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THE WORLD TRADE ORGANIZATION (WTO) AND THE ACCESSION
PROCESS: TESTING THE IMPLEMENTATION OF THE MULTILATERAL
TRADE AGREEMENTS

by

Anna Lanoszka

Submitted in partial fulfillment of the requirements
for the degree of Doctor of Philosophy

at

Dalhousie University
Halifax, Nova Scotia
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In memory of my dear high-school friend Agata Maciejewska (1966 –1999)

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Abstract

The geopolitical changes that have occurred over the last two decades have provided the impetus for the creation of the World Trade Organization (WTO). And yet the Uruguay Round of negotiations that eventually gave birth to the WTO took over four years of preparations and seven more years of talks to complete. Unlike its predecessor, the General Agreement on Tariffs and Trade of 1947 (GATT), the WTO is a formal rule-based member institution with its own strengthened dispute settlement mechanism. Furthermore, and in contrast to the GATT, the WTO scope is vastly enlarged to include such new issues as investment, services and intellectual property.

The WTO accession process is a test of what it means to be a WTO member. Since the organization has changed dramatically the criteria for joining it reflect the magnitude of these changes. WTO accession is difficult and lengthy because it corresponds to implementing a demanding package of WTO agreements. For the candidate countries the WTO membership has enormous political and other implications, since it goes to the heart of the most fundamental questions about the role of the state in the economy and the meaning of economic globalization.

The establishment of the WTO brings attention to the fact that new developments in the world economy have intensified the interaction between international and domestic law. Particularly in transitional and developing economies, international rules play a significant role in guiding the reform of political, legal and economic institutions. The WTO instructs reforming states to build the legal institutions needed to coordinate a market economy and to ease the integration of those states into the global economy. However, in a bargaining situation for WTO accession where candidates have no power and face highly intrusive demands for internal reforms, the process raises the questions of what are the long lasting consequences of implementing international legal rules by economically weak states.

Abbreviations

ATC	Agreement of Textiles and Clothing
EC	European Communities
EU	European Union
FDI	Foreign Direct Investment
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
HS	Harmonized System
IMF	International Monetary Found
IPRs	Intellectual Property Rights
MFN	Most-Favored-Nation
NAFTA	North American Free Trade Agreement
OECD	Organization for Economic Cooperation and Development
R&D	Research and Development
TRIMs	Trade-Related Investment Measures
TRIPS	Trade-Related Intellectual Property Rights
UNCTAD	United Nations Conference on Trade and Development
WIPO	World Intellectual Property Rights Organization
World Bank	International Bank for Reconstruction and Development
WTO	World Trade Organization

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Introduction

The following study concerns itself with the accession of new members to the World Trade Organization (WTO). On a theoretical level we investigate the relationship between international rule making, rule implementation and the behavior of the state in a time of global market integration. In practical terms the research examines the legal requirements, the corresponding procedural steps of the WTO accession process, and the anticipated benefits of the WTO membership. The accession to the WTO – which can be understood as a new kind of globally oriented organization - is equally important from both of these perspectives. The accession process testifies to an unprecedented role played by the WTO by illuminating the diversity of policy problems which global market integration presents to policy makers at the national and international level. The following research makes an argument that WTO accession reflects a fundamental dilemma of the contemporary state coming to terms with a globalizing economy: a struggle to establish reliable and effective administrative and regulatory standards to ensure the internal stability necessary to allow its full participation in a changing international economic order.

The geopolitical changes that have occurred over the last two decades have encouraged a need for a coordinated approach to international decision-making. As a result international law has begun to play an important role of facilitating a shift towards a rule-based system of international governance. The key to understanding the shape of

new governance structures in the post-Cold War world lies in the way that international legal rules are influencing the world economy.

Following a seven year round of international negotiations, an agreement was reached in 1995 to enlarge the scope of the GATT (General Agreement on Tariffs and Trade) and establish a legally binding trade organization (WTO). The legal code of the WTO was designed to be a significant factor in remedying global economic policy coordination failures, mainly through disciplining states to overcome their own limitations by advancing their interests through collective action. Moreover, it was believed that by forcing higher standards WTO legal rules could also help build market-supporting mechanisms, such as a professional judiciary to enforce property rights and ensure a due process, administrative transparency in government agencies, and regulatory predictability to coordinate policy making. Such outcomes could be particularly beneficial for the reforming countries that had had a disastrous interventionist past.

Notwithstanding the anticipated benefits of a rule-based international order, however, the advent of the WTO poses many difficult questions concerning the relationship between international law and the domestic law of a sovereign state. One of the questions asked here is what happens when a small country commits itself to implementing a comprehensive framework of international legal rules? What if such commitments exceed its capabilities? And can legal rules be truly neutral especially when they support an inherently uneven system?

These are complex times, in particular for the state. In the world of weakening borders, the state has to ensure that its social and economic environment can cope with the increased pressures caused by the international system. But in pursuit of participation

on equal terms in a globalizing economy, the state needs be able to protect its constituencies from any possible crises caused by volatile world commercial transactions. WTO membership offers a promise of equal participation, but it does not guarantee an instant surge in prosperity, distributive justice or technological progress. The prosperity and security of its citizens remains the responsibility of the state. It is clear, however, that it would be difficult for the state to achieve these goals without actively participating in the intensifying global economic transactions.

To accede to the WTO means that the candidate state has to meet the requirements specified by the present WTO Members. These requirements no longer relate only to border measures. The WTO expanded the scope of international trade rules by including under its mandate trade in services, intellectual property and issues of investment. These obligations can be quite demanding, and therefore accession negotiations place tremendous pressure on candidate countries to make numerous concessions and to undergo massive domestic regulatory reforms meant to create a credible and equitable system of commercial and administrative law. This entails minimum standards of due process necessary to establish domestic stability and to ensure that foreign investors feel secure about their investments. However, without any legal right or ability to impose costs on the powerful WTO Members, negotiations must continue until those Members are satisfied with the reformist changes and concessions made by the candidate state. Thus, irrespective of the size of the candidate state, the accession negotiations will be protracted unless the candidate quickly concedes the vast and challenging volume of the standardized demands of the large WTO Members.

My basic proposition recognizes that international relations have entered a new reality of deepening global integration of economic transactions. This changing global environment impacts the behavior of the state through the variety of expanding international linkages associated with new patterns of production and new technologies, especially in the fields of communications and transportation. It is argued that deepening global integration has created a sense of urgency over the need to strengthen the mechanisms of international cooperation by establishing a set of global legal rules to govern the growing number of cross-border activities.

The WTO was created in the belief that a new and more integrated international economy necessitated a strong organizational structure with a global scope. As a result the WTO institutionalized a particular view of how economies should be organized and regulated, which often runs counter to the past experience, and even the present capabilities of certain states. For the candidate countries the WTO membership has enormous political and other implications, since it goes to the heart of the most fundamental questions about the role of the state in the economy and the meaning of economic globalization. Therefore, the WTO accession process amounts to a substantial inquiry into the process of implementation of international rules by the state. The main question is how the globally institutionalized legal regime is affecting the state in terms of its supervisory and administrative policies. A further question is whether the kind of formula it offers for the successful regulatory framework of the state can be applied in a universal fashion, and how this framework affects the national economic development strategies.

The length and costliness of the process suggests that WTO accession is biased against the candidate because the process gives enormous powers to the WTO Members to extract commitments that often exceed the abilities of the acceding countries. In fact, the acceding countries are undergoing a structural reform process under the supervision of the WTO. Scholars examining international regimes have long observed that international norms and rules not only matter but they can powerfully influence domestic policy-making. The main proposition underlying this work considers the WTO accession process as negotiation of commitments intended to reform a country in economic crisis. On the other hand, however, WTO obligations mean that drastic demands are placed on the candidate state. These can result in severe spending and management constraints imposed on the reforming state. The application of international rules can circumscribe the regulatory power of the state in terms of allowable public policy options, such as, the financing of public sector spending, monetary policies, agricultural subsidies and economic development strategies.

It should be noted that the above argument is not inconsistent, but rather reflects the predicament of the contemporary state attempting to adjust to the changing nature of the international system. Joining the WTO implies membership in a globalizing world order. However, WTO accession means enormous costs for the candidate states. Most importantly, the terms of WTO accession permanently bind the acceded countries into compliance with a demanding set of legal obligations. Yet, for the state to remain outside the WTO carries a threat of marginalisation and of falling behind the rapidly progressing pace of economic globalization firmly advanced by the industrialized nations.

The WTO code is a very real set of legal obligations. This means that each new signatory takes upon itself the responsibility for conducting its commercial affairs in accordance with its rules or else it may be the subject of legal proceedings and be faced with retaliatory measures in case of the violation of rules. In order to meet these obligations, the acceding state has to establish effective enforcement and implementation mechanisms, and to liberalize its economy. What the candidate countries must do in order to meet the demands of the WTO accession process constitute the backbone of this research.

Theoretically speaking, we cautiously consider the WTO to be a first step towards the establishment of global rules of international conduct that are necessary to regulate the increasingly complex global economy. By definition, however, global rules inevitably penetrate state borders. How global rules affect the behavior of the state is a fundamental problem of contemporary international relations. The following study hopes to offer some new theoretical propositions on the subject. Consider, for example, the tension between the concept of state sovereignty and a liberal world order. A sovereign state is an inherently protectionist and self-interested institution meant to protect its citizens even at the expense of the outside world. But protectionism is contradictory to free trade. Thus, sovereignty has a different and somehow reduced role in the global trading regime of the WTO. Accession negotiations illustrate this well, since the process is about conceding some of the country's sovereignty in exchange for the anticipated benefits derived from submission to the constraints of the international legal regime.

The process of WTO accession demonstrates how much the international trading environment has changed. Acceding to the GATT in the 1980s meant resolving issues of

market access for goods, and negotiations therefore tended to focus only on border barriers. Negotiating accession to the WTO after the Uruguay Round is much more complex. International trade is no longer about goods, tariffs and border measures, but includes among other things such new issues as services, intellectual property, and investment, and as a result it increasingly deals with the domestic regulatory regime of the state. Being successful as a trading partner often depends on whether the state has a capacity to facilitate consistent economic growth and internal stability, and whether it can attract foreign investment and provide a secure environment for outlets of globally changing patterns of production.

The dynamics of accession to the WTO is a microcosm of the clashes currently transpiring in the international political economy. The accession process usually gets initiated because the applicant recognizes a new geopolitical reality, that is, the changing nature of the global economy and the ensuing pressures tearing the state in contradictory directions. Accession is sought because the candidate appreciates the significance of the WTO as a universal, rule-based international institution with a strong dispute settlement mechanism. Furthermore, WTO membership is viewed as worthwhile because the organization plays the role of a much-needed global forum aimed at coordinating a growing volume of international economic transactions. Furthermore, it has the capacity to mitigate the potential power struggles between the most powerful members.

WTO accession also provides evidence on the changing role of the state because of the pressure put on it by the international system. After all, the process mainly revolves around the internal reforms that the candidate state must undergo in order to behave in accordance with the legal principles that the WTO is based on. The task is

enormous since the candidate is effectively attempting to accelerate the construction of a mature market economy that normally takes generations to evolve. This often means that the state has to establish new institutions and introduce new laws that are foreign in their novelty or even contradictory to the local understanding of the issues they are intended to institutionalize. In the end, an applicant state often makes a leap of faith from a position of political and economic dependence on a stronger state to a position of independence while struggling to become globally competitive.

The WTO framework is based on a few fundamental principles rooted in the long lasting tradition of the GATT. These principles inform the demands placed on the candidate states. First of all, to accede to the WTO means to adhere to the principle of non-discrimination and as well that a country is ready to apply 'national-treatment' to goods and selective services that cross its borders. It also means that the candidate becomes an open market economy and accepts all the legal obligations placed on it by the Uruguay Round Agreements. Furthermore, membership in the WTO confirms that the state's economic, legal and political institutions resemble similar institutions in the rest of the member states, ensuring the transparency of economic transactions and a fair treatment of foreign business activities as stipulated in the legal texts of the WTO.

The WTO accession negotiation involves a long and difficult bargaining between the candidate and the interested member states. The process is complex because the WTO is quite different from other institutions of the international economy by virtue of its scope and its impact on the domestic economic policies of its members. Acceding to its provisions has a much greater significance for the public policy options of state governments than has been the case with the GATT. This is because the WTO has

specific new powers, and covers a much wider array of economic activities. Consequently, a move to join the World Trade Organization involves concrete policy obligations. In fact, especially in the case of transitional economies, the WTO accession process often provides a framework for reforming both political and economic institutions of reforming states. Moreover, acceding countries expect that WTO membership will have a stabilizing effect on their economies and will give them a chance to fully participate in international economic networks.

The WTO has redefined the concept of international trade by including within its authority those areas of commercial activities that have traditionally belonged to the state. This development can be seen as an outcome of a larger trend in the 1980s and 1990s, namely, the unprecedented opening up of national economies and the deepening linkages among them. The establishment of the WTO in the period immediately following the end of the Cold War was not accidental but rather it reflected the changing nature of a globalizing world economy. The geopolitical landscape of the international system has been profoundly altered with the collapse of the Soviet Union, thus allowing for the closer integration and increased liberalization of the global economic transactions.

The following work argues that the WTO is an international regime created by states to facilitate the proper functioning of global economic transactions through the establishment of a rule-based system of governance. This is what makes the WTO a unique actor of the international relations. The WTO signifies the decline of an international organization based on the principle of diplomacy and heralds the ascendance of a legally binding institution with global appeal and aspirations for universal membership. The WTO has at its disposal the only legally enforceable dispute

settlement mechanism under international law capable of authorizing trade sanctions. and, as we shall demonstrate, this fact takes on great importance in the accession process. The WTO dispute settlement system is playing an active role in the development of the substantive and procedural content of international law through the clarification and interpretation of trade rules. As a legally binding institution, the WTO advances a particular model of a domestic administrative and regulatory framework. That model aims to achieve predictability and transparency of commercial transaction both inside and outside state borders, but in doing this it also determines the rights of access for new and existing members.

The establishment of the WTO brings attention to the fact that new developments in the world economy have intensified the interaction between international and domestic law. Particularly in transitional and developing economies, international rules play a significant role in guiding the reform of political, legal and economic institutions. The WTO instructs reforming states to build the legal institutions needed to coordinate a market economy and to ease the integration of those states into the global economy. However, in a bargaining situation for WTO accession where candidates have no power and face highly intrusive demands for internal reforms, the process raises the questions of what are the long lasting consequences of implementing international legal rules by economically weak states.

Chapter 1

The Uruguay Round as a Turning Point in the History of International Trade and Legalization of World Politics

Introduction

Over the last two decades, the rapidly growing volume of the world's commercial transactions has created a need for a coordinated approach to international decision-making¹. In addition, the geopolitical changes that have occurred since the end of the Cold War have encouraged a turn away from ideologically charged bi-polar rivalry towards a rule-based system of international governance. As a result the rule of law has begun to play an important new role in the organization of international relations. Some scholars have called this tendency a legalization of world politics, in which "legalization, a particular form of institutionalization, represents the decision in different issue-areas to impose international legal constraints on governments."² International institutions differ in this context as the extent of legalization varies across issue-areas³. Institutions that are characterized by the obligatory nature of rules, their legal precision, the inclusion of an

¹ Peter A.G. van Bergeijk & Nico W. Mensink (1997) "Measuring Globalization," in *Journal of World Trade*, Vol. 31, No. 3 (June), pp. 159-168.

² Judith Goldstein, Miles Kahler, Robert O. Keohane, and Anne-Marie Slaughter (2000) "Introduction: Legalization and World Politics" A special issue of *International Organization* titled "Legalization and World Politics" Vol. 54, No. 3, Summer, pp. 385-399.

³ Compare, for example, the legal system of the European Union and the European Court of Justice, the UN Convention on the Law of the Sea, the Law of the Sea Tribunal, the North American Free Trade Agreement (NAFTA), the Montreal Protocol on Substances Depleting the Ozone Layer, the Vienna Conventions on the Law of Treaties and on Diplomatic Relations, and the International Criminal Court.

outside interpretative body and a conflict-resolution mechanism with authority to coerce. clearly represent a more substantial legalization⁴.

The evolution of the GATT system in the direction of a legalized regime with third-party adjudication of trade disputes under transparent rules was a victory for the legalists⁵. The recent dramatic economic and political developments in the international order have provided the impetus for the creation of the World Trade Organization (WTO). And yet the Uruguay Round of negotiations that eventually gave birth to the WTO took over four years of preparations and seven more years of talks to complete⁶. Unlike its predecessor, the General Agreement on Tariffs and Trade of 1947 (GATT), the WTO is a formal rule-based member institution with its own strengthened dispute settlement mechanism. Furthermore, and in contrast to the GATT, the WTO scope is vastly enlarged to include such new issues as investment, services and intellectual property.

Since the main intention of this work is to analyze the process and politics of WTO accession, we should explain why this process justifies detailed consideration. Two propositions are suggested. First, we argue that the establishment of the WTO was an important international development that took place in response to the changed geopolitical environment following the collapse of the Soviet Bloc. Secondly, it is suggested that the establishment of the WTO constitutes a turning point in the history of international trade relations because of its enlarged scope and its enhanced legal powers. The WTO accession process is a test of what it means to be a WTO member. Since the

⁴ Judith Goldstein and al., (2000) "Legalization and World Politics," op. cit, p. 387.

⁵ Robert Hudec (1993) *Enforcing International Trade Law: The Evolution of the Modern GATT Legal System*. Salem, N.H.: Butterworth Legal Publishers.

⁶ John Croome (1995) *Reshaping the World Trading System – A history of the Uruguay Round*, Geneva: World Trade Organization.

organization has changed dramatically the criteria for joining it reflect the magnitude of these changes. WTO accession is difficult and lengthy because it corresponds to implementing a demanding package of WTO agreements. Full implementation of WTO agreements is a non-negotiable prerequisite to join the WTO but this arduous process requires reforming the regulatory framework of the acceding state.

Accession negotiations are already a vital part of the overall functioning of the WTO. Even a cursory look at the acceding countries indicates that WTO membership symbolizes for them a sense of belonging to the world of the international economy. The process of accession, however, is lengthy and to become a WTO member means much more than any diplomatic talks seem to communicate. It has far-reaching consequences. Accession negotiations go hand in hand with a precarious process of painful internal restructuring of economic, legal and political institutions. And if the candidate is successful, the completion of the process brings sweeping change in the way a new member will behave and will be treated while conducting its commercial relations with the 140 WTO Member states⁷.

It is no coincidence that the WTO personifies a still unclear but hotly debated phenomenon of globalization. They both began to dominate the scene of international relations about the same time, suggesting a noteworthy connection between them. Some political pundits go as far as calling the WTO an agent of globalization. It should be observed, however, that if the concept of globalization is to make any sense at all, it has to address the struggles and aspirations of the small, reforming, and often quite peripheral states. This is particularly important when discussing the universal character of the WTO since many states continue to remain largely outside global economic networks.

⁷ As of April 2001.

Globalization implies universality. It signals silencing the ideological disputes of the past waged over conflicting economic designs. However, if the international norms that the WTO represents are to carry global authority, the institution itself must meaningfully embrace all nations seeking participation in the global economy. In other words, the ambition of the WTO to become an effective global forum for regulating international trade flows can be fulfilled only if the organization finds a way to admit the states that are aspiring to join. Yet this also means that, “the terms and conditions of entry should be such as to preserve and, hopefully, strengthen the credibility of the multilateral trading system rather than to weaken it or expose it to disputes and divisions.”⁸

With respect to the historical significance of the WTO, it should be noted that this research does not uncritically embrace the view that the inception of an international trade organization based on legal rules and with a broad membership is a flawless achievement of international negotiation. The WTO is unique, and it is the result of the changing climate of the international political economy. Looking back on the decades following World War II and the political and economic hostilities of the Cold War era, it is difficult to ignore the calling of the moment that presents an opportunity for global cooperation. In a world no longer divided between two competing camps, some argue that the WTO “represents an evolutionary adaptation on the part of GATT members to a new political context, rather than a revolutionary change of direction stemming from a new ideological consensus.”⁹ The WTO does have the potential to facilitate cooperation

⁸Peter Milthorp (1997) “Integration of FSU/Economies in transition into the World Trade Organization” in *Economics of Transition*, Vol.5 (1), p.215.

⁹ Kendall Stiles (1996) “Negotiating Institutional Reform: The Uruguay Round, the GATT, and the WTO,” in *Global Governance* Vol. 2., No.1, p. 119.

among countries but this potential can evaporate if the organization cannot meaningfully integrate all developing countries into the system. This is why accession negotiations are a crucial test of whether the WTO can meet the challenge of this historical moment.

Contemplating recent geopolitical changes

When the Uruguay Round of negotiations began in 1986 the world was still divided along ideological lines. The so-called communist camp led by the Soviet Union practiced the orthodoxy of a state-run planned economy, it was hostile to the concepts of private property and free market exchange based on supply and demand, and it perceived foreign trade as being politically dangerous¹⁰. The other side was less unified in terms of ideology but it was generally accepted that the US provided leadership as the most economically powerful state. The economies of this camp continued to function according to free market principles, although there were clear differences among them with respect to the degree of state involvement¹¹. One of the main unifying forces and an important source of prosperity for the democratic states was the framework for economic cooperation designed at Bretton Woods, which was largely neglected by the Soviet group.

Thus the international context of the first meeting of the Uruguay Round was a bipolar world with the hierarchy of issues still based on geopolitical concerns organized around the questions of security and nuclear deterrence¹². With the two different

¹⁰ M.M. Kostecki (1978) *East-West Trade and the GATT System*, New York: St. Martin's Press, pp. 3-6.

¹¹ Paul R. Krugman and Maurice Obstfeld (1997) *International Economics – Theory and Practice*, New York: Addison-Wesley, pp. 275-295.

¹² Charles W. Kegley Jr. and Eugene R. Wittkopf (1989) *World Politics - Trend and Transformation*, St. Martin's Press: New York, pp. 61-86.

economic systems founded on incompatible principles, it was difficult to talk about a global economy. After all, the competition between the two superpowers was not only about the strength and power of their weaponry but also about the superiority of one economic system over the other. And although the two sides maintained some degree of economic interaction, their relations were neither free from strategic and political considerations, nor facilitative of greater international economic cooperation.

The 1990s, however, have brought immense geopolitical changes. The Soviet Union disintegrated into a myriad of small independent states. The idea of a communist state with a planned economy was bankrupt. The free market and the policy of economic liberalization gained an instant momentum. After becoming free to conduct their affairs independently of Moscow, all of the former Soviet satellites, and even Russia itself, embarked on the path of political democratization and economic liberalization. It appeared that democracy triumphed¹³ and that a growing sense of shared global values began to emerge.

However, the peculiar feature of the post-Cold War period had nothing to do with the Hegelian idea of the Universal Homogenous State but rather with an unprecedented number of nations seeking political independence. Instead of unification, a quest towards separation in the name of preserving national identity became the most pervasive consequence of the end of the Cold War¹⁴. In contemplating the meaning of these geopolitical changes, Samuel Huntington ponders the emerging new obstacles on the path

¹³ Francis Fukuyama (1992) *The End of History and the Last Man*. New York: The Free Press/Macmillan.

¹⁴ Sabrina Petra Ramet (1995) *Social Currents in Eastern Europe – The Sources and Consequences of the Great Transformation*. Durham, NC: Duke University Press.

to coordinated international decision-making.¹⁵ He describes the present international system as *uni-multipolar* with one super-power, several major powers and a growing number of newly independent states. Huntington considers the contemporary world to be dangerously differentiated since there is a clear absence of decisive hegemonic actors capable of mitigating grievances among the smaller states.

Ironically, this political fragmentation of the international system has occurred simultaneously with the increased significance of new mechanisms for regional and international economic integration¹⁶. During the past decade, the European Union (EU) has completed the Single Market Act and passed the Maastricht treaty on European Monetary Union (EMU). In North America, Canada, the United States, and Mexico have created a free trade area (NAFTA) and the countries in South America have formed Mercosur. Finally both ASEAN and APEC have agreed to establish free trade areas¹⁷. And although these organizations are characterized by diversity of institutional forms, they all share an objective of economic cooperation. The WTO, however, is the ultimate multilateral forum created to oversee an integrated dispute settlement mechanism and to undertake an active trade-policy monitoring role¹⁸.

These tendencies in favor of expanding the networks for economic cooperation outside the state coincided with growing support for economic liberalization and a move towards keeping state intervention in the economy at a minimum. Following the

¹⁵ Samuel Huntington (1999) "The Lonely Superpower," *Foreign Affairs*, Vol. 78, No. 2, March/April, pp. 35-49.

¹⁶ Edward D. Mansfield and Helen V. Milner (eds.) *The Political Economy of Regionalism*, New York: Columbia University Press, 1997, pp. 164-187.

¹⁷ Michael J. Trebilcock and Robert Howse (1995) *The Regulation of International Trade*, London: Routledge, pp. 25-47.

¹⁸ "The Marrakesh Agreement Establishing the WTO" *The Legal Texts – The Results of the Uruguay Round of Multilateral Trade Negotiations*. First published in 1994 by the GATT Secretariat in Geneva. Reprinted several times, most recently (2000) by the Cambridge University Press. "The Legal Texts...." are also available at <http://www.wto.org>

depression of the early 1980s, the Western governments were faced with rising fiscal deficits that increasingly constrained public spending and made state subsidies exceedingly costly, although the evidence continued to indicate that the government had an important role to play¹⁹. Furthermore, lower prices for commodities worldwide and the arrival of new high tech industries put additional pressures on the state by raising the price of subsidizing potentially obsolete industries to expensive levels. It can be argued that the search for alternatives like regional agreements reflected the rational responses of governments to their increasingly unstable domestic situations.²⁰

The question remains whether regional economic agreements facilitate or inhibit the move towards global economic integration. Exponents of the functionalist approach²¹ argue that the expansion of economic activity creates incentives for states to further liberalize economic exchanges because doing so enhances the economic prosperity of the participants and leads to ongoing multilateral integration. Most importantly, however, and leaving aside the debate about the impact of regional trade agreements, we observe that, contrary to the growing political fragmentation of the international system, there is strong evidence suggesting a substantial deepening of the processes of international economic integration, and possibly the arrival of a global economy. But how can a world with a growing number of political units be globalizing at the same time?

If we allow few untested generalizations, it could be argued that these seemingly contradictory tendencies are in fact mutually reinforcing. As new states appear on the

¹⁹ Robert Wade (1990) *Governing the Market – Economic Theory and the Role of Government in East Asian Industrialization*, Princeton, NJ: Princeton University Press, pp. 8-33.

²⁰ Helen Milner (1997) "Industries, Governments, and Regional Trade Blocs," in Edward D. Mansfield and Helen V. Milner (eds.) *The Political Economy of Regionalism*, New York: Columbia University Press, 1997, p. 77.

²¹ David Mitrany (1944) *A Working Peace System: An Argument for the Functional Development of International Organization*. Oxford: Oxford University Press.

world's map and past empires disintegrate, it is often a matter of political survival to become connected to global networks of economic exchange. Also, joining a regional bloc may not provide sufficient insurance that a newly independent state will persist. Hence the WTO, as a global regime based on formal rules and founded on the principle of non-discrimination, becomes so attractive. What's more, the WTO possesses the ability to constrain the most powerful states from engaging in devastating conflicts that threaten the overall stability of the system. The WTO, with its ambition of universal membership and enforcement constraints, has emerged to become "an instrument through which governments coordinate and achieve a self-enforcing cooperative trade-policy relationship²²." The question remains, however, why the WTO multilateral system can facilitate greater cooperation and benefits than participation in regional or bilateral trade agreements.

Giovanni Maggi tries to answer this question by identifying two sets of benefits that come from the WTO's multilateral and compulsory enforcement mechanism.²³ The first benefit arises in the presence of inherent *local imbalances of power*, defined as a situation in which the more powerful countries stand to lose less from a local trade war. In such a circumstance, in a multilateral enforcement mechanism, each country can serve as a third-party enforcer of low tariffs and other liberalizing commitments with respect to bilateral and regional relationships where it has influence, in exchange for receiving third-party enforcement and support in bilateral or regional relationships where it has

²² Kyle Bagwell & Robert W. Staiger (2000) *GATT-Think*, NBER Working Paper 8005. Cambridge, MA: NBER, November, p. 72.

²³ Giovanni Maggi (1999) "The role of multilateral institutions in international trade cooperation," in *The American Economic Review*, Vol. 89, No. 1, pp.190-214.

weak or no influence. This *exchange of enforcement power*, as Maggi calls it, can only work under the multilateral system effectively benefiting weak and strong states.

