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## Can it be true?

In the early evening of 15 December 1993, the last Director-General of General Agreement on Tariffs and Trade (GATT), Peter Sutherland, gavelled through the final agreement on the Uruguay Round to ‘huge applause’<sup>1</sup> from ministers gathered in the plenary hall of the Geneva Conference Centre.

For many, it was as much an expression of their relief that the Uruguay Round negotiations had finally reached a conclusion, as recognition of the momentous changes that had been made to the world trading system. Sutherland spoke of a ‘major renewal’ of the trading system; others talked of a momentous beginning and a new direction. *The Economist* magazine asked: ‘Can it be true?’

One of the major results of the agreements concluded on that eventful day, which would come into effect on 1 January 1995, was the Agreement Establishing the World Trade Organization. Its articles included:

**Article I****Establishment of the Organization**

The World Trade Organization (hereinafter referred to as ‘the WTO’) is hereby established.

**Scope of the WTO**

1. The WTO shall provide the common institutional framework for the conduct of trade relations among its Members in matters related to the agreements and associated legal instruments included in the Annexes to this Agreement.

**Article III****Functions of the WTO**

1. The WTO shall facilitate the implementation, administration and operation, and further the objectives, of this Agreement and of the Multilateral

<sup>1</sup> John Croome, *Reshaping the World Trading System: A History of the Uruguay Round*, Geneva, 1998.

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Trade Agreements, and shall also provide the framework for the implementation, administration and operation of the Plurilateral Trade Agreements.

2. The WTO shall provide the forum for negotiations among its Members concerning their multilateral trade relations in matters dealt with under the agreements in the Annexes to this Agreement. The WTO may also provide a forum for further negotiations among its Members concerning their multilateral trade relations, and a framework for the implementation of the results of such negotiations, as may be decided by the Ministerial Conference.

The agreement to create the WTO in 1995 stands in sharp contrast to the disagreements among countries over the proposal in the mid-1940s to create an International Trade Organization (ITO) that would be a complement to the World Bank and the International Monetary Fund. As the ITO proposal foundered, the GATT, created in 1948 as a preparatory measure for the new trade organization, lived on to provide the basis for the conduct of international trade relations for the next 50 years.

The establishment of the World Trade Organization, with a clear legal status and mandate was in itself the crossing of an important threshold in international trade relations.

### **Coming to grips with a globalizing economy**

The world economy has experienced several periods of ‘globalization’, dating back to the end of the nineteenth century when vast trading empires made European wealth a function of the diverse supply of a global market. The period since the Second World War when those empires finally dissolved brought a new era of market globalization, with still broader horizons, greater flows of trade, investment and technology and many more economies that were potential beneficiaries of the market’s wealth.

The General Agreement on Tariffs and Trade (GATT), formed provisionally at the start of this era (1947), had been successful in a task that had been framed by the experiences of the 1920s and 1930s. It ensured non-discrimination in the management of tariff-based trade barriers, reducing the impact of those barriers on merchandise trade (the average tariff of GATT Contracting Parties fell from double-digit levels to 4% through six negotiating rounds). But the governments who made up the membership of the GATT, known as Contracting Parties, had determined that it was not equipped to manage the multilateral trade system in a new era of globalization, much less to help its Members, both developed and

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developing countries, secure a share of the benefits of continuing growth in global trade.

The GATT concerned itself mainly with tariffs – in an era when commercial policies were expressed in new forms of trade regulation – and with merchandise alone: it ignored traded services (transport, communications, finance), which, by the mid-1980s, had grown to be a third of global trade in terms of value and underpinned all the rest.

For five decades following the creation of the GATT, the world saw an extraordinary increase in economic growth and prosperity. On an annual average basis, merchandise exports grew by 6% in real terms from 1948 to 1997. The large gains in income growth, job creation and overall prosperity in that period were in part attributable to the success of the multilateral trading system in lowering trade barriers. During this period of intense economic activity the GATT provided a forum where disputes over conflicting trade policies could be isolated and often resolved.

But well before its 40th anniversary, its Members concluded that the GATT system was already straining to adapt to the new realities of a globalizing world economy.

