of international relations' (Krasner, 1983: 2). The principles and procedures imply obligations, even though these are not enforceable through a hierarchical legal system. Regimes reflect patterns of cooperation over time among members that are based on the existence of shared interests. The multilateral trading system is a good example of a regime. Two viewpoints are helpful in understanding the role of the trading system. The first is to regard it as a mechanism for the exchange of trade policy commitments. The second is to view it as a code of conduct.

The System as a Forum for Exchange

The basis of international cooperation is communication and the exchange of information on national policy objectives and allowing for identification of the potential detrimental impact of policies on foreign economies. This is an important function of any international regime, and is a vital aspect of the multilateral trading system (chapter 2). However, the WTO is more than a forum for communication, it is a forum for the exchange of liberalization commitments. That is, it is a market. Bargaining and negotiation are the main instruments used to reduce barriers to trade and agree to rules of be-

7 The academic literature on the relationship between trade and the probability of war has argued that this may go either way. For example, two countries that are on opposing sides of the globe and do not trade at all are less likely to go to war than two neighbouring states that trade a lot. However, Mansfield (1994) has concluded that, controlling for other factors, there is a robust negative relationship between the volume of trade between country pairs and the probability of a war between them.

havior. MTNs are mechanisms to facilitate the reciprocal exchange of market access commitments.

Whether there is an economic rationale for trade restrictions depends largely on the market power of a country. A small country that cannot influence prices on world markets will generally lose from imposing trade barriers, and therefore has much to gain from multilateral agreement to lower trade barriers. Indeed, such countries should pursue liberalization unilaterally. That other countries also reduce barriers is icing on the cake (see Box 1.2). In contrast, large countries may be able to change the terms of trade—the price of their exports relative to the price of imports—in their favor by restricting trade. However, for the world as a whole the imposition of trade restrictions by one or more countries can only reduce welfare. Large countries thus may find themselves in a so-called Prisoners' Dilemma situation: it is in each country's interest to impose restrictions, but the result of such individually rational behavior is inefficient (see chapter 4). All countries end up in a situation where their welfare is lower than if they applied free trade policies.[8] Both small and large countries therefore have an incentive to cooperate and agree to reduce or abolish trade barriers. Trade and trade liberalization is a positive-sum game.

Box 1.2. Why liberalize trade?

The central concept underlying trade is opportunity cost. Producing (consuming) something comes at the cost of not producing (consuming) something else. An important economic theorem states that there are gains from trade associated with minimizing opportunity costs through the division of labor (specialization). Consider a simple example. Suppose the people of Plains, who are good at raising animals (say cows), must also spend time growing wheat (at which they are less good than in raising cows). Each hour spent growing wheat has a high opportunity cost in terms of cows forgone, but there is no choice but to devote the time required to grow wheat. Suppose the people of Agria are good at farming, but do not have much aptitude for raising cows. Agria will then have a high opportunity cost in terms of time not spent farming. If these two countries/groups of people could trade with each other, they could concentrate on what each one does best. Economists say that they would specialize according to their comparative advantage. This will ensure that total output produced expands in both regions,

[8] That is, large countries need to take into account the possibility of retaliation. Another problem is that if tariffs are not set at the optimal level, large countries may easily lose from activist trade policy—even if other countries pursue free trade.

and that each is able to consume more wheat and beef and milk than would be possible without trade.

The decision what to specialize in depends on what one does best compared with the other things that could (or would have to) be done. The people of Plains might be better farmers than those in Agria, in that for every hour invested in farming they get a larger harvest. However, as long as an hour spent by the people in Plains on farming has a higher cost in terms of forgone cows than does an hour spent on farming in Agria, Plains should specialize in cows. What matters is not *absolute*, but *comparative* advantage. International trade provides nations with the opportunity to specialize in production according to their comparative advantage.

This suggests that countries interested in maximizing their wealth should not impose trade barriers. This is certainly the case for small countries that are price-takers on world markets. A practical problem is that there are often political difficulties in liberalizing access to markets, because some people will always lose from liberalization. In principle, such groups can be compensated, as the increase in total output and consumption is always larger than the losses incurred by those who must change the economic activity they are engaged in. Actually compensating the losers is not always easy, however. It is also true that although a country will benefit from liberalizing its trade, it is even better if trading partners do the same. This is one of the primary rationales for engaging in multilateral liberalization efforts and is the raison d'être of the WTO: by making liberalization conditional on greater access to foreign markets, the total gains of liberalization increase and in the process liberalization becomes more feasible politically.

Achieving multilateral trade liberalization is no trivial matter. In all countries there are numerous groups that have different preferences with respect to trade measures. Abstracting from revenue considerations, the structure of protection at any point in time is the result of the interaction between the demands expressed by various groups in society and the supply offered by governments. Attempts to alter this equilibrium and move towards a welfare-increasing reduction in protection will generate opposition by those groups that expect to lose from liberalization. Such losses are usually concentrated in import-competing industries, while the gainers—consumers of the products concerned—tend to be much more diffuse. This gives rise to a political economy problem. Those facing losses have a much greater individual incentive to organize and invest in lobbying against liberalization than those that gain from reform have to lobby for liberalization. Individual gains are relatively small and dispersed among a large number of voters, while losers are more concentrated. This is the main reason why trade restrictions are imposed in the first place.[9] A MTN can solve this problem by confronting those who gain from protection with another lobby that may be equally powerful: the set of firms that benefit from greater access to foreign markets. Similarly, by requiring reciprocal reductions in trade barriers, the prisoners' dilemma that in principle may confront large countries can be overcome, again improving world welfare. Finally, by including many products in the negotiation, losers obtain some automatic compensation through access to cheaper imports.

Trade liberalization helps nations to realize a more efficient utilization of their resources (production capacities). Trade liberalization has two essential effects. First, it brings about a reallocation of resources towards those activities in which the country has comparative advantage. Secondly, trade liberalization expands the consumption opportunities of countries, as more efficient production generates greater income and increased opportunities to buy goods and services from other countries. See annex 2 for an illustration of the standard mechanics of the gains from trade.