The second category of gains from a multilateral enforcement mechanism over a collection of bilateral and regional agreements, as identified by Maggi, is linked with the aggregation of enforcement power. The key proposition is that when a country misbehaves and breaks its commitments, under a multilateral system many governments decide to join the potential dispute, even if its consequences are mainly bilateral, leading to more severe punishments than would be possible under bilateral or regional agreements. Again, it could be further argued that the aggregation of enforcement power can act as a preventive mechanism against non-compliance or frivolous arbitrary actions by some governments.

Such an argument leads to the conclusion that the WTO has been pressed into existence because of changed international conditions and with the underlying rational purpose of bringing order to the increasingly complex political economy of a changing world order. Indeed, the creation of a strong international trade regime appears to be the most pragmatic way of reconciling the two contradictory tendencies that characterize the current international system. "The increasing divergence between the political and economic functions of states means that the increasing desire for political autonomy on the part of relatively small and distinct groups, usually based on ethnicity, can be assuaged simultaneously with the external benefits of economic integration made possible by global trade liberalization."²⁴

²⁴ Harvey W. Armstrong and Robert Read "Trade and Growth in Small States: The Impact of Global Trade Liberalisation" in Peter Lloyd and Chris Milner (eds.) *The World Economy- Global Trade Policy 1998*, Blackwell Publishers, 1998, p. 153.

The scope of the liberalization process, however, necessitates reaching an international consensus on the set of priorities guiding the global economy. It is a fallacy to assume that once the drive towards global economic cooperation has been set in motion, the world's economy will automatically follow the most desirable path for enhancing prosperity everywhere. What is urgently needed is global policy coherence in relation to a fair and sustainable distribution of resources, and this depends on and requires a strong leadership capable of addressing the need for democratization of WTO operations and the inclusion of all of its members in its decision-making processes.

It is clear that the Uruguay Round would not have resulted in creating the WTO if it were not for the changes that had occurred in the world economy. What has happened since the end of the cold war rivalry between the communist camp and the rest of the world has been analyzed and interpreted by many different schools of analysis. Most frequently, however, the observations made in connection with the new international order involve the notion of globalization.

Despite extensive literature on the subject, globalization remains an elusive concept²⁵. In most easily measurable terms it translates into global market integration. However, there are many different perceived aspects of this phenomenon ranging from propositions about vanishing borders and the withering of the state to the emergence of a unified global culture and the uncontestable dominance of a single economic model of development. For the purpose of this research, it is taken as settled that globalization primarily rests on four pillars. These are: the increased volume of international trade, the unprecedented growth of global investment, the surge in international financial

²⁵ Certainly, we cannot rely on the clever definition of Anthony Giddens, who ironically observes that: "The global spread of the term is evidence of the very developments to which it refers." "Globalisation" Lecture 1 of 1999 Reith Lectures 1999, London, April 1999.

transactions, and the shift from vertically organized firms to horizontal, networked and knowledge-based global production.

The changes occurring in the international political economy are of particular interest when it comes to the relationship between the state and the market. The era of the postwar welfare state, characterized by the belief that domestic policy making can ignore international economic developments, may well be over. Global economic restructuring has created powerful forces that push the state in contradictory directions and directly affect government policies²⁶. Until recently, there has been little need for governments to learn to respond quickly to the changing global environment. The new 'competition state'²⁷, in contrast, is expected to act like an arbiter between domestic pressures and international forces. In the new trading global environment, competitive advantage stems from a coordination of and reciprocity among national policies, corporate strategies, and global economic organizations²⁸. These are major challenges for every state but in particular the new global competition agenda often defines the external pressures faced by the economically struggling states.

Globalization does carry a warning about the changing role of the state. In its extreme form, a doomsday scenario conceives of a world dominated by multinational corporations and global institutions like the WTO, which elbow the state into an irrelevant position. But in reality there is mounting evidence that a domestic environment conducive to economic growth and technological innovation facilitates the increased

²⁶ Keith Banting (1996) *Social Policy Challenges in a Global Society*. Kingston, ON: International Development Research Centre, April.

²⁷ While welfare state is characterised by a regulatory approach to public policy making, the competition state is based on the principle of domestic de-regulation. For detailed analysis look in Philip Cerny, "Globalization and the Changing Logic of Collective Action." *International Organization* 49 (4), 1995, pp. 621-625.

²⁸ Ronald Masticelli (1999) *The Growth Warriors; Creating Sustainable Global Advantage for America's Technology Industries*, Northridge, CA: Technology Perspectives, p. 77.

inflow of foreign direct investment and often constitutes the prime determinant of economic prosperity and social stability. However, incorporating dynamic elements into competitive state strategies requires more than minor adjustments to traditional thinking. In this context, Hirst and Thomson offer few words of caution: "One key effect of the concept of globalization has been to paralyze radical reforming national strategies, to see them as unviable in the face of the judgment and sanction of international markets."²⁹

The authors further observe that the danger of the rhetoric of globalization is that it tends to ignore the questions of uneven distribution, since the world's wealth and output remain local and extremely unevenly distributed. Moreover, globalization treats the world as a single open competitive market and the location of economic activity as dictated by purely commercial considerations. Thus, as Jagdish Bhagwati wisely tells us, "pro-globalization and pro-privatization economic reforms must be treated as complementary and indeed friendly to both the reduction of poverty and social agendas."³⁰

One certainly has to be careful not to accept an easy definition of globalization, particularly in relation to the WTO. The result could be a distorted picture of international economic transactions. Most importantly, however, using globalization as a blanket that covers an inherently uneven world precludes the possibility of identifying problems and then rectifying them. The lack of a critical approach can obscure any analysis by preventing us from acknowledging problematic gaps and inconsistencies. Constructive criticism, on the other hand, acquires a pragmatic meaning when it comes to

²⁹ Paul Hirst and Grahame Thompson (1996) *Globalization in Question: The International Economy and the Possibilities of Governance*. London: Polity Press, pp. 1-3.

³⁰ Jagdish Bhagwati (1998) "Poverty and Reforms: Friends and Foes?" in *Journal of International Affairs*, Vol. 52, No. 1, Fall, p. 34.

the WTO. Since the WTO remains an unfinished project, its problem areas are in particular need of analysis.

Most economists already agree that a free market cannot operate without state guidance. Adam Smith's invisible hand is that, but it may not be real³¹. This carries a strong message at a time of increased global influence by largely unregulated financial markets and the ascendance of powerful corporations that often defy the fundamental principles of fair competition. With the enlarged scope of the WTO and its new legal authority, the state has to be prepared to deal with the complexity of issues associated with global market integration. The emphasis must be placed on devising an effective regulatory, administrative and judicial framework. The WTO advocates a model of such a framework. It is, however, up to individual countries to set their priorities for the future.

The WTO is a member-driven organization. This means that the member states decide on its course of action. Yet, the contemporary system of states is unable to muster a vision for its future and it suffers from a continuing leadership deficit. The danger is obvious, particularly with respect to organizations like the WTO, which require clear and decisive agenda setting.³² Otherwise they can stumble over a misplaced emphasis on tactics instead of strategy, resulting in a policy vacuum. If the WTO truly aims to promote prosperity and fairness in global economic transactions, it can be argued that it should take into consideration the impact its trade rules are having with respect to political, social and environmental issues around the world. As Ernst-Ulrich Petersmann has recently commented in the context of the failure of the Seattle WTO Ministerial

³¹ Adam Przeworski (1995) *Sustainable Democracy*, Cambridge: Cambridge University Press, pp. 110-112.

³² Marcus Noland (1999) "Learning to Love the WTO," *Foreign Affairs*, Vol. 78, No.5, p. 92.

Conference: "The non-economic values of WTO law are no less important for the human rights and welfare of citizens than the economic welfare effects of liberal trade".³³

The road to the Uruguay Round - negotiations at the Bretton Woods

The goal of cooperating rather than competing constituted a backbone of the post-World War II negotiations aimed at establishing global institutions for the coordination of global economic transactions. The economic priorities of the post-war era were twofold. The first concerned the goal of economic growth and full employment. This meant the restructuring of national economies, increased government intervention, and the establishment of the welfare state. The second priority was to construct a stable world order that would prevent a return to the interwar period and its basic feature, the economic nationalism that had given rise to destructive "beggar thy neighbor" economic policies³⁴.

Focusing on these two priorities helped the pursuit of common international objectives and eventually resulted in the Bretton Woods settlement. The main principles of the system rested on the idea that governments should have considerable freedom to go after national economic objectives, while observing an international monetary order based on fixed exchange rates and currency convertibility for current account transactions³⁵. The negotiations at Bretton Woods in 1944 were from the beginning dominated by two different visions of the international guiding rules as expressed

³³ Ernst-Ulrich Petersmann, (2000) "The WTO Constitution and Human Rights" *Journal of International Economic Law*, March, p. 19.

³⁴ C.P. Kindleberger (1973) *World in Depression. 1929-1939*, Berkeley: University of California Press.

³⁵ Peter B. Kenen (1994) *Managing the World Economy: Fifty Years After Bretton Woods*, Washington DC: Institute for International Economics, pp. 9-13.

respectively by Britain and by the United States³⁶. These two countries' different positions were an outcome of distinct historical experiences and their preoccupation with opposing set of concerns.

There were many contentious issues, particularly with respect to the balance of payments, the removal of trade restrictions and other discriminatory practices. The United States sought to avoid exchange rate instability by getting rid of all exchange controls, and to prevent the trade protectionism that had hampered the economic recovery of the 1920s by devastating international trade and finance. Britain, on the other hand, primarily sought to avoid the threat of high unemployment and social and political instability and wanted to keep its reserve currency role and the imperial preference system³⁷.

Another set of contentious issues related to the formation of an international organization "designed to ensure the workability of a new world order."³⁸ If the negotiators at Bretton Woods had learned anything from the disaster of the 1930s and the failure of the League of Nations, it was that solving major political and economic problems required practical and concrete solutions. But practicality alone could not produce the ambitious vision of comprehensive institutions for global governance. More than anything, the guiding principle behind the Bretton Woods agreements was an inspired goal of creating a set of institutions that would work in concert, ensuring long lasting peace and prosperity.

³⁶ Sylvia Ostry (1997) *The Post-Cold War Trading System: Who's on First?* Chicago, MI: The University of Chicago Press, pp. 54-56.

³⁷ Sylvia Ostry (1997) *The Post-Cold War Trading System: Who's on First?*, op. cit., p. 59.

³⁸ Allan Hansen (1945) *America's Role in the World Economy*. New York: W.W. Norton, p. 8.

One of the institutions in the making was a regime intended to deal with international trade. The idea behind the International Trade Organization (ITO) was to design an effective regime with a broad mandate for the regulation of trade, including private business, commodity agreements, economic development and foreign direct investment. In essence, “the ITO was designated as the international agency of the United Nations charged with overseeing global governance”³⁹. However, it is important to remember that the Bretton Woods negotiations did not embark on the trade agenda in a detailed or comprehensive fashion. Indeed, they were dedicated to monetary and banking issues that formed the charters of the International Monetary Fund (IMF) and the World Bank⁴⁰. A world organization for trade was envisaged only to complement the new agreement on financial principles. Still, trade issues were firmly rooted within the overall Bretton Woods agenda.

Ironically, post-war institutional developments separated international trade and international finance into two distinct divisions of international political economy. This distinction has always been quite superficial. In the real world there is no simple dividing line between trade and monetary issues. This division, however, makes sense when analyzing the events surrounding the Bretton Woods negotiations and their outcome. Sylvia Ostry observes that the creators of the Bretton Woods system understood perfectly well that there was a strong connection between the monetary and trading system since “a stable rule-based payments system requires a stable, rule-based trading system and vice

³⁹ Daniel Drache (1997) *The Short But Amazingly Significant Life of the International Trade Organization (ITO); Free Trade and Full Employment: Friends or Foes Forever?* York University, p.7. (Unpublished)

⁴⁰ John Jackson (1997) *The World Trading System – Law and Policy of International Economic Relations* Cambridge, Mass: MIT Press.

versa.”⁴¹ It nevertheless proved to be impossible to agree on a consensus regarding both. And while the consensus on the monetary rules was eventually achieved, the disagreement between the U.K. and U.S. Treasuries over the trade rules could not be resolved. So the trade and monetary debates continued to follow, however superficially, separate paths.

Trade politics are always difficult, and volatile. They occur in an unstable policy area, particularly in the US with its strongly protectionist Congress and high tariff policy in the immediate postwar period. US politics were polarized between the liberal minded interest groups around the Council on Foreign Relations and the equally powerful views of US Treasury bureaucrats wanting to secure new advantages for certain US domestic business interests. The full employment objectives of the Labour Government were accepted by most interest groups, the general public and even large parts of the Conservative Party, but overall the British position appeared less enthusiastic about free trade and foreign investment. Therefore, as Drache observes: “So although public opinion was strongly committed to organizing the world economy to serve explicit democratic ends in the Anglo-American democracies, trade politics remained a wild card of domestic politics as well as international organization that could change any outcome.”⁴²

In July 1944, representatives of the forty-four countries meeting in the Bretton Woods drafted and signed the Articles of Agreement of the International Monetary Fund (IMF). The issues of trade, however, remained unresolved. Not until 1947 was the general Agreement on Tariffs and Trade (GATT) inaugurated as a forum for the multilateral reduction of trade barriers. The GATT was originally meant as a provisional

⁴¹ Sylvia Ostry (1997) *The Post-Cold War Trading System: Who's on First?* op. cit., p. 58.

⁴² Daniel Drache (1997) *The Short But Amazingly Significant Life of the International Trade Organization (ITO); Free Trade and Full Employment: Friends or Foes Forever?* op. cit., p.7.

arrangement designed to serve as a framework for the creation of the International Trade Organization (ITO) agreements. However, when it became clear that the proposed ITO was doomed by the resistance of the US Congress to ratify its charter,⁴³ the GATT was pressed into service as the only international trading system instrument left.

The conflict that most probably contributed to the collapse of the ITO was an unresolved problem of foreign investment rights and the obligations of host states to protect them⁴⁴. The ITO charter did not guarantee investors' rights but rather enforced the sovereign authority of the state by allowing it to take any actions deemed necessary even if it meant expropriating foreign property. By 1949 US elites had formed a consensus that US interests were not well enough protected by the new international organization for trade and they were increasingly opposed to the notion of creating mechanisms for international governance to regulate domestic markets from outside⁴⁵.

The GATT treaty was primarily conceived for mature free market economies and none of the emerging communist countries participated in the negotiations. It was precisely around the time of the Bretton Woods agreements that the growing ideological discord between the two main superpowers became the underlying current of international relations. The significant political development of that period was the division of Europe and the subsequent deepening of the East-West conflict. After the Soviet Union ceased to participate in the Bretton Woods negotiations it was only a matter of time before the rest of the countries under its sphere of influence would gradually be

⁴³ Peter B. Kenen (1994) *Managing the World Economy: Fifty Years After Bretton Woods*, op. cit., p.14.

⁴⁴ C. Lipson (1985) *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Century*. Berkeley: University of California Press, p.87.

⁴⁵ Louis W. Pauly (1997) *Who Elected the Bankers? Surveillance and Control in the World Economy*. Ithaca: Cornell University Press, pp. 88-97.

forced to withdraw. Of course it was clear from the start that central planning was incompatible⁴⁶ with the kind of free market trading rules envisioned by the GATT.

With Moscow tightening its knot over Eastern and Central Europe, the subdued countries became submerged in a sea of rhetorical commitments to Soviet-style industrialization and the principles of a planned economy. Institutions were soon established for administering foreign trade relations. Under the umbrella of state communism, such institutions were the result of distorted patterns of state-run industrialization programs and a deliberate decision to reject the Bretton Woods order, notably on foreign trade. Over time the Soviet planners developed the CMEA (Council for Mutual Economic Assistance) organizational network for cooperation among the communist countries. It had its own special trade rules, pricing, and payments that differed significantly from those practised in free market economies.

The main features of trade relations conducted in the CMEA context, in addition to the above, were: "bilateralism, currency and commodity inconvertibility, the monopoly of foreign trade and payments, and special foreign-trade organizations that buffer domestic economic activity against interactions with foreign sectors."⁴⁷ The primary political goal behind the CMEA was an achievement of regional self-sufficiency in order to keep the interaction with free market economies at a minimum, finally leading to permanent isolation from the rest of the world economy.

The architects of the Bretton Woods agreements could not predict the full extent of the political and economic divisions that were just beginning to unravel in the 1940s, but

⁴⁶ Jozef M. van Brabant (1998) "Eastern Europe and the World Trade Organization: The Present Position and Prospects for Accession," in Iliana Zloch-Christy (ed.) *Eastern Europe and the World Economy – Challenges of Transition and Globalization*, Edward Elgar Publishing, 1998, p. 154.

⁴⁷ Jozef M. van Brabant (1998) *The Political Economy of Transition – Coming to grips with history and methodology*. London: Routledge, pp. 51-52.

they did realize the inherent problems involved in bringing under one set of rules countries representing vastly diverse interests. Fortunately they were visionary people who believed that it was possible to devise an ubiquitous set of trade regulations that could apply to all. Most importantly, however, “near-universal membership was in itself sought as a guarantee for reversing a sharp rise in the degree of intervention of the state in economic affairs since the 1930s. Against that backdrop, compromises had in principle been entertained to accommodate countries with ‘another economic system,’ if only because it was believed that participation in the global order would persuade those countries in time to bring their system into closer harmony with those of mainstream market economies.”⁴⁸

Thus despite the fact that East-West relations were deteriorating rapidly, the negotiators behind the Havana Charter argued for the inclusion of a special GATT Article addressing the issue of state trading. In the end ‘state-trading countries’ landed a small, although very special place in the international trading order “as ‘state trading’ provisions (under Article XVII of the GATT, dealing with state monopolies in market economies) provided the only modality by which these economies could be accommodated, however awkwardly.”⁴⁹ As weak and cumbersome as these provisions were, they nevertheless allowed six of the Soviet Bloc countries to join the GATT despite their official adherence to planned economy principles.

The GATT, however, was firmly entrenched within the principles of free market economies. And as a vehicle for trade liberalization, it continued to be viewed with

⁴⁸ Jozef M. van Brabant (1998) “Eastern Europe and the World Trade Organization: The Present Position and Prospects for Accession,” *op. cit.*, p. 155.

⁴⁹ Jozef M. van Brabant (1998) “Eastern Europe and the World Trade Organization: The Present Position and Prospects for Accession,” *op. cit.*, p. 156.

apprehension by the Soviet camp. Yet, its original and simple purpose of making the exchange of goods between different countries easier turned out to be the best point of departure for progressive trade liberalization around the world. The practical principles of the GATT eventually marched into the Soviet-run universe at the end of the 1960s, when several of the Soviet satellites applied for the GATT membership. The GATT tradition of adopting the multilateral disciplines of non-discrimination, embedded in the Favor-One-Favor-All (MFN), the national treatment principles, and a commitment to transparency, paved the way for the gradual expansion of its mandate and membership.

The GATT as a replacement for the ITO

It has been a remarkable achievement that the GATT, which began as a provisional set of agreements, has grown to the position of a vibrant international regime. After all the GATT was an unintended consequence of a whole spectrum of negotiations that were intended to establish a visionary institutional framework for the post-war world order⁵⁰. The GATT agreements evolved on the side of drafting the charter for the formation of the trade organization.

In 1946, the newly created Economic and Social Council of the United Nations called a conference to consider the creation of the International Trade Organization (ITO), which was envisaged as the final leg of a triad of post-war economic institutions. Behind the ITO was an ambitious concept that there could be no stable and effective trade organization unless “the removal of trade obstacles is undertaken side by side with a

⁵⁰ Robert E. Hudec (1999) *Essays on the Nature of International Trade Law*, London: Cameron May, pp. 18-21.

program of development, expansion and full employment throughout the world.”⁵¹ The advocates of the ITO were convinced that without the larger approach to trade issues, nothing could be achieved.

This was a new departure for industrialized nations because it meant that bargaining over tariffs and quotas would also include the issues of development, natural resources, restrictive trade practices and safeguards. After the establishment of a preparatory committee to draft the ITO charter, it was expected that its framework would be based on the desire: “to assure a large and steadily growing volume of real income and effective demand, to increase the production, consumption and exchange of goods and thus contribute to a balanced and expanding world economy.”⁵²

While working on the draft, the committee members were also conducting tariff-cutting negotiations among themselves in advance of the ITO. These negotiations resulted in about 45,000 tariff concessions. Most importantly, however, the negotiators agreed to protect the value of the tariff concessions by early acceptance of some of the trade rules of the draft ITO charter, allowing for the solidification of commitments within the framework of what later became known as the GATT⁵³.

In November 1947, delegations from 56 countries met in Havana, Cuba, to consider the ITO draft as a whole. After long and difficult negotiations, some 53 countries signed the Final Act authenticating the text of the Havana Charter in March 1948. There was no commitment, however, from governments to ratification and, in the end, the ITO was stillborn, leaving GATT as the only international instrument governing the conduct of world trade.

⁵¹ Allan Hansen (1945) *America's Role in the World Economy*. New York: W.W. Norton, p. 92.

⁵² Clair Wilcox (1949) *A Charter for World Trade*. New York: The Macmillan, p. 165.

⁵³ Robert E. Hudec (1999) *Essays on the Nature of International Trade Law*, op. cit., pp. 21-33.

In the absence of other formal institutional arrangements, the multilateral tariff reductions since World War II have taken place under the umbrella framework of the General Agreement on Tariffs and Trade⁵⁴. The GATT embodied a set of rules of conduct for international trade policy that were then monitored by a bureaucracy headquartered in Geneva. As with any law, the provisions of the GATT were complex in detail, but the main constraints it placed on trade policy were: 1. Export subsidies: signatories of the GATT may not use export subsidies, except for agricultural products; 2. Import quotas: signatories of the GATT may not impose unilateral quotas on imports, except when imports threaten with “market disruption” (an undefined phrase usually interpreted to mean surges of imports that threaten to put a domestic sector suddenly out of business); 3. Tariffs: any new tariff or increase in a tariff must be offset by reductions in other tariffs to compensate the affected exporting countries⁵⁵.

The collapse of the ITO, which had been designed to be a far-reaching trade organization, corresponded to the abandonment of some of its fundamental standards and provisions. Among the most important issues no longer addressed by the GATT was competition policy. The ITO charter contained the anti-monopoly provisions that targeted trade-distorting commercial activities⁵⁶. The second major weakness of the GATT agreements stemmed from the fact that the GATT had no binding interpretative powers.

⁵⁴ Article XXVIII bis of GATT 1947.

Tariff Negotiations

1. The contracting parties recognize that customs duties often constitute serious obstacles to trade; thus negotiations on a reciprocal and mutually advantageous basis, directed to the substantial reduction of the general level of tariffs and other charges on imports and exports and in particular to the reduction of such high tariffs as discourage the importation even of minimum quantities, and conducted with due regard to the objectives of this Agreement and the varying needs of individual contracting parties, are of great importance to the expansion of international trade. The CONTRACTING PARTIES may therefore sponsor such negotiations from time to time.

⁵⁵ Paul R Krugman and Maurice Obstfeld (1997) *International Economics*, op. cit., p. 243.

⁵⁶ Robert E. Hudec (1999) *Essays on the Nature of International Trade Law*, op. cit., pp. 23-27.

Without the power of formal and legally binding interpretation, the GATT's dispute settlement mechanism was voluntary and could be ignored without consequence, making new legal norms difficult to establish⁵⁷.

The ITO was initiated out of the idea that there should be a common ground between the full employment obligation and the developmental needs of the states. The new peaceful world order could not be maintained on the basis of commercial considerations alone and the institutions of global governance could not be designed to advance the business interests at any cost. This made simple economic sense because, when economic growth stalled, few countries would accept the dictates of crude market logic and open their economies regardless of the economic costs and social consequences. The framers of the Havana Charter realized that public demands and private interests required regulation on the international level since, as Louis Pauly rightfully reminds us, "modern markets do not run themselves"⁵⁸.

The Havana charter tried to strike a balance among the issues of international trade, state policies, and development by including a detailed chapter on anti-competitive practices. The negotiators recognized that there were many trade-distorting activities that prevented markets from functioning effectively. Some of them related to the actions taken by states, but a lot of them were related to the activities of international corporations. What was needed was an international institution with broad regulatory powers. The framers of the Havana Charter responded to this need.

One of the crucial achievements of the ITO was that the Havana Charter not only applied to governments but also to the transactions of private firms whose restrictive

⁵⁷ John Jackson (1995) *The World Trading System*. op. cit. pp. 94-103.

⁵⁸ Louis W. Pauly (1997) *Who Elected the Bankers? Surveillance and Control in the World Economy*. op. cit., p. 131.

business practices threatened to undermine the liberal goal of nondiscriminatory trade⁵⁹. Anti-competitive business practices, however, were explicitly excluded from GATT procedures and were not covered by its dispute settlement mechanism, which meant that under the GATT only governments would be subject to international regulation, not businesses⁶⁰.

Another major loss following the defeat of the ITO concerned the settlement and resolution of trade disputes. The Havana Charter had a clear provision that the members had the authority to make legal and binding interpretations of the Charter. This gave the ITO substantial authority for “joint action”⁶¹ that would reinforce the incentives for ongoing cooperation among members and advance the objectives of the Agreement. Instead of the usual recommendation provision typical of so many international agencies, the ITO had a mechanism for ensuring that dispute settlement decisions and interpretations would be legally binding. Since the ITO failed, the GATT had no such

⁵⁹ Clair Wilcox (1949) *A Charter for World Trade*. New York: The MacMillan, pp. 80-95.

⁶⁰ Article XXIII of the GATT 1947.

Nullification or Impairment

1. If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as the result of

- (a) the failure of another contracting party to carry out its obligations under this Agreement, or
- (b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement, or

(c) the existence of any other situation, the contracting party may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other contracting party or parties which it considers to be concerned. Any contracting party thus approached shall give sympathetic consideration to the representations or proposals made to it.

2. If no satisfactory adjustment is effected between the contracting parties concerned within a reasonable time, or if the difficulty is of the type described in paragraph 1 (c) of this Article, the matter may be referred to the CONTRACTING PARTIES. The CONTRACTING PARTIES shall promptly investigate any matter so referred to them and shall make appropriate recommendations to the contracting parties which they consider to be concerned, or give a ruling on the matter, as appropriate.

⁶¹ John Jackson (1997) *The World Trading System*. op. cit., pp. 90-92.

authority. Under its rules, a contracting party was not obliged to accept an amendment that it disagreed with⁶².

The complex rules that were negotiated at Geneva in 1947 as preparatory to the ITO still gave the post-war trading system a badly needed stimulus. The single largest tariff cut ever, a result of an unprecedented number of concessions, caused the value of world trade to increase dramatically during the next twenty years. Still, despite this initial success, post-war multilateral trade negotiations proceeded somewhat slowly. To date there have been eight major multilateral trade agreements. The first five of them took the form of “parallel” bilateral negotiations, in which each country negotiated pair-wise with a number of countries at once. The sixth multilateral trade agreement, known as the Kennedy Round, was completed in 1967. The agreement involved an across-the-board 50 percent reduction in tariffs by the major industrial countries, except for specified industries whose tariffs were left unchanged. Thus the Kennedy Round represented the first truly multilateral trade agreement, and was later followed by the even more sophisticated Tokyo Round⁶³ and most recently the Uruguay Round⁶⁴. The Uruguay Round introduced quite radical changes to the international trade regime, permanently altering inter-state commercial relations.

The significance of the Uruguay Round

An ironic yet pointed observation by Sylvia Ostry may be the best way to begin assessing the significance of the Uruguay Round. “So how would one evaluate the

⁶² John Jackson (1997) *The World Trading System* op. cit., pp. 94-103.

⁶³ Gilbert R. Winham (1985) *International Trade and the Tokyo Round Negotiation* Princeton, NJ: Princeton University Press.

⁶⁴ John Croome (1995) *Reshaping the World Trading System – A history of the Uruguay Round*. op. cit.

results? An apt summary could be the Curate's Egg: Bishop: How is your egg, my good man? Curate: Parts of it are excellent, m'Lord"⁶⁵. The Round resulted in a further lowering of import duties on industrial products. It initiated the reforming of provisions affecting agriculture and textiles. It extended the GATT discipline to new areas such as services, investment, and intellectual property. And most importantly, by establishing the WTO as a legal entity, it strengthened the GATT rules, specifically, the dispute settlement mechanism. Still the unfinished business included safeguards, trade remedy laws, investment rules, and competition policy. The reality of high tariffs in agriculture also designated this area as one in need of urgent consideration, and there are some serious unresolved problems surrounding the textile agreement.