- There were 18 economies that were parties to GATT at its foundation. By 1985 there were 90 Contracting Parties. The membership was much more diverse industrially, economically and constitutionally than it had been when it comprised the major powers of the Second World War and their former empires and emerging colonies. ‘North’ and ‘South’ were concepts that had not existed in 1947 when the world had been divided ‘East’ and ‘West’.
- Trade became much more important in relation to output (6.8% of GDP in 1950, 11.1% in 1973, 17.2% by 1998 at constant 1990 prices)<sup>2</sup> and its direction began to diversify away from the still predominant ‘north-south’ orientation set in the earlier era of globalization. The ‘newly industrializing’ economies of East Asia, especially, had expanded their share of trade and strengthened the growth of ‘south-south’ trade.<sup>3</sup> But even among the industrialized economies – now spread around the northern hemisphere – the waves of new industrial production in industries such as automobiles and steel created persistent peaks and troughs of trade imbalances.

<sup>2</sup> Angus Maddison, *Economic Progress: The Last Half Century in Historical Perspective*, Australian Academy of Social Sciences Annual Symposium, 1999.

<sup>3</sup> WTO, *World Trade Report*, 2003, p. 22ff.

- Technological change re-shaped production processes that had been devised around the time of the first era of globalization. This led to changes in scale, capital intensity and location that brought new competitors into light- and then heavy-industrial markets, creating new directions for trade and re-making the composition of imports and exports while dramatically increasing the importance of both in national accounts.
- In all quarters of the globe, governments were mid-wives or even parents of a new era of, first, industrial and then electronic development while managing – sometimes minutely – the pace and distribution of change in sectors such as agriculture. Many governments that had once taxed the ‘old’ source of wealth now subsidized it in the name of food security or in an effort to compensate for the redistribution of national wealth towards a more productive industrial and services sector. These actions, too, had spillover impacts on global trade of an order that the GATT was not designed to manage.
- The wealth that accompanied the new era of globalization itself brought consequences GATT could not manage. The rapid expansion of investment and of consumption possibilities in the new era of globalization saw the spread of designer and entertainment goods and the delivery of new communication and production technologies to vast new consumer markets in jurisdictions where the essential IP component of the goods was not secure. Consumer and producer put different values on the problem, at least in the short-term, creating tensions the GATT could not resolve.
- As the symbol of inter-governmental management of the trading system, the GATT’s own structures were by the 1980’s out of tune with the phenomenon then being called ‘interdependence’; the network of exchange that linked each economy to every other and made the welfare of any individual country vulnerable to the policies of others. The fabric of Members’ rights was patched by ‘voluntary’ codes that made their Members more equal than others; many smaller economies had been introduced into membership by former imperial powers without having to integrate a meaningful level of GATT disciplines into their trade policies; small groups managed internal GATT affairs with reference to the whole membership only at the last moment.
- Finally, the ‘gold standard’ that had been an icon of the first era of globalization broke, in the early 1970s, under the combined pressure of decades of fiscal expansion and speculation. The end of fixed exchange rates demanded more sophisticated economic strategies than many

governments were able to deploy and put unexpected pressures on economies with either surplus or deficits on their current accounts – including the world’s largest economies – to resolve imbalances using crude trade barriers or some form of subsidy. Developing economies felt the challenges most keenly but found the multilateral institutions of the defunct Bretton Woods system still equipped only with harsh, anti-inflationary options.

Nowhere were the limits of the GATT more evident than in the Declaration following the turbulent 1982 Ministerial meeting of GATT’s Contracting Parties. It catalogues the problems in language that conveys the dissatisfaction of the majority:

The deep and prolonged crisis of the world economy has severely depressed levels of production and trade. In many countries growth rates are low or negative; there is growing unemployment and a climate of uncertainty, exacerbated by persistent inflation, high rates of interest and volatile exchange rates, which seriously inhibit investment and structural adjustment and intensify protectionist pressures. Many countries, and particularly developing countries, now face critical difficulties created by the combination of uncertain and limited access to export markets, declining external demand, a sharp fall in commodity prices and the high cost of borrowing . . .

In the field of trade, the responses of governments to the challenges of the crisis have too often been inadequate and inward looking. Import restrictions have increased and a growing proportion of them have for various reasons been applied outside GATT disciplines, thus undermining the multilateral trading system. Trade patterns have also been adversely affected by certain forms of economic assistance for production and exports and by some restrictive trade measures applied for non-economic purposes . . . [leading to] delays . . . in necessary structural adjustment, increased economic uncertainty and discouraged productive investment.