A MTN is a market in the sense that countries come together to exchange market access commitments on a reciprocal basis. It is a barter market. In contrast to the markets one finds in city squares, countries do not have access to a medium of exchange: they do not have money with which to buy, and against which to sell, trade policies. Instead they have to exchange apples against oranges: tariff reductions for iron against foreign market access commitments for cloth. This makes the trade policy market less efficient than one where money can be used, and is one of the reasons that MTNs can be a tortuous process.

A Code of Conduct for Trade Policy

One of the results of the market exchange is a code of conduct. The WTO contains a set of specific legal obligations regulating trade policies of member states. These are embodied in the GATT, the GATS, and the agreement on TRIPs. The rules and principles of the WTO constrain the freedom of governments to use specific trade policy instruments. They influence the balance between interest groups seeking protection and those favoring open markets in the domestic political marketplace. Industry associations, labor

[9] In the case of developing countries that do not have a well-developed tax administration, taxing trade flows frequently has an important revenue rationale as well. More generally, most people tend to be nationalistic in their thinking about economic matters. Trade policy is by definition a nationalistic policy in that it discriminates against foreign producers.

unions, regional authorities, consumer lobbies and government agencies all interact in determining the policy outcome. The WTO is somewhat analogous to a mast to which governments can tie themselves to escape the siren-like calls of various pressure groups (Roessler, 1985). It is a mechanism through which the political market failure that is inherent in many societies—both industrialized and developing—can be corrected, at least in part, because reneging on liberalization commitments requires compensation of affected trading partners. This increases both the cost and the visibility of adopting inefficient trade policies to placate domestic interest groups. However, much depends on the will of governments to tie themselves to the mast. WTO rules and disciplines—discussed at length in later chapters—embody many holes and loopholes that governments can invoke if they desire to. Much also depends on whether it makes economic sense to tie oneself to the mast. A necessary condition is that abiding by the rules is in the national interest of members. As discussed subsequently, a number of existing WTO rules do not meet this test.

The WTO embodies a rule-oriented approach to multilateral cooperation. This contrasts with what can be characterized as a results-oriented or managed-trade approach—agreements on trade flows, market share or international prices. The WTO establishes a framework for trade. It does not define or specify outcomes. Five principles are of particular importance in understanding both the pre-1994 GATT and the WTO: (1) nondiscrimination; (2) reciprocity; (3) enforceable commitments; (4) transparency; and (5) safety valves.

Nondiscrimination

The principle of nondiscrimination has two components, the MFN rule and the national treatment principle. Both components are embedded in the main WTO rules on goods, services and intellectual property. However, their precise scope and nature differ across these three areas, especially national treatment (see later chapters). The MFN rule requires that a product made in one member country be treated no less favorably than a 'like' (very similar) good that originates in any other country. Thus, if the best treatment granted a trading partner supplying a specific product is a five percent tariff, then this rate must be applied immediately and unconditionally to the imports of this good originating in all WTO members. Because the initial set of contracting parties to the GATT was quite small (only 23 countries), the benchmark for MFN is the best treatment offered to any country, including countries that may not be a member of the GATT. Similar wording applies under the WTO. Disputes can be brought to the WTO alleging not just *de jure* violation of MFN, but also *de facto* violation.[10]

The national treatment rule is the second component of the nondiscrimination principle. It requires that foreign goods—once they have satisfied whatever border measures are applied—be treated no less favorably than like or directly competitive goods produced domestically in terms of internal (indirect) taxation (Article III:2 GATT). That is, goods of foreign origin circulating in the country should be subject to the same taxes and charges that apply to identical goods of domestic origin. A similar obligation applies to nontax policies (regulations) (Article III:4 GATT). In both cases, the obligation is to provide treatment 'no less favorable'. A government is free to discriminate in favor of foreign products (against domestic goods) if it desires, subject, of course, to the MFN rule—all foreign products must be given the same treatment.

MFN applies unconditionally. It cannot be made conditional on considerations of reciprocity. However, exceptions are made for the formation of free trade areas or customs unions and preferential treatment of developing countries. Upon accession of a new member, an existing member may also invoke the WTO's nonapplication clause (Article XIII). These exceptions to MFN are discussed in subsequent chapters. MFN is a basic pillar of the WTO for a number of reasons. The first is economic. Although trade barriers are inefficient instruments (see annex 2), if policy does not discriminate between foreign suppliers, importers and consumers will continue to have an incentive to source from the lowest-cost foreign supplier. The second is to provide smaller countries with a guarantee that larger countries will not exploit their market power by raising tariffs against them in periods when times are bad and domestic industries are clamoring for protection, or alternatively, give specific countries preferential treatment for foreign policy reasons. MFN helps enforce multilateral rules by raising the costs to a country of defecting from the trade regime to which it committed itself in an earlier MTN. If it desires to raise trade barriers it must apply the changed regime to all WTO members. This raises the political cost of backsliding on trade policy because importers will object. Finally, MFN reduces negotiating costs—once a negotiation has been concluded with a country, the results

10 For example, in a recent case (Canada-US Autopact), a WTO dispute settlement panel was asked to consider whether a measure that limits the benefits of an import duty exemption to a certain class of domestic importers without imposing any restrictions regarding the origin of the imported goods constitutes a *de facto* violation of MFN. The panel and the Appellate Body found against Canada, arguing that the extensive intra-firm trade in automotive products between Canada and the US implied that the Canadian duty exemption scheme was likely to benefit imports from the US.

extend to all. This obviates the need for other countries to initiate discussions to obtain similar treatment. Instead, negotiations can be limited to principal suppliers.