Furthermore, the Uruguay Round final act established a unified system of dispute settlement procedures for all portions of the agreement, and a legal text (rather than just customary practice) to serve as the basis for carrying out those procedures. The new procedures include measures to avoid the blocking that occurred under previous consensus decision-making rules, and a new appellate procedure to substitute for some of the old procedures that were vulnerable to blocking⁶⁶. To conclude with Sylvia Ostry's observation, "none of the models can estimate the full implications of deepening integration or the heart of the new system, the WTO. These parts of the Curate's Egg are not so easily captured by econometric estimates or conventional trade policy analysis."⁶⁷

A move towards such a codified rule-based system naturally prompted developing countries to become involved in the trade negotiations. As Sylvia Ostry observes: "The

⁶⁵ Sylvia Ostry (1997) *The Post-Cold War Trading System*, op. cit., p. 176.

⁶⁶ John H. Jackson (1995) "Managing the Trading System: The World Trade Organization and the Post-Uruguay Round GATT Agenda", op. cit., p. 133.

⁶⁷ Sylvia Ostry (1997) *The Post-Cold War Trading System*, op. cit., p. 177.

middle powers recognized that the alternative to a rule-based system would be a power-based system and, lacking power, they had most to lose.”⁶⁸ Indeed, the unquestionable accomplishment of the Uruguay Round was the expansion of the membership⁶⁹. Not all countries were attracted to the GATT. In particular, developing countries were by and large outside these rules. It was traditional for the developing countries to express varying degrees of hostility towards the multilateral talks aiming at further trade liberalization⁷⁰. Such sentiments were consistent with past developing country behavior at both the Tokyo and the Kennedy Round negotiations, where developing countries played a small if not marginal role. The Uruguay Round, however, signaled a major change in this context. The numbers were impressive as 117 countries⁷¹ actively participated in the negotiations and 123 signed the final declaration.

Initially opposed to a new round of multilateral trade negotiations, the developing countries ended up embracing the WTO. They recognized its significance in establishing legally binding minimum standards for market reforms, having the legal capacity to enforce the agreements, and offering a forum for policy review and the settlement of disputes. Thus “the Uruguay Round marked a watershed in the evolution of a new multilateral rules-based system.”⁷²; it was a possibly hopeful move towards a more equitable international coordination of the increasingly interconnected world’s economic transactions. More specifically, however, three factors were responsible for the support of

⁶⁸ Sylvia Ostry (1997) *The Post-Cold War Trading System*, op. cit., p. 193.

⁶⁹ Will Martin and L. Alan Winters (eds.) (1996) *Uruguay Round and the Developing Countries*. Cambridge: Cambridge University Press.

⁷⁰ Anne O. Krueger (1984) “Trade Policies in Developing Countries.” in Ronald W. Jones & Peter B. Kenen (eds.) *Handbook of International Economics*, Vol. 1, Amsterdam: North-Holland.

⁷¹ Sylvia Ostry (1997) *The Post-Cold War Trading System*, op. cit., p. 175.

⁷² John H. Jackson (1994) “Managing the trading System: The World Trade Organization and the Post-Uruguay Round GATT Agenda” in Peter B. Kenen *Managing the World Economy: Fifty Years After Bretton Woods*, op., cit.

developing countries for the conclusions of the Uruguay Round: 1. The trade-offs in the final agreement provided various attractive benefits to developing countries; 2. The negotiation process produced negative incentives and positive incentives that on balance encouraged a negotiated outcome. 3. Macroeconomic change and economic reform in developing countries led to new trade policies that were consistent with the liberalizing thrust of GATT multilateral negotiations.⁷³

By the end of the 1980s it was becoming painfully obvious that the credibility of the GATT had seriously eroded as the process of fragmentation that had begun with the Tokyo Round created growing legal and political difficulties⁷⁴. It was feared that new separate agreements would lead to even more fragmentation, causing the already overburdened system to collapse. The establishment of the WTO then 'cleans up the mess' by establishing a legal framework that brings together all the various pacts and codes and other arrangements that were negotiated under GATT. Members of the WTO must abide by the rules of all these agreements as well as the rules of the GATT as a "single undertaking."⁷⁵

The implementation of the agreements, however, has been quite problematic. Many developing countries are struggling to complete the implementation of the challenging WTO agreements under the threat of trade dispute with the developed countries. Problems with implementing the comprehensive set of WTO agreements were anticipated from the start. Many developing countries resisted the profound transformation that came about with the establishment of the WTO. Their governments

⁷³ Gilbert R. Winham (1998) "Explanations of Developing Country Behaviour in the GATT Round Negotiation," *The World Economy*, Vol. 21, No.3, pp. 116-117.

⁷⁴ The Tokyo Codes were legally separate from the GATT and applied only to the signatories that, in turn, varied from code to code. Sylvia Ostry, *The Post-Cold War Trading System*, op. cit., p. 193.

⁷⁵ A few exemptions, however, still apply. Ibid, op. cit., p. 194.

had reservations about the capabilities of developing countries to introduce the necessary regulatory changes in order to comply with the demanding requirements of the new WTO agreements. To facilitate implementation of the WTO agreements, developing countries were granted special transition periods and certain preferential provisions. However, during the implementation period following the establishment of the WTO, it has become clear that provisions existing in favor of developing countries have been ignored by the industrialized nations.

Main accomplishments of the Uruguay Round by issue areas

Dispute Settlement Mechanism

The distinctive feature of the Uruguay Round was a transformation of the GATT into the WTO, which is a formal member organization possessing the status of an international legal entity.⁷⁶ The Preamble to the Marrakesh Agreement Establishing the World Trading Organization sets out the primary objectives of the WTO: to ensure the reduction in tariffs and other barriers to trade, and the elimination of discriminatory treatment in international trade relations. These goals are intended to facilitate a higher standard of living, full employment and sustainable development in the member states⁷⁷. This way the WTO makes an important connection with the ill-fated ITO⁷⁸. This connection is clear with respect to the dispute settlement mechanism. The legal authority of the WTO infuses it with the power to make the results of trade disputes into legally

⁷⁶ Gabrielle Marceau (1995) "Transition from GATT to WTO: A Most Pragmatic Operation," *Journal of World Trade*, Vol. 29, No. 4, pp. 147-163.

⁷⁷ The Preamble in *The Results of the Uruguay Round of Multilateral Trade Negotiations. The Legal Texts*, The GATT Secretariat, Geneva, 1995.

⁷⁸ John H. Jackson (1996) "Designing and Implementing Effective Dispute Settlement Procedures: WTO Dispute Settlement, Appraisal and Prospects," in Anne O. Krueger (ed.) *The WTO as an International Organization*, Chicago, ILL: The University of Chicago Press, 1996, pp. 163-165.

binding decisions. Thus the organizational chasm that prevailed after the failure of the ITO has been corrected. The irresolute and wavering dispute settlement mechanism under the GATT has been replaced with a unified and legally binding system.

The Uruguay Round produced a new treaty text on dispute settlement, “the dispute settlement understanding (DSU)⁷⁹.” The DSU clauses are much longer than the GATT⁸⁰ and there are other specific and supplementary provisions outside Annex 2 that relate to various areas of trade. The crucial aspect of the DSU is the automatic acceptance of decisions reached by a dispute settlement panel and the appellate panel, which then become legally binding. This procedural innovation has been called “the negative consensus rule⁸¹”. In addition, since Annex 2 unifies the previously acutely fragmented assemblage of GATT procedures, the DSU increases the predictability and discipline of the overall system. The DSU also addresses the issue of the implementation of panel reports, by stipulating requirements for timely adoption, compensation, or retaliatory type actions. The DSU permits limited sanctions against members breaking the WTO trade rules. These actions can target either the same sector that was the subject of the dispute or some other one as a “cross-retaliation”⁸².

The Understanding is intended to preserve the rights and guard the obligations of the WTO members. Its purpose is also to clarify provisions of the WTO code in

⁷⁹ Annex 2: Understanding on Rules and Procedures Governing the Settlement of Disputes, in *The Results of the Uruguay Round of Multilateral Trade Negotiations. The Legal Texts*, The GATT Secretariat, Geneva, 1995.

⁸⁰ The dispute settlement measures in the GATT treaty consisted of merely three pages, while DSU is about forty pages long.

⁸¹ Andrew W. Shoyer (1998) “The First Three Years of WTO Dispute Settlement: Observations and Suggestions” in *Journal of International Economic Law*, Vol. 1, No. 2, p. 278.

⁸² Sylvia Ostry *The Post-Cold War Trading System*, op. cit., p. 197.

accordance with the rules of interpretation under customary international law⁸³. Access under the dispute settlement framework is available only to members of the WTO. Hence, the DSU constitutes a unique and much appreciated feature of the Uruguay Round Agreements. In fact, the WTO dispute settlement procedures are the only system⁸⁴ for the settlement of disputes among states with universal compulsory jurisdiction, appellate body and binding arbitration.

The General Agreement on Trade in Services (GATS)

For the first time services have been brought within the multilateral framework of rules. The GATS rules set a general framework for the conduct of trade in services. Although they are based on disciplines known from trade in goods, the included restrictions make the GATS rules weaker than those in the GATT. Two types of obligations are articulated: general and specific. The general obligations under the GATS, which apply to all sectors, are transparency and the MFN principle⁸⁵. The specific commitments are confined to the particular service sector commitments members have undertaken in their respective schedules⁸⁶. General exemptions for regional arrangements, balance of payments, public order and health, also apply⁸⁷. The Annex on Financial Services, which contains definitions of financial services in three sectors,

⁸³ See Article 3 of the DSU, *The Results of the Uruguay Round of Multilateral Trade Negotiations. The Legal Texts*, The GATT Secretariat, Geneva, 1995.

⁸⁴ Ernst-Ulrich Petersmann (1998) "From the Hobbesian International Law of Coexistence to Modern Integration Law: The WTO Dispute Settlement System," in *Journal of International Economic Law*, Vol. 1, No. 2, pp. 175-198.

⁸⁵ Pierre Sauve (1995) "Assessing the General Agreement On Trade in Services – half-full or half-empty?" in *Journal of World Trade*, Vol. 29, No. 4, pp. 125-146.

⁸⁶ See Article XX of the GATS (ANNEX 1B), *The Results of the Uruguay Round of Multilateral Trade Negotiations. The Legal Texts*, The GATT Secretariat, Geneva, 1995.

⁸⁷ See Article XIV of GATS, *The Results of the Uruguay Round of Multilateral Trade Negotiations. The Legal Texts*, op. cit.

insurance, banking and securities, also contains a clause that exempts from basic rules measures undertaken for prudential purposes.⁸⁸ The Annex on Air Transport Services provides that GATS does not affect bilateral or multilateral agreements in the field of Air Transport Services.

The GATS permits only limited liberalization of market access for services. The disciplines only apply to the schedules of commitments agreed to during the negotiations (the positive list approach).⁸⁹ Most countries heavily restrict service sectors with respect to foreign direct investment. For example, many developed and developing countries restrict access to their financial services, telecommunications, transportation sectors, and cultural industries. The GATS contains market access and national treatment guarantees for those foreign service suppliers that desire to establish a physical presence in the host country. However, these guarantees again are limited to sectors in which countries have accepted scheduled commitments, and such sectoral coverage varies widely.

An Agreement on Trade-Related Investment Measures (TRIMs)

The Uruguay Round Agreement on Trade-Related Investment Measures (TRIMs) grew out of a GATT panel ruling⁹⁰ that certain performance requirements, which host countries are imposing on foreign investors, are inconsistent with basic GATT obligations, such as national treatment and the requirement to avoid quantitative restrictions on trade. The significance of the TRIMs lies in its clear identification of two

⁸⁸ See Annex on Financial Services in General Agreement on Trade in Services (Annex 1B). *The Results of the Uruguay Round of Multilateral Trade Negotiations. The Legal Texts*, The GATT Secretariat, Geneva, 1995.

⁸⁹ Asif H. Qureshi (1996) *The World Trade Organization: Implementing International Trade Norms*, Manchester : Manchester University Press, p. 43.

⁹⁰ John Mutti (1994) "TRIMs, Policy Change, and the Role of the GATT" in Alan V. Deardorff and Robert M. Stern (eds.) *Analytical and Negotiating Issues in the Global Trading System*, Michigan: The University of Michigan Press, pp. 455- 489.

trade distorting measures⁹¹ that, although previously prohibited under the GATT, are now firmly connected with investment. The TRIMs agreement requires the WTO members to eliminate the prohibited measures but only those affecting trade in goods. TRIMs does not cover services, unless specified in the schedule of the country's service commitments.

At the insistence of developing countries⁹² the TRIMs agreement proscribed only the most notorious trade distorting restrictions. These include local content requirements and export performance requirements. Governments can still impose specific obligations on local sales and production, employment and re-investment. Moreover, developing and least-developed countries were given longer transitional periods of five and seven years respectively to eliminate the forbidden measures.

By comparison, the Agreement on Subsidies and Countervailing Measures regulates the use of export and other subsidies that influence the pattern of trade in goods. Disciplines on subsidies in the service sector have not been established yet. Some of the rules in the subsidies agreement are of relevance for foreign investors, most notably the prohibition of subsidies that are contingent on export performance or level of domestic content. The same requirements exist under TRIMs. The Subsidies Agreement, however, does not directly try to control the investment incentives policies (such as tax exemptions) used by the countries to attract foreign investment.

To compare TRIMs with the NAFTA (Chapter 11), the patchwork of WTO investment rules provides only limited safeguards against arbitrary and trade distorting policies. For example, TRIMs does not provide investment protection guarantees against

⁹¹ See Article III and Article XI of the GATT 1994.

⁹² Patrick Low and Arvind Subramanian (1996) "Beyond TRIMs: a case for multilateral action on investment and competition policy?" in Will Martin and L. Alan Winters (eds.) *Uruguay Round and the Developing Countries*, Cambridge: Cambridge University Press, pp. 380-408.

expropriation, nor any right to compensation⁹³. Investment may be hampered by restrictive practices in the private sector as well as government policy actions, yet the WTO rules focus on government behavior only. Most importantly, however, the Uruguay Round did not produce an effective anti-competition policy.

Subsidies

This is one of the Uruguay Round's main accomplishments. The Agreement on Subsidies and Countervailing Measures supplements Articles XVI and VI of GATT 1994 and builds upon the Tokyo Round Agreement on Subsidies and Countervailing Duties.⁹⁴ yet there has been a historical lack of consensus on how these articles should be applied. The significance of this agreement stems from the fact that "it produced a legal settlement of an issue that has resisted collective decision making in the international trade regime for most of this century."⁹⁵

A subsidy is defined as a financial contribution directly or indirectly by a government or public body within the territory of a Member. It occurs when there is a direct transfer of funds; or when government revenue otherwise due is foregone; or where goods and services are made available⁹⁶. To be relevant the subsidies must result in a

⁹³ Article 2 of TRIMs, *The Results of the Uruguay Round of Multilateral Trade Negotiations. The Legal Texts*, The GATT Secretariat, Geneva, 1995.

⁹⁴ Asif H. Qureshi (1996) *The World Trade Organization: Implementing International Trade Norms*, Manchester University Press, p. 27.

⁹⁵ Gilbert R. Winham (1999) (an unpublished manuscript on file with author, p. 11)

⁹⁶ See Article 1 of The Agreement on Subsidies and Countervailing Measures, *The Legal Texts-The Results of the Uruguay Round of Multilateral Trade Negotiations.*, op. cit.

benefit to the recipient. The definition of a subsidy is further elaborated through an illustrative list⁹⁷.

The agreement distinguishes between prohibited subsidies, actionable subsidies, and non-actionable subsidies (red, yellow and green). A countervailable subsidy has to be specific. The concept of specificity refers to the question of whether a subsidy is a general one, or one that relates to or is targeted at a specific enterprise or industry. A major problem with the Subsidy Agreement is the absence of adequate rules for determining specificity and the lack of reliable methods for calculating the amount of subsidy in terms of the size of benefit to the recipient⁹⁸. The stipulated criteria allow for judgment on the part of authorities deciding whether the subsidy takes place. Therefore, this flaw in The Agreement on Subsidies and Countervailing Measures can lead to potential abuse⁹⁹.

Agriculture

Agriculture remains a problematic area within the multilateral framework of international trade. Although the original GATT applied to trade in agriculture, various exceptions to the disciplines on the use of non-tariff measures and subsidies meant that it has done so ineffectively, particularly as regards export subsidies. The Uruguay Round Agreement on Agriculture attempts to bring order and fair competition to this highly distorted sector of world trade. It is obvious, however, that the Round did not go far

⁹⁷ See Annex I of The Agreement on Subsidies and Countervailing Measures, *The Results of the Uruguay Round of Multilateral Trade Negotiations. The Legal Texts*, The GATT Secretariat, Geneva, 1995.

⁹⁸ Paul Waer and Edwin Vermulst (1999) "EC Anti-Subsidy Law and Practice After the Uruguay Round – A Wolf in Sheep's Clothing?" *Journal of World Trade*, Vol. 33, No. 3, pp. 19-43.

⁹⁹ A. Anderson (1993) "An Analysis of the Proposed Subsidies Code Procedures in the 'Dunkel Text' of the GATT Uruguay Round," *Journal of World Trade*, Vol. 27, N. 3, pp. 71-100.

enough to open the borders for trade in agricultural products¹⁰⁰. But even if the Round only represents a partial liberalization, the fact is that reductions have been agreed for domestic support and export subsidies and nearly all agricultural tariffs are now bound, an even higher percentage than for industrial goods. Important new rules have been agreed for dispute settlement and on Sanitary and Phytosanitary Measures, which should facilitate trading relations in agricultural products.

The Agreement on Agriculture was conceived as part of a continuing process with the long-term objective of securing substantial progressive reductions in support and protection in agriculture. Two distinct forces for change were operating during the Uruguay Round negotiations, but they were not always pulling in the same direction. The first aimed at *trade* liberalization, per se, by the elimination or reduction of border measures which would increase market access and ensure a greater degree of responsiveness in the domestic market to world market signals. This was to be achieved by eliminating quotas, lowering tariffs and reducing other non-tariff barriers. The second drive for change advocated agricultural reforms, which aimed, in the first place, at changing the fundamental *rules* that affect trade, i.e. at defining the set of acceptable policies that countries can use to provide border protection, support domestic producers and compete in the export market. The Final Act¹⁰¹ was, in a way, a compromise between these two forces, namely, there was a considerable degree of reform in the fundamental rules governing agriculture but only a modest move towards trade liberalization.

¹⁰⁰ See Article 2, Annex I of the Agreement on Agriculture, *The Legal Texts- The Results of the Uruguay Round of Multilateral Trade Negotiations*, op. cit.

¹⁰¹ Agreement on Agriculture, *The Legal Texts- The Results of the Uruguay Round of Multilateral Trade Negotiations*, op. cit.

The Uruguay Agreement on Agriculture accomplished three things. First, with a few temporary exceptions, it converted all non-tariff barriers and unbound tariffs into bound tariffs. These tariffs had to be cut by an average of 36% between 1995 and 2000. Second, it prohibited new export subsidies and cut existing ones. And third, it began to tackle domestic subsidies, which, in effect, protect farmers against foreign competition in much the same way as tariffs¹⁰².

Agreement on Trade-Related Intellectual Property Rights (TRIPS)

Intellectual property, together with services and investment represented the so-called “new issues” negotiated in the Uruguay Round. The resulting “Agreement on Trade-Related Aspects of Intellectual Property Rights, including Trade in Counterfeit Goods” (TRIPS), is the most comprehensive international agreement on Intellectual Property Rights ever negotiated. The TRIPS agreement was conceived as a way of bringing intellectual property rights under a harmonized system of international rules. It was an attempt to globalize intellectual property rights, in the name of establishing a stronger intellectual property rights protection legally enforceable around the world.

Intellectual property is property that is intangible and indivisible, in that an unlimited number of users can consume it without depleting it. Patents, trademarks, copyrights (and neighboring rights), industrial designs, geographical indicators and trade secrets are the major classifications of intellectual property¹⁰³. Under TRIPS, patentable innovations include biologically modified plants, seeds, animals, software, medicines,

¹⁰² Dale E. Hathway and Merlinda D. Ingo (1996) “Agricultural liberalization and the Uruguay Round” in Martin, Will and L. Allan Winters (eds.) *The Uruguay Round and the developing countries*. Cambridge: Cambridge University Press.

¹⁰³ Keith E. Maskus (2000) *Intellectual Property Rights in the Global Economy*, Washington, DC: Institute for International Economics, pp. 2-6.

music and clothing designs. When the WTO agreements took effect on January 1 1995, developed countries were given one year to ensure that their laws and practices were in conformity with the TRIPS agreement. Developing countries and some transition economies were given five years, while the least developing countries have eleven years.

Implementation problems

The successful implementation of WTO Agreements and the goal to extend the benefits of an open multilateral trading system to all states remains one of the greatest challenges facing the World Trade Organization. Currently however, most developing WTO Members are experiencing serious implementation problems. They simply lack the proper infrastructure and have very limited financial and human resources allowing them to fulfill the complex requirements of their commitments. Developing countries also express concerns about the impact of the WTO rules on their economies given the fact that overall the implementation of the UR agreements has not benefited them the way they had expected¹⁰⁴. There are at least three main issues of concern for developing countries with respect to implementation of WTO agreements.

The first set of concerns relates to the new obligations and standards of protection required under the WTO agreements. These requirements no longer relate only to goods and corresponding border measures. The WTO expanded the scope of international trade rules by including under its mandate trade in services, intellectual property and issues of investment. Hence WTO obligations are new and quite demanding from a developing

¹⁰⁴ Asoke Mukerji (2000) "Developing Countries and the WTO – Issues of Implementation" *Journal of World Trade*, Vol. 34, No. 6, pp. 73-74.

country perspective. Quite often, developing countries must liberalize those sectors of their economies that were traditionally belonged to the state.

Special and differential provisions for developing countries are included in most of the WTO agreements. They correspond to more flexible terms, longer transition periods and less demanding commitments. There are also special clauses, which say that developed countries are required to help developing countries with the implementation process¹⁰⁵. However, after more than five years since the Uruguay Round agreements took effect developing countries continue to feel that these provisions are insufficient¹⁰⁶.

The second area of concern for developing countries has to do with enforcement of the WTO obligations on the domestic front. Some WTO agreements stipulate certain principles applicable to the enforcement procedures.¹⁰⁷ Subsequently, developing countries are required to introduce deep changes into their existing regulatory, judicial and administrative framework. Developing countries worry about the high costs of establishing all the necessary institutional mechanisms to effectively meet with WTO obligations. Moreover, developing countries consistently lack expertise in designing the new WTO compatible laws and regulations.

Lastly, developing countries point out that the implementation of the WTO agreements in the areas of interest to developing countries such as their exports of textiles, clothing, and agricultural products have not met the expectations. The existence of high tariffs and imports quotas in industrialized countries of these products against the

¹⁰⁵ Article 67 of the TRIPS Agreement (Agreement on Trade-Related Aspects of Intellectual Property Rights). Annex 1C of the Marrakesh Agreement Establishing the WTO.

¹⁰⁶ WTO Document (2000) *Implementation-Related Issues and Concerns – Decision by General Council* (WT/L/384), 19 December.

¹⁰⁷ Articles 42-49 of the TRIPS Agreement (Agreement on Trade-Related Aspects of Intellectual Property Rights). Annex 1C of the Marrakesh Agreement Establishing the WTO.

credo of the WTO agreements, have prevented developing world from enjoying the benefits of trade liberalization¹⁰⁸.

In summary, the grievances expressed by developing countries over implementation of the WTO agreements center on the following issues: adjusting implementation schedules, more influence in decision-making, transforming special and differential treatment into tangible gains, duty-free and quota-free treatment of exports from the least developed countries and a moratorium on new forms of protectionism in the developed world. Consequently, developing countries want to participate in the agenda setting for any future multilateral trade negotiations. In preparation for Seattle these demands were ignored leading to a breakdown of negotiations and a failure to reach a consensus over the purpose of the Seattle meeting¹⁰⁹.

Indeed, developing countries are concerned about the overall structure of a consensus based decision-making process at the WTO that prevents the organization from seriously addressing the implementation problems. The process has major deficiencies. It was developed under the GATT when the membership was so much smaller and where the process was dominated by the industrialized nations. As the membership grew under the WTO, the management of the decision-making process slowly became unworkable.

For example, in Seattle, the Director General opted for a so-called 'The Green Room' scheme, under which the chair leads a meeting consisting of the developed countries and a number of developing countries that constitute a group discussing any

¹⁰⁸ Asoke Mukerji (2000) "Developing Countries and the WTO – Issues of Implementation" *Journal of World Trade*, op. cit, pp. 39-51.

¹⁰⁹ Dilip K. Das (2000) "Debacle at Seattle – The Way the Cookie Crumbled" *Journal of World Trade*, Vol. 34, No.5, pp. 186-187.

particular issue. The problem was that there were no clear criteria for admission into the Green Room and thus most of the membership felt marginalized¹¹⁰. Even if some developing countries were present in the Green Room, they did not have a mandate to represent those that were omitted. Naturally, the 135 countries that constituted the membership of the WTO in December 1999 could not create a manageable drafting committee and therefore there would have to be some smaller group charged with resolving key issues. Such a group, however, would have to satisfy the principles of transparency and representation. The question for the WTO membership on how to resolve this problem remains open.

It is clear that the WTO must address the challenges associated with the implementation of its agreements in order to remain an effective organization and to maintain the credibility of the world trading system. So far WTO Members negotiated an understanding at the Special Session of the General Council on 15 December 2000. In the communication issued later that month WTO Members decided by consensus to take the appropriate steps to address the implementation problems¹¹¹. It was decided that Members would work with the relevant international standard-setting organizations on the issue of the participation of developing countries in their work.¹¹² The *General Council's Decision* also reaffirmed that WTO Members must make an extra effort to work to address the outstanding issues related to implementation, most importantly those relating to the implementation of the TRIPS agreement with a view to completing the

¹¹⁰ Interview with a WTO official, Geneva 2000.

¹¹¹ WTO Document (2000) *Implementation-Related Issues and Concerns – Decision by General Council* (WT/L/384), 19 December.

¹¹² To help developing countries to comply with the WTO Agreements on Sanitary and Phytosanitary Measures and on Technical Barriers to Trade.

process no later than the Fourth Session of the Ministerial Conference by the end of 2001.¹¹³ The *Decision*, however, fell short of proposing concrete policy options.

Concluding remarks about the establishment of the WTO

The WTO enlarged the scope of the GATT (General Agreement on Tariffs and Trade) by strengthening its dispute settlement system, by including within its authority provisions regulating the trade-related aspects of intellectual property rights and services, and by significantly broadening its membership. While the original GATT was signed by twenty-three Contracting Parties, and only dealt with trade in goods, the formal conclusion of the Uruguay Round in April 1994 involved one hundred-seventeen countries establishing a complex organization in response to “a different world of ever deepening integration and globalization¹¹⁴.”

The WTO framework is based on a few fundamental principles rooted in the long lasting tradition of the GATT. These principles establish the demands placed on the candidate states. Furthermore, the principle of transparency receives a particular attention under the WTO regime. In creating the WTO, the Uruguay Round Final Act founded a unified system of dispute settlement procedures for all parts of the agreement¹¹⁵ and a legal text (rather than just customary practice) to serve as the basis for carrying out those

¹¹³ WTO Document (1999) *The Revised Draft of the Ministerial Text*, (Job(99)/5868/Rev.1) 19 October.

¹¹⁴ Sylvia Ostry (1997) *The Post-Cold War Trading System -Who is on First?*, op. cit, pp. 175-176.

¹¹⁵ In 1994, the WTO Agreement integrated the GATT, the Tokyo Round Agreements, and the Uruguay Round Agreements, including “Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU),” into one institutional and legal framework. The text of the original GATT now constitutes the main component of what is called the GATT 1994, which is also part of the WTO Agreement.

procedures¹¹⁶. The new WTO procedures include measures to avoid the blocking that occurred under previous consensus decision-making rules, along with a standing appellate body, to substitute for some of the old procedures that were vulnerable to blocking¹¹⁷.

Clearly, it was not enough for the international community to fashion a substantive legal code of the World Trade Organization (WTO). It must also ensure competent techniques for the implementation of this code and equal participation of all Members. The WTO accession process very much resembles the implementation process faced by developing countries. As the accession process unfolds, the candidates struggle to fully implement WTO rules and regulations in order to gain permission to join the organization.