. . . [D]espite the strength and resilience which it has shown, the stresses on the [trading] system, which are reflected in the growing number and intensity of disputes between contracting parties, many of which remain unresolved, have made more pronounced certain shortcomings in its functioning. Existing strains have been aggravated by differences of perception regarding the balance of rights and obligations under the GATT, the way in which these rights and obligations have been implemented and the extent to which the interests of different Contracting Parties have been met by the GATT . . . Disciplines governing the restriction of trade through safeguard measures are inadequate; there is widespread dissatisfaction with the application of GATT rules and the degree of liberalization in relation to

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agricultural trade, even though such trade has continued to expand; trade in textiles and clothing continues to be treated under an Arrangement which is a major derogation from the General Agreement – a matter of critical importance to developing countries in particular. Such differences and imbalances are particularly detrimental to the stability of the international trading system when they concern access to the markets of major trading countries or when, through the use of export subsidies, competition among major suppliers is distorted.

(Paras 2–4 of the Declaration, 38th Session of Contracting Parties at Ministerial Level, Geneva, 29 November 1982)

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## The GATT becomes the WTO, 1995

The decades (1947–1994) in which the GATT organized the development of global trade in merchandise demonstrated that the concept could work and achieve results, while developing new methods to avoid or resolve trade disputes. The challenge that Members faced in the creation of the WTO was to build on the successes of the GATT system while overcoming its limitations.

The first thing that strikes us in comparing the GATT to the WTO is the obvious difference in size: ten agreements under the GATT (barely 80 pages in length) compared to 28 Uruguay Round agreements (26,000 pages, and 200 kilos in the originals, which include the national schedules). The WTO comprises more than 60 different formal councils and committees, compared to less than one third that number under GATT in its last years.

The increase in size is a symptom of the huge expansion in the scope of the agreements. Subjects covered by one or two articles of the GATT, such as agricultural trade, or only in passing, such as trade in textiles and clothing, have been spun out to individual agreements under the WTO with detailed schedules, footnotes and annexes. A single line in the GATT, such as Article XX(b) – which reads ‘necessary to protect human, animal or plant life or health’ – has been elaborated in the WTO into a complex, finely-balanced Agreement on Sanitary and Phytosanitary Measures (SPS) whose title alone is almost as long as the GATT provision.

In response to the problems identified in the 1982 Ministerial Declaration, the Uruguay Round agreements revised and expanded the GATT’s rules on ‘contingent’ barriers such as anti-dumping, subsidies and safeguards, providing much more precise characterizations of GATT disciplines.

The approach adopted by the Uruguay Round negotiators was not merely to annotate, but to expand, define, explicate and consolidate the concepts and disciplines that already existed, combining them with new provisions that absorbed the experience of 40 years of the multilateral

trading system. Some articles of the GATT were expanded – or rather ‘complemented’ since the original articles remain in force – to become entire agreements; paragraphs became articles; terms became lists and definitions.

It is worth remembering, for example, that the GATT did not define what it meant by an ‘export subsidy’ – although it had prohibited their use in non-primary products since the 1960s and weakly disciplined their use in agriculture. The Agreement on Subsidies and Countervailing Measures (SCM) filled this obvious gap.

The Agreement on Safeguards prohibits practices such as ‘voluntary’ export restrictions that obscured the use of unscheduled import barriers. But it also makes it possible to use safeguards more effectively as part of a legitimate trade adjustment program with expanded provisions for temporary, compensated use of import barriers, even on a discriminatory basis.

Governments extended the multilateral trading system to encompass the vast domain of trade in services. The General Agreement on Trade in Services (GATS) replicates the GATT principles for trade in ‘intangibles’ which make up an increasing percentage of world trade.<sup>1</sup>

The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) specifies minimum standards of protection for intellectual property for all Members of WTO.

### A capacity for reform

It is obvious that the WTO agreements introduced big changes. But there was much greater novelty in this revision of the trading system than even the explosion of numbers of agreements and topics indicates.

For the first time, The Uruguay Round Agreement gave the multilateral trading system a reform agenda. You’ll search in vain for the word ‘reform’ in the text of GATT 1947, but it occurs ten times in the WTO Agreement on Agriculture alone, including in the first line. The WTO takes an intentional approach that more strongly implies policy choices and directions than anything found in the GATT.