National treatment is a general obligation in the GATT, although not in the GATS (see chapter 7). Its role is to ensure that liberalization commitments are not offset through the imposition of domestic taxes and similar measures. By requiring that foreign products be treated no less favorably than competing domestically produced products, foreign suppliers obtain greater certainty regarding the regulatory environment in which they must operate. The national treatment principle has often been invoked in dispute settlement cases brought to the GATT. It is a very wide-ranging rule. The obligation applies whether or not a specific tariff commitment was made, and covers taxes and other policies: all policies must be applied in a nondiscriminatory fashion to like domestic and foreign products. It is also irrelevant whether a policy hurts an exporter. What matters is discrimination.

Reciprocity

Reciprocity is a fundamental element of MTNs, reflecting a desire to limit the scope for free riding that may arise because of the MFN rule, and the desire to obtain 'payment' for trade liberalization in the form of better access to foreign markets. Thus, trade liberalization occurs on a quid pro quo basis. Reciprocity in trade negotiations comes in many guises. It may be diffuse (Keohane, 1984) or specific. If specific, it may be expressed in quantitative or qualitative terms, and may apply to levels or to changes in protection (Winters, 1987*a*). Although the GATT and the GATS have as underlying goals a broad balance of market-access commitments, MTNs in general and tariff negotiations in particular proceed by agreeing to incremental changes in trade barriers. Convergence in the levels of protection is gradual.

By requiring reciprocity, nations attempt to minimize free riding. In the case of bilateral negotiations, this is done by a suitable choice of products on which concessions are offered and sought; in the case of multilateral across-the-board negotiations, it is done by a suitable choice of products to be exempted from liberalization. Generally, nations are quite successful in minimizing free riding. For example, internalization, defined by Finger (1974, 1979) as the sum of all imports originating in countries with whom a country exchanges concessions as a percentage of total imports of goods on which concessions are made, was about 90 percent for the US in the Dillon (1960–1) and Kennedy (1964–7) Rounds. Allen (1979), focusing explicitly on bilateral bargains made in the Kennedy Round, showed that there was a relationship between the sizes of concessions made on commodity tariffs and the degree of bargaining power a country had on a commodity *vis-à-vis* its major trading partners. Thus, reciprocity is in part a function of the weight a country can bring to bear in a negotiation.

Reciprocity also applies when countries accede to the WTO. Given that new members obtain all the benefits in terms of market access that have resulted from earlier negotiating rounds, existing members invariably demand that potential entrants pay an 'admission fee'. In practice this implies not only that upon joining the WTO a country's trade regime must conform as much as possible with the rules of the GATT, GATS and TRIPs, but that the government will be asked to liberalize access to its market as well. Accession modalities are discussed further in chapter 2.

As noted earlier, a rationale for reciprocity can be found in the political economy literature. Costs of liberalization generally are concentrated in specific industries, which often will be well organized and oppose reductions in protection. Benefits, while in the aggregate usually greater than costs, accrue to a much larger set of agents, who thus do not have a great individual incentive to organize themselves politically. In such a setting, being able to point to reciprocal, sector-specific export gains may help to sell the liberalization politically. By obtaining a reduction in foreign import barriers as a quid pro quo for a reduction in domestic trade restrictions, specific export-oriented domestic interests that will gain from liberalization have an incentive to support it in domestic political markets. A related point is that for a nation to negotiate it is necessary that the gain from doing so be greater than the gain available from unilateral liberalization. By obtaining reciprocal concessions, these gains are ensured (Box 1.3). More generally, reciprocity in trade negotiations can help to offset the externalities that are imposed by countries on each other as they implement trade policies. In effect, by insisting on reciprocity countries may be able to ensure that their terms of trade are not affected detrimentally (Bagwell and Staiger, 1999*a*).

Box 1.3. Why liberalize on a reciprocal basis?

Hillman and Moser (1995) argue that a useful way to understand the role of reciprocity is to start from the premise that import-competing industries have property rights to their home markets, a right that has been acquired as a result of past lobbying or political support granted to governments. In the same way that protection can be explained as the outcome of a political process where governments seek to maximize political support—taking into account the fact that tariffs are often used for revenue purposes and tend to persist after alternative tax bases are developed—reciprocal liberalization can be explained as the outcome of a political process. In this case the interests of the domestic right-holders (the import-competing industries) are balanced with those of domestic export industries seeking equivalent rights in foreign markets (and lower input costs). If the latter group offers enough political support, erosion of the former group's rights may prove politically rational.

Whatever is offered by one country (the demandeur) in a MTN as a quid pro quo for a demand on an issue, must be of interest to the government asked to alter its policies. Thus, to be effective the offer must help meet the objectives of influential foreign lobbies that will then push for the desired change in policy in their country. Alternatively, offers might be designed to help the government compensate groups that are likely to lose significantly from a reduction in protection. Options here include a gradual reduction in the level of protection and acceptance of safeguard mechanisms (see chapter 9).

Although export interests are the primary players in supporting liberalization in the MTN context, other groups favoring liberalization may also play a role. Examples include consumer or economic-development lobbies (the effect of development aid is frequently offset by protection against developing country exports). To mobilize such groups they must be aware of the detrimental impact of trade policies on their objectives, and these impacts must be large enough to induce them to organize. The provision of information on the effects of protectionist policies is therefore of great importance. Indeed, the need for such information is quite independent of the MTN process, as in many instances a unilateral change in policy would be welfare improving. The main point, however, is that what counts is political support. If consumer and other groups favoring a liberal trade policy do not mobilize and exercise political influence, they generally will be irrelevant.

For reciprocity to work it is important that lobbies favoring open markets do not have other means of getting what they want. Finger (1991) has pointed out that large countries increasingly negotiate increased market access for their exporting firms bilaterally. Such bilateral alternatives weaken the power of reciprocity in the multilateral context, as they reduce the incentives for export interests to support liberalization during MTNs. This is also one of the potential downsides of regional integration.