There are many problems with implementation of the demanding WTO agreements. The accession process especially demonstrates this well because every new Member is expected to join the organization without any recourse to transition periods and without any recourse to deferential provisions¹¹⁸. The acceding countries are expected to complete a series of comprehensive regulatory changes and introduce a full-scale liberalization of their trade regime. Such comprehensive reformist changes are a pre-condition to become a WTO Member for the acceding countries. For developing

¹¹⁶ The WTO agreements were first published in 1994 by the GATT Secretariat in Geneva. The set has been reprinted several times since, most recently by the Cambridge University Press, under the title: *"The Legal Texts – The Results of the Uruguay Round of Multilateral Trade Negotiations."*

"The Legal Texts...." are also available at <http://www.wto.org>

¹¹⁷ For an excellent comparative analysis see: Edwin Vermulst and Bart Driessen (1995), "An Overview of the WTO Dispute Settlement System and its Relationship with the Uruguay Round Agreements" in *Journal of World Trade*, Vol. 29, No. 2, pp. 131-161. Also, for an overview of the dispute settlement procedures under the DSU see: Hyun Chong Kim (1999) "The WTO Dispute Settlement Process: A Primer," in *Journal of International Economic Law*, Vol. 2, No.3, pp. 457-476.

¹¹⁸ WTO Document (2000) *Technical Note on the Accession Process*, (WT/ACC/7/Rev.2) November 01, p. 4.

countries already in the WTO. however, such regulatory reforms are a consequence of being a WTO member. The stakes are high. Countries that are struggling with implementation of the WTO agreements understand the threat of being taken to dispute settlement on the charges of failing to comply with the commitments they made.

Although the WTO rules are intended to tolerate a considerable degree of diversity in domestic policies, they nevertheless advocate a regulatory framework meant to impose a number of constraints on domestic policies to reduce their adverse impact on cross border commercial transactions. Yet these reforms are believed to be necessary in order for the state to be able to participate in rapidly integrating global economic transactions. The WTO accession process demonstrates the difficult task of the candidate state to introduce and then consolidate a set of institutional reforms that are meant to overhaul its regulatory, judicial and administrative mechanisms. Indeed, a global policy regime can provide an essential external commitment to force the internal reform process. It does so through a series of positive and negative incentives perceived by the state authorities. These incentives can effectively unify competing domestic interests: on the one hand, by exploiting the ambition to become a member of the largest trading 'club' in the world, and, on the other hand, by projecting the fear of being left behind in a rapidly globalizing economy.

The WTO package of multilateral agreements is seen to be a significant factor in helping to eliminate global economic policy coordination failures, through disciplining states to overcome their limitations as isolated economies by advancing their interests through collective action. This, of course, has been the rationale behind the GATT system

from its beginnings in 1947¹¹⁹. There is, however, something significantly new about the WTO. Because of its new legal powers fostered by the powerful dispute settlement mechanism and its enlarged scope, the WTO has a potential to influence the economic environment inside the state. For example, by forcing higher regulatory standards, transparent policy-making, and by encouraging national treatment for the commercially present foreign suppliers of services, WTO legal rules can help build the following market-supporting mechanisms: a professional judiciary to enforce contracts; secure property rights; legal due process; administrative transparency in government agencies; and regulatory predictability to domestic policy making. Such outcomes can be particularly beneficial for acceding countries that are trying to integrate into the global economy while overcoming the legacy of a destructive interventionist past¹²⁰.

Internationally-agreed legal rules are significant because of their relationship to the legal structure of the state system. For example, Tom Franck has observed that the state recognizes and respects its international obligations because of the reciprocal validation of its statehood by the international community¹²¹. For smaller and less able states, legal recognition by the international system carries a powerful meaning in terms of confidence- building for the government in power. This can be of particular importance following the declaration of independence or the end of civil war. For weak states international legal treaties reinforce the ability to survive as independent polities.

¹¹⁹ John Jackson (1989) *The World Trading System – Law and Policy of International Economic Relations*. (Cambridge, Mass: MIT Press), pp. 6-24 & 31-43.

¹²⁰ János Kornai (1994) "Transformational Recession: The Main Causes," *Journal of Comparative Economics*, Vol. 19, August, pp. 39-63.

¹²¹ Tom M. Franck (1990), *The Power of Legitimacy among Nations*, New York: Clarendon, p. 196.

providing them with strong incentives to take rules seriously¹²². On the other hand, the powerful states also have valid reasons to consent to the principles of the legal order. The major state actors of the international system have a disproportionate stake in maintaining the stability of the world order. The persistence of a peaceful international system is the best guarantee of their continuing influence.

The creation of the WTO can be considered as a turning point in the history of international relations. The WTO's enlarged scope, its new responsibilities, and its powers of enforcement make it an important object of study in the area of international regimes and international law. Overall it could be argued that international relations have entered a new reality of a deepening global integration of economic transactions. This changing global environment affects the behavior of the state through a variety of expanding international linkages associated with new patterns of production and new technologies, especially in the fields of communications and transportation. Deepening global integration has created a sense of urgency to strengthen the mechanisms of the international cooperation, with preference being given to a legal approach because of its greater precision, transparency and predictability.¹²³

Consequently, there are two basic assumptions underlying this dissertation. The first is an understanding that the two dimensions of current international relations, political and economic, cannot be separated in any meaningful sense. And the second is that there is a connection between domestic and international levels of analysis. In other

¹²² Robert Jackson (1987) "Quasi-States, Dual Regimes, and Neo-Classical International Theory: International Jurisprudence and the Third World" in *International Organization*, Vol. 41, pp. 519-549.

¹²³ Harvey W. Armstrong and Robert Read (1998) "Trade and Growth in Small States: The Impact of Global Trade Liberalisation" in Peter Lloyd and Chris Milner (eds.) *The World Economy- Global Trade Policy 1998*, Oxford: Blackwell Publishers, pp. 152-154.

words. “the international systemis spanning domestic and international levels of analysis. with the institutions and agencies of the state at its core.”¹²⁴

The establishment of the WTO also brings attention to the fact that a growing variety of international economic linkages have intensified the interaction between international and domestic law. This causes some tensions with respect to the concept of state sovereignty but it also means that international legal rules can provide necessary incentives for conducting the internal reform processes. Particularly in transitional and developing economies, international rules play a significant role in guiding the reform of political, legal and economic institutions. As a multilateral institution, the WTO serves to encourage reforming states to build the legal institutions needed to guide a market economy and ease its integration into the global economy¹²⁵. This is why it is important to take a comprehensive view of the role that WTO legal rules are playing on many different levels of international relations. As Donald M. McRae carefully cautions us. “They [international lawyers] will have to move beyond the easy assumption that the WTO is no more than the continuation of a tradition and look at the ‘new frontier’ of international law that is rapidly emerging from the work at the WTO.”¹²⁶

¹²⁴ Geoffrey R.D. Underhill (1994) “Conceptualizing the Changing Global Order” in *Political Economy and the Changing Global Order* edited by Richard Stubbs and Geoffrey Underhill, Toronto: Macmillan, p. 20.

¹²⁵ Compare the introductory statements made by the representatives of the acceding states in the final Reports of the Working Parties, for example: Ecuador (WT/L/77), Mongolia (WT/ACC/MNG/9), Panama (WT/ACC/PAN/19), Latvia (WT/ACC/LVA/32), Jordan (WT/ACC/JOR/33), Albania (WT/ACC/ALB/51) and Oman ((WT/ACC/OMN/26) at <http://www.wto.org>

¹²⁶ Donald M. McRae (2000) “The WTO in International Law: Tradition Continued or New Frontier?” in *Journal of International Economic Law*, Vol. 3, No.1, p. 41.

Chapter 2

Designing the Regulatory Framework for a Market Economy - Theoretical Significance of WTO Accession

Introduction

The first chapter of this study has been aimed at explaining the significance of the WTO as a new kind of a global institution, and identifying its accession process as a major test of its effectiveness. It is important to recognize how establishing the WTO has considerably expanded the definition of international trade and how much it has enhanced the development of international economic law.

The enlarged scope of the WTO's legal code and its new powers in relation to the settling of international trade disputes as well as the extension of its mandate to include non-traditional tradable areas such as services and intellectual property, all speak to a changing international order. We can observe the emergence of a new global system structured not only by the states but also by the factors of economic interdependence and inter-societal linkages. The traditional demarcation of relations between market and non-market activities is no longer clear because of the deep penetration of the market principle into the sphere of daily experience.

The idea of a new global economy stems from the changed scope and content of international economic transactions. We have explored some aspects of the new global trade regime. In analyzing the significance of establishing the WTO, we have examined its historical and geopolitical background, the substance of the new multilateral

agreements and the problems with its implementation by developing and the acceding countries. We have determined that WTO accession is a major test for the organization. Nevertheless, we have not yet addressed the question about the theoretical significance of the accession process. When the accession negotiations are taking place the WTO's legal rules begin to affect policy-making on the domestic level. WTO accession can be then understood as a peculiar structural adjustment process that is conducted in the name of facilitating trade. Overall, this chapter develops a basis for a theoretical argument by situating discussions about the WTO within international relations theory. Overall, the aim of this chapter is to ponder the significance of creating the WTO and the impact that its legal code is having on the contemporary state, in particular on those under-developed states that attempt to become its members.

The stimulus to accede to the WTO acquires particular force when it comes to countries often facing economic collapse. Such states quite often are characterized by a long and disastrous legacy of state interventionism and mismanagement, as in the case of the former members of the collapsed Soviet Bloc. The recent additions to the debate on institutions and international relations seek to demonstrate how international rules and norms can affect national policy making through the actions of domestic political actors, their preferences and their ambitions¹. The research stresses the crucial effect that the international pressure imposed by the promise of membership in the new global regime has on reinforcing political and economic stabilization for the government, mainly through the unification of competing interests groups.² The desire to participate in the

¹ Adam Cortell and Davis J. (1996) "How do International Institutions Matter? - The Domestic Impact of International Rules and Norms" in *International Studies Quarterly*, Vol. 4 No. 4.

² Ralph Rotte (1998) "International Commitment and Domestic Politics - A Note on the Maastricht Case" in *European Journal of International Relations*, Vol. 4, No. 1.

global economy, on the one hand, and the threat of being marginalized from it, on the other, can help the acceding government to formulate an effective economic foreign policy very much centered on pursuing WTO membership. An important goal of the accession process is to establish an effective administrative, judicial and regulatory framework that will ensure the predictability of the domestic environment and promote its readiness to cope with the challenges presented by a changing global economy. Thus, the establishment of the WTO as the first legally binding commercial institution provides evidence about the progressive codification of international law³ and the attempts to move beyond simple assumptions about economic liberalization and political democratization processes.

Situating the Theoretical Argument

International relations theory is historically rooted in three classical traditions⁴. The Hobbesian tradition, which is the precursor of modern realism, views international politics as a survival strategy of self-help in the global state of anarchy in which the interests of each state exclude the interests of other states. At the other extreme, the Kantian universalist tradition takes the essential nature of international relations to lie in the network of transnational social bonds that link individuals, communities and societies. Contemporary liberalism draws upon the insight of this cooperative conception of international politics⁵.

³ Ernst-Ulrich Petersmann, (1998) "From the Hobbesian International Law of Coexistence to Modern Integration Law: The WTO Dispute Settlement System" in *Journal of International Economic Law*, Vol. 1, pp. 175-198.

⁴ Michael W. Doyle (1997) *Ways of War and Peace: Realism, Liberalism and Socialism*. New York: W.W. Norton.

⁵ Thomas W. Pogge (1992) "Cosmopolitanism and Sovereignty," in *Ethics* Vol 103, No.1, pp. 48-72.

The Grotian or internationalist tradition lies between the realist and the Kantian universalist tradition. Contrary to the Kantian perspective, the Grotian tradition accepts the Hobbesian premise that sovereign states are the essential national actors in international politics. In sharp contrast to the Hobbesian realist tradition, the Grotian perspective views the state as bound by rules, norms and imperatives of law and principles of conduct⁶. These factors are the necessary ingredients for coexistence and cooperation among states, for the maintenance of their sovereignty and for the preservation of the system of society of states itself. As Hedley Bull has observed: "The particular international activity which, as the Grotian view, best typifies international activity as a whole is neither war between states, nor horizontal conflict cutting across the boundaries of states, but trade – or, more generally, economic and social intercourse between one country and another."⁷

All contemporary interpretations of international politics include broad conceptions of international order and the organization of the international system. The core of traditional realism rests on the theory of power politics whose most influential modern proponents have been Hans Morgenthau and Raymond Aron. Another prominent strand in this debate is the structural systemic theory that emerged from Waltz's influential work, *Theory of International Politics*, and became known as 'neo-realism'. Waltz considers a system as "set of interactive units having behavioral regularities and identity over time. Its structure defines the ordering of its parts".⁸ A third influential strand is the theory of political and economic hegemony associated with the works of

⁶ K.J. Holsti (1985) *The Dividing Discipline: Hegemony and Diversity in International Theory*. Boston: Unwin Hyman.

⁷ Hedley Bull (1977) *The Anarchical Society*, New York: Columbia University Press, Chapter 2.

⁸ Kenneth Waltz (1979) *Theory of International Politics*, New York: McGraw Hill, p. 40.

Modelski and Gilpin. Known as the theory of hegemonic stability, this theory considers the rules, institutions and codes of conduct of the international system as a function of the goals, preferences and interests of the dominant or leading actor in the system.⁹

For realists, inequalities in the global distribution of power define the structure of the international system, which in turn constrains the behavior of individual states. From the realist perspective international regimes, rules and institutions play a negligible role in the organization of the international order. They are only the reflections of the preferences of states seeking to maximize their interest and power. Proponents of hegemonic stability theory have argued that actors may be forced to join international regimes because of the coercive power of the hegemonic state¹⁰.

In contrast, the modern neo-liberal school links the Kantian and Grotian tradition by insisting that the order of the international system is largely influenced by the propensity of states and national groups to cooperate. In the global environment, international institutions foster increased interaction among a variety of states, on sub-national and trans-national levels. Increased international interaction, in turn, changes attitudes and international coalition opportunities. From the liberal perspective international regimes, rules and institutions matter since they derive from voluntary agreements among states and because they gradually erode the hierarchical configuration of the international system¹¹.

One important strand of the liberal view of the international system concerns itself with the doctrine of international law as influenced by the internationalist tradition of

⁹ Robert Gilpin (1981) *War and Change in World Politics*, Cambridge: Cambridge University Press.

¹⁰ Hans J. Morgenthau (1978) *Politics Among nations: The Struggle for Power and Peace*. New York: Knopf.

¹¹ David Held (1993) "Liberalism Marxism and Democracy," *Theory and Society*, Vol. 22.

Grotius. The main premise of this position is that international legal rules and principles of international conduct play a considerable role in international relations. Even during a time of increased inter-state rivalry, states are conditioned by, and perceived themselves to be constrained by, principles, norms and rules that regulate various aspects of international conduct. Central to the Grotian conception of the international system is the view that, rather than power, the principles of international law mitigate against conflict and promote the development of a society of states. In this society national actors, recognizing common interests, and bound by a common set of rules, share in the working of common institutions. What is distinctively different about the contemporary international law perspective is that it includes in its calculations not only the need for an international coordination of state sovereignties but also the need to establish international rules of equity, equality and justice¹². Modern neo-liberal, institutional interpretations emphasize the ways in which international trade and finance and other types of economic activity influence or constrain the behavior of states¹³. Further, both transnational economic institutions and forces, and trans-governmental contacts improve international communication and cooperation.¹⁴

International Relations Theory and International Rule Making

The emergence of international regimes and norms as a major focus of theoretical debate within the field of international relations can be traced back to a seminal article by

¹² Ernst-Ulrich Petersmann (1998) "From the Hobbesian International Law of Coexistence to Modern Integration Law: The WTO Dispute Settlement System" *Journal of International Economic Law*, Vol. 1, p. 176.

¹³ David Held (1995) *Democracy and the Global Order – From the Modern State to Cosmopolitan Governance*. Stanford California: Stanford University Press.

¹⁴ Joseph Nye (1988) "Neorealism and Neoliberalism," *World Politics*, Vol. 15, No. 2, p. 247.

John Ruggie who concluded in 1975 that "international behavior is institutionalized".¹⁵ Initially, it was the theory of hegemonic stability that offered the most consistent explanation of regime dynamics. It linked regime formation and maintenance to the hegemon's ability to sustain its dominance and its interest in stabilizing the system. This theory has long been contested on analytical grounds but also, most importantly, it has lost its meaning in the contemporary uni-multipolar¹⁶ post-Cold War system.

While the main premise of the hegemonic theory of international regimes considers them to be products of the coercive influence of the hegemonic state, proponents of *after hegemony* theories of international regimes perceive them as social institutions, with recognized practices consisting of rules and roles that place limitations on the actors and govern relations among them¹⁷. The rules of convention that develop around these roles encompass sets of rights and entitlements and prohibitions. International regimes as social institutions can form and thrive in the absence of hegemonic power. The philosophical and theoretical basis behind the concept of social institutions has been formulated by John Rawls in his work contemplating the concept of justice as fairness.¹⁸

Rawls' understanding of international regimes is compatible with other definitions, most notably with the famous one by Krasner and with the definition formulated by Keohane and Nye in *Power and Interdependence*. This definition sees international regimes as governing arrangements that include: "networks of rules, norms

¹⁵ John G. Ruggie (1975), "International Responses to Technology: Concepts and Trends," *International Organization* Vol. 29, No. 3, p. 559.

¹⁶ Samuel Huntington (1999) "The Lonely Superpower," *Foreign Affairs*, Vol. 78, No. 2.

¹⁷ For example, a market confers the roles of buyer and seller; or employer and employee: opting out from these roles carries prohibitive costs.

¹⁸ John Rawls (1971) *A Theory of Justice*, Cambridge Mass: Harvard University Press.

and procedures that regularize behavior and control its effects¹⁹. Regimes, institutions and rules of conduct are established by states to coordinate and govern their expectations and manage their behavior.

At this point, it is useful to remember Keohane's observation about the possibility for international cooperation that may exist "after hegemony,"²⁰ that is, in an environment that resembles Huntington's assessment of the present condition of the international order, where there is no one single state capable of controlling and successfully stabilizing the political and economic world order. For Keohane, the most important prerequisite for international cooperation *after hegemony* is the existence of international regimes. What follows is an account of the theory that puts forward the idea that stability and order in the international system is not dependent on the exercise of hegemony, but rather may emerge from cooperation between nations through the medium of international regimes.

As a starting point for his analysis, Keohane takes a famous definition of Krasner: "Regimes can be defined as sets of implicit and explicit norms, rules, and decision-making procedures around which actors' expectations converge in a given area of international relations".²¹ In going beyond this definition, Keohane warns about its obvious limitations in not paying attention to the nature of both regimes and actors. It is on the basis of this warning that Keohane defines regimes in terms of their functions.

According to Keohane, regimes exist, or are created by states, because there is a 'Need' for them. In other words, self-interested actors (nation-states) seek to establish

¹⁹ Robert O. Keohane and Joseph Nye (1977) *Power and Interdependence*. Boston: Little Brown, p. 19.

²⁰ Robert O. Keohane (1984) *After Hegemony: Cooperation and Discord in the World Political Economy*. Princeton, NJ: Princeton University Press, pp. 34-35.

²¹ Stephen Krasner (ed) (1983) *International Regimes*. Ithaca, NY: Cornell University Press, p. 2.

international regimes through mutual agreements due to an increased necessity for the cooperation that benefits them in return. Moreover, says Keohane:

the demand for international regimes will be in part a function of the effectiveness of the regimes themselves in developing norms of generalized commitment and in providing high-quality information to policy makers.²²

Keohane believes that the behavior of states is strongly affected by systemic constraints and incentives, and that changes in the international system would bring about changes in incentives and behavior²³. Such changes in turn, he observes, can further facilitate international cooperation, greatly enhancing the possibility of global governance. Although firmly grounded in realist assumptions about the anarchical nature of the international order, he nevertheless goes beyond them by stating that his vision of international reality takes account not only of the distribution of power but also of international institutions and practices, that is, international regimes. This understanding of regimes clearly echoes the concept of regimes as social institutions. The regimes have as their principal function to facilitate the making of mutually beneficial agreements among states, which makes it possible that the reality of anarchy that underlines the rationality of the world order will not lead to a Hobbesian state of war²⁴. For Keohane, then, international regimes are of significance in understanding international reality, in so far as such reality is composed of the distribution of both power and wealth.

We accept the conclusion that international regimes, rules and norms arise from states interests and preferences. Yet we also believe that their habitual way of setting the

²² Robert O. Keohane (1983) "The demand for international regimes" in Krasner S. (ed.) *International Regimes*, Ithaca, NY: Cornell University Press, pp. 170-171.

²³ Robert O. Keohane (1984) *After Hegemony*, op. cit., p. 24.

²⁴ Robert O. Keohane (1983) "The demand for international regimes" op. cit., p. 148.

boundaries of acceptable behavior that arise from a need to coordinate inter-state relations play an important role. Self-interested states design rules of conduct and conventions with the expectation that they will facilitate repeated inter-state contact and interaction over prolonged periods of time. Thus, regardless of the initial impetus for their formation, international regimes can be considered primarily as social institutions of the international system exerting a powerful influence on states' behavior. As Oran Young has noted: "Actors frequently experience powerful incentives to accept the behavioral constraints associated with institutional arrangements in order to maximize their own long-term gain, regardless of their attitudes toward the common good. Whether individual actors approach such issues in terms of rule utilitarianism, the development of the ethical system, or some sort of non-utilitarian contractarianism is not crucial at this juncture. The point is that "actors would willingly abandon a truly anarchical social environment for a world featuring recognized social institutions".²⁵

International institutions are based on norms that become their standards of behavior as defined in terms of rights and obligations²⁶. These general obligations and rights are designed to guide the behavior of states in the formulation and implementation of rules. Legal rules vest these rights and obligations in international law. However, because of the absence of a centralized authority with a monopoly over the use of force in the international system, compliance with rules of law among states has been somehow problematic.

²⁵ Oran R. Young (1986) "International Regimes: Towards a New Theory of Institutions," *World Politics*, Vol. 39, No. 1, p. 109.

²⁶ Stephen Krasner (ed.) (1983), *International Regimes*, Ithaca: Cornell University Press, p.2.

Haggard has suggested different ways in which international regimes can influence state behavior²⁷. For example, the regime can alter the global environment within which states interact, increasing the incentives for cooperation by lowering the transaction costs associated with bilateral bargaining. International regimes can also alter calculations of interest by assigning property rights, providing information, and altering patterns of transaction costs. Not only are regimes powerful behavior-guides because it is so costly to construct alternatives. The sheer existence of a regime puts an extra burden of proof on regime opponents because in discourses about the proper behavior of states and other regime actors, the regime structure serves automatically as a frame of reference.

Such an understanding of international regimes, norms and rules led to the idea of governance without government. We mean governance that is based on non-hierarchical normative institutions involving a stabilized pattern of behavior for a given number of actors in recurring situations. Normative institutions are based on persistent and connected set of rules that define behavioral roles, shape activity and expectations, constrain the range of acceptable behavior, and thus govern the relations among the participants²⁸. Yet, according to Coleman, interactions among states do not alone create sufficient demand for normative institutions. It is again a configuration of interests that constitutes the most important factor in understanding international social order²⁹.

The WTO's legal code is a treaty and the obligations that apply to members are legally binding obligations. This is because the WTO provides a mechanism for settling disputes among members. The uniqueness of this mechanism stems from the fact that the

²⁷ Stephen Haggard (1986) "The newly industrializing countries in the international system" *World Politics* Vol. 38, pp. 343-370.

²⁸ Robert O. Keohane (1989), "Neoliberal Institutionalism: A Perspective on World Politics" in *International Institutions and State Power: Essays in International Relations Theory*, Boulder, CO. p. 1-20.

²⁹ James S. Coleman (1990) *Foundations of Social Theory*, Cambridge, Mass: Cambridge Press.

WTO dispute settlement system is obligatory for all WTO members. And as a result of the reverse consensus rule, its decisions are in effect both final and binding³⁰. The member states can still decide not to obey but such a decision would go against their interests, mainly because the overall credibility of the system could be destroyed. Furthermore, the WTO dispute settlement mechanism plays another important role. It allows for the development of international commercial law through judicial interpretation of its provisions. As Donald McRae noted: "The interpretation of the WTO agreements is an active, law-creating process."³¹

Thus, we suggest that the WTO is important from the point of view of international relations theory because it demonstrates a change of attitude towards a concept of sovereignty and a redefining of the state's role as affected by the new global economy. Furthermore, the WTO's appeal derives from its claims to be a global organization with universal membership. As Peter D. Sutherland notes: "The universal membership of the WTO means that it is ideally placed to contribute to new cooperative arrangements at the international level aimed at promoting global coherence in economic policymaking, not only in trade relations, but also more generally in other aspects of economic policy."³² Therefore, the WTO has the potential to intensify a move towards establishing the mechanisms of global governance.

Combining the findings of the international relations literature on institutions with the tradition of international law, this work proposes that international regimes, rules and

³⁰ "The Legal Texts – The Results of the Uruguay Round of Multilateral Trade Negotiations." - DSU (Dispute Settlement Understanding) Article 22.

³¹ Donald M. McRae (2000) "The WTO in International Law: Tradition Continued or New Frontier?" *Journal of International Economic Law*, March, p. 30.

³² Peter D. Sutherland (1998) "Globalisation and the Uruguay Round" in Jagdish Bhagwati and Mathias Hirsch (eds.) *The Uruguay Round and Beyond – Essays in Honour of Arthur Dunkel*. Berlin: Springer Publishing, p. 152.

institutions establish limits on permissible international conduct and guidance for interactions among states, thereby enhancing cooperation and preventing conflict. These rules, however, are only effective so far as they can restrain the unilateral actions of the individual states from breaching the rules of the system. The issues of effectiveness, enforcement and implementation have been always uneasy with respect to the international regimes. Those who supported the establishment of the WTO sought to address this fundamental weakness of the existing institutional tradition by constructing a legal code supported by a compulsory mechanism for settling the disputes.

Theoretical Hypothesis about the Significance of the WTO Accession Process

All of the states that have decided to join the WTO have been experimenting with various packages of economic reforms for some time. The candidates for WTO membership come from many different corners of the international system but they all share a past legacy of heavy state interventionism. Many of them are coping with unsustainable economic situations since the state's previous involvement in their economies lacked accountability and suffered from an excessive corruption that often led to many disastrous development initiatives³³. Therefore, pursuing WTO membership is seen as a credible means of gaining an enhanced international reputation, upsetting the old power structures and improving economic conditions.

The problem confronting most of the governments at the beginning of the WTO accession process is that the reforms they have introduced have brought disappointing

³³ John Williamson (1994) "In Search of a Manual for Technopols" in John Williamson (ed) *The Political economy of Policy Reform*, Washington, DC: Institute for International Economics, pp. 19-25.

results³⁴. Reforms, however limited in scope, that have aimed at the political democratization and economic liberalization have done little to create an open society, improve income distribution, attract solid foreign investment, or diversify the economy. And even where the reforms have produced some positive outcomes, the results seem to be inconclusive and difficult to evaluate.

Thus, WTO membership becomes an objective for several important reasons. The WTO accession process helps acceding governments to formulate their development strategy for both internal and external reasons. In terms of internal policy making, the acceding countries often share a very similar experience of institutional paralysis. Their first attempts at reform took place in the presence of at least two legacies of state-run economies. One was the ineffective, huge, and poorly trained bureaucratic administration that lacked coordination mechanisms among its many branches and outlets. The other was the presence of unclear, if not conflicting, economic directives and regulations accumulated over many years of arbitrary central planning or state-controlled economy. These two legacies posed serious obstacles to economic and political restructuring at the beginning of the reform period. The reformist efforts were routinely hampered by a large bureaucracy that lacked the expertise and resources to draft needed laws and to administer new macroeconomic policies and regulations.³⁵ The WTO accession process therefore serves a useful purpose in combating such institutional paralysis by focusing on reforming the administrative and regulatory framework of the state.

³⁴ For a comparative analysis of the failure of *Perestroika* in Russia and problems with similar reforms through the former Soviet Bloc see Patrick Heenan and Monique Lamontagne (1999), *The CIS Handbook*, Fitzroy Dearborn Publishers. Also, International Monetary Fund (1998), *Cambodia: Recent Economic Developments*, IMF Staff Country Report 98/54 (Washington: IMF). World Bank (1998), *East Asia: The Road to Recovery* (Washington: DC).

³⁵ Josef M. van Brabant (1998) *The Political Economy of Transition*, op. cit., pp. 223-226, 228-232.

