
WTO News

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Commentary

10 Years of WTO: A Reason to Celebrate?

Looking back 10 years after the foundation of the WTO, there is certainly reason to celebrate the achievements. GATS and TRIPS have expanded the ambit of the WTO rules approach. In financial services and information technology, members have been able to agree on substantial extensions of previous commitments. The Dispute Settlement System is a valuable contribution to conflict resolution. Finally, since 1995, 36 countries have been accepted as new members, with China being a particularly important addition.

However, it is difficult to discern sentiments of joy. For critics of globalisation, the WTO is a focal

point of protest with broad attention from the media. The Doha process gives no reason for optimism, either. How will the future of the WTO develop? In management practice, SWOT analysis (“Strengths – Weaknesses – Opportunities – Threats”) has proven to be a very useful scenario technique. The method can also be used to analyse possible future developments of the WTO.

Strengths: Inclusive Membership

With close to 150 members, the WTO has not only very broad membership, but it includes also countries of extremely different size, development and economic interests. The notion of “inclusive membership” brings this to the point. This is particularly noteworthy, if one considers the broad coverage of WTO rules on trade-related regulations.

This broad geographic and thematic reach of WTO rules is supported by consolidated institutional structures. The WTO can rely on more than 50 years of GATT history with negotiation routines and an experienced Secretariat. Very important is also the fact that the Dispute Settlement System provides effective mechanisms for dispute resolution.

Weaknesses: Overstrained Decision Processes

The consensus principle is an important ingredient of inclusive membership. Without this *de-facto* veto right, membership would clearly be lower, because individual countries would risk being forced into future new commitments that could be detrimental to their interests. But consensus is a very demanding decision rule, particularly with heterogeneous membership. This clearly restricts the reach of new negotiations. Successful rounds are possible only if one can put together a package for acceptance which brings advantages relative to the status quo for all participants. For the Uruguay-Round, this proved to be possible: For industrialised countries, the GATS and the TRIPS brought clear benefits for which they were willing to undertake commitments in agriculture and textiles. Developing countries wanted to harvest the agriculture and textile agreements and the multilateral control of US sanctions, achievements for which they were willing to consent to the TRIPS. It is very difficult to conceive a dominant package for the Doha-Round which could induce strong members to assume ownership of the ongoing negotiations.

Outside the multilateral rounds, political decision-making is even more difficult because one needs to find compromises without the possibility of compensation in other areas of a single package. As a consequence, the dispute settlement organs are sometimes forced to rule on issues which go in fact beyond a mere interpretation of legal texts, and are of a highly political nature. The pending dispute on genetically-modified organisms is a case in point. The imbalance between weak political decision rules and a strong judicial system that can be observed in the WTO nurtures the perception that the Organisation is infringing on national sovereignty and can undermine the legitimacy of the system.

Opportunities: Broad Consensus for Reciprocal Market Opening

Opportunities and Threats refer to external or internal developments which could prove to be particularly beneficial or harmful to an organisation. The WTO would be well equipped to translate a public consensus for free trade into respective agreements and to control their implementation. But how realistic is it to expect such a broad consensus for reciprocal market opening? On the one hand, the economic success of central and eastern European countries, and the very successful reforms in Asian countries, have rendered liberal policies more credible. On the other hand, both transition and industrialised countries tend to be more market-oriented with regard to domestic reforms than with regard to external market opening. For liberal import policies to gain currency, it would be important that governments and the public perceive reductions in protection not as “concessions” to other countries, but as an important source of welfare gains, as is demonstrated in a great number of economic studies.

One could object that under such circumstances, the unilateral reduction of import barriers without the support of the WTO should be possible. However, this is not necessarily the case. Unilateral reduction of market barriers could lead to a worsening of the terms of trade with a resulting loss in welfare. Co-ordinated action on a reciprocal basis avoids such effects. From an economic point of view, the terms of trade argument can be seen as the

raison d'être of GATT and WTO. Political economy arguments give additional reasons to believe in positive effects of the WTO. Even if there is broad consensus on the overall positive outcome of liberal trade, such policies must be implemented against political pressure of negatively-affected interest groups. If one assumes that producer interests have greater political clout than broad consumer interests, it is important that the government can also manage to generate support from export industries in order to counterbalance pressures from import-competing interests. Hence, reciprocal trade negotiations shift the domestic balance towards more open trade.

Threats: Regional Preferential Agreements

It is obvious that the reverse side of the opportunity argument is the strongest threat to the WTO. If general public opinion turned against free trade, governments would lose domestic support to implement liberal trade agreements. Here, I want to concentrate on a development which could undermine the WTO even if the general public supports free international trade.

In recent years, initiatives for bilateral or regional Free Trade Agreements (FTAs) have flourished. Economists tend to be more cautious with regard to their economic benefits and costs than politicians (or the public). They point to the risks of trade diversion and the segmentation of markets due to incompatible rules of origin. But apart from economic costs and benefits, FTAs represent a serious threat to the WTO as an organisation. Market access conditions negotiated in the WTO cover only a small fraction of bilateral trade relations. Preferences undermine the most-favoured-nation principle (MFN), which is one of the fundamental principles of non-discrimination. The most-favoured tariff rate becomes *de facto* the highest tariff which creates competitive disadvantages for firms from countries which do not enjoy preferential access, which is in turn a strong incentive either to join existing or to create new FTAs – the famous domino effect. Finally, bilateral negotiations divert scarce negotiation capacity from the multilateral WTO to the bilateral FTA level. The high-level expert report on the future of the WTO, which had been commissioned by the Director-General of the WTO and was recently presented to the public, speaks a clear language with regard to the high risks of a further proliferation of FTAs (see also the review by THOMAS A. ZIMMERMANN in this issue).

A New Coalition for Free Trade

The arguments outlined above support the conclusion that the WTO risks stagnation, that no substantial improvements will be possible in the near future, that the WTO will concentrate on administering the status quo, and that integration dynamics will shift to bilateral and regional market integration schemes.

Yet, this must not necessarily be the case. I have outlined that the capacity of the WTO to host multilateral trade negotiations and to support conflict resolution is an institutional opportunity, if external forces support a development in this direction. But a coalition for free trade can no longer be built solely on the US, the EU, and some other smaller industrial countries. If the WTO should become again the driving force for a liberal trade order, countries such as India, China, Korea, or Brazil must be active members in such a new strong coalition for free trade. *Heinz Hauser*



Dispute Settlement

United States - Subsidies on Upland Cotton

On 6 February 2003, Brazil requested the establishment of a panel to examine the conformity with WTO law of certain US agricultural-support measures to producers, users and exporters of upland cotton (WT/DS267/R). Brazil alleged the inconsistency of these measures with various provisions of the Agreement on Agriculture (AoA), the Agreement on Subsidies and Countervailing Measures (SCM) and the GATT. In its report – which was issued on 8 September 2004 – the panel decided with regard to crucial issues in favour of the applicant and found various support measures and payments to be in violation of obligations under the AoA and SCM. Meanwhile, the US have appealed the panel report. A closer examination of the panel report appears worthwhile, since it comments – at times in a surprising fashion – on some important questions as to the permissibility of agricultural domestic support measures.

Rigid Interpretation of Green Box Requirements

Inter alia, the panel remarkably sets forth the inconsistency of US direct payments with green box requirements under Annex 2 AoA, (No. 7.354 ff.). The US claimed that their direct payments (and underlying schemes) to producers of upland cotton represented decoupled income support that fully complies with the criteria in Annex 2:6(b) AoA. This provision states that the amount of support in any given year shall not be related to, or based on, the type or volume of production undertaken in any year after the base period. Although US support schemes contained no programme requirements to produce any particular type or volume of a product, support could be reduced where a producer undertook certain types of production (fruit, vegetables) in a year after the base period. Hereunto, the panel found that even in the case of such *planting flexibility limitations*, the amount of payment is related to the production undertaken by the producer after the base period. Therefore, the US direct payments did not fully conform to Annex 2:6(b) AoA.

This is the first panel proceeding concerned with the interpretation of green box criteria and the findings appear to construe the requirements of Annex 2 AoA as rather restrictive. With regard to trade liberalisation, one must welcome the panel ruling. However, it will certainly be a cause for grave concern in Brussels, Tokyo and Berne. In the first place, the modification of various support schemes (hitherto considered to be WTO-consistent) could become necessary. The findings would be even more far-reaching, if the Cotton case became the cornerstone for a restrictive application of the green box in the future. Given the great freedom traditionally presumed to be offered by Annex 2, the panel report will surely not facilitate the successful conclusion of the ongoing Doha negotiations.

SCM Provisions as Additional Requirements

The section of the report with the probably most explosive content can be found under No. 7.1019 ff. There, the report addresses the question of to what extent domestic support measures that fully comply with the AoA can violate obligations under the SCM. If the Appellate Body (AB) were to affirm the panel's findings as to the relationship between AoA and SCM obligations in the area of domestic support measures, this could have significant consequences to the lawfulness of existing agricultural support programmes and would probably influence the further development of the Doha round.

Specifically, the panel examined subsidies to users and exporters of upland cotton. The right to receive such payments was contingent on the use of domestic upland cotton. Brazil claimed these support measures to be illegal import substitution subsidies following Art. 3.1(b), 3.2 SCM. The US did not contest the import substitution character but strongly challenged the general applicability of Art. 3.1(b) SCM, since the support measures at issue were so-called amber box subsidies that complied entirely with Art. 3, 6, 7, Annex 3 AoA (fulfilment of reduction commitments and inclusion in the AMS calculation). The crucial question was now how SCM obligations correlate with the AoA in the case of domestic support measures that fully meet the terms of the AoA.

The panel held that even if the requirements of the amber box are fully complied with, the obligations under Art. 3.1(b) SCM would run parallel and thus need to be observed. With regard to the specific case, the panel ruled that the support measures violate Art. 3.1(b) SCM. If the report's argumentation can be considered a main determinant for agricultural domestic support with regard to the relationship between the obligations under the AoA and under the SCM, this could have some explosive effects. Support schemes that contain requirements as to the use of domestic raw materials may then prove to be illegal under the SCM.

Potentially Far-Reaching Argumentation of the Panel

By underlining the *interlocking nature* of the SCM and AoA and primarily invoking Art. 21.1 AoA, the panel decided as follows: In principle, the SCM is applicable to agricultural products and the obligations under the SCM run parallel to the AoA provisions. Only in the event, and to the extent, of a *conflict* between the provisions of the AoA and SCM, the AoA would take precedence. In a footnote – but with a surprisingly clear-cut wording – the panel stressed that the AoA may not necessarily contain provisions that would have the effect of carving out certain domestic support measures from SCM provisions or rendering those disciplines inapplicable to agricultural domestic support. Accordingly, a *conflict* between AoA and SCM provisions cannot automatically be assumed. It is recalled that the WTO Agreement is rather to be understood as a single undertaking. Consequently, the same measure can be subject to more than one WTO obligation.

With regard to the case at hand the panel denied the existence of a *conflict*. The amber box provisions would not comment on the obligations contained in Art. 3.1(b) SCM (prohibition on import substitution subsidies). According to the panel, the domestic support reduction commitments in the AoA only relate to the object and

purpose of imposing *quantitative* limitations and do not address all of the *qualitative* aspects of subsidization exhaustively. Art. 3.1(b) SCM comprises some *qualitative* obligations which are not addressed in the amber box provisions. Therefore, there is no *conflict* as to the *qualitative* obligations in Art. 3.1(b) SCM.

An application of the panel's argumentation to all categories of agricultural domestic support (e.g. green and blue box) would require in future cases additional complex examination: Namely, whether the AoA provisions – that contain the requirements for granting a subsidy – deal in fact exhaustively with all potential characteristics of the support measure. If this question is answered negatively, since the SCM comprises *qualitative* aspects which are not addressed by the AoA provisions, to that extent the existence of a *conflict* must be denied. Consequently, the relevant SCM obligations would apply concurrently.

Unresolved Questions

It is difficult to predict the AB's position with regard to the panel's theory of *conflict*. Although one must appreciate the report because of its implied liberalising effects upon agricultural markets, it leaves a few questions unresolved. The theory of *conflict* that is developed in the report does not seem to be the one and only interpretation

of Art. 21.1 AoA. The mere existence of Art. 13 AoA appears to support the panel's view. However, given the exceptional position of the agricultural sector within the WTO, an absolute primacy of the AoA over the SCM (at least concerning domestic support) may be supposed as well. Moreover, the report hardly addresses the question of which party bears the burden of proof as to the (non-) existence of a *conflict*. Concerning the amber box support under consideration, the panel fails to examine thoroughly whether the absence of *qualitative* aspects could be construed as a tacit assumption that no *qualitative* requirements need to be met. Finally, the panel report does not pronounce on the questions of how one can determine whether a AoA provision deals exhaustively with all potential characteristics of a support measure, and how to proceed when the AoA does in fact contain *qualitative* requirements but these requirements are potentially non-exhaustive.

Given the potential impact of the panel report on the WTO-conformity of agricultural domestic support and the various unresolved problems that have been alluded to, the AB's report will be awaited with great interest. *Christiane Wurzbacher*

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From the Book Shelf

CONSULTATIVE BOARD TO THE DIRECTOR-GENERAL SUPACHAI PANITCHPAKDI (ED.) (2004): THE FUTURE OF THE WTO – ADDRESSING INSTITUTIONAL CHALLENGES IN THE NEW MILLENNIUM; GENEVA: WORLD TRADE ORGANIZATION, 86 PAGES, AVAILABLE ONLINE ([HTTP://WWW.WTO.ORG/ENGLISH/THEWTO_E/10ANNIV_E/10ANNIV_E.H TM#FUTURE](http://www.wto.org/english/thewto_e/10anniv_e/10anniv_e.htm#future))

In June 2003, WTO Director-General SUPACHAI PANITCHPAKDI established a Consultative Board on the Future of the Multilateral Trading System. It was entrusted with the preparation of a “report on how to institutionally strengthen and equip the WTO to respond effectively to future systemic challenges brought about by an increasingly integrated global economy”.

The group, which was chaired by PETER SUTHERLAND, presented its 90-page report in January 2005. The nine Chapters deal with globalisation and the case for liberalising trade (I); the erosion of non-discrimination (II); sovereignty (III); coherence and co-ordination with inter-governmental organisations (IV); transparency and the dialogue with civil society (V); dispute settlement (VI); decision-making and variable geometry (VII); political reinforcement and efficient process (VIII); and with the role of the Director-General and the Secretariat (IX). In addition, a synthesis of major conclusions and recommendations is included.

The authors are particularly worried about the current erosion of non-discrimination – both through the proliferation of preferential trade agreements and through

mechanisms of special and differential treatment of developing countries. They call upon Members to “take into account the damage being done to the multilateral trading system” before embarking on “new discriminatory initiatives”. Moreover, they call for an effective reduction of most-favoured nation tariffs and non-tariff measures in multilateral negotiations, and for developed countries agreeing to a date by which all their tariffs will move to zero as remedies for the “spaghetti bowl of discriminatory preferences”.

Whereas the report of the Consultative Board provides a comprehensive overview on institutional and organisational challenges to the WTO, it refrains from making recommendations on areas of substance that are under negotiation in the Doha Round (e.g. agriculture, non-agricultural market access, services). Nevertheless, the report is worthwhile reading with numerous interesting proposals that might – once they are implemented – get the WTO institutionally back on track. *Thomas A. Zimmermann*

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