Enforceable Commitments

Liberalization commitments and agreements to abide by certain rules of the game will have little value if they cannot be enforced. The nondiscrimination principle, embodied in Articles I (MFN) and III (national treatment) of the GATT, plays an important role in ensuring that market access commitments are implemented and maintained. Other GATT Articles play a supporting role, including Article II (on Schedules of Concessions). The tariff commitments made by WTO members in a MTN and upon accession are enumerated in schedules (lists) of concessions. These schedules establish so-called ceiling bindings—the member concerned cannot raise tariffs above bound levels without negotiating compensation with the principal suppliers of the products concerned. The MFN rule then ensures that such compensation—usually reductions in other tariffs—extends to all WTO members, raising the cost of reneging. Once tariff commitments are bound, it is important that other, nontariff, measures that have the effect of nullifying or impairing the value of the tariff concession are not used. Hence the importance of GATT Article XI (prohibiting quantitative restrictions on imports and exports) and the rules on subsidies (see chapter 5).

If a country perceives that actions taken by another government have the effect of nullifying or impairing negotiated market access commitments or the disciplines of the WTO, it may bring this to the attention of the government involved and ask that the policy be changed. If satisfaction is not obtained, it may invoke WTO dispute settlement procedures. These involve the establishment of panels of impartial experts who are charged with determining whether a contested measure violates the WTO. Because the WTO is an inter-governmental agreement, private parties do not have legal standing before the WTO's dispute settlement body. Only governments have the right to bring cases. The existence of dispute settlement procedures precludes the use of unilateral retaliation. For small countries in particular, recourse to a multilateral body is vital, as unilateral actions will be ineffective and thus not be credible. More generally, small countries have a great stake in a rule-based international system, as this constrains the likelihood of being confronted with bilateral pressure from large trading powers to change policies that are not to their liking.

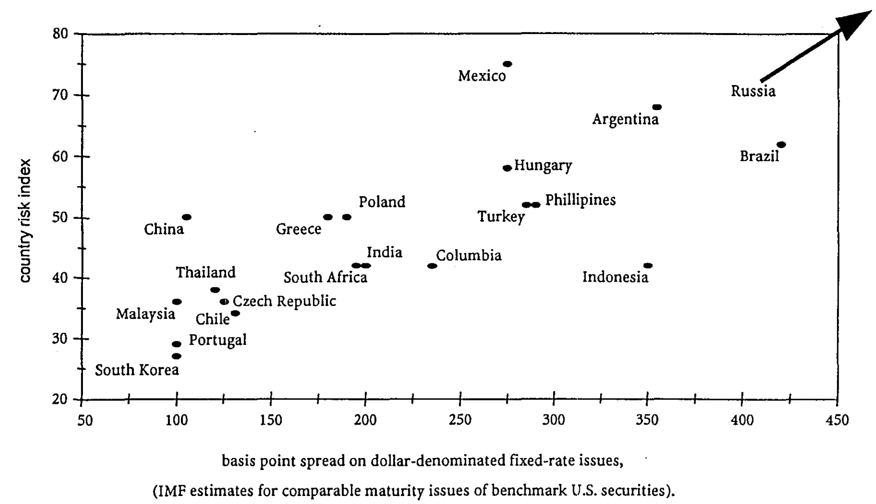
Transparency

Enforcement of commitments requires access to information on the trade regimes that are maintained by members. Numerous mechanisms are therefore incorporated into the agreements administered by the WTO to facilitate communication between WTO members on issues. Numerous specialized committees, working parties, working groups, and Councils meet regularly in Geneva. These interactions allow for the exchange of information and views and permit potential conflicts to be defused in an efficient manner.

WTO members are required to publish their trade regulations, to establish and maintain institutions allowing for the review of administrative decisions affecting trade, to respond to requests for information by other members, and to notify changes in trade policies to the WTO. These internal transparency requirements are supplemented by multilateral surveillance of trade

policies by WTO members, facilitated by periodic country-specific reports (Trade Policy Reviews) that are prepared by the secretariat that are discussed by the WTO Council—the so-called Trade Policy Review Mechanism (see chapter 2). This external surveillance also fosters transparency, both for citizens of the countries concerned and for trading partners. It reduces the scope for countries to circumvent their obligations, thereby reducing uncertainty regarding the prevailing policy stance. Transparency is a basic pillar of the WTO. It is a legal obligation, embedded in Article X GATT and Article III GATS.

Transparency has a number of important benefits. It reduces the pressure on the dispute settlement system, as measures can be discussed in the appropriate WTO body. Frequently such discussions can address perceptions by a member that a specific policy violates the WTO—many potential disputes are defused in informal meetings in Geneva. Transparency is also vital in terms of ensuring 'ownership' of the WTO as an institution—if citizens do not know what the



Source: Francois (1999).

FIG. 1.5 Risk and return in emerging markets, 1994–5

organization does, its legitimacy will be eroded. The Trade Policy Reviews are a unique source of information that can be used by civil society to assess what the implications are of the overall trade policies that are pursued by their government. From an economic perspective, transparency can also help reduce trade-policy related uncertainty. Such uncertainty is associated with lower investment and growth rates and with a shift in resources toward nontradables (Wincoop, 1992; Mendoza, 1997). Countries with policy regimes that are perceived by investors as unstable are generally associated with higher capital costs—investors will demand a risk premium on funds invested in such countries to take into account the probability of losses due to policy reversals. Such premia can be high. Figure 1.5 plots estimates of the basis point spread charged to emerging economies for dollar-denominated fixed rate loans in 1994–5 against country risk indexes compiled by the Economist Intelligence Unit for 1995. Country risk correlates closely with rates of return. The 'safer' a market, the lower the premium. Mechanisms to improve transparency can help lower risk perceptions by reducing uncertainty. WTO membership itself, with associated commitments on trade policies that are subject to binding dispute settlement can also have this effect.