Confusion about the transitions to a market economy

For many countries the transition from the state-run interventionist model to open market capitalism has been one of the main social and economic events of the twentieth century. However, the transition suggests taking a path to pursue a rational program of change: a gradual sequence of steps that includes redesigning institutions, bringing back the notion of private property, and guaranteeing basic human rights. But it is striking how unsuitable the idea of a path based on gradual objectives has proven to be in the states urgently seeking an immediate improvement in political and economic conditions. Political analysis lacks a proper theory of expectations that could take into account the sense of urgency and the limits of patience. The most immediate consequence of the new changes has been to substitute frustration for high expectations. This is why it is so crucial to establish clear priorities while designing a plan of action for the reform processes.

In order to examine what steps are crucial during the reform process it is essential to look at the options that are available and that influence decision-making during the post-interventionist transition. In general terms there are two main paths the reformers can undertake. The first is a path that stresses the political side of the reforms and aims at ensuring democracy. The second emphasizes the need for a quick economic liberalization. Given the urgency of the situation, the governments in power must prioritize and often chose between these two perspectives, in order to design their reforms

accordingly³⁶. Thus, to begin our inquiry into the dynamics of the post-interventionist transition, we have to examine which perspective has greater merit.

In short, we plan to test the causal relationship between economic liberalization and political democratization. To begin, we have to assess what have we learned so far about the relationship between the economy and politics in emerging markets. The relationship of politics and economics during transitions is important, and it has polarized the scholarly debate about what is the best plan of action for a country embarking on the reform process. Two questions must be considered. Is it economic development that leads to democracy? Or is it democracy that facilitates economic performance? According to a vast body of literature, the ultimate end of the democratic transition is market democracy. But can this end be ensured and how?

After the collapse of the Soviet Bloc the number of democracies multiplied, thereby giving some validity to the proposition that there was an international consensus recognizing that liberal democracy was the final political aspiration of all nations³⁷. Yet in the majority of the reforming countries the emergence of democratic institutions coincided with a major economic crisis. This combination of political and economic transitions posed an enormous challenge for the governments and policy makers of the reformist states. It also brought into question many of the assumptions previously made by scholars who considered democratization to be a long process that leads eventually, among other things, to economic development.

For example, in Britain democratization took two centuries, while the contemporary processes (Brazil, Poland, Greece) lasted only a few years.

³⁶ Jozef van Brabant (1998) *The Political Economy of Transition*, op. cit. pp. 126-130.

³⁷ Francis Fukuyama (1992) *The End of History and The Last Man*, op. cit., pp. 199-208.

Democratization no longer consists of a slow evolution during which the interested political and economic actors can gradually negotiate the system of institutional guarantees. The time-scale discussed in Dahl's analysis of the establishment of democratic regimes has thus been reduced. Most notably, competitive pluralism no longer precedes mass participation³⁸. Moreover, in the new democracies the instruments of free markets are being introduced from above, as a governmental policy, rather than being a natural consequence of the free marketplace of ideas.

The recent unprecedented wave of democratizations created confusion in academic circles. As time went by it became clear, to complicate the analyses even more, that the so-called democratic transitions in many countries had not produced the expected outcome. Quite often the results turned out to be a confused political scene characterized by a multiplicity of political parties viciously competing with each other, weak political institutions that have been charged with ideological struggles, and administrative conflicts between the three branches of government. This was most clearly visible in the former communist countries of Central and Eastern Europe and Central Asia, where the revolutionary upheavals exposed the ideological fallacy of the authoritarian dictatorships in power. When it became clear that those regimes were based on a false principle of authority, their collapse led to a perception of politics as the arena of social climbers, opportunists, impostors and adventurers³⁹. This explains the difficulties in establishing and sustaining new principles of authority.

The economic scenario of the new democracies appeared to be even more distressing. The huge social costs of many reforms were not always matched by the

³⁸ Robert A. Dahl (1971) *Polyarchy*, New Haven: Yale University Press, Chapter 3.

³⁹ Vladimir Tismaneanu (1992) *Reinventing Politics: Eastern Europe from Stalin to Havel* New York: The Free Press, pp. 279- 282. .

anticipated improvement in the overall standard of living. The emerging democracies have also experienced high inflation, the collapse of the banking systems, corruption, high unemployment, and a chronic lack of solutions for the hugely inefficient state enterprises⁴⁰. All the above problems have been further magnified by the growing incidence of ethnic claims and cultural demands made by previously disadvantaged groups.

It should come as no surprise, therefore, that, after the initial euphoria over the post-Soviet democratization process, the mood soon turned sour. The grim reality of life in many of the post-interventionist states suggests the need for more thoughtful scholarly analysis of the processes of political democratization and economic liberalization. This is especially so, since a growing number of critics have been fast to conclude that 'market democracy' is only a theoretical abstraction, and that its universalist claim cannot be successfully justified⁴¹. It has been further argued that the democratic test of stability and progress that is applied to so many countries around the world is misleading.

Still the burning question remains of what changes actually matter during the post-interventionist transition and where the emphasis should be placed while designing the framework for reforms. And why are the countries that are exhausted with futile experiments in democratization and economic liberalization abandoning previous reform frameworks and turning to the WTO instead? The accession negotiations somehow seem to give a sense of clear destination where the reforms should be going. However, before we get to the analysis of the accession process, we must first illuminate the problems

⁴⁰ Jozef M. Brabant (1998) *The Political Economy of Transition*. op. cit., pp. 88-90.

⁴¹ Zaki Laidi (1998) *A World Without Meaning: The Crisis of Meaning in International Politics*. London: Routledge, pp. 43-55.

inherent in the debate over the virtues and vices of political democratization and economic liberalization.

Defining the Terms

In order to have a proper set of reference, we begin by considering how the term 'democratic transition' has been explained in the literature on the subject. The most penetrating work preoccupies itself with investigating the final goal of the transition process, a consolidated democracy. The definition by Linz and Stepan says⁴²: "*A democratic transition is complete when sufficient agreement has been reached about political procedures to produce an elected government, when a government comes to power that is the direct result of a free and popular vote, when this government de facto has the authority to generate new policies, and the executive, legislative and judicial power generated by the new democracy does not have to share power with other bodies de jure*".

The definition helps us to understand why we should always make a distinction between economic *liberalization* and political *democratization*. Economic liberalization entails a mix of policy choices aiming at establishing the mechanisms of a free market, privatization, how to manage the exchange rate, how to reorient foreign economic activity, financial market liberalization, the creation of commercial banking, and so forth. Political democratization on the other hand is a wider and more specifically political concept. Democratization requires a working institutional structure to allow for open

⁴² Juan J. Linz and Alfred Stepan (1996) *Problems of Economic Transitions and Consolidation*. Baltimore: The Johns Hopkins University Press, p. 4.

competition over the right to win control of the government, and this in turn requires free competitive elections.

The introduction of a standard definition of what is necessary - theoretically speaking - to complete a democratic transition allows us to highlight two important issues. First, it helps guard against the "electoralist fallacy" of claiming that a *necessary* condition of democracy, free elections, is also a *sufficient* condition of democracy. Secondly, by including in the definition the need to reach an agreement on the specific institutional arrangement for producing democratic government, Linz and Stepan alert us to the decision-making processes within the political arena of the transforming state⁴³. Disagreements among interests groups over such issues as whether there should be a unitary or a federal state, a monarchical or a republican form of government, and a proportional representation or some other type of electoral system may lead to a breakdown of the reforms. Tensions that are unresolved can be destructive in leading to challenges to the legitimacy of the new post-interventionist government, the priorities of the reform process, and the shape of the state's institutions. Such an institutional conundrum, especially if it creates continuous confrontation and ambivalence about the state institutions among the political elites and the majority of the population, with no sign of accommodation, may leave the democratization incomplete, or perverted⁴⁴.

Being aware of the dangers of easy over-generalization, Adam Przeworski has researched the question of what makes a democratic state effective. His answer points clearly to the institutions of the state. "A democratic state 'works', he notes, "when it generates normatively desirable and politically desired effects, such as economic growth.

⁴³ Juan Linz and Alfred Stepan, (1996) *Problems of Economic Transitions and Consolidation*. op. cit.

⁴⁴ Josef M. van Brabant (1998) *The Political Economy of Transition*. op. cit., pp. 230-255.

material security, freedom from arbitrary violence, legal assurance that the contracts entered into will not be broken, and other conditions conducive to the full development of individuals. And democracy 'lasts' when it can absorb and effectively regulate all major conflicts and when rules are changed only according to rules"⁴⁵. In summary, the emphasis is placed on the rule of law and on the institutional framework of the state.

The conclusion reached by Przeworski has been relatively new in the literature on democratic transitions. Since the early '80s, under the label 'transitions to democracy', a branch of the social sciences has concerned itself with comparative studies of political modernizing processes since the Second World War⁴⁶. Three groups of countries stand at the center of these investigations: the post-war democracies (Italy, Austria, Japan, West Germany); the Mediterranean democratization processes of the '70s (Portugal, Spain, Greece); and the collapse of the authoritarian regime in South America in the '80s (Argentina, Brazil, Uruguay, Chile, Paraguay) and South Africa⁴⁷. The suggestive temptation to add a fourth group to these (the post-Cold War transitions) and to analyze them with the proven instrument supplied by this research tradition turns out, however, to be at least partially misleading. The transitions that have been taking place over the last two decades are different in two respects from the transitions in the countries mentioned above.

In the first three historical contexts the territorial integrity and organization of each country was largely preserved and the changes did not result in large-scale migrations.

⁴⁵ Adam Przeworski (1995) *Sustainable Democracy*, Cambridge: Cambridge University Press, p. 11.

⁴⁶ Guillermo O'Donnell and Philippe C. Schmitter (1986) *Transitions from Authoritarian Rule*, Baltimore: John Hopkins University Press.

⁴⁷ Larry Diamond, Juan J. Linz and Seymour Martin Lipset (eds.) (1990) *Politics in Developing Countries – Comparing Experiences with Democracy*, Boulder, CO: Lynne Rienner Publishers.

The present situation is different; the scene is dominated by territorial disputes, migrations, ethnic conflicts and corresponding secessionist longings. But even more important is the second difference. In the earlier examples of democratic transitions, the modernizing processes were mainly of a political and constitutional sort, whereas in the post-interventionist transitions the additional task of reforming the economy and creating an economic society has also been the order of the day⁴⁸. But if the management of the economy matters more than ever before, does this mean that the post-interventionist reformers should forget about politics?

On the theoretical level, we have already separated the concept of economic liberalization from political democratization. Practical consideration would then suggest that open market reforms can take place without democratization; or that democratization can take place without parallel economic changes. If this is the case, however, we must investigate what reform path has a better chance of advancing and consolidating democratization and economic liberalization for the benefit of the transforming state.

Relationship between Economic Performance and Democracy

Perhaps the most long-standing proposition is that which maintains that economic development is a precondition of democracy. This argument, which places emphasis on building proper economic institutions first, has been supported by solid empirical evidence. Following Seymour Martin Lipset's seminal work⁴⁹, many studies of this type have been carried out covering a wide range of different countries. On the basis of the

⁴⁸ Gerard Roland (2000) *Transition and Economics: Politics, Markets, and Firms*. Cambridge, MA: The MIT Press.

⁴⁹ Seymour Martin Lipset (1959) "Some Social Requisites of Democracy" *American Political Science Review*, Vol. 53, No. 1. Lipset reaffirmed his argument 30 years later in a 1993 article "A Comparative Analysis of the Social Requisites for Democracy," *International Social Science Journal*, 136)

statistical analysis, the studies have repeatedly concluded that a successful open market economy facilitates political democratization. However, this thesis contains a number of weak points that should be tested.

The relationship between economic development and democracy has often been understood in functional terms. Democracy ‘requires’ a certain level of economic development, which, in turn, ‘requires’ democracy. A functionalist would argue that societies are functionally integrated and interrelated systems, which must always maintain a necessary ‘degree of fit’. In this way, democratic change would consist of an adjustment to a prior economic change. Thus, the logic of this type of explanation does not necessary lead to the conclusion that when certain requisites of democracy are met the result will inevitably be democracy. The logical conclusion is that democracy can only then be possible.

However, if we examine the relationship between the economy and democracy more closely, we conclude that it is presented in terms of probability rather than determinism. The most important empirical studies of democratization do not defend the existence of a mechanical relationship between economic development and democracy. Rather, they merely affirm that if the former takes place, the probability of the latter occurring increases⁵⁰. No law of destiny guarantees that a developed country will be democratic, or that a poor country will be a dictatorship. Certainly poor countries are not all characterized by a concentration of resources, the submissiveness of their societies, and extensive illiteracy⁵¹.

⁵⁰ Seymour Martin Lipset, Kyoung-Ryung Seong and John C. Torres (1993) “A Comparative Analysis of the Social Requisites of Democracy,” *International Social Science Journal*, Vol. 136.

⁵¹ Wei-Wei Zhang (2000) *Transforming China – Economic Reform and its Political Implications* London: Macmillan Press, pp. 9-20.

If the causality is weak, this is because it reflects the considerable room for maneuver that individuals and societies enjoy under varying structural conditions. Economic development may favor democracy, but exceptions always exist, as in the case of Germany in the 1930s. Thus, economic development is not a sufficient cause of democracy, and the degeneration of political regimes can take place in the context of increased economic prosperity⁵². Nor is the relationship, to the extent that it does exist, a linear one. Lipset originally argued that the relationship was linear⁵³. Subsequently, Robert W. Jackman⁵⁴ suggested that it was curvilinear. Finally Lipset, Seong and Torres described it as N-shaped implying that rate of economic growth would enter a stage of declining after an initial period of swift development and then would rise again in a later phase if the development strategy were consistently maintained⁵⁵. The probabilities of democratization would increase during certain phases of economic development and decline in others, and the degree of democratization would not increase before a certain minimum threshold was reached. These economic thresholds of democracy correspond to what Huntington has labeled "the transition zone"⁵⁶. As a result, his study shows that in three out of four cases, countries entering this transition zone established their democratic regimes 15 years later, and they account for 2/3 of the democratizations that have taken place since 1974.

⁵² Claus Offe (1997) *Varieties of Transitions – The East European and East German Experience*. Cambridge, MA: The MIT Press, pp. 162-178.

⁵³ Seymour Martin Lipset (1959) "Some Social Requisites of Democracy" op. cit.

⁵⁴ Robert W. Jackman (1973) "On the Relation of Economic Development to Democratic Performance" *American Journal of Political Science*, Vol. 17, pp. 611-21.

⁵⁵ Seymour Martin Lipset, Seong, Torres, (1993) "A Comparative Analysis of the Social Requisites of Democracy," op. cit., p. 157.

⁵⁶ Samuel P. Huntington (1991) *The Third Wave: Democratization in the Late Twentieth Century*. University of Oklahoma Press, p. 61.

This seems to suggest that in the long run economic development does eventually affect authoritarian or interventionist regimes, but the effect operates indirectly, through a variety of intermediate variables. As an economy develops, it also becomes more complex, and hence more difficult to manage through authoritarian institutions. Moreover, the social order becomes more plural and coercion less viable, as the number of civil organizations multiplies. These developments strengthen the society's collective capacity for creating social conditions conducive to democracy⁵⁷.

There is a further reason why the economy affects authoritarian regimes. The more an interventionist regime claims legitimacy on the grounds of economic performance the more vulnerable it becomes to economic crisis. This vulnerability not only affects the personality in power but also the regime itself. For as Huntington has argued, under authoritarianism the 'legitimacy of the rulers,'⁵⁸ which is based on performance, overlaps with 'procedural legitimacy,' which is based on the rules of the game. When the former collapses, so too does the latter⁵⁹.

In support of this argument, Stephen Haggard and Robert Kaufman, after examining 23 governments in East and South-East Asia, Latin America and Africa, have shown that authoritarian regimes which tended to rely heavily on purely instrumental appeals and were thus particularly vulnerable to "legitimation crises" when economic conditions turned sour⁶⁰. After examining the above argumentation and evidence, one can conclude that democracy appears to be somehow an unintended consequence of

⁵⁷ Sabrina Petra Ramet (1995) *Social Currents in Eastern Europe*, op. cit., pp. 3-9.

⁵⁸ Huntington, Samuel P. (1991) *The Third Wave: Democratization in the Late Twentieth Century*: op. cit.

⁵⁹ Josef M. van Brabant (1998) *The Political Economy of Transition*, op. cit., pp. 88-99.

⁶⁰ Stephen Haggard and Robert Kaufman (1992) *The Politics of Economic Adjustment*. Princeton, NJ: Princeton University Press, pp. 22-34.

economic development. No matter what regime governs, sooner or later sustained high economic growth will pave the way for democracy. Yet, this does not mean that this development will be steady, predictable and irreversible. In conclusion, we still do not have precise answers for what matters most when designing the framework for the post-interventionist reforms.

Democracy as a cause of economic development

Ironically, democracy can emerge as a result of economic crisis. In fact, the democratic movement in the interventionist states of Central and Eastern Europe was a result of a profound economic and political crisis⁶¹. And 'crisis' often meant a collapse of the institutional mechanisms of authoritarian regimes that found it increasingly difficult to manage their economies. Thus, problems of economic performance provoked a crisis of legitimacy for de-ideologized regimes in power⁶². They all experienced a gradual exhaustion of their protectionist strategies and populist policies, which had led to an inefficient expansion of the state, excessive economic regulation, uncontrolled expenditures, and massive public debt.

A crisis implies a limited time for decision-making. The temporal structure of the post-interventionist transitions is decisive - it is a painful task of a patient waiting⁶³. Albert Hirschman⁶⁴ discusses this problem of the ability to wait, using the metaphor of the tunnel effect. He paints a picture of a tunnel full of fast moving cars in which there

⁶¹ Leszek Balcerowicz (1995) *Socialism, Capitalism, Transformation*. Budapest: Central European University Press and Oxford University Press, pp. 28-35.

⁶² Sabrina Petra Ramet (1995) *Social Currents in Eastern Europe - The Sources and Consequences of the Great Transformation*. op. cit., pp. 38-44.

⁶³ Claus Offe (1997) *Varieties of Transitions - The East European and East German Experience*. op. cit., pp. 35-37.

⁶⁴ Albert Hirschman (1981) *Essays in Trespassing: Economics to Politics and Beyond*. Cambridge: Cambridge University Press, pp. 39-58.

are two lines going in the same directions. There occurs a nasty traffic jam. In both lanes cars come to a standstill and no one can see what is going on. Suddenly the cars in the right lane begin to move forward and pass by the cars still blocked in the left lane. The people in the left lane go through the variety of emotions ranging from relief to growing envy, frustration, and open aggression. This metaphor conveys very well the sense of urgency that stands at the heart of the transition processes that are taking place in the countries experiencing economic collapse. It illustrates how difficult it is to coordinate the situation and ensure that those who can not be gratified immediately will patiently wait for their turn.

The gravity of this situation leads to the temptation to supplement the domestically available options with some sort of subsidy from outside as a measure of helping to cope with the hardships of economic reform. For a number of reasons, however, this strategy of seeking or providing 'support from outside' poses certain difficulties. For example, due to distribution problems, money can be misappropriated, or recipients can suspect that the real motive behind the loans is an attempt to exploit them. Furthermore, the transferred funds can make bearable the costs, which arise from the preservation of existing structures, thereby encouraging a slowing down or indefinite postponement of the renewal⁶⁵.

Any help from outside is thus problematic because it can potentially distort the transformation process. The priority should be given to the reorganization of the state so it can stand on its own⁶⁶. Only then can the devastating effect of the legitimization crisis be reversed. Otherwise the impatience of the public will make its presence known by

⁶⁵ Josef M. van Brabant (1998) *The Political Economy of Transition*, op. cit., pp. 123-130.

⁶⁶ Leszek Balcerowicz (1995) *Socialism, Capitalism, Transformation*, op. cit., pp. 232-272.

bringing to a halt the necessary reforms. The worsening crisis encourages the suspicion that the emerging political regime is acting, once again, not on the basis of the principle of fairness, but in a way that will continue to foster inequalities and poverty.

Scenarios like this one are already a reality in Romania, Ukraine, Belarus, and Russia, and this fact has prompted many political scientists to venture the idea that democracy can never really take place in these countries. The argument is that because of the limited time available and because of the need for instant gratification, dictatorships can be useful, or even superior to democracy, in promoting economic efficiency⁶⁷.

Skepticism regarding the economic efficiency of democracies has usually been based on the argument that democracies are inherently vulnerable to pressure to increase immediate consumption at the expense of investment and growth. We note here the findings of Mancur Olson and his work on interest groups and distributive game⁶⁸. New democracies, then, are arguably weak in terms of their ability to implement unpopular austerity and adjustment programs. Unless a new regime is able to improve the population's material conditions of life, the new regime would find it difficult to survive.

The argument that authoritarian regimes are more efficient than democratic one has been already supported by some extensive empirical research in Latin America and East Asia⁶⁹. However, none of the evidence suggests that authoritarian regimes have a special capacity to survive economic crises, but quite the opposite. Authoritarian regimes were also found to be particularly sensitive to interest group pressures and fiscal and

⁶⁷ Patrick Heenan and Monique Lamontagne (1999) *The CIS Handbook*, London: Fitzroy Dearborn Publishers.

⁶⁸ Mancur Olson (1982) *The Rise and Decline of Nations*, New Haven: Yale University Press, pp. 41-47.

⁶⁹ Robert Kaufman and Barbara Stallings (1989) "Debt and Democracy in the 1980s: The Latin American Experience" in *Debt and Democracy in Latin America*, Boulder, CO: Westview Press, pp. 201-223.

monetary crises. It has been noted that overwhelming foreign debt burdens were more often the result of the 'developmentalism' of dictatorships - the military regimes in Latin America and the communist regimes in Eastern and Central Europe - than the 'populism' of democracies.

It is also true, however, that when dictatorships were able to generate economic development, this did in fact eventually lead to unintended processes of liberalization and democracy (Spain, South Korea from the early 1980s, Taiwan after 1987). However, towards the end of the 1980s, new empirical comparative studies began to suggest not only that authoritarian regimes performed badly in times of economic crisis, but also that dictatorships find it difficult to maintain high levels of economic growth. Joan Nelson's⁷⁰ analysis of the experience of 13 countries and 19 governments during the 1980s has shown that the dictatorships are more likely to fall than democracies, and that half of them have postponed introducing necessary reforms or have proved incapable of implementing them successfully⁷¹. Also, the research has documented that democracies have paid more attention to education, and in this way have laid the ground for future economic development.

In light of the empirical evidence available, therefore, it is hard to defend the view that democracy hinders development, or that authoritarian regimes implement more efficient economic policies. Przeworski seems right to argue that "politics does matter, but regimes do not capture the relevant differences...it does not seem to be the

⁷⁰ Joan Nelson (1984) "The Politics of Stabilization", in Richard E. Feinberg and Valeriana Kallab(eds.) *Adjustment Crisis in the Third World*, New Brunswick: Transaction Books, pp. 99-118.

⁷¹ The economic records of democracies have varied but the governments led by Arias and Monge in Costa Rica, by Betancur in Colombia, by Aquino in the Philippines, and by Seaga in Jamaica performed better than those of Marcos in the Philippines, Rawlings in Ghana, and Kaunda in Zambia.

democracy or authoritarianism per se that makes the difference but something else"⁷². We argue that the 'something else' is the institutions and regulatory framework of the state.

The most recent studies assessing the events that have taken place since 1989 in post-Communist Europe confirm the importance of the regulatory power of the state previously documented in Latin America. The evidence is growing that effective privatization (often mistakenly equated with the shrinking of the state) is best done by relatively strong states that are able to implement a coherent policy. The essence of a rich body of research on privatization and state restructuring shows that effective privatization entails less state *scope* but greater state *capacity*.⁷³

Still, after examining the literature on democratic transition, we seem to be unable to find conclusive answers to the initial questions. It is impossible to be theoretically convincing in attempting to determine whether it is the process of political democratization that matters most during the post-interventionist transition, or whether it is privatization and economic liberalization that ensures progress towards a working and open economic system⁷⁴. Thus, being overwhelmed with contradictory empirical evidence we look for clues in WTO accession requirements. They are currently 30 ongoing accession processes at different stages of negotiations⁷⁵. Below there are two very special cases that are worthy of particular attention because the internal restructuring of these two countries appears to be the fundamental aim of their WTO accessions.

⁷² Adam Przeworski (1995), *Sustainable Democracy*, op. cit.

⁷³ Joan Nelson (ed.) (1994) *Intricate Links: Democratization and Market Reforms in Latin America and Eastern Europe*, New Brunswick: Transactions Publishers. (particularly article by Jacek Kochanowicz, "Reforming Weak States and Deficient Bureaucracies")

⁷⁴ The direction of causality can often be confusing here but we have to remember we are not examining about the *emergence but rather the persistence* of the democratic state.

⁷⁵ WTO Document (2000) *Technical Note on the Accession Process* (WT/ACC/7/Rev. 2), 01 November, pp. 13-15.

Two special cases: Yugoslavia and China

Yugoslavia

Yugoslavia was the first centrally planned economy to desire GATT association. In 1950 Yugoslavia was desperate to trade with the Western market economies after a collapse of its trade relations with the Eastern European countries following its expulsion from Cominform⁷⁶.

As the Cold War began, Yugoslavia was allied with the USSR. In 1947 Yugoslavia joined the Communist nations in establishing the Communist Information Bureau (Cominform), which succeeded the Third International that had dissolved in 1943. Early in 1948, however, Tito refused to accept orders from Soviet leader Joseph Stalin, and the USSR, through Cominform, retaliated. In a meeting in Bucharest in June, which Yugoslavia boycotted, Cominform denounced Tito and the Yugoslav Communist Party, accusing them of major deviations from orthodox Communist policy. The Soviet-Yugoslav struggle became sharper in 1949, as the USSR and other Communist states denounced treaties of friendship with Yugoslavia and banned the country from membership in the newly formed Council for Mutual Economic Assistance (Comecon, or CMEA).

Yugoslavia declared itself a reforming pro-market economy when it decided to join the GATT in the 1950. It took, however, more than a decade before Yugoslavia became a GATT Contracting Party. The entry negotiations followed several different stages from an associate status in 1959, subsequent status as a provisional GATT

⁷⁶ Jozef M. Van Brabant, *The Planned Economies and International Economic Organizations*, op. cit., pp. 202-204.

Contracting Party in 1962⁷⁷ to holding a full unconditional membership in 1966⁷⁸. Yugoslavia's long road to gaining full GATT status underlined the reforms required to shift from the centrally planned economy model. These reforms, however, only concerned further decentralization measures. Yugoslavia's acceded under a "Protocol of Provisional Application" that naturally included an 'existing legislation' exemption.

Following its political breakdown in 1992, Yugoslavia was asked by the GATT Contracting Parties to apply *de novo* for membership in the organization despite participating as GATT Contracting Party in the Uruguay Round. The GATT Council at its meeting on 19 June 1992 decided that the representatives of the Federal Republic of Yugoslavia should refrain from participating in the business of the Council⁷⁹. This happened because it was decided that the GATT membership had been nullified by the political disintegration of Yugoslavia and that the changed circumstances meant that a completely new accession protocol was required. First, the Federal Republic of Yugoslavia (FRY) laid claim to the status of successor to the former Socialist Federal Republic of Yugoslavia⁸⁰. This claim was immediately contested by some of the Contracting Parties, while others had initially reserved their position on the issue.

However, after the United Nations General Assembly adopted Resolution 47/1 recommending that the Federal Republic of Yugoslavia should apply *de novo* for membership in the UN and suspended its participation in the work of the General

⁷⁷ Derived from the fact that Yugoslavia did not have customs duties in 1962.

⁷⁸ GATT Document (1968) *Protocol for the Accession of Yugoslavia* (The Protocol entered into force on 25 August 1966), and *Report of the Working Party on Accession of Yugoslavia*, GATT, Basic Instruments and Selected Documents (BISD) Fifteen Supplement, pp. 49 and 53-61.

⁷⁹ GATT Document (1992) *Council - Minutes of the Meeting of 19 June 1992* (C/M/257 and Corr.I. Item 1), 10 July.

⁸⁰ GATT Document (1992) *Communication from Yugoslavia* (L/7000), 29 April.

Assembly,⁸¹ the GATT Council addressed the Resolution at its meeting in June 1993. As a result it modified its original decision by asking Yugoslavia to apply for accession. The decision stated: "The Council considers that the Federal Republic of Yugoslavia (Serbia and Montenegro) cannot continue automatically the contracting party status of the former Socialist Federal Republic of Yugoslavia in the GATT, and therefore decides that the Federal Republic of Yugoslavia (Serbia and Montenegro) should apply for accession to the GATT and that it shall not participate in the work of the Council and its subsidiary bodies"⁸².

