

EC246-2-AU – Lecture 6
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The WTO as an Institution

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Plan of talk

- **Introduction**
 - 1. Organisation**
 1. Structure
 2. Functioning
 - 2. Membership**
 - 3. Dispute settlement**
 - 4. Negotiating forum**
- **Wrap-up**

Aim and learning outcomes

- **Aim:** understand
 - what WTO *is*
 - and what it *does*
- **Learning outcomes**
 - clarify the *difference* between GATT 1947 and WTO
 - describe WTO *dispute settlement* mechanism
 - summarise WTO *accession procedure*
 - *measure and compare tariff reductions* in alternative ways
 - present WTO *negotiations* from the perspectives of a few relevant approaches of economic theory

WTO: birth

- 1 January 1995, Geneva: WTO's **birthday**
 - not envisaged in Punta del Este, 1986, neither before 1990
 - established following decisions embodied in the Final Act of the Uruguay Round signed on 15 April 1994 in Marrakech
- Earlier related **attempts**
 - 1948, Havana: ITO
 - 1955, GATT review session: OTC
 - 1963: UN EcoSoC ideas for a *UN agency* regulating international trade
=> *GATT* to become this agency's *Committee on Tariffs* to implement decisions by UNCTAD and other relevant UN policy decisions
 - 1990: Canada's proposal for an MTO came as a surprise
 - motivated by a wish to create a single institutional framework for world trade
 - subsequently supported by EU
 - initially opposed by US, then agreed upon (including the name change)

WTO: legal basis

- 1994 Marrakech Agreement
 - **establishes** the WTO, and
 - **charges** it to provide the common institutional framework for the conduct of trade relations among its members *in matters for which* agreements and associated legal obligations apply (Art. II)
 - **4 annexes** define the substantive *rights and obligations* of members
 - Annex 1 has 3 parts
 - Annex 1A: GATT 1994 (GATT 1947 as amended by the Uruguay Round)
 - Annex 1B: GATS
 - Annex 1C: TRIPs
 - Annex 2: Understanding on Settlement of Disputes (DSU)
 - Annex 3: Trade Policy Review Mechanism (TPRM)
 - Annex 4: Plurilateral Trade Agreements (Tokyo Round codes that were *not multilateralised* during Uruguay Round and therefore bind only signatories)

WTO: structure

- Discuss **organisational chart** from WTO website
 - *Ministerial Conference: trade ministers + other officials*
 - *topmost* decision-making body
 - brings together *all* members (countries or *customs unions*, e.g. EU)
 - meets at least once every *two* years
 - *General Council: meets ≈ 12 times a year*
 - as a trade policy review body (TPRB), or
 - as a dispute settlement body (DSB)
 - *3 subsidiary councils: on each of the 3 parts (GATT, GATS and TRIPS) of the Multilateral Agreement*
 - *separate committees: outside the Multilateral Agreement*
 - *additional committees and working parties: inside each of GATT, GATS and TRIPS*
 - *committees to administer the Plurilateral Agreements*
 - *Appellate Body*

WTO: day-to-day functioning

- Blackhurst (1998): WTO as a **network organisation** – quite *big* (at least 5000 people involved, *indirectly* at ministries, etc.)
 - main actors in day-to-day activities are *officials*
 - affiliated with the *delegations* of members
- **WTO Secretariat**: relatively *small* ($\approx$ 500 staff)
 - to provide technical and logistic support
 - to organise meetings
 - to prepare background documentation (when requested by the committees or the Council)
 - very little formal power to take initiatives
- **(GATT-)WTO Director-General**
 - 7 thus far, including the current one, Dr Supachai (see Box 2.1, pp. 55-56 in HK): choice shifting with WTO creation from *officials* to *politicians*
 - to act as a *broker*, not as a *decision-maker*

WTO: budget and contributions

- Financial contributions to WTO budget based on GATT 1947 practice
- WTO budget revenue comes from **assessed contributions** calculated as
 - *share* of each member in the total *trade* of all WTO members
 - *3-year average* of the most recent trade figures
 - if share is less than 0.12%, a *minimum* contribution is due
- 1999: 9 largest members $\Leftrightarrow \approx 2/3$ of contributions
- **Voluntary contributions** (grants) by *developed* economies for *specific* purposes in *developing* countries
 - technical assistance
 - training of officials

WTO: decision making

- **Consensus:** where *not otherwise* specified
 - modus operandi of GATT: *negotiation/bargaining, consultation, consensus*
 - does not mean unanimity; is, in fact *weaker* than unanimity
 - *no fundamental objection* on an issue
 - those *not present* or *abstaining* (from a vote) do *not count*
 - imposes conservative tendencies
 - proposals for change adopted only if not opposed => *paralysis?*
 - but helps enhance the *legitimacy* of decisions that are taken collectively
- **Voting:** if no consensus reached and only where *provisions* allow; “one member – one vote” system ($\neq$ IMF, WB: *weighted* voting)
 - **Unanimity:** amendments on *general* principles, e.g. nondiscrimination
 - **Three-quarters** majority
 - *interpretations* of WTO provisions
 - *waivers* of WTO disciplines (for a member)
 - **Two-thirds** majority
 - amendments related to issues *other* than general principles
 - *accession*
 - **Simple** majority: *sufficient* where consensus cannot be reached

WTO: membership

- **148 members** (on 13 October 2004, and as of today)
- **Open** to any *State or separate customs territory* possessing full autonomy in the conduct of its external commercial relations
- **Accession**
 - **terms** must be agreed between applicant and WTO members (Art. XII)
 - procedure evolves in **stages** (from a few years to over a decade)
 1. observer status
 2. Government writes a **letter** to WTO Director-General with a wish to join
 3. General Council establishes a **working party** of interested members to examine the *application*
 4. Government seeking accession must submit a detailed *memorandum* describing its **trade regime** => check for consistency with WTO rules
 5. **Report** by the working group with a draft *Decision and Protocol of Accession* and the negotiated *Tariff Schedule* attached to it => **vote** (2/3 to approve)

WTO: China, Russia, other LDCs?

- Langhammer and Lücke (1999): $\approx$ 30 countries were included in **WTO accession process** during 1995-2000
 - all of them together $\Leftrightarrow$ 8% of world trade in merchandise, 5% of global GDP and 30% of global population
 - 11 of these applicants became members within same period
- Economic importance of China and Russia weighs heavily on WTO negotiations and prospects
 - **China**: negotiated over 15 years, member since December 2001
 - **Russia**: long negotiation process too, not yet WTO member
- **Other LDCs**

WTO dispute settlement: generalities

- Disputes arising under any WTO agreement are dealt with by
 - the **Dispute Settlement Body** (DSB),
 - which is simply the **WTO Council** changing name for this role
- DSB is the **authority** to:
 - establish *panels*
 - scrutinise *implementation* of recommendations
 - authorise *retaliatory measures* if the losing party does not abide by the panel's recommendations
- As under GATT 1947, **complaints** may take 3 forms:
 1. *violation* complaints
 2. “*nonviolation*” complaints: no specific WTO rules are violated but a government measure *nullifies* a previously granted concession/benefit
 3. *situation* complaints: anything that is not 1. or 2. but has the effect of 2.

WTO dispute settlement: stages

1. Consultation and mediation
2. Request for a panel
3. Panel work
 1. examination of facts and arguments
 2. meetings with the parties and interested third parties
 3. interim review
 4. drafting of conclusions and recommendations
 5. panel report circulated to the parties and the DSB
4. Adoption decision or appeal
5. Implementation
 - immediately
 - after a “reasonable period of time”

WTO dispute settlement: banana case

- 1993: in creating a single market, EU adopted a complex import licensing and distribution system, favouring traditional African, Caribbean and Pacific (ACP) suppliers
 - Latin American countries brought the matter to GATT and won
 - 1994: EU concluded a Banana Framework Agreement with Costa Rica, Colombia, Nicaragua and Venezuela
 - 1996: Ecuador, Guatemala, Honduras, Mexico and US contested EU banana regime as discriminating against their producers
 - 1997: WTO panel report found EU regime in violation of WTO nondiscrimination and market access rules
 - 1998: EU revised the regime, but kept the dual tariff rate quotas
 - 1999: US (\$191 mln), Ecuador (\$200 mln) authorised to retaliate
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WTO as negotiating forum: game theory

- Negotiation as the *driving force* of MTS
- WTO as a **permanent negotiating forum**: even bilateral and plurilateral interactions are, in effect, *multilateralised* by MFN
- **Game theory**: *interaction* among “players” in a “game”
 - structure (rules): one-shot vs. repeated, simultaneous vs. sequential
 - information available to players: complete vs. incomplete
 - rationally formed expectations about the best “moves” of other players
 - types: cooperative (efficient outcome + enforcement) vs. noncooperative
- **Pareto optimality**: no party can be made better off without making another party worse off
- MTNs as an **institution-setting exercise**: efforts to set rules of the *noncooperative* international trade game (example: slide 16)

The Prisoners' dilemma in trade policy:

$P(\text{ay-off}) > c(\text{ost}) > 0$ (HK, p. 110)

	Country B		
		Free trade	Protection
Country A	Free trade	$P - c, P - c$	$-c, P$
	Protection	$P, -c$	$0, 0$

WTO as negotiating forum: externalities

- **Externality:** arises when an agent does not take into account the impact (bad or good) of its actions on another agent
- *2 ways to address it (within a country)*
 1. a central authority to impose targeted taxes/subsidies
 2. agents attempt to bargain a Pareto-optimal solution
 - Coase theorem: given (i) enforceable property rights and (ii) absence of transaction costs, a Pareto-optimal outcome: the market – bargaining – will ensure efficiency if (iii) the externality is the only market failure
 - the reality of MTNs: imperfect information in addition to (i), (ii) and (iii)
- **MTNs as barter:** *3 kinds of inefficiencies (=> national money)*
 1. the market (total supply) offers no good a trader is interested to obtain
 2. not necessarily double coincidence of wants
 3. impossible to equate trader's marginal valuations of (indivisible) goods

WTO as negotiating forum: bargaining

- Establishing an **agenda** of a MTN is a negotiation in itself
- **Trade negotiation** can be decomposed into *4 stages*
 1. *catalyst*: a policy vision of a government or interest group
 2. *prenegotiation*: discussion of a possible negotiating agenda
 3. *negotiation*: formal (government-level) bargaining
 4. *postnegotiation*: implementation
- **Issue linkage**: policy packages – in class: HK, Fig. 4.1, p. 117
- *Integrative (win-win) vs distributive (win-lose) bargaining*
- **Coalitions**: like-minded countries join bargaining power
- **Lobbying**: political constraints to a government's actions

WTO as negotiating forum: mechanics

- **Reciprocity formulas:** specific (item-by-item) vs. general (across-the-board)
- **Methods to evaluate offers:** examples in class – HK, p. 124
 - trade coverage
 - 50% (one) equivalent
 - average cut
- **Nominal vs effective *rate of protection*** (NRP vs ERP):
examples in class – HK, p. 132
 - $NRP = (P - P^*)/P^*$
 - $ERP = (V - V^*)/V^*$, with $V = (1+t_f)P_f - (1+t_i)P_iX$
- WTO focuses on NRP but interest groups care about ERP
- $ERP > NRP$ since governments protect activities generating VA

Concluding wrap-up

- **What have we learnt?**
 - how WTO is different from (and similar to) GATT 1947
 - what its organisational structure is
 - how trade disputes are settled within WTO
 - in what underlying contexts WTO negotiations are effected (in the real world) and modelled (by economic theory)
 - how tariff reductions are measured and compared
- **Where we go next:** to the Multilateral Agreement within WTO (GATT + GATS + TRIPs)