Safety Valves

A final principle embodied in the WTO is that governments should be able to restrict trade in specific circumstances. There are three types of provisions in this connection: articles allowing for the use of trade measures to attain noneconomic objectives, articles aimed at ensuring 'fair competition', and provisions allowing for intervention in trade for economic reasons. The first include provisions allowing for policies to protect public health or national security, and to protect industries that are seriously injured by competition from imports. The underlying idea in the latter case is generally that governments should have the right to step in when competition becomes so vigorous as to injure domestic competitors. Although not explicitly mentioned in the relevant WTO agreement, the underlying rationale for intervention is that such competition causes political and social problems associated with the need for the industry to adjust to changed circumstances. The second type of measures include the right to impose countervailing duties on imports that have been subsidized and antidumping duties on imports that have been dumped—sold at a price that is below that charged in the home market. The objective of 'fair competition' is often in direct conflict with market access, as the instrument used by governments to attain 'fairness' is usually a trade barrier. Such barriers are, however, perfectly legal and permitted as long as they satisfy the criteria laid down in the relevant WTO provisions. Finally, the third type of 'safety valve' allows for actions to be taken if there are serious balance-of-payments difficulties, or if a government desires to support an infant industry.

1.4. FROM GATT TO WTO

GATT was not formally an international organization (that is, a legal entity in its own right), but an inter-governmental treaty. As a result, instead of member states, GATT had contracting parties. This changed with the establishment of the WTO, which is an international organization that administers multilateral agreements pertaining to trade in goods (GATT 1994, as well as numerous issue-specific agreements on antidumping, subsidies, import licensing, and so forth), trade in services (GATS), and trade-related aspects of intellectual property rights (TRIPs). To reflect the fact that the WTO is an organization, in this book we will generally use the term contracting parties to refer to signatories of the old GATT, and members to refer to signatories of the WTO. We also make a distinction between the GATT 1947 (the old GATT) and the GATT 1994 that is embodied in the WTO. The old GATT was both a set of rules and an institution; the new GATT is simply a set of rules that is part of the WTO.

The various treaties overseen by the WTO are between nation states and customs territories, and address government policies. The WTO deals predominantly with the actions of governments, establishing disciplines on trade policy instruments such as tariffs, quotas, subsidies or state trading. Thus, the WTO is a regulator of regulatory actions taken by governments that affect trade and the conditions of competition facing imported products on domestic markets. In this it is no different from the old GATT.

A fundamental perception of the founders of the GATT was that multilateral institutions facilitating cooperation between countries were important not only for economic reasons, but that the resulting increase in interdependence between countries would help to reduce the risk of war (Penrose, 1953; Hirschman, 1969). The expected increase in real incomes following trade liberalization and nondiscriminatory access to markets was expected to reduce the scope for political conflicts. The increase in transparency and the availability of a forum in which to discuss potential or actual trade conflicts was expected to reduce the probability of these spilling over into other domains. The Preamble of the GATT 1947 states that its objectives include raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, developing the full use of the resources of the world and expanding the production and exchange of goods' (GATT, 1994*a*, 486). It goes on to say that reciprocal and mutually advantageous arrangements involving a substantial reduction of tariffs and other barriers to trade as well as the elimination of discriminatory treatment in international trade will contribute to the realization of these objectives. Nowhere is any mention made of free trade as an ultimate goal. This continues to be the case under the WTO.

The GATT emerged from the negotiations to create an International Trade Organization (ITO) after the Second World War. The negotiations on the charter of such an organization, although concluded successfully in Havana in 1948, did not lead to the establishment of the ITO because the US Congress was expected to refuse to ratify the agreement. The GATT was negotiated in 1947 between 23 countries—12 developed and 11 developing—before the ITO negotiations were concluded.[11] The countries involved in the 1947 exchange of tariff reductions were anxious that implementation of liberalization not be conditional upon the conclusion of the ITO talks. They therefore created the GATT as an interim agreement. As the ITO never came into being, the GATT was the only concrete result of negotiations.

Although the GATT incorporated the provisions of the commercial policy chapter of the ITO, having been conceived as a temporary trade agreement, it lacked an institutional structure. In the first years of its operation it did not even exist as an entity except once or twice a year when formal meetings of the contracting parties were held (Curzon and Curzon, 1973). Its organizational structure emerged only gradually. While major decisions were taken at the sessions of the CONTRACTING PARTIES,[12] it rapidly became obvious that a standing body was needed. An inter-sessional committee was formed in 1951 to organize voting by airmail or telegraphic ballot on issues relating to import restrictions justified for balance of payments reasons. This committee was replaced in 1960 by a Council of Representatives which was given broader powers and responsibilities for day-to-day management. Throughout the 1947–94 period, the GATT secretariat was formally known as the Interim Commission for the International Trade Organization (ICITO), created during the negotiations on the ITO. It was technically a United Nations (UN) body, as the ITO negotiations occurred under UN auspices. Because the ITO never came into existence, the formal relationship between the GATT (a treaty) and the UN was always tenuous.

Over the more than four decades of its existence, the GATT system expanded to include many more countries. It evolved into a *de facto* world trade organization, but one that was increasingly fragmented as 'side agreements' or codes were negotiated among subsets of countries. Its fairly complex and carefully crafted basic legal text was extended or modified by numerous supplementary provisions, special arrangements, interpretations, waivers, reports by dispute settlement panels, and Council decisions. As of the early 1990s, a well-oiled GATT machine existed, helping contracting parties manage developments in the trading system, including through surveillance of trade policies and assisting conflict resolution through consultations, negotiations, mediation and dispute settlement.

[11] The founding parties to the GATT were 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. China, Lebanon and Syria subsequently withdrew.

[12] The term CONTRACTING PARTIES, in capital letters, was used to denote joint actions taken by all signatories to the agreement.

Some of the major milestones are summarized in Table 1.3. GATT's early years were dominated by accession negotiations, a Review Session in the mid-1950s that led to modifications to the treaty, and the creation of the European Economic Community (EEC) in 1957. In 1962, derogations from the GATT rules in the area of trade in cotton textiles were negotiated. This developed into successive Multifibre Arrangements (MFA-I through MFA-IV; see chapter 6)—a complex system of managed trade that was inconsistent with the basic principles of the GATT. Starting in the mid-1960s, recurring rounds of MTNs gradually expanded the scope of the GATT to a larger number of nontariff policies, and eventually led to the creation of the WTO. Until the Uruguay Round, no progress was made on agriculture and textiles and clothing. The deal that finally allowed these sectors to be subjected to multilateral disciplines included the establishment of rules for trade in services and enforcement of IPRs, as well as the creation of the WTO.

TABLE 1.3 *From GATT to WTO: A chronology*

Date	Event
1947	The GATT is drawn up to record the results of tariff negotiations between 23 countries. The agreement enters into force on January 1, 1948.
1948	GATT provisionally enters into force. Delegations from 56 countries meet in Havana, Cuba, to consider the final draft of the ITO; 53 countries sign the so-called Havana Charter establishing an ITO in March 1948.
1949	Annecy round of tariff negotiations.
1950	China withdraws from GATT. The US Administration abandons efforts to seek Congressional ratification of the ITO.
1951	Torquay round of tariff negotiations. The Inter-sessional committee is established to organize voting by airmail ballot on issues concerning use of trade measures to safeguard the balance of payments. Germany (Federal Republic) accedes to the GATT.
1955	A review session modifies numerous provisions of the GATT. A move to transform GATT into a formal international organization (an Organization for Trade Cooperation—OTC) fails. The US is granted a waiver from GATT disciplines for certain agricultural policies. Japan accedes to the GATT.
1956	Fourth round of MTNs is held in Geneva.
1957	Creation of the European Economic Community.
1960	A council of representatives is created to manage day to day activities. The

Date	Event
	Dillon round is started and is concluded in 1961.
1961	The Short-Term Arrangement permitting quota restrictions on exports of cotton textiles is agreed as an exception to the GATT rules.
1962	The Short-Term becomes the Long Term Arrangement on Cotton Textiles. It is renegotiated in 1967 and extended for three years in 1970 until replaced by the MFA in 1974.
1964	The Kennedy Round begins (concluded in 1967). The United Nations Conference on Trade and Development (UNCTAD) is created to press for trade measures to benefit developing countries.
1965	Part IV (on Trade and Development) is added to the GATT, establishing new guidelines for trade policies of-and towards-developing countries. A Committee on Trade and Development is created to monitor implementation.
1967	Poland becomes the first centrally planed country to accede to the GATT.
1973	The Tokyo Round is initiated (concluded in 1979).
1974	The Agreement Regarding International Trade in Textiles, better known as the Multifibre Arrangement (MFA) enters into force, restricting export growth to six percent per year. It is negotiated in 1977 and 1982 and extended in 1986, 1991, and 1992.
1982	A GATT ministerial meeting—the first in almost a decade—fails to agree on an agenda for a new round. A GATT work program is formulated with a view to establishing an agenda for a new MTN.
1986	Launching of the Uruguay Round in Punta del Este, Uruguay.
1988	A GATT ministerial meeting to review progress in the Uruguay Round is held in Montreal in December. The midterm review is completed only in April 1989.
1990	Canada formally introduces a proposal to create a Multilateral Trade Organization that would cover the GATT, the GATS and other multilateral instruments agreed in the Uruguay Round. A ministerial meeting in Brussels fails to conclude the Uruguay Round.
1993	In June the US Congress grants fast-track authority to the US Administration—under which it cannot propose amendments to the outcome of negotiations—setting a December 15 deadline for talks to be concluded. The Uruguay Round is concluded on December 15 in Geneva.
1994	In Marrakech, on April 15, ministers sign the Final Act establishing the World Trade Organization (WTO) and embodying the results of the Uruguay Round.
1995	The WTO enters into force on January 1. Financial services agreement concluded (US does not sign).
1996	Maritime services talks collapse. Decision to revisit the issue in 2000. The first WTO ministerial conference hosted by Singapore creates working groups on trade and investment, trade and competition policy, transparency in public procurement and agrees to undertake work on trade facilitation.
1997	Forty governments agree to eliminate tariffs on computer and telecommunication products by the year 2000 (the Information Technology Agreement). Negotiations on an Agreement on Basic Telecommunications are concluded under GATS auspices, after suspension of talks in 1996. A Financial Services Agreement is negotiated that brings on board the US, and expands commitments significantly.
1998	The second WTO ministerial conference commemorating the 50th anniversary of the multilateral trading system takes place on May 18–20 in Geneva.
1999	Appointment of a new Director-General proves contentious and distracts attention from the preparatory process for the 1999 ministerial meeting. Ministerial meeting in Seattle fails to launch a new round.
2000	Negotiations start on the so-called built-in agenda determined at the end of the Uruguay Round—agriculture and services.

There are many similarities between the old GATT and the WTO. The basic principles remain the same. The WTO continues to operate by consensus and continues to be member-driven. However, a number of major changes did occur. Most obviously, the coverage of the WTO is much greater. Moreover, in contrast to the old GATT, the WTO agreement is a 'single undertaking'—all its provisions apply to all members. This implies it is much more important for developing countries than the GATT was. In the dispute settlement area, it became much more difficult to block the formation of panels and the adoption of panel reports (through the adoption of a 'negative consensus' rule: all must oppose a finding). Finally, much greater transparency and surveillance functions were granted to the secretariat through the creation of a Trade Policy Review Mechanism.

1.5. THE CHALLENGE OF GLOBAL COOPERATION

The GATT proved a very successful instrument to induce countries to lower and bind tariffs over time. The idea that a rule-based approach is superior to an outcome- or results-based trading system steadily gained adherents. Whereas many governments in the 1960s and 1970s were engaged in efforts to manage trade—through central planning, barter, or commodity agreements—and actively pursued international agreements that can be characterized as results-oriented, this approach proved unsuccessful. Commodity agreements were difficult to enforce, and the prevalence of central planning and centralized trade was greatly reduced with the dissolution of the CMEA and the USSR.

Recognizing that tariffs were becoming less important as barriers to trade, the agenda of MTNs gradually grew to include various nontariff policies. In part this shift in focus reflected the expansion in use of instruments that circumvented GATT disciplines—voluntary export restraint agreements being an important example (Nogues, Olechowski and Winters, 1986). More recently the focus of attention has turned to domestic regulatory regimes. However, tariffs have not become irrelevant. In OECD countries, tariffs for agricultural production are a multiple of those applied to manufactures, and within manufacturing, there are tariff peaks exceeding 15 percent on many labor-intensive products in which developing countries have a comparative advantage (Table 1.4). Developing countries tend to have barriers against imports of manufactures that are much higher than those prevailing in OECD countries. They also have high rates of protection on imports of many agricultural goods.

Although a significant tariff negotiating agenda still exists, future MTNs will revolve increasingly around nontariff measures (NTMs) and domestic policies that are deemed to have an impact on trade. The interface between trade policy and economic policy more generally defined has become increasingly blurred. Agreeing on the elimination or reduction of NTMs is more difficult than negotiating downward the levels of tariffs. One reason for this is that it is much less obvious that specific NTMs are detrimental to a country's welfare. For example, attitudes towards environmental quality or product safety differ across countries, and this may be reflected in differences in environmental or product standards or in targeted subsidy programs. Economic theory suggests that under certain conditions intervention will be called for (see annex 2). Negotiations on regulatory issues therefore may be zero-sum games (some countries may lose), in contrast to tariff reductions, which are positive sum (all countries gain, even though certain groups in each country will lose unless they are compensated). Another problem, again in contrast to tariffs, is that it can be difficult to agree on what constitutes a NTM. Even if agreement is reached on what types of policies are trade distorting, incrementally reducing their negative impact may not be feasible. For many NTMs, all that may be possible is to agree to apply basic principles of transparency, national treatment, and MFN, and to seek to adopt procedural rules. However, pressures for harmonization of policies have been mounting. Although the GATT traditionally shied away from attempts to agree on common policies, differences in nontrade policies—regarding the environment, labor standards, or antitrust—are increasingly leading to claims that these result in unfair competition and should be countervailed. A major challenge for WTO members going into the next millennium is to deal with these pressures.

TABLE 1.4 *Patterns of protection, 1995 (percent)*

Exporting Region	Importing Region	
	High Income	Developing
Manufactures		
High Income	0.8	10.9
Developing	3.4	12.8
World	1.5	11.5
Agriculture		
High Income	15.9	21.5
Developing	15.1	18.3
World	15.6	20.1

Source: Hertel and Martin (2000).

Experience has amply demonstrated that pressures for protection and incentives to renege on liberalization commitments will inevitably arise. The Uruguay Round negotiations were a response to the managed trade and new protectionism that had proliferated during the late 1970s and early 1980s. The extensive recourse made by OECD governments to trade-distorting NTMs (antidumping, export restraint agreements, subsidies) was in part driven by exogenous shocks. These included the collapse of the Bretton Woods system of fixed exchange rates, and successive price hikes for crude oil imposed by the OPEC cartel which helped give rise to stagflation (a mix of rising prices, weak output growth and rising unemployment). Matters were compounded by international political developments such as *détente* that reduced the primacy of foreign policy considerations in maintaining cooperation in trade. As in the inter-war period, trade restrictions formed part of an inappropriate policy response to structural adjustment pressures, which were augmented by the emergence of East Asian countries as competitive suppliers of labor-intensive manufactures. The difference with the inter-war period was that multilateral cooperation did not break down. Although GATT rules were frequently ignored and circumvented, more often than not the letter, if not the spirit, of the rules of the game was honored. The explosion of grey area measures, especially VERs, constituted a major challenge to the system, but as discussed at greater length in subsequent chapters, VERs emerged in large part because of GATT disciplines on the use of emergency protection. The launch and successful completion of the Uruguay Round revealed that the major trading nations were willing to maintain multilateral cooperation and strengthen disciplines regarding the use of nontariff measures. The system proved robust during the 1997–8 financial crises—there was no significant increase in protectionism in East Asia or the OECD.

WTO members confront a very different world from that existing in the immediate post-Second World War period. While the US continues to be the dominant economy of the world, it is no longer a public-spirited hegemon willing to tolerate free riding and deviations from multilateral rules by trading partners. Many of the trade disputes and the recourse to NTMs that emerged in the 1980s were in part a reflection of what Bhagwati (1991) has called the diminished giant syndrome of the US. The world economy is much more integrated today than it was in the 1950s. Instead of one dominant economic and political power (the US), there is now a triad (the EU, Japan and the US). None of the three can be relied upon to take up the type of leadership role provided by the US at the end of the Second World War. At the same time, the WTO as an international organization cannot take the lead—it is a weak institution in that it is membership driven, having no power to self-initiate action or to make decisions. At the end of the day what matters is the continued willingness of WTO members to abide by the negotiated rules of the game, and to use the multilateral institution as a mechanism to liberalize trade further and pursue cooperation in areas that give rise to disputes and friction. This requires there to be clear-cut gains for all members—something that is becoming more difficult to achieve as talks confront thorny issues of domestic regulation. However, much still needs to be done on the 'traditional' agenda—the potential gains from further liberalization of trade in goods and services are still very large, for both OECD countries and for developing economies.

1.6. FURTHER READING

John Gallagher and Ronald Robinson, 'The Imperialism of Free Trade', *Economic History Review*, 6 (1953), 1–15 is a classic article on British trade and trade policy during the nineteenth century. Douglas Irwin, 'Multilateral and Bilateral Trade Policies in the World Trading System: An Historical Perspective', in J. De Melo and A. Panagariya (eds.), *New Dimensions in Regional Integration* (London: CEPR, 1993) is an informative and accessible analysis of the historical background to the GATT. *Against the Tide: An Intellectual History of Free Trade* (Princeton: Princeton University Press, 1996), by the same author, is a masterful tour de force that is required reading for anyone with an interest in the case that has been made for and against free trade since prehistoric times. Richard Gardner, *Sterling-Dollar Diplomacy: The Origins and the Prospects of Our International Economic Order* (New York: McGraw-Hill, 1969, 2nd ed.) is an excellent discussion of the motivations and processes underlying the construction of the postwar international economic institutions, including the GATT.

Charles Adams, *For Good and Evil: The Impact of Taxes on the Course of Civilization* (Lanham: Madison Books, 1993) is an entertaining and informative birds-eye view of the role that taxes (including tariffs) have played in the course of recorded history. David Mansfield, *Power, Trade and War* (Princeton: Princeton University Press, 1994) is a careful empirical analysis of the relationship between an open international system, bilateral trade flows and the probability of war.

A good textbook treatment of globalization can be found in Peter Dicken, *Global Shift: Transforming the World Economy* (London, Paul Chapman Publishing Ltd., 1998). Kevin O'Rourke and Jeffrey Williamson, *Globalization and History: The Evolution of a 19th Century Mid-Atlantic Economy* (Cambridge, MIT Press, 1999) analyze the extent of integration that prevailed before World War One.

Jeffrey Sachs and Andrew Warner, 'Economic Reform and the Process of Global Integration', *Brookings Papers on Economic Activity*, 1 (1995), 1–95 is a widely read and influential empirical study that concludes there is an unambiguous positive relationship between openness and economic performance. Dan Ben David, *Free Trade and Economic Growth* (Cambridge, Mass.: MIT Press, forthcoming) is a fascinating exploration of the empirical evidence on the relationship between trade liberalization, economic growth and performance, and income convergence across countries and country groups. Dani Rodrik, *Has Globalization Gone Too Far?* (Washington DC: Institute for International Economics, 1997) provides a rather skeptical view of the benefits of globalization on growth and welfare in the absence of institutions and policies to manage downside risks.

For an appraisal and history of negotiations of the Havana Charter and the General Agreement on Tariffs and Trade see William Brown, *The United States and the Restoration of World Trade* (Washington DC: The Brookings Institution, 1950); and William Diebold, *The End of the ITO* (Princeton: Princeton University Press, 1952). Judith Goldstein, 'Creating the GATT Rules: Politics, Institutions and American Policy', in John Ruggie (ed.), *Multilateralism Matters: The Theory and Praxis of an Institutional Form* (New York: Columbia University Press, 1993), is an insightful analysis of US views and interests in creating the GATT.

There is a large literature on the political economy of trade policy decisions and institutional design issues. An early study of the GATT system that continues to be well worth reading is Gerard Curzon's *Multilateral Trade Diplomacy* (London: Michael Joseph, 1965). I.M. Destler, *American Trade Politics* (Washington DC: Institute for International Economics, 1996), now in its third edition is a classic and regularly updated book on the politics of US trade policy. Arye Hillman, *The Political Economy of Protectionism* (New York: Harwood, 1989) surveys the economic literature. Robert Keohane, 'Reciprocity in International Relations', *International Organization*, 40 (1986), 1–27 discusses the notion of reciprocity from a political science and international relations perspective. L. Alan Winters, 'Reciprocity', in M. Finger and A. Olechowski (eds.), *The Uruguay Round: A Handbook* (Washington DC: The World Bank, 1987) does so from the perspective of an economist. S.H. Bailey, 'The Political Aspect of Discrimination in International Economic Relations', *Economica*, 12 (1932), 96–115 is an often-cited contemporary assessment of the costs of discrimination in trade.

Those interested in the theoretical economic literature on the WTO, reciprocity and nondiscrimination can do no better than consult Kyle Bagwell and Robert Staiger, 'An Economic Theory of GATT', *American Economic Review*, 89 (1999*a*), 215–48. Other recommended theoretical analyses of the GATT include Rod Ludema, 'International Trade Bargaining and the Most-Favored-Nation Clause', *Economics and Politics*, 3, (1991), 1–20.

A clear and accessible introduction to the legal and institutional aspects of the world trading system is presented in John H. Jackson, *The World Trading System: Law and Policy in International Relations* (Cambridge: MIT Press, 1997). John Croome, *Reshaping the World Trading System* (Leiden: Kluwer, 1999) is a detailed negotiating history of the Uruguay Round, written by a GATT insider. The prevalence of NTBs at the beginning of the 1980s is documented and quantified in Julio Nogues, Andrej Olechowski and L. Alan Winters, 'The Extent of Nontariff Barriers to Industrial Countries Exports', *World Bank Economic Review*, 1 (1986), 181–99. Patrick Low, *Trading Free: The GATT and US Trade Policy* (New York: Twentieth Century Fund, 1993) discusses the evolution of US trade policy thinking in the 1980s, the use of contingent protection and VERs, and US attitudes towards the GATT.

Gilbert Winham, 'GATT and the International Trade Regime', *International Journal*, 15 (1990), 786–822, is a leading political scientist's view of the GATT and its role in international relations. Frieder Roessler, 'The Scope, Limits and Function of the GATT Legal System', *The World Economy*, 8 (1985), 287–98 discusses the role of GATT rules as constraints on governments. Alan Deardorff, 'An Economist's Overview of the World Trade Organization', in G. Flake and F. Myeong-Hwa Lowe-Lee (eds.), *The Emerging WTO System and Perspectives From East Asia* (Washington DC: Korea Economic Institute of America, 1996) provides a very insightful and accessible economist's view of the WTO, emphasizing the importance of the institution as a forum for communication.

PART II
THE INSTITUTION