Having tried unsuccessfully to contest this decision to the Council, Yugoslavia remained outside the world's trading body for several years. In September 1996, Yugoslavia sent the accession application to the WTO Secretariat⁸³ but an accession working party was not established since Yugoslavia continued to be outside the UN system. This was changed in the fall of 2000, when after an overturn of the previous authoritarian regime, Yugoslavia was re-admitted to the UN⁸⁴. Accordingly, following the decision by the WTO General Council on 8 February 2001, and in response to request for accession sent by the government of the Federal Republic of Yugoslavia in January 2001, an accession working party was established. The Director-General of the WTO welcomed this important development as "a very strong signal of the importance of trade in bringing peace and stability to troubled regions of the world". He further added that:

⁸¹ UN Document (1992) *UN Resolution General Assembly (A/RES/47/1)* 22 September.

⁸² GATT Document (1993) *Council- Minutes of the Meeting 16-17 June 1993 (C/M/264)*, 14 July.

⁸³ WTO Document (2000) *Technical Note on the Accession Process (WT/ACC/7/Rev. 2)*, op. cit.

⁸⁴ UN Document (2000) *UN Resolution General Assembly (A/RES/55/12)*, 10 November.

“Membership in the WTO will go a very long way toward assisting Yugoslavia’s re-integration in the global community”⁸⁵.

China

A very special case of accession is China. China was one of the 23 original signatories of the GATT 1947. After China’s revolution in December 1949, General Chiang Kai-shek announced the establishment of the Chinese National Government on Taiwan. In 1950 the National Government sent a message to the GATT headquarters in Geneva withdrawing China from the GATT⁸⁶. In 1965 Taiwan requested and was granted observer status as sessions of the Contracting Parties. In 1971, however, observer status was removed by the Contracting Parties⁸⁷ following a decision by the United Nations General Assembly that recognized the People’s Republic as the only legitimate government of China⁸⁸. In 1982, the People’s Republic of China was granted observer status in the GATT and in June 1986 China requested “resumption” of its GATT Contracting Party status, on the basis that the withdrawal notice sent by the Taiwanese Government was null and void. However, in its request for resumption China declared that it would be prepared to accept a non-retroactive approach to the negotiation of its rights and obligations resulting from resumption⁸⁹.

⁸⁵ WTO News Release of 8 February 2001: “Moore welcomes start of Yugoslavia membership talks” at [http: www.wto.org](http://www.wto.org)

⁸⁶ A. Neil Tait & Kui-Wai Li (1997) “Trade Regimes and China’s Accession to the World Trade Organization,” *Journal of World Trade*, Vol. 31, No. 3, p. 98.

⁸⁷ Harold K. Jacobson and Michael Oskenberg (1990) *China’s Participation in the IMF, the World Bank, and GATT: Toward a Global Economic Order*, Ann Arbor: The University of Michigan Press. pp. 63-64.

⁸⁸ UN Document (1971) *UN General Assembly - Resolution 2758 – Restoration of the Lawful Rights of the People’s Republic of China in the UN*, 26 October.

⁸⁹ Sylvia A. Rhodes & John H. Jackson (1999) “United States Law and China’s Accession Process,” *Journal of International Economic Law*, Vol. 2, No.3, p. 500.

It is worth remembering that from the first meeting in Punta del Este in 1986 China had been a full participant in the Uruguay Round and signed the Marrakesh Agreement Establishing the World Trade Organization on 15 April 1994 subject to ratification. Legally, in terms of becoming a WTO member, this meant very little.

In March 1987, the Council established a Working Party on China's Status as a Contracting Party. The negotiations showed the signs of good progress until June 1989, but the negotiations stalled for almost three years⁹⁰ following the Tiananmen Square uprising. The process was back on track in the spring of 1992 but it was not until seven years later that a sure momentum was achieved. Politics, however, again played a detrimental role because in May 1999 China walked out of the advanced negotiations after the NATO forces damaged its embassy in Belgrade⁹¹. About the same time Taiwan successfully finalized, in principle, its accession negotiations and reached an agreement with all the Members of its Working Party. However, the Chinese government has expressed concerns and disappointment at the prospect of finalizing the Taiwan accession negotiations ahead of China⁹². This led to an understanding between WTO Members and the government in Taiwan that its accession process would be put on hold until Mainland China finalizes its negotiation.

When a working party to examine China's status met for the first time in Geneva in October 1987, China's reform program, which had begun in the early 1980s, was already having a profound effect on the country's economy. Since 1978, the value of China's trade had increased from more than \$20 billion to over \$80 billion in 1987.

⁹⁰ From June 1989 to February 1992.

⁹¹ *Xinhua News* (1999) "China, U.S. Continue WTO Talks," 22 April. Also, Gill Bates (1999) "Limited Engagement" in *Foreign Affairs*, Vol. 78, No.4, pp. 65-76.

⁹² *Globe and Mail* (1999) "Beijing, Taipei wage psychological warfare," August 16.

China's trade has more than quadrupled in value again since then. New figures for 1999 now show China as the world's 9th largest exporter and 10th largest importer. The value of China's merchandise exports in 1999 was \$195.2 billion, while its imports totaled \$180.7 billion. Chinese exports of services in 1999 totaled \$23.7 billion. Imports totaled \$24.5 billion, making China the world 15th largest services exporter and 10th largest importer⁹³.

China's bid for WTO accession has involved the negotiation of bilateral agreements with key WTO Members, which will be extended to all WTO Members upon accession. In November 1999 there was an important breakthrough in the Chinese accession process that produced a bilateral deal between the Chinese and US trade envoys and in May 2000 the agreement with the EC was signed⁹⁴. However, even after the signing of these long anticipated agreements, China still has much negotiating to do before the rest of the Working Party members find a compromise that will allow it to assume full WTO membership⁹⁵. As a former socialist state, China must reform its foreign trade regime to address at least six issue areas that were particularly affected by the legacy of the state-run economy: removal of quantitative restrictions on exports and imports; national treatment for foreign investors; new industrial policy; agricultural subsidies; non-discriminatory market access of goods and services; and other issues like protection of intellectual property rights and recognition of international standards⁹⁶.

⁹³ WTO (2000) *International Trade Statistics 2000*. Published by the WTO, Geneva Switzerland.

⁹⁴ For a good overview and comprehensive bibliography read: Qingjiang Kong (2000) "China's WTO Accession: Commitments and Implications" in *Journal of International Economic Law*, Vol. 3, No.4, pp. 655-690.

⁹⁵ A. Neil Tait & Kui-Wai Li (1997), "Trade Regimes and China's Accession to the World Trade Organization," *op. cit.*, p. 99.

⁹⁶ Jeffrey D. Sachs & Wing Thyee Woo (1997) "Understanding China's Economic Performance," NBER Working Paper 5935, Cambridge, Massachusetts: NBER.

There is also the parallel problem of reforming an ineffective state sector that in 1996 provided employment for 110 million people⁹⁷.

The goal of WTO Member states has been to secure greater access to the growing Chinese market. However, China's application to join the organization has aroused a number of concerns from both developing and developed Member states. Some of the issues raised have included how China's growth and accession will affect the world agricultural and merchandise markets; whether China's accession will further increase the U.S. trade deficit; whether increased competition will result in lower real wages for skilled and unskilled workers; and how increased competition will affect the development prospects of other nations in South Asia who compete with China in similar markets.

The main problem, however, in negotiating WTO accession for China is the very limited mandate for transparency in administrative and judicial processes and guarantees that foreign investors and companies can function according to the rule of law. The confusing historical condition of China's legal and administrative systems poses many questions about the implementation of all WTO obligations by China. Although the government of China has made enormous progress since reforms began in the late 1970s, the development of a modern legal and administrative system has been uneven and lengthy. Long-held traditions under the authoritarian leaders have dictated the subordination of law to political factors⁹⁸. This reflects worries expressed by WTO Members that failure to address issues of due process and reform of legal institutions

⁹⁷ Hiddo Houben (1999) "China's Economic Reforms and Integration into the World Trading System," in *Journal of World Trade*, Vol. 33, No.3, p.6.

⁹⁸ Wei-Wei Zhang (2000) *Transforming China*, op. cit., pp. 9-20.

would lead to corrosive disputes within the WTO⁹⁹. Thus, it remains unclear whether the Accession Protocol should follow that established in the previous twelve WTO accessions pattern or whether it should be different to address the issues in question.

The lessons of the WTO Accession Process

The lessons from present WTO accession negotiations challenge the long-standing assumption that the establishment of democratic institutions is the most desirable step in the political life of a country. This assumption presupposes, among other things, that without democracy the state is not able to have a well-functioning market economy. Contrary to this argument, however, the present WTO accession processes teach us that, although democracy matters, whether a country can in fact advance its reforms and continue to satisfy its population entails more specific requirements than free elections or privatization schemes. The WTO accession negotiations require that there be a system in place that will ensure, above all, a regulatory order, administrative transparency, judicial independence, and the accountability of different branches of government: in short - the rule of law¹⁰⁰. These objectives hint at democracy, yet, when it comes to examining the transition reform processes, they force us to look beyond the sheer facade of the democratic ideal.

Most of the countries in line for WTO membership are new and fragile democracies that hope to be strengthened through international commitments and support. Since the WTO works on the principle of equal rules for all members, the

⁹⁹ Compare in Sylvia Ostry (1998) "China and the WTO: The Transparency Issue," in *UCLA Journal of International Law and Foreign Affairs*, Vol. 3, Summer.

¹⁰⁰ For some factual references see WTO Document (1999) *Technical Note on the WTO Accession*, March.

habitual approach is to ensure that every new member meets the criteria of being a working democracy and having an open market economy. From the point of view of the present WTO members, only a democratic state can ensure an independent judiciary capable of safeguarding the contractual obligations and guaranteeing fairness of due process when conflicts arise. Secondly, a reformist move towards economic liberalization is equated with the introduction of predictable, fair, and free market mechanisms without which the underlying rationality of free trade makes no sense.

The above points sound plausible, if simplistic. In truth, when it comes to the WTO accession process they only constitute a framework for negotiations. We can agree that democracy is essential to guarantee the individual economic freedom and creativity necessary for progress. We all know that a system of political checks and balances implied by a democratic state guards against corruption, distortionary favoritism and voluntarist interventionism. The question remains: since no two democracies are the same, which democratic institutions matter more than others with relation to economic performance? And since there is no such thing as an unregulated free market economy, another question to ask is what are the fundamental free market mechanisms that must be introduced to make sure that the post-interventionist reforms can succeed?

It appears that the main problem in negotiating WTO accession protocols for new members is the very limited mandate for transparency in administrative and judicial processes and guarantees that foreign investors and companies can function according to the rule of law¹⁰¹. Because of the uncertain character of most candidates' legal and administrative systems, thoughtful supporters of enlarging the WTO's membership are

¹⁰¹ This observation is based on an analysis the 12 completed accessions to date as well as over 30 others that are still in progress. WTO Document (2000) *Technical Note on the Accession Process* (WT/ACC/7/Rev. 2), 1 November.

quietly worried that failure to address issues of due process and the need for the reform of regulatory institutions will result in incomplete or distorted post-interventionist transitions, and lead to corrosive disputes within the WTO. Increasingly, then, the present WTO members have been placing emphasis on the relevant legislative developments inside the candidate state.

The process of transition from an interventionist to an open economy requires a deep understanding of how free market economies work in order to decide how the essential mechanisms can be put in place over the course of time. However, what makes this problem so difficult is that, while economists think that the full benefits of a market economy are not realized unless most of its key features are implemented, governments in practice cannot do everything at once.

One of the most important features of a free market economy is an open society characterized by a freedom of movement and speech and the right to private property. Any mature market economy is linked closely with the working democratic institutions of the state. But it is not always immediately clear which institutions matter most during the transition to a new (and immature) market economy. The rhetoric of democratization tends to distort the preferences of reformers in favor of democracy as an ideal rather than working towards the principle of due process. The vision of "building democracy" may not be the best guiding principle while trying to deal with the reality of economic crisis. It follows that embarking on market-oriented liberalizing reforms requires putting in place new and concrete policies, institutions, and policy instruments. In short, a consistent and effective regulatory and administrative framework has to be established to ensure the

recognition of basic property rights, the honoring of legal contracts, the enforcement of rules, and, above all, the sanctity of due process.

Governments embarking on the difficult path of a transition toward political democracy and a market economy have to satisfy at least two judges. The first is the domestic constituency, often fragmented and hostile, while the other is the international community, which voices its demands via the specific requirements of international treaties and conventions that the reforming state wants to belong to. The WTO accession process is a unique example of an external source of demands that influence post-interventionist transitions. It not only generates pressure to reform but it also provides guidance on how these reforms should proceed. Furthermore, accession to the WTO can silence the dissatisfied interest groups by making it possible for the government to stress the weight of its international commitment.

Yet, every WTO accession is different. Some of the negotiations proceed quickly to their successful conclusion, while others stumble along the way. Quite often the reason for breakdown in accession negotiations has to do with the acceding government's inability to satisfy either the demands of the international community or the expectations of its own electorate, or both. Sometimes the government is unable or unwilling to introduce the required reforms, and this leads to a breakdown in the negotiations. More commonly, however, the reason for not proceeding with reforms lies in the government's loss of internal support.

The danger underlying the post-interventionist reform process is that decision making with respect to the reform plan is neither consistent nor transparent. As a result it cannot produce desirable outcomes. Most importantly, there is a danger at the beginning

of the reform process that the quest for rapid economic improvement at a time of crisis can underestimate the societal preference for the creation of predictable and fair regulatory state institutions. In other words, it is assumed that the temporal urgency characterizing post-interventionist transitions necessitates prioritizing economic reforms. But economic reforms alone can hardly constitute a legitimizing factor sufficient to generate a sustained level of public support. In fact, to press for economic reforms alone without working on the apparatus of the state can eventually produce a rapid deterioration in such support, and risk stalling the whole reform process indefinitely.

The dilemma of setting the priorities at a time of crisis, which Offe¹⁰² calls the "political economy of patience," is not so much about the need for immediate improvement in living conditions, as it is about the need for assurance that such improvement will eventually take place. The society undergoing a reform process expects the transition to lead to the development of legitimate institutions and laws, with clearly defined property rights supporting a genuine political process and an economic environment that conveys a sense of impartiality and opportunity for all.

Recent innovations in economic theory also provide new clues about the vital role that the institutions and the regulatory framework of the state play in economic processes. When economists consider a successful market economy, they relate to a set of convergent expectations in the society about how other people will behave. These expectations support an extremely elaborate division of labor, and a high degree of specialization among individuals, firms, and geographic areas. This specialization increases the profitability of new innovations, modernization and skill improvement.

¹⁰² Claus Offe (1997) *Varieties of Transitions – The East European and East German Experience*. op. cit., pp. 1-8.

However, the economists researching the interaction of expectations and behavior in the development of norms and institutions have shown that the emergence of convergent expectations is a very long and volatile process¹⁰³. Many economists further stress the importance of innovation as a crucial factor of a successful economy. Learning from the disastrous experiences of failed interventionist states, they are returning to the Shumpeterian view that the advantage of a market economy derives from its incorporation of new innovations rather than, as previously believed, from its allocative efficiency¹⁰⁴. But innovation is born only in the context of a secure regulatory environment that provides for incentives with respect to property rights and guarantees the promise of commercial contracts. All the interventionist economies, and especially the systems of central planning, have been deficient in both respects.

Another development in economics that has reduced the attractiveness of Lange's conception of a state-run economy¹⁰⁵ is the increased attention paid to the motivation of government officials, both legislators and bureaucrats. In the 1960s, much of the economic analysis was focused on market failures and governmental actions to remedy these failures. It was assumed that government authorities were rational actors who would always arrive at the optimal decision under the circumstances, and would not have problems implementing it. But an examination of the logic of collective action and new theories about the formation of the interest groups together reinforce the view that

¹⁰³ An Schotter (1981) *The Economic Theory of Social Institutions*. New York: Cambridge University Press. Also, Sugden, R. (1986). *The Economics of Rights, Cooperation, and Welfare*. New York: Basil Blackwell.

¹⁰⁴ Ha-joon Chang (1998) "Globalization, transnational corporations, and economic development: can the developing countries pursue strategic industrial policy in a globalizing world economy?" (1998) in *Globalization and Progressive Economic Policy* Dean Baker, Gerald Epstein and Robert Pollin (eds.) Cambridge: Cambridge University Press, pp. 97-113.

¹⁰⁵ Oscar Lange (1938) *On the Economic Theory of Socialism*, The University of Minnesota Press.

government failure and the limitations of a free market must be taken into consideration when designing or reforming the state institutions¹⁰⁶.

WTO accession provides an excellent lesson in this respect. It demonstrates that all reform processes must begin with questions about reality of the implementation of the proposed changes. The accession negotiations bring together many concerns about the design of the political institutions and their impact on the economic life of the specific country. Every accession is different precisely because every acceding country is quite unique. Each of the candidates has a different resource base, specific industrial infrastructure, distinct agricultural sector, peculiar configuration of interest groups, particular tradition of law, special societal preferences, different cultural priorities, and its own employment concerns. The challenge of the accession process is to bring all of these factors together under the umbrella of a regulatory framework that can slowly address them in a predictable and transparent manner.

There are over 30 countries that are currently negotiating accession, and most of them are awash with social, political and economic problems. Consequently, WTO accession is a process of negotiation about the right of access to global markets, about the appropriate model for the regulatory and administrative framework of the state, and about the state's ability to implement the undertaken commitments. In the final analysis, WTO accession becomes a valuable case-study, both theoretically and practically, of the political, economic and social adjustment process in the post-interventionist economies at a time of global market integration.

¹⁰⁶ Paul B. Stephan (1997) "Toward a positive theory of privatization: Lessons from Soviet-type economies," in *Economic Dimensions in International Law*. Bhandari Jagdeep and Alan O. Sykes (eds) Cambridge University Press.

Chapter 3

The Transformation of the GATT/WTO Accession Process – The Procedural Steps and the Legal Provisions

Introduction

One of the greatest challenges facing the World Trade Organization is to extend the benefits of an open multilateral trading system to all trading states. From the beginning, the GATT had been viewed as a multilateral treaty with open membership and with provisions that encouraged it to work towards universal membership¹. In the case of its successor, the WTO, some thirty countries are currently applying for membership and many of them are countries that are undergoing a transition from a state-controlled to an open market economy. Admission into the WTO and the subsequent integration of those states into international economic networks is essential if the WTO is to address the needs of the globalizing economy in the decades to come. However, the accession of new members to the WTO is not as simple as it was under the GATT. The candidates confront comprehensive obligations covering not only border measures but also domestic regulatory policies. At the same time, special privileges and exemptions for developing countries have been scaled down. Twelve

¹ John H. Jackson (1969) *World Trade and the Law of GATT*, Indianapolis: Bobbs Merrill, p.776.

countries have successfully completed their accession negotiation since the establishment of the WTO in 1995.²

There is a significant difference between WTO accessions and accessions during the GATT era. Under the old regime it was possible for non-market economies to join the system without making commitments to introduce pro-market reforms. Furthermore the non-market economies that joined the GATT were treated differently. since, in principle, their participation was regarded as incompatible with the GATT system³. In this chapter we demonstrate how the accession process was transformed with the creation of the WTO. It is now no longer possible for non-market economies to join the world trading body. The acceding countries that are in the middle of economic transitions are expected to make commitments to complete the pro-market reforms on schedule. In fact accession, which involves a series of economic reforms, is best understood as a structural adjustment process under the supervision of the WTO⁴.

What makes accession a strenuous process is the fact that many of the acceding states are coping with the devastating legacy of a Soviet-style planned economy, or some other kind of interventionist system, while others are in the midst of economic reforms aimed at a greater opening of their markets. The overwhelming majority of candidates are economies in transition confronted with the remnants of central planning or/and years of economic mismanagement and political authoritarianism. Making the transition to an open market economy entails severe challenges, including the need to

² Ecuador; Mongolia; Bulgaria; Panama; Kyrgyz Republic; Latvia; Estonia; Jordan, Georgia, Albania and Croatia and Oman. There were 140 WTO Members as of April 2001.

³ Vassil Breskovski (1993) "Bulgaria and the GATT – A Case Study for Accession" *World Competition*, Vol. 17, No. 2, p. 45.

⁴ Roman Grynberg and Roy Mickey Joy (2000) "The Accession of Vanuatu to the WTO – Lessons for the Multilateral Trading System" in *Journal of World Trade*, Vol. 34, No. 5, p. 160.

privatize existing state enterprises, to establish a viable commercial code. to encourage prices that will reflect relative costs and scarcities, to remove the monetary overhang, and to find new sources of government revenue. All these issues are carefully addressed during accession negotiations.

After explaining the transformation of the GATT/WTO accession process, this chapter also examines the mechanics and legal provisions that guide accession negotiations. It is important to remember that every accession is different and case specific. There are a few general legal provisions that have to be met in the process, but they leave plenty of room for variations in patterns from one case to the next. In fact, one has to take into account a certain degree of unpredictability when trying to speculate on how a particular accession negotiation will unfold.

Transformation of the accession process

Since the issue of non-market economies' participation in the GATT was first considered, the argument was put forward that the General Agreement, which was intended to regulate trade flows among open market countries, couldn't apply meaningfully to centrally planned and interventionist economies⁵. However, it is important to remember that from its beginnings the architects of the GATT system attempted to include non-market economies and cooperate with the Soviet Bloc

⁵ Throughout the 1950s, it was understood that there was no room in the GATT for any non-market communist country. For example, Czechoslovakia was one of the original GATT Contracting Parties in 1947. At that time, it was considered a market economy. In 1951, as a reaction to the Cold War, the U.S. Congress enacted a law which prohibited the U.S. from granting MFN status to communist countries. The only country affected was Czechoslovakia, which complained to the GATT about this unilateral action. The GATT approach was to adapt a resolution that merely recognized the nullification of benefits between the two countries. GATT. *Suspension of Obligations between Czechoslovakia and the U.S. under the Agreement (Declaration of 27 September 1951)*. GATT: Basic Instruments and Selected Documents (BISD) 1952, Volume II, p. 36. Also, John H. Jackson (1989) *The World Trading System – Law and Policy of International Economic Relations*, The MIT Press: Cambridge: MA. pp. 332.

countries⁶. During the discussions that eventually led to the Havana Charter, key members of the negotiating teams were deliberating how to accommodate the special trade requirements of the Soviet Union, which was expected to become one of the founders of the proposed International Trade Organization (ITO).⁷ All the earlier drafts of the ITO Charter included provisions relevant to countries with “a complete state monopoly of imports.” Non-market economies were taken for granted and the charter even provided for technical arrangements to align them with the principles of the future ITO to ensure equal participation⁸.

Given the rapidly deteriorating political environment for postwar cooperation among the allies, the Soviet Union decided not to participate in the Geneva conference. The motive behind the efforts to accommodate centrally planned economies gradually faded and the above provisions were consequently weakened in the subsequent drafts. After the ITO Charter failed to be ratified, the General Agreement as it later emerged contained no special provisions dealing specifically with non-market economies. The provisions in Article XVII on state monopolies in the context of market economies provided the only basis in the General Agreement for accommodating centrally planned economies. Article XVII:3 of the GATT-1947 clearly provided for “negotiations on a reciprocal and mutually advantageous basis designed to limit or reduce obstacles” to

⁶ For the most comprehensive account of the preparations leading to the Bretton Woods conferences read: Georg Schild (1995) *Bretton Woods and Dumbarton Oaks: American Economic and Political Postwar Planning in the Summer of 1944*, New York: St. Martin's Press.

⁷ The Soviet Union played an active role in the Bretton Woods and related discussions about the future international economic, financial, and trading frameworks. However, it did not join the Preparatory Committee for the Havana Conference and thus it was not asked to participate in the tariff conference and the discussions about the General Agreement in Geneva in 1947. It signed the Articles of Agreement at the final Bretton Woods conference in 1944, although in the end it failed to ratify them. For more details see: Jozef M. Van Brabant (1991) *The Planned Economies and International Economic Organizations*, Cambridge: Cambridge University Press, pp. 44-52.

⁸ Jozef M. Van Brabant (1991) *The Planned Economies and International Economic Organizations*, op. cit, p. 53.

trade resulting from the operation of state trading enterprises⁹. Contracting Parties used this provision in the context of GATT accession negotiations by the Soviet Bloc state trading countries.

Article XVII of the GATT-1947 was initially constructed to address and to regulate the market behavior of state-owned monopolies¹⁰. The drafters, however, were unsure about the future role of state trading. These practices were just about emerging from the difficult war period. Thus, the provisions in the GATT were left vague to maintain some flexibility in the system. Article XVII did not provide a clear definition of what constituted state trading, and Contracting Parties routinely provided their own interpretation of what was meant by it¹¹. Later, the inherent flexibility of Article XVII permitted the extension of its application to state trading countries. Since the GATT articles did not stipulate any membership criteria, the terms of accession were agreed between the Contracting Parties and a candidate state, hence the provisions of Article XVII could be used to admit non-market economies into the GATT system. And since the GATT related only to trade in goods, the main concerns of the negotiators were border measures. Such concerns could be accommodated without placing demands on the acceding countries to reform their domestic economies.

⁹ Ernst-Ulrich Petersmann (1998) "GATT Law on State Trading Enterprises: Critical Evaluation of Article XVII and Proposals for Reforms" in *State Trading in the Twenty-First Century*, Thomas Cottier and Petros C. Mavroidis (eds.) The University of Michigan Press, p. 76.

¹⁰ Article XVII of the GATT: *State Trading Enterprises*

1. Each contracting party undertakes that if it establishes or maintains a State enterprise, wherever located, or grants to any enterprise, formally or in effect, exclusive or special privileges, such enterprise shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting imports or exports by private traders.

¹¹ In the Uruguay Round, the final agreement at last defined state trading enterprises in the "Understanding on the Interpretation of Article XVII of the GATT 1994" The definition was of particular importance with respect to notification requirements.

In fact, under the GATT, the Protocols of Accessions specifically allowed for a limited application of Part II of the General Agreement¹². In the case of Poland the accession Protocol stated that Poland would have to apply to contracting parties provisionally Parts I, III, and IV of the General Agreement, but Part II only “to the fullest extent not inconsistent with its legislation existing on the date of this Protocol”.¹³ The reference to the limited application of Part II in the GATT Protocols of Accessions was customary. This practice was consistent with a long established precedent. When GATT was first brought into existence, the countries that signed it adopted a Protocol of Provisional Application. After all, the General Agreement was to be replaced by the International Trade Organization (ITO). The GATT was originally meant as a provisional arrangement designed to serve as a framework for the creation of the ITO agreements. However, when it became clear that the proposed ITO was doomed by the resistance of US Congress to ratify its charter,¹⁴ the GATT was pressed into service as the only international trading instrument left.

A Protocol of Provisional Application (PPA) became the legal device that ensured that the tariff negotiations would be implemented without requiring that other substantial obligations be ratified by domestic legislation¹⁵. Thus, Part I and Part III of the GATT were to be fully implemented by Contracting Parties. Part I contained the MFN and the tariff concession obligations, while Part III was mainly procedural. Part

¹² Part II includes GATT Articles III to XXIII (For example: Article III on National Treatment, Article V on Freedom of Transit, Articles VI on Anti-Dumping, Article VII on Customs Valuation, Article X on Publication and Administration of Trade Regulations, Article XVI on Subsidies, etc.)

¹³ GATT Document: *Protocol for the Accession of Poland*, GATT: Basic Instruments and Selected Documents (BISD) Fifteen Supplement, 1968, p. 47.

¹⁴ Peter B. Kenen (1994) *Managing the World Economy: Fifty Years After Bretton Woods* Washington DC: Institute for International Economics, p.14.

¹⁵ Read more about the GATT jurisprudence with respect to this issue in Robert E. Hudec (1999) *Essays on the Nature of International Law*, London: Cameron May, pp. 37-75.

II, on the other hand, included many of the principal obligations like those relating to national treatment, quotas, customs procedures, subsidies, and anti-dumping, and it was given a PPA exception. It effectively meant that GATT Contracting Parties could deviate from those GATT Part II obligations that did not comply with their existing legislation¹⁶. Countries that later negotiated GATT accession did so on terms that incorporated the same PPA or 'existing legislation' exemption¹⁷.

Furthermore, with respect to the Part II obligations, each GATT Contracting Party was entitled to have *grandfather rights* for any legislation that existed when it joined the GATT system, and which was inconsistent with a GATT Part II obligation. For the existing Contracting Parties, however, this issue became less and less important. Many of the *grandfather rights* and old legislation became extinct and new legislation did not qualify for a PPA exemption. The exemption, however, continued to play an important role during accession negotiations. The socialist countries had economies incompatible with the GATT system, because GATT rules assumed the existence of a market economy "where enterprises make decisions on the basis of economic factors, not government directives¹⁸." However, thanks to the Protocol of Provisional Application exemption, they could join the system while maintaining existing legislation that was naturally designed to support a non-market economy¹⁹.

¹⁶ In fact, two countries, Haiti and Liberia, accepted the General Agreement without reservation as provided in Article XXVI:2 and 4. The latter withdrew after a short while.

¹⁷ John H. Jackson (1989) *The World Trading System – Law and Policy of International Economic Relations*, op. cit., pp. 39-41.

¹⁸ William J. Davey (1998) "Article XVII GATT: An Overview" in *State Trading in the Twenty-First Century*, Thomas Cottier and Petros C. Mavroidis (eds.), Ann Arbor: The University of Michigan Press, p. 21.

¹⁹ Presently, during the WTO accession negotiations, the acceding countries are routinely asked to submit a *legislative plan of action* indicating implementation of the requested legislative changes and the introduction of the new commercial laws and regulations.

The GATT Contracting Parties employed different legal techniques and safeguard clauses in negotiating accession protocols. The countries that joined under Article XXXIII of the GATT-1947, and were parties to Protocols of Accession, in addition to acceding provisionally to the General Agreement, had protocols that included schedules of tariff and other concessions that reflected accession negotiations with the Contracting Parties. Without these tariff and other concessions, and because of the MFN principle, a new Contracting Party would benefit unilaterally from prior concessions under the GATT without having to reciprocate.

It is important to note that GATT accession negotiations evolved around tariff levels and import quotas and thus did not need to penetrate inside the borders of the acceding countries. For example, Poland was a centrally planned economy when it acceded to the GATT in 1967. As a result of its accession it agreed to increase imports from the Contracting Parties according to a specified formula, and to include in its accession Protocol the selective safeguard clause, a provision relating to quantitative restrictions, and special surveillance and consultations provisions²⁰. The GATT Contracting parties retained discretion to impose selective safeguard measures²¹ on imports from Poland. Under the Polish protocol, the right to apply such measures was available only to the market economy GATT countries but it was not available to Poland²². The right is reciprocal in the protocols of Romania and Hungary. In addition,

²⁰ GATT Document (1968) *Protocol for the Accession of Poland*, Basic Instruments and Selected Documents (BISD) Fifteen Supplement, pp. 46 and 52.

²¹ The measures were referred to as *selective* safeguard measures to distinguish them from safeguard measures permitted under Article XIX of the GATT. Article XIX permits measures that are applied on an MFN basis, namely, against all imports of the product in question, regardless of the source.

²² *Protocol for the Accession of Poland*, op. cit.

Paragraph 4: "If any product is being imported into the territory of a contracting party from the territory of Poland in such increased quantities or under such conditions as to cause or threaten serious

many Contracting Parties pushed for keeping the discriminatory quantitative import restrictions on Polish goods during an unspecified transitional period²³. Romania's accession protocol (1971)²⁴ contains quantitative import commitments but the accession protocol of Hungary (1973)²⁵ does not. In both these cases the GATT Contracting Parties reserved their right to use selective safeguards and to maintain quotas on Hungarian and Rumanian products.

The three non-market economies were allowed to join the GATT according to a protocol approach where each protocol was different and contained a unique accession formula for each country. For example, Poland's accession protocol stipulated that there were to be annual consultations to oversee the implementation of the obligations but the Rumanian and Hungarian protocols allowed for the reviews to be held every second year. These reviews went on record as meetings full of hostile exchanges over trade policy issues²⁶. In fact, Poland's, Rumania's, and Hungary's accessions to the GATT were often considered only as symbolic gestures. The move, that was intended to bridge the East and West divide, in reality translated to a very few tangible economic

injury to domestic producers in the former territory of like or directly competitive products, the provisions of (b) and (d) of this paragraph shall apply.

(d) If following action under (b) and (c) above, agreement is still not reached between Poland and the contracting party concerned, the contracting party shall be free to restrict imports from the territory of Poland of the product concerned to the extent and for such time as is necessary to prevent or remedy the injury. Poland shall then be free to deviate from its obligations to the contracting party concerned in respect of substantially equivalent trade.

(e) In critical circumstances, where delay would cause damage difficult to repair the contracting party affected may take action provisionally without prior consultation, on the condition that consultation shall be affected immediately after taking such action" GATT, Basic Instruments and Selected Documents (BISD) 15 Supplement, 1968, *Protocol for the Accession of Poland*, pp. 48-49.

²³ Jan Woznowski (1974) *Polska w GATT (Poland and the GATT)*, Warsaw: PWE.

²⁴ GATT Document (1972) *Protocol for the Accession of Romania*, Basic Instruments and Selected Documents (BISD) Eighteen Supplement, pp. 5-10

²⁵ GATT Document (1974) *Protocol for the Accession of Hungary* GATT, Basic Instruments and Selected Documents (BISD) Twentieth Supplement, pp. 3-8.

²⁶ Leah A. Haus (1992) *Globalizing the GATT – The Soviet union's Successor States, Eastern Europe, and the International Trading System*, Washington, DC: The Brookings Institution, p. 53.

benefits. Eventually, the special protocol approach used in those accessions became contested as unsatisfactory both by the GATT Contracting Parties and the Eastern European countries themselves as they claimed that such an approach “provided for their second-class treatment²⁷.”

In fact, the non-market economies that joined the GATT system could not be embraced unconditionally by Contracting Parties. Such an admission would go against the fundamental free market principles underlying the GATT because of their reliance on governmental foreign trade monopoly and a central plan. Specifically, a non-market economy based entirely on state-trading principles could easily evade Article XI²⁸, prohibiting the use of quantitative restrictions, and Article II²⁹, requiring that every state-trading enterprise established by GATT Contracting Parties adhere to the rules and maintain the level of tariff concessions specified in the countries’ Tariff Schedule. Naturally, in a centrally planned economy where all enterprises belonged to the state, a tariff schedule was as a rule without real operational meaning. Overall, non-market

²⁷ Vassil Breskovski (1993) “Bulgaria and the GATT – A Case Study for Accession” in *World Competition*, Vol. 17, No. 2, p. 46; Eliza R. Patterson (1986) “Improving GATT Rules for Nonmarket Economies.” *Journal of World Trade Law*, Vol. 20, No. 2, p. 186.

²⁸ Article XI of the GATT 1947 *General Elimination of Quantitative Restrictions*

1. No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party.

²⁹ Article II of the GATT 1947 *Schedules of Concessions*

4. If any contracting party establishes, maintains or authorizes, formally or in effect, a monopoly of the importation of any product described in the appropriate Schedule annexed to this Agreement, such monopoly shall not, except as provided for in that Schedule or as otherwise agreed between the parties which initially negotiated the concession, operate so as to afford protection on the average in excess of the amount of protection provided for in that Schedule. The provisions of this paragraph shall not limit the use by contracting parties of any form of assistance to domestic producers permitted by other provisions of this Agreement

economies did not use customs tariffs as an effective mechanism of trade control³⁰. A typical planned economy consisted of state-owned enterprises, which were instructed by the Central Planning Agency regarding what to import. The same agency also determined the quantity of the imported products and decided under what fixed price those products were to be sold on the domestic market.³¹

The main challenge in admitting the three non-market economies into the GATT system was finding a reciprocity formula to ensure non-discrimination in their trading relations with their free market partners. Poland's accession protocol stipulated the formula based on the exchange of Poland's import commitments for tariff concessions from Contracting Parties. It simply said in return for tariff reductions on Polish goods by the GATT trading partners: "Poland shall, with effect from the date of this protocol, undertake to increase the total value of its imports from the territories of contracting parties by no less than 7 per cent per annum"³². Clearly, the formula was very general and did not take into account the balance-of-trade principle of reciprocity as it did not make any connection between export and import performance. Also, Polish import commitments were to be evaluated in current dollar prices, and no inflation provisions were included permitting adjustments for the fall of the dollar with respect to other currencies.

³⁰ Michael M. Kostecki (1979) *East-West Trade and the GATT System*, New York: St. Martin's Press, pp. 83-87.

³¹ The decisions by the Central Planning Agency were never based on the basic supply/demand considerations. Rather they reflected the politically motivated priorities of the government's five-year economic plan. This led to many paradoxes and eventual collapse of those economies. To learn more about the absurdity of central planning read: "Scientific Direction of Communist Construction" in V. Afanasyev (1967) *Scientific Communism*, Progress Publishers, Moscow, pp. 192-226.

³² GATT Document (1968) *Protocol for the Accession of Poland*, GATT, Basic Instruments and Selected Documents (BISD) Fifteen Supplement, (Annex B – Schedule LXV – Poland), p. 52.

The government of Romania learned a lesson from the Polish accession, and since the country suffered from a chronic trade deficit, it opposed any arrangement based on an obligation to increase imports from the GATT trading partners³³. Thus its entry formula was quite different. Romania promised: “to increase its imports from the contracting parties as a whole at a rate not smaller than the growth of total Romanian imports provided for in its Five-Year-Plan³⁴”. In contrast to Poland, which promised to increase its imports from GATT partners at a rate negotiated in advance, the government of Romania was allowed to decide the rate itself.

Hungary was the only country that considered its customs tariffs to be a main protective trade policy instrument by the time it applied for GATT accession in 1969³⁵. However, the GATT Contracting Parties viewed the Hungarian tariff schedules with suspicion. Hungary was openly a centrally planned economy characterized by state monopolies and restrictions on free price formation³⁶. In the end, the GATT countries accepted tariffs as an instrument of Hungarian concession making. This move had an obvious political significance. Although Hungary appeared to be admitted into the GATT as a market economy, in practice, the *existing legislation* exemption firmly testified to its non-market economy reality. Thus, many Contracting Parties reserved the right to impose discriminatory quantitative restrictions in case exports from Hungary would cause injury to domestic producers. Finally, their accession formula

³³ M.M. Kostecki (1979) “*East-West Trade and the GATT System*, op. cit, p. 86.

³⁴ GATT Document: *Protocol for the Accession of Romania*, Basic Instruments and Selected Documents (BISD) Eighteen Supplement, 1972, p. 10.

³⁵ The Hungarian tariffs schedule was a unique result of the recent economic reforms in Hungary. The introduction of the tariff schedule had to overcome many domestic and ideological restraints before being accepted. Read more about the Hungarian reforms in Josef M. van Brabant (1998) *The Political Economy of Transition – Coming to grips with history and methodology*, op. cit., pp. 64-74.

³⁶ M.M. Kostecki (1979) “*East-West Trade and the GATT System*, op. cit, p. 97.

contained the selective safeguard clause that in effect nullified most of the benefits anticipated by Hungary.³⁷

In summary, the three countries were allowed to join the GATT as non-market economies but they were treated differently within the system from the original Contracting Parties to the GATT 1947³⁸. Furthermore, each of three socialist states was admitted on different terms. These differences were reflected in respectively different Protocols of Accession.

In contrast to GATT practice, the Protocols of Accession of the twelve countries that joined the WTO under Article XII of the Marrakesh Agreement Establishing the World Trade Organization follow a common pattern and an almost identical text³⁹. A WTO Protocol of Accession indicates that the new Member is prepared to observe all the rules included in the legal texts of the Uruguay Round Agreements. This approach is called a ‘Single Undertaking’⁴⁰, which means that a WTO member cannot pick and choose among different agreements, as was the case with the GATT, but has to accept the WTO legal code as a complete package. The Protocols bind the acceding governments to observe the rules contained in the WTO Agreements, and in addition each Protocol binds the new Member to observe the specific commitments⁴¹. These commitments can vary in their depth and their numbers among the acceding countries.

³⁷ GATT Document (1974) *Protocol and Working Party Report for the Accession of Hungary*. GATT, Basic Instruments and Selected Documents (BISD), Twentieth Supplement, pp. 37-41.

³⁸ “Under the GATT system, Poland was a secondary member of the world trading system. Poland had no rights while other Contracting Parties could take unilateral actions against Poland as they pleased” Interview with the Polish officials, Geneva, 2000.

³⁹ WTO Document (2000) *Technical Note on the Accession Process* (WT/ACC/7/Rev.2), 1 November, pp. 71-73.

⁴⁰ Read more about the concept of ‘single undertaking’ in John Croome (1995) *Reshaping the World Trading System – A history of the Uruguay Round*, op. cit.

⁴¹ WTO Document (2000) *Technical Note on the Accession Process*, (WT/ACC/7/Rev.2), op. cit., pp. 18-20.

The accession of Ecuador, the first country to accede to the WTO under Article XII was a novelty for the world trading system. The nature of the world trading body was changed dramatically from the GATT. The enlarged domain of the WTO and its strengthened dispute settlement system called for a different and more complex approach to the accession process. Thus, with Ecuador WTO Members began to request commitments about compliance with WTO rules, about the introduction of new measures and regulations, and about the implementation of WTO obligations by the acceding country⁴². The commitments listed in the Protocol of Accession were to be legally binding and enforceable via the WTO Dispute Settlement Understanding. These commitments are contained in the commitment paragraphs of the relevant Working Party Reports, which are incorporated by reference in the Protocols. Both the Protocol and the Report of the Working Party have the same status and legal effect.

The commitments can be classified according to the following three categories: (1) commitments to abide by the existing WTO rules; (2) commitments about the recourse to particular WTO provisions, such as transitional periods and developing country status under certain agreements; (3) commitments to abide by rules created by the commitment paragraphs and not contained in the Uruguay Round Agreements, which relate to privatization, state-trading, and membership in other Plurilateral Trade Agreements⁴³. The Protocol of Ecuador incorporates 21 specific commitments⁴⁴. Comparable commitments figures for the other eleven governments that have acceded

⁴² WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 81, also pp. 32-33.

⁴³ WTO Document (2000) *Technical Note on the Accession Process*, (WT/ACC/7/Rev.2), ANNEX 2, op. cit.

⁴⁴ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July. The Protocol of Accession of Ecuador is included within the Report (pp. 32-33). This is the case in every subsequent Report. The Reports are available at <http://www.wto.org>

are: Mongolia 17;⁴⁵ Bulgaria 26;⁴⁶ Panama 24;⁴⁷ Kyrgyz Republic 29;⁴⁸ Latvia 22;⁴⁹ Estonia 24;⁵⁰ Jordan 29;⁵¹ Georgia 29;⁵² Croatia 27;⁵³; Albania 29;⁵⁴ Oman 26⁵⁵. Two additional rules specific to Mongolia are contained in the body of its Protocol⁵⁶. The entire package of Report, Protocol of Accession and Schedules of Concessions and Commitments in Goods and Services constitute the conditions under which the acceding government is permitted to join the WTO⁵⁷.

It is especially important to recognize that the current commitment approach to WTO accession is possible because of the changes introduced to the dispute settlement mechanism. Under the GATT, the weak and vulnerable to blocking dispute settlement process provided no assurances as an enforcement mechanism. Contracting parties used the selective safeguards as the only reliable guarantee that their producers could be protected when the acceding country didn't meet its obligations. The idea of trying to

⁴⁵ WTO Document (1996) *Report of the Working Party on the Accession of Mongolia*, (WT/ACC/MNG/9), 27 June.

⁴⁶ WTO Document (1996) *Report of the Working Party on the Accession of Bulgaria*, (WT/ACC/BGR/5), 20 September.

⁴⁷ WTO Document (1996) *Report of the Working Party on the Accession of Panama*, (WT/ACC/PAN/19), 2 October.

⁴⁸ WTO Document (1998) *Report of the Working Party on the Accession of the Kyrgyz Republic*, (WT/ACC/KGZ/26), 31 July.

⁴⁹ WTO Document (1998) *Report of the Working Party on the Accession of Latvia*, (WT/ACC/LVA/32), 30 September.

⁵⁰ WTO Document (1999) *Report of the Working Party on the Accession of Estonia*, (WT/ACC/EST/28), 9 April.

⁵¹ WTO Document (1999) *Report of the Working Party on the Accession of Jordan*, (WT/ACC/JOR/33), 3 December.

⁵² WTO Document (1999) *Report of the Working Party on the Accession of Georgia*, (WT/ACC/GEO/31), 30 August.

⁵³ WTO Document (2000) *Report of the Working Party on the Accession of Croatia*, (WT/ACC/HRV/59), 29 June.

⁵⁴ WTO Document (2000) *Report of the Working Party on the Accession of Albania*, (WT/ACC/ALB/51), 13 July.

⁵⁵ WTO Document (2000) *Report of the Working Party on the Accession of Oman*, (WT/ACC/OMN/26), 29 September.

⁵⁶ WTO Document (2000) *Technical Note on the Accession Process*, (WT/ACC/7/Rev.2), op. cit., p. 73.

⁵⁷ WTO Document (1998) *Minutes of the General Council* (WT/GC/M/23), 22 October. Also, WTO Document (2000) *Technical Note on the Accession Process* (WT/ACC/7/Rev.2), op. cit., page 22.

remedy the injury or contesting the violation of the accession protocol via the lengthy GATT dispute settlement process, which was almost certainly doomed to be blocked. did not appeal to Contracting Parties as an effective solution. The legalization of WTO dispute settlement procedures, due to the right to the establishment of a panel with standard terms of reference and the automatic adoption of dispute settlement reports created a powerful enforcement mechanism of WTO rules and obligations. In fact the drafters of the WTO Dispute Settlement Understanding (DSU) clearly stated in Article 3.2: "The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system."⁵⁸ Indeed, the WTO dispute settlement mechanism not only facilitates the settlement of disputes among the WTO Members, but it can serve as an instrument of the enforcement of the commitments made by the acceding countries.

Taken together the GATT Protocol for the Accession of Poland⁵⁹ and the GATT Report of the Working Party are only 10 pages long. In contrast the shortest WTO Report of the Working Party (including Protocol) to date under the WTO is on the accession of Mongolia, which has 30 pages, while the one on the accession of Albania has 60 pages⁶⁰. The current length of the WTO Working Party Reports reflects the

⁵⁸ "The Legal Texts – The Results of the Uruguay Round of Multilateral Trade Negotiations." DSU, Article 3, General Provisions:

2. The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system. The Members recognize that it serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law. Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements.

⁵⁹ The Protocol entered into force on 18 October 1967. *Protocol for the Accession of Poland*, GATT, Basic Instruments and Selected Documents (BISD) 15 Supplement, pp. 46-52 and *Report of the Working Party on Accession of Poland* Adopted on 26 June 1967 (L/2806), pp. 109-112.

⁶⁰ *Report of the Working Party on the Accession of Mongolia*, 27 June 1996 (WT/ACC/MNG/9) and *Report of the Working Party on the Accession of Albania*, 13 July 2000 (WT/ACC/ALB/51). After the accession of Mongolia, the subsequent Working Party Reports on Accessions are over 50 pages long.

complexity of the negotiations and the depth of the commitments made to ensure the implementation of WTO obligations. For example, both Mongolia and Albania made commitments with respect to the following issues: privatization programs, trading rights, pricing policies, industrial policies, technical barriers to trade and sanitary and phytosanitary measures, the dismantling of monopoly structures, agricultural policies, transparency, trade-related aspects of intellectual property rights, the liberalization of selective services sectors like opening distribution channels and allowing access to foreign banks, insurance companies, telecommunication providers and individual professional service-providers. None of these issues preoccupied the negotiators during the GATT accessions.

The WTO accession negotiations in principle relate only to three main areas: concessions and rules for trade in goods, in services, and in trade-related aspects of intellectual property rights. However, during the multilateral meetings, the implementation of the accepted offers and the ability of a state to comply with the WTO obligations is also at issue. Hence the overall regulatory framework of the country, its administrative institutions, and its capacity to consolidate the promised reforms, are carefully evaluated. We also note here another striking change that took place with the establishment of the WTO. Presently, the acceding countries are routinely asked to submit *a legislative plan of action* indicating implementation of the requested legislative changes and the introduction of the new commercial laws and regulations⁶¹. The absence of WTO compatible legislation with respect to all three main pillars of the organization, namely goods, services, and intellectual property, is

⁶¹ WTO document (2000) *Technical Note on the Accession Process*, (WT/ACC/7/Rev. 2) op. cit.

now naturally considered as an area in need of necessary reforms by the candidate country before it is allowed to accede⁶².

WTO Accession - Legal Provisions and Procedures

Any state or customs territory having full autonomy in the conduct of its trade policies may accede to the WTO on terms agreed to by the WTO Members. It should be noted that there are no legal obstacles to a country becoming a Member of the WTO, nor was there previously in the case of the GATT.⁶³ The General Council considers accession applications under WTO Article XII of the Marrakesh Agreement Establishing the World Trade Organization. The full text of Article XII reads as follows:

- “1. Any State or separate customs territory possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement and the Multilateral Trade Agreements may accede to this Agreement, on terms to be agreed between it and the WTO. Such accession shall apply to this Agreement and the Multilateral Trade Agreements annexed thereto.
2. Decisions on accession shall be taken by the Ministerial Conference. The Ministerial Conference shall approve the agreement on the terms of accession by a two-thirds majority of the Members of the WTO.
3. Accession to a Plurilateral Trade Agreement shall be governed by the provisions of that Agreement.⁶⁴”

⁶² For example, there must be WTO compatible legislation in the following areas: customs valuation, licensing, pre-shipment inspection, anti-dumping, investment, banking, taxation with respect to administration, notifications and enforcement, etc. Roman Grynberg and Roy Mickey Joy (2000) “The Accession of Vanuatu to the WTO – Lessons for the Multilateral Trading System” op. cit, p. 163. Also, Qingjiang Kong (2000) “China’s WTO Accession: Commitments and Implications.” *Journal of International Economic Law*, Vol. 3, No. 4, pp. 667-677.

⁶³ Article XXXIII of the GATT 1947.

⁶⁴ “*The Legal Texts – The Results of the Uruguay Round of Multilateral Trade Negotiations*” op. cit.

Article XII does not stipulate any membership criteria, and this signals perhaps the most problematic legal aspect of the accession process. In fact, the obvious feature, and the ensuing legal weakness, of Article XII is its conciseness. No guidance is given on the 'terms to be agreed', these being left to negotiations between the WTO Members and the candidate. Furthermore, Article XII does not identify any concrete steps nor does it provide any advice when it comes to the procedures to be used for negotiating the terms of accession.

In practice, the above deficiencies are remedied with the help of the long established GATT tradition that allows procedures to evolve separately over time in the light of precedents and previous rulings. In accordance with this tradition, the process of accession follows a pattern of instructions set out in a note drafted by the Secretariat in 1995⁶⁵. This note, together with its stipulated accession procedures, reflects an understanding reached by the Contracting Parties to GATT 1947. It also includes the *Complementary Procedures on Accession Negotiations* agreed to by the Council of GATT 1947 on 27 October 1993⁶⁶ and the statement by the Chairman of the Council of GATT 1947 on the *Management of Accession Negotiations* on 10 November 1994⁶⁷.

A number of other WTO provisions are also relevant to accession. For instance: Article XVI:1, stipulates that:

"Except as otherwise provided under this Agreement or the Multilateral Trade Agreements, the WTO shall be guided by the decisions, procedures and customary practices followed by the CONTRACTING PARTIES to GATT 1947 and the bodies established in the framework of GATT 1947";

⁶⁵ WTO Document (1995) *The WTO Accession Process* (WT/ACC/1), 24 March.

⁶⁶ GATT Document (1993) *Council - Minutes of the General Meeting* (L/3713) 27 October.

⁶⁷ GATT Document (1994) *Meeting of the General Council* (C/COM/4), 10 November.

Article IX deals with decision-making:

“ The WTO shall continue the practice of decision-making by consensus followed under GATT 1947. Except as otherwise provided, where a decision cannot be arrived at by consensus, the matter at issue shall be decided by voting.” Furthermore, on 15 November 1995 the General Council agreed to procedures regarding decision-making under Articles IX and XII of the WTO Agreement which clarified the relation between these two provisions⁶⁸;

Article XIII:1 provides that:

“This Agreement and the Multilateral Trade Agreements in Annexes 1 and 2 shall not apply as between any Member and any other Member if either of the Members, at the time either becomes a Member, does not consent to such application.” and.

Article XIII:3 states that:

“Paragraph 1 shall apply between a Member and another Member which has acceded under Article XII only if the Member not consenting to the application has so notified the Ministerial Conference before the approval of the agreement on the terms of accession by the Ministerial Conference.”

It should be noted that there are no legal obstacles to a country becoming a member of the WTO, nor was there previously in the case of the GATT. However, the political considerations often influence the questions and demands placed on the acceding countries. For example, Yugoslavia was asked to apply *de novo* for membership in the WTO despite its having been previously a Contracting Party to the GATT. This happened because it was decided that the GATT membership had been nullified by the political breakdown of Yugoslavia and that the changed political circumstances necessitated that completely new terms of accession were to be negotiated.

⁶⁸ WTO Document (1995) *Minutes from the Meeting of the General Council (WT/GC/M/8)*, op. cit.

The 1993 Iranian accession request, properly submitted to the Director-General, never even made it to the meeting of the General Council for further consideration. It was abruptly rejected by the Secretariat on political grounds, on the understanding that this was the consensus position, but without general debate or consultation with all the members.

One of the most prominent issues currently on the WTO agenda is the accession of China. China was one of the 23 original signatories of the GATT 1947. After China's revolution in December 1949, General Chiang Kai-shek announced establishment of the Chinese National Government on Taiwan. In 1950 the National Government sent a message to the GATT headquarters in Geneva withdrawing China from the GATT⁶⁹. In June 1986, China requested "resumption" of its GATT Contracting Party status, on the basis that the withdrawal notice sent by the Taiwanese Government was null and void.⁷⁰ The negotiations on China re-accession to the GATT began in 1986 and they were not completed before the establishment of the WTO to ensure that China introduced profound free market reforms. Since February 2000 there have been some positive developments in the Chinese accession but the whole process is still far from being completed.

In short, the legal framework that governs the procedural dynamics of WTO accession is not fully developed. Despite its limitations, however, it has a virtue in that it leaves the organization open to a variety of potential candidates for accession. Given the legal flexibility of the process, the current procedures for accession have been

⁶⁹ A. Neil Tait & Kui-Wai Li (1997), "Trade Regimes and China's Accession to the World Trade Organization," *Journal of World Trade*, Vol. 31, No. 3, p. 98.

⁷⁰ Sylvia A. Rhodes & John H. Jackson (1999) "United States Law and China's Accession Process," *Journal of International Economic Law*, Vol. 2, No.3, p. 500.

developed on the basis of a long-standing tradition of the GATT/WTO Secretariat. Still, every accession is unique and follows a difficult-to-predict path. After the process is initiated and then activated with the establishment of the Working Party, the negotiations can take years before mutual satisfaction is achieved with a drafting of the Protocol of Accession. Along the way many different factors can hamper the negotiations, most frequently during the course of some of the bilateral talks.

Thus, despite the inherently legal nature of the WTO, the accession process follows an unpredictable path of difficult negotiations in which the acceding country is faced with exhausting demands for introducing sweeping changes to its economic and legal institutions. Essentially, the rules of the game are decided by the existing WTO Members that form the Working Party on accession. WTO Members are legally free to conduct the negotiations in any way they deem necessary.

Application and the establishment of the Working Party

In order to initiate the accession process, the government of an aspiring country is expected to send an official request for accession under Article XII to the office of the Director General. This request is then forwarded to a meeting of the General Council, where a decision is made to establish a Working Party and designate its chairman⁷¹. Every interested WTO member country can join the Working Party and become actively involved in the resulting accession negotiations. This is intended to ensure the transparency of the multilateral phase of the accession negotiations. The size

⁷¹ This is in no way an automatic move. For example, when it came to designating a chairman of the Working Party on accession of China it took several months of intensive consultations to reach a consensus. Finally H.E. Mr. Pierre-Louis Girard, the then Swiss Ambassador to GATT, was nominated in 1987 and has been on the job since.

of the Working Party can vary considerably: presently the two largest, those of China and the Russian Federation, have 74 and 58 members respectively, while two of the smallest, Seychelles and Vanuatu, have only 23 and 29⁷².

As of April 2001, there were 140 Members of the World Trade Organization, the most recent entrant being Croatia (on 30 November 2000). WTO Members are currently conducting accession negotiations with 30 applicants. The most recent requests for accession are from Lebanon, Samoa, the Lao People's Democratic Republic, Andorra, Azerbaijan, Bhutan, Cape Verde and Yemen. Existing requests for accession include major economies that are nevertheless still undergoing economic liberalization reforms, notably China, Taiwan (Chinese Taipei), the Russian Federation, Saudi Arabia, Ukraine, Kazakhstan, Armenia, Cambodia and Vietnam. There are also accession requests from smaller transition economies at the peak of their economic reform efforts, such as Armenia, Bialorus, and the Former Yugoslav Republic of Macedonia, Bosnia-Herzegovina, Yugoslavia and Moldova. There are other developing economies too, like Algeria and Tonga. And there are nine 'least developed country' applicants⁷³: Bhutan, Cambodia, Cape Verde, Lao People's Democratic Republic, Nepal, Samoa, Sudan, Vanuatu and Yemen.⁷⁴ These countries and territories represent a wide range of economic and political interests.

⁷²These numbers can change as additional WTO Members can join the Working Party any time before it completes its mandate.

⁷³As of May 2001, according to the decision of the UN General Assembly, there are 49 Least-Developed Countries, of which 29 are WTO Members.

⁷⁴WTO Document (2000) *Technical Note on the Accession Process*, (WT/ACC/7/Rev. 2), op. cit.

Submission of Memorandum

In the first stage of the accession negotiations, the applicant government is required to provide the Members of the Working Party with a trade policy Memorandum describing all aspects of its trade and economic policies that have a bearing on the WTO agreements⁷⁵. This phase in the process is one of fact finding, and is designed to give WTO Members an understanding of the applicant country or territory, its economy and, in particular, its trade regime. This process is inevitably demanding, especially for the applicant, but is an essential preliminary to, and basis for, the negotiation of the terms of accession.

The Memorandum describes in detail the applicant's foreign trade regime and provides relevant statistical data for circulation to all WTO Members according to the outline format attached to WTO/ACC/1⁷⁶. This outline was designed on the basis of experience gained in the GATT 1947 working parties, but is much expanded to reflect the wider coverage of the WTO Agreements. The length of time it takes to present a Memorandum is an indication of the fact that its preparation represents a considerable investment of energy and resources for the applicant. Many of the Memoranda presented to WTO Members have been rejected as not fully consistent with the outline format. In some cases, Working Parties have started their work by considering information on certain main sections of the Memorandum. In others, an applicant may be asked to supplement and complete its Memorandum⁷⁷. The submission of a comprehensive and detailed Memorandum can significantly advance the process, since

⁷⁵ See, for example, the following WTO Documents: *Memoranda on Accessions* of Ecuador (L/7202), Kyrgyz Republic (WT/ACC/KGZ/3), Georgia (WT/ACC/GEO/3), Albania (WT/ACC/ALB/3), Oman (WT/ACC/OMN/2), *op. cit.*

⁷⁶ WTO Document (1995) *The WTO Accession Process* (WT/ACC/1) *op. cit.*

⁷⁷ WTO Document (2000) *Technical Note on the Accession Process*, (WT/ACC/7/Rev. 2). *op. cit.*

the Memorandum constitutes the fundamental step in the WTO accession process. It is a basis for launching the actual negotiations between an acceding country and members of the Working Party. However, the preparation of the Memorandum poses serious difficulties to the acceding governments which routinely lack experience with the economic and legal concepts involved. In most cases the candidate does not have human or material resources to meet the wide-ranging requirements of WTO members with respect to preparation of Memorandum. As a result, the acceding governments are compelled to seek technical and legal assistance from foreign experts.

Submission of legislative documents

The procedural guidance as expressed in the WTO Secretariat document WT/ACC/1 states that laws and regulations relevant to accession are to be made available to members of the Working Party at the same time as the Memorandum. It is clearly stipulated that, "the customary practice in this respect has been that the Applicant send a complete and comprehensive copy of the relevant laws and regulations to the Secretariat. If the textual material is short, it should be entirely translated by the Applicant into one of the WTO official languages (English, French and Spanish), if it is long, the Applicant should provide a detailed summary in one of the official languages."⁷⁸

The purpose of this arrangement is, of course, to enable Working Party Members to check relevant sections of the Memorandum to ensure that the laws and regulations conform to WTO requirements. As made clear in the technical note⁷⁹, only laws and

⁷⁸ WTO Document (1995) *The WTO Accession Process* (WT/ACC/1), op. cit.

⁷⁹ WTO Document (1995) *The WTO Accession Process* (WT/ACC/1), op. cit., p. 11.

regulations that are relevant to the particular accession in question should be submitted. In practice, many laws and regulations are supplied to the WTO after the Memorandum has been distributed, especially since many acceding governments are in transition or are undertaking a process of economic reform, which require major changes in their legislation⁸⁰.

Submission of other relevant documentation

The procedures defined in note WT/ACC/1 provide that copies of the candidate country's currently applicable tariff schedule in the internationally recognized Harmonized System (HS) nomenclature also should be made available to members of the Working Party at the same time as the Memorandum. The expectation of WTO Members has been that the applied rates will be taken as the base rates in the negotiations on the tariff concessions to be included in the Goods Schedule of the applicant⁸¹. The procedural framework set out in WT/ACC/1 foresees that the Memorandum will contain a description of the range of policies affecting foreign trade in agricultural products. In addition, a Technical Note by the Secretariat (WT/ACC/4) has been circulated "to allow acceding Governments to present factual information on their domestic support and export subsidy measures actually in place in agriculture ... in a manner consistent with the notification requirements of the Agreement on Agriculture. Information is required "normally for each of the three most recent years."⁸²

⁸⁰ Interview with a WTO official, Geneva 2000.

⁸¹ WTO Document (1995) *Technical Note on the Accession Process*, (WT/ACC/7/Rev. 2), op. cit.

⁸² WTO Document (1996) *The WTO Accession Process – Agricultural Support* (WT/ACC/4), 18 March.

The requested data have to be arranged according to a specific pattern and in tabular form, as described in document WT/ACC/4. The preparation of the supporting tables involves a thorough grasp of complex WTO requirements and detailed technical work. Working Party Members have stressed the importance that they attach to the full and accurate presentation of the regulatory system of the acceding state. They also look for the actual amount of money spent on government subsidies and not, for instance, budgetary estimates. It is therefore not surprising that these tables are often presented at a fairly advanced stage of the accession process. Nor is it unusual that the tables are revised several times before becoming acceptable to members of the Working Party and that the revision of the tables becomes a part of the process of negotiation dealt with below. Acceding governments often hold many bilateral and plurilateral meetings with interested WTO Members to assist in the revision of these tables⁸³.

Submission of Data on Services

The outline format attached to WT/ACC/1 gives some guidance on the information which should be included in the Memorandum on the applicant's trade-related services regime. Here again, the WTO Secretariat in consultation with its Members, has put together a document WT/ACC/5⁸⁴ designed to assist acceding Governments in submitting factual information on their policies affecting trade in services relevant to their economy. It appears that acceding governments have experienced difficulties in collecting and presenting the information called for in the Technical Note. Past experience demonstrates that some members of the Working Party

⁸³ Interview with a WTO official, Geneva, 2000.

⁸⁴ WTO Document (1996) *The WTO Accession Process and Preparation of Services Schedules* (WT/ACC/5) 31 October.

have shown understanding of this problem and have indicated that they would be prepared to open negotiations on specific commitments to be included in the Services Schedule of the Applicant on the basis of a detailed offer, rather than a full response to WT/ACC/5.

Questions and answers

The WT/ACC/1 procedures provide that, following the circulation of the Memorandum, members of the Working Party be invited to submit questions in writing. Answers are provided in writing by the acceding country to the Secretariat, which consolidates them and arranges them by topic under the headings of the Memorandum. It was foreseen from the outset that more than one round of questions and answers might be necessary before the first meeting of the Working Party is held. The Memorandum headings, on the whole, have provided a good framework for the questions and answers and Members have posed questions on other topics in only a few instances. However, an understanding of the precise relationship between certain measures and the WTO provisions has sometimes proved difficult to establish, resulting in an apparent lack of procedural order.

Questions on the Memorandum are submitted in all cases by the Members of the Working Party, and, in a few cases, more than one round of questions and answers has taken place before their first meeting. The number and diversity of questions and the number of rounds have varied widely from one accession to another. Discussions have also been complicated on occasion by the fact that different delegations have put similar questions to different sections of the Memorandum. Thus, duplication of

questions has occurred fairly often, for instance, between Sections II 2(b) monetary and fiscal policies and IV 1(k) application of internal taxes on imports; between Sections II 2(a) which includes privatization plans and IV 3(e) state-trading practices; and between Sections IV 1(e) quantitative import restrictions and IV 1(f) import licensing procedures⁸⁵.

Document WT/ACC/1 is further supplemented by the two technical notes distributed by the WTO Secretariat. The first one is WT/ACC/8⁸⁶ (*Information to be Provided on Policy Measures with Respect to SPS (Sanitary and Phytosanitary measures) and TBT (Technical Barriers to Trade) Issues*), and the other is WT/ACC/9⁸⁷ (*Information to be Provided on Implementation of the Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement*). These documents have been prepared in consultation with WTO Members and reflect the development of standardized questionnaires in the completed accession negotiations. They are aimed at assisting acceding governments in the gathering of relevant information for submission at the meetings of the Working Party.

Examination of the candidate's trade regime in the Working Party

At their first meeting, representatives of the applicant and members of the Working Party examine the Memorandum and the questions and answers are provided. This is done with a view to seeking any further clarifications that may be required in

⁸⁵ WTO Document (2000) *Technical Note on the Accession Process*, (WT/ACC/7/Rev2), op. cit.

⁸⁶ WTO Document (1999) *The WTO Accession Process - Information to be Provided on Policy Measures with Respect to SPS (Sanitary and Phytosanitary measures) and TBT (Technical Barriers to Trade) Issues* (WT/ACC/8), 15 November.

⁸⁷ WTO Document (1999) *The WTO Accession Process- Information to be Provided on Implementation of the Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement*. (WT/ACC/9), 15 November.

the light of the various provisions of the WTO Agreements. After the meeting, members of the Working Party submit the comments and questions posed during the meeting, and any additional points that they may have, to the Secretariat, which consolidates them and forwards them to the candidate country. Further fact-finding meetings may be held as necessary before the Working Party begins to negotiate the terms on which the applicant will accede. In practice, the fact-finding and negotiating phases of the work often overlap. Experience has shown that six weeks need to be left between the circulation of the documentation and the meeting at which it is to be examined, if the meeting is to be productive⁸⁸.

The number of fact-finding meetings that have been held by each Working Party has varied considerably, depending on a number of factors, including the interest generated by the particular accession, the complexity of the policies examined and the adequacy of the information supplied. Increasingly, in order to accelerate the process and ensure that time is used most productively, it has been found useful for acceding governments to submit, sufficiently in advance, supporting information on agriculture, on services, on SPS and TBT Agreements⁸⁹ and on Intellectual Property Rights regime. Questions from WTO Members are channeled through the WTO Secretariat, which obtains consolidated answers in writing. The written 'Questions and Answers' document that is distributed after each meeting of the Working Party constitutes a record of the discussions.

In accordance with the agreed procedures set out in WT/ACC/1, at the conclusion of each meeting of the Working Party, the Chairman sums up the state of

⁸⁸ WTO Document (2000) *Technical Note on the Accession Process*, (WT/ACC/7/Rev. 2), op. cit.

⁸⁹ "The Legal Texts," op. cit. Agreement on the Application of Sanitary and Phytosanitary Measures (SPS) and Agreement on Technical Barriers to Trade (TBT).

play and the next steps to be taken⁹⁰. The practice has emerged, since the circulation of WT/ACC/1, of asking the Secretariat at an appropriate stage to prepare a Factual Summary of Points Raised. Such a Summary should be arranged by topic under the headings of the Memorandum, in order to consolidate the information contained in the Memorandum, in supplementary documents and in the questions and answers relevant to the Working Party's Report. The aim of this step is to facilitate the work of the applicant and the members of the Working Party by identifying the points that are established, and those that require further elucidation and examination in the negotiating stage. Generally, the objective is to make the process more transparent. As work proceeds and as negotiations advance on multilateral commitments, the Factual Summary of Points Raised gradually evolves into a Report of the Working Party. During this process, further revisions are prepared as necessary and circulated to Working Party members. The final version of the Report of the Working Party sets out the results of the work done by the Working Party.

The Protocol of Accession indicates that the new member is prepared to observe all the rules included in the legal texts of the Uruguay Round Agreements. This approach is called a 'Single Undertaking', which means that a WTO member cannot pick and choose among different agreements, as was the case with the GATT, but has to accept the whole package of the WTO legal code. The Protocol of Accession also binds the new member to observe the specific commitments undertaken in order to meet the demands of the Working Party.

In the final stage of the accession process, the results of the negotiations between the members of the Working Party and the candidate state as summarized in the draft

⁹⁰ Interview with a WTO official, Geneva, 2000.

Protocol of Accession and the agreed schedules resulting from the bilateral negotiations are presented to the General Council for adoption. The applicant is then free to sign the protocol and to accede to the Organization after ratification in its national parliament or legislature. Thirty days after the applicant country notifies the WTO Secretariat that it has completed its ratification procedures, the applicant government becomes a member of the WTO.

In Conclusion: The Precarious Aspects of the Accession Process

Accession to the WTO takes place pursuant to Article XII of the WTO Agreement. Article XII makes clear that the applicant for accession must negotiate the precise terms of its accession with the current Membership of the WTO. The negotiations are complex and require agreement on a difficult package of rights and obligations - many of which may present serious implementation problems for the acceding countries. The main concern of the acceding government is whether the commitments it undertakes in the course of the negotiations are realistic and beneficial for the country.

The Memorandum sets in motion the accession negotiation since it becomes the basis for a detailed examination of the accession request in a WTO working party. However, many acceding countries and also some member countries have complained that this so-called *fact finding stage* is often too lengthy, inquisitorial and demanding⁹¹.

⁹¹ WTO Document (2000) *Technical Note on the Accession Process* (WT/ACC/7/Rev.2), op. cit

Countries acceding to the WTO can be overwhelmed by the new obligations and by the higher standards of protection required under the WTO agreements⁹². The candidates must not only familiarize themselves with the new rules with respect to services and intellectual property but are also under obligation to liberalize those sectors of their economies that were traditionally under the control of the state. such as for example, the customs procedures. intellectual property, phytosanitary and technical standards, procurement and the investment regime. WTO membership requires that these policies and institutions be brought in line with the provisions of the WTO administered multilateral agreements. Moreover, many of the acceding governments even lack knowledge of the fundamental legal terms entrenched in the WTO system. With respect to some of the agreements, most notably the TRIPS Agreement, some acceding countries are struggling to come to terms with the concept of patent protection, which was previously unknown to them⁹³.

As a necessary cost of gaining WTO membership, the acceding countries make remarkable commitments, particularly in relation to their previous trade practices. This is because joining the organization not only concerns economic and trade issues, but also concerns the issue of global integration. The acceding countries feel that they cannot afford to be either economically or politically excluded from the world's trading regime and fall behind the fast progressing pace of economic progress firmly advanced by the industrialized nations.

⁹² See, for example, Hiddo Houben (1999) "China's Economic Reforms and Integration into the World Trading System," in *Journal of World Trade*, Vol. 33, No.3, pp. 1-18. See also: United Nations (2000) *The Future WTO Agenda and Developing Countries*, UN: New York, pp. 63-70.

⁹³ Carlos M. Correa (1994) "The GATT Agreement on Trade-related Aspects of Intellectual Property Rights: New Standards for Patent Protection," in *European Intellectual Property Review*, Vol. 16, Issue 8.

Many acceding countries stress the difficulties that they are facing in attempting to put into practice the massive legislative changes required by the TRIPS Agreement⁹⁴. These countries often lack expertise in designing new intellectual property rights laws and regulations to comply with the TRIPS Agreement. With respect to the TRIMs⁹⁵ Agreement, acceding countries often maintain that insufficient time is given to eliminate all the GATT-inconsistent investment measures. They also want to have an option to choose the investment strategy that they consider necessary to meet their developmental needs in the context of industrial policy but also in agriculture and services sectors. There are also problems with implementation of the SPS and TBT Agreements,⁹⁶ since acceding countries never participated in setting the relevant international standards but are still expected to comply with them. The problem is that these standards often go beyond the technical ability and financial capacity of many acceding countries.

Another area of concern for acceding countries has to do with enforcement of the WTO obligations on the domestic front. Several WTO agreements lay down certain general principles applicable to the enforcement procedures. The TRIPS agreement, for example, contains provisions on civil and administrative procedures and remedies, provisional measures, special requirements related to border measures and criminal procedures, which say that the procedures and remedies must be available so that right

⁹⁴ 'Agreement on Trade-Related Aspects of Intellectual Property Rights'. Articles 41-49. See "*The Legal Texts.*" op. cit.

⁹⁵ 'Agreement on Trade-Related Investment Measures'. Article 5 and Annex. See "*The Legal Texts.*" op. cit.

⁹⁶ 'Agreement on the Application of Sanitary and Phytosanitary Measures' and 'Agreement on Technical Barriers to Trade.' See "*The Legal Texts.*" op. cit.

holders can effectively enforce their rights⁹⁷. These requirements mean that acceding countries have to introduce deep changes into their existing regulatory, judicial and administrative framework. Quite often they have to create completely new institutions, draft new laws, design procedures for their enforcement, and train experts that would be responsible for ensuring the speedy and lawful administration of all the relevant regulations. Acceding countries do not have the financial resources and necessary institutional mechanisms to effectively meet with WTO obligations. Moreover, acceding countries do not have the required expertise to design the new WTO compatible laws and regulations.

Both the Singapore 1996 and Geneva 1998 Ministerial Declarations call for 'meaningful market-access commitments'⁹⁸. This signals that some WTO Members express concerns about the acceding countries' ability to undergo all the reforms necessary to meet WTO obligations. Furthermore, taking into account the successfully completed accessions, it can be noted that special and differential treatment for developing governments has not been granted often, despite the difficult economic situations confronting the candidates⁹⁹. In conclusion, one has to ponder whether placing such far-reaching demands during the accession negotiations forces an acceding country to make excessive and unrealistic commitments that can dangerously strain the already limited resources of the acceding countries.

⁹⁷ Articles 42-49 of the TRIPS Agreement (Agreement on Trade-Related Aspects of Intellectual Property Rights). Annex 1C of the Marrakesh Agreement Establishing the WTO. *The Legal Texts..*" op. cit.

⁹⁸ The first WTO Ministerial was held in Singapore, December 1996. The second WTO Ministerial was held in Geneva, May 1998. For the final texts go to: www.wto.org/ministerial

⁹⁹ WTO Document (2000) *Technical Note on the Accession Process* (WT/ACC/7/Rev.2), op. cit. p. 16.

Forty-three governments have applied to accede under Article XII since the WTO Agreement entered into force on 1 January 1995. Twelve of these have completed the accession procedures and have become WTO Members. These are, in the order in which they acceded: Ecuador; Mongolia; Bulgaria; Panama; Kyrgyz Republic; Latvia; Estonia; Jordan, the Republic of Georgia, Albania and Croatia and Oman. Table 1 is a timetable of completed Accessions and shows the length of time between presentation of Memoranda and accession. The shortest of these accession processes took 34 months (Kyrgyz Republic) and the longest 123 months (Bulgaria), or between approximately three and ten years. These are the governments that have completed the process. Table 2 shows the status of the current accession negotiations.

Table 1a: Timetable of Completed Accessions¹

Country	Ecuador		Mongolia		Bulgaria		Paraguay		Kyrgyz Republic		Latvia	
	Date	Time Since Memo	Date	Time Since Memo	Date	Time Since Memo	Date	Time Since Memo	Date	Time Since Memo	Date	Time Since Memo
Application	Sep 92		Jul 91		Sep86		Aug 91		Feb 96		Nov 93	
Working Party Established	Oct 92		Oct 91		Feb 90		Oct 91		Apr 96		Dec 93	
Memorandum	May 93		Jan 92		Jul 93		Jun 93		Aug 96		Aug 94	
1st Meeting of Working Party	Jul 93	2 months	Jun 93	17 months	Jul 93	1 month	Apr 94	10 months	Mar 97	7 months	Mar 95	7 months
Draft WP Report	Oct 94	17 months	Dec 94	35 months	May 94	10 months	May 96	35 months	Apr 98	20 months	Dec 96	28 months
Report Adopted by Working Party	Jul 95	26 months	Jun 96	53 months	Sep 96	38 months	Sep 96	39 months	Jul 98	23 months	Sep 98	49 months
Report Adopted by Council	Jul 95	26 months	Jul 96	54 months	Oct 96	39 months	Oct 96	40 months	Oct 98	26 months	Oct 98	50 months
Membership	Jan 96	32 months	Jan 97	60 months	Dec 96	41 months	Sep 97	51 months	Dec 98	28 months	Feb 99	54 months
Total Time Passed Since Memorandum		2 years 8 months		5 years		3 years 5 months		4 years 3 months		2 years 4 months		4 years 6 months

¹ These governments are arranged in the order that they became WTO Members

Table 1b: Timetable of Completed Accessions²

Country	Estonia		Jordan		Georgia		Albania		Oman		Cuba	
	Date	Time Since Memo	Date	Time Since Memo	Date	Time Since Memo	Date	Time Since Memo	Date	Time Since Memo	Date	Time Since Memo
Application	Mar 94		Jan 94		Jul 96		Nov 92		Apr 96		Sept 93	
Working Party Established	Mar 94		Jan 94		Jul 96		Dec 92		June 96		Oct 93	
Memorandum	Mar 94		Oct 94		Apr 97		Jan 95		June 96		June 94	
1st Meeting of Working Party	Nov 94	8 months	Oct 96	24 months	Mar 98	11 months	April 96	15 months	Apr 97	10 months	April 96	22 months
Draft WP Report	Nov 98	56 months	Apr 99	54 months	Feb 99	22 months	July 99	54 months	Mar 99	33 months	Aug 98	26 months
Report Adopted by Working Party	Apr 99	61 months	Nov 99	61 months	Oct 99	30 months	July 2000	66 months	Sep 2000	39 months	June 2000	72 months
Report Adopted by Council	May 99	62 months	Dec 1999	62 months	Oct 1999	30 months	July 2000	66 months	Oct 2000	40 months	July 2000	73 months
Membership	Nov 99	68 months	Apr 2000	66 months	June 2000	38 months	Sept 2000	68 months	Nov 2000	41 months	Nov 2000	77 months
Total Time Passed Since Memorandum		5 years 8 months		5 years 6 months		3 years 2 months		5 years 8 months		3 years 5 months		6 years 5 months

Table 2a: Status of Ongoing Accession Processes²

Country	China	Algeria	Nepal	Chinese Taipei	Russian Fed.	Saudi Arabia	Belarus	Moldova	Armenia	Ukraine
Application	July 86	Jun 87	May 89	Jan 92	Jun 93	Jun 93	Sep 93	Nov 93	Nov 93	Nov 93
Working Party Established	Mar 87	Jun 87	Jun 89	Sep 92	June 93	July 93	Oct 93	Dec 93	Dec 93	Dec 93
Memorandum	Feb 87 Sep 93 Mar 00	Jul 96	Feb 90 Aug 98 Sep 98 June 00	Oct 92	Mar 94 Oct 95 Nov 97	Jul 94 May 96 Jul 96	Jan 96	Sep 96	Apr 95	July 94
First Meeting of Working Party	Mar 87	Apr 98	May 00	Nov 92	July 95	May 96	June 97	June 97	Jan 96	Feb 95
Tariff Offers	Sep 94 Apr 98		July 00	Feb 96 July 99	March 00	Sep 97 Jun 99		Mar 98 Jan 99 Oct 99 Sep 00	Jan 99	May 96
Services Offers	Apr 94 Sep 94 Dec 96 Nov 97		July 00	Sep 94 July 96 Oct 98 Apr 99 July 99	Oct 99	Sep 97 Aug 98 Jun 99		Feb 98 Oct 98 Jan 99 Feb 99 Aug 99 Aug 00	Oct 98 Jan 99 June 99 Oct 99	Feb 97 Nov 97 June 98 April 00
Agricultural Data	June 94 Apr 96 June 00 Sep 00	Jan 98	Sep 98 July 99	July 98 Feb 99 July 99	Oct 96 Dec 98 May 00	May 97 Oct 97 Sep 98 Nov 99 Feb 00	Mar 2000	May 97 Oct 98 Jan 99 July 99 Oct 99 Mar 00 May 00	Mar 97 Mar 99	Oct 95 Feb 97 Nov 97 Apr 98 Feb 00 Apr 00
Draft Working Party Report	Dec 94 May 97 June 00 July 00 Sept 00 Oct 00			Mar 98 Apr 99 July 99		Jan 00 Oct 00		Mar 99* July 99 Oct 99 May 00 Sep 00	Mar 97* Mar 98 Feb 99 June 99 Aug 99 Nov 99	

* Elements of a Draft Report Note: Applicants are arranged in the order that they made their application.

² As of March 2001.

Table 2b: Status of Ongoing Accession Processes

Country	Lithuania	Sudan	Cambodia	FYR of Macedonia	Uzbekistan	Vietnam	Seychelles	Tonga	Vanuatu	Kazakhstan
Application	Jan 94	Oct 94	Dec 94	Dec 94	Dec 94	Jan 95	May 95	Jun 95	July 95	Jan 96
Working Party Established	Feb 94	Oct 94	Dec 94	Dec 94	Dec 94	Jan 95	Jul 95	Nov 95	July 95	Feb 96
Memorandum	Dec 94	Jan 99	June 99	April 99	Oct 98	Sep 96	Aug 96	May 98	Nov 95	Sep 96
1st Meeting of Working Party	Nov 95					Jul 98	Feb 97		Jul 96	Mar 97
Tariff Offers	Oct 96 Jun 97 Aug 00						Jun 97		Nov 97 May 98 Nov 99	Jun 97 May 00 Sep 00
Services Offers	Jul 96 Sep 97 Oct 99 Jul 00						May 97		Nov 97 Nov 99	Sep 97 May 00 Sep 00
Agricultural Data	July 96 Oct 96 Jun 97 Oct 97 Jan 98 Aug 00									July 97 Sep 00
Draft Working Party Report	Jun 97 Oct 98 Jun 99 Feb 00 Sep 00									

* Elements of a Draft Report

Table 2c: Status of Ongoing Accession Processes

Country	Iran	Yugoslavia	Azerbaijan	Andorra	Laos	Samoa	Lebanon	Bosnia - Herzegovina	Bhutan	Cap Verde	Yemen
Application	Sep 96	Sep 96	June 97	July 97	July 97	Apr 98	Jan 99	May 99	Sep 99	Oct 99	Apr 00
Working Party Established		Feb 01	July 97	Oct 97	Feb 98	July 98	Apr 99	July 99	Oct 99	July 00	
Memorandum			Apr 99	Mar 99		Feb 00					
1st Meeting of Working Party				Oct 99							
Tariff Offers				Sep 99							
Services Offers				Sep 99							
Agricultural Data				Aug 99							
Draft Working Party Report											

Chapter 4

The First Pillar of the WTO – Trade in Goods and the Commitment

Approach to the Regulatory Reforms.

Introduction

Accession negotiations deal with two wide-ranging sets of issues. First, negotiations deal with market access in the candidate countries for WTO Members. New Members are required to bind policy instruments (for example, tariffs on merchandise imports, agricultural subsidies, application of trade-related investment measures, and customs valuations and licensing procedures) to levels agreed with current Members. Second, current WTO Members seek assurances that the acceding country will fully apply all binding WTO rules. In practice this involves examining existing legislation for consistency with the various WTO agreements and identifying required changes that the candidate country then commits itself to implementing.

In order to insure the full implementation of the WTO agreements, the acceding countries engage in extensive administrative reforms. For the twelve countries that have joined the WTO since its establishment, accession negotiations played an important role in advancing economic transitions and guiding the transformation of legal systems. More importantly, however, the successful accessions locked in permanently a number of reformist measures. The measures introduced in response to the demands of the accession process translate into legally binding commitments by the acceding countries. These commitments are listed in the respective Protocols of Accession, which are included in

the Working Party Reports of the newest WTO Members¹. The commitments reflect the terms on which the twelve countries joined the organization.

As an illustrative example the chapter examines the final results of Ecuador's accession to the WTO. Ecuador was the first country to accede under Article XII of the *Marrakesh Agreement Establishing the WTO*. As a necessary cost of its WTO accession, Ecuador made remarkable commitments to diversify and liberalize its economy. These commitments remain legally binding under the WTO dispute settlement mechanism. This chapter looks at the extent of the commitments made by Ecuador, particularly in relation to its previous foreign trade practice.

It is important to remember that the commitment approach to WTO accession is an indirect outcome of the changes introduced to the dispute settlement mechanism. The ineffective and vulnerable-to-blocking GATT dispute settlement mechanism could not provide any assurances as an enforcement mechanism. As was explained in the previous chapter, GATT Contracting Parties used selective safeguards as a deterrent against the violation of its obligations by the newly acceded country. In