The GATT avoided policy prescriptions. It was agnostic about the intention of commercial policies confining itself to regulating the impact

<sup>1</sup> Services represent the fastest growing sector of the global economy and as of 2004 accounted for 60% of global output, 30% of global employment and nearly 20% of global trade.



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of commercial policies associated with cross-border movements of merchandise trade. It reached behind the border only to regulate internal taxes, levies or various 'advantages' that might circumvent or modify commitments given on border measures. It contained no directions to Members on the content of their laws and offered them no examples or templates that would help them to achieve conformance. Not until the last moment - more than 40 years after its creation - did the GATT show any interest in understanding the trade policies of its Members.<sup>2</sup>

GATT accommodated the policy objectives of its founding Members even to the point of inconsistency in the rules applying, for example, to the use of subsidies and quota barriers in the non-primary and primary sectors. It provided a waiver to allow many of the same countries to maintain tailored protection policies for their textile and clothing markets that were inconsistent with its non-discrimination objectives and its prohibition on quotas for manufactured products. But, these were merely inconsistencies in what were agreed sectoral objectives.

The WTO, too, avoids policy prescriptions, but not as thoroughly as the GATT. The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), for example, sets out detailed requirements for Members' domestic laws on the protection of Intellectual Property (IP) and for the enforcement of those protections. The Agreement on the Application of Sanitary and Phytosanitary Measures (SPS) prefers standards and policies embodied in other multilateral agreements.<sup>3</sup> The Agreement on Technical Barriers to Trade (TBT) provides a template for best practice in the management of industrial standards. The GATS Annex on Telecommunications contains a 'reference paper' with specific standards for the regulation of complex market structures such as inter-connection of telecom networks.

The WTO recognizes, more explicitly than the GATT, that trade measures are part of a larger environment of economic policies that serve many goals. The Trade Policy Review Mechanism (TPRM) offers an opportunity to observe that environment in Member economies.

But the most profound changes are found in the Agreement on Agriculture where the comprehensive and detailed provisions on the tariffication of non-tariff barriers, the opening of all markets to a

<sup>2</sup> At the Montreal Ministerial meeting in December 1988 the GATT Contracting Parties established the Trade Policy Review Mechanism, which retains a prominent role in WTO.

<sup>3</sup> Those of the Food and Agriculture Organization (FAO) and the World Organization for Animal Health (OIE).

minimum extent, the requirement for sector-wide bindings on border measures, the limits on the use of export supports and the value and character of domestic market support add up to a program for sectoral policy change on a global basis.

No global campaign on trade policy of this breadth had been attempted since the ill-fated Havana Charter (1947). However, this time the proposed reform of the global trading system was adopted and implemented. The Agreement on Textiles and Clothing, for example, matches the Agreement on Agriculture for its evident intention to bring about a sector-wide global policy reform; although in textiles and clothing the reform comprised merely a reversal of the anomalous waiver for quantitative border restrictions, without requirement for changes in the nature of domestic policies.

Everywhere, too, the new agreements provided for a much larger flow of information and reporting by each Member. Notifications that had been almost matters of courtesy under the GATT became obligatory and detailed under WTO agreements. Members are required to notify changes in circumstances and policies, or completion of obligations, under the agreements or national schedules. Committees established under the agreements created templates for notifications to ensure consistency and completeness.

### Legal consistency

The GATT [1947] is a diplomat's agreement. Compared to the WTO Agreements, the articles of GATT are concise, but their terms are no more precise than they needed to be for the sake of agreement. Important differences that emerged during the 40 years in which the GATT was the guarantor of the multilateral trading system revealed ambiguities that 'papered over' imprecise concepts or seemed to create rights or obligations that, in practice, turned out to be unenforceable.

The Tokyo Round<sup>4</sup> 'Codes' attempted to improve the GATT in areas such as anti-dumping and countervailing duties that were frequently litigated in industrial markets and where greater forensic precision was essential. But the impact of the Codes was reduced by their limited membership and by their dependence, ultimately, on the enforcement powers of the main agreement whose vitality they sapped by undermining its central principle of non-discrimination.

<sup>4</sup> The Tokyo Round of trade negotiations took place from 1973 to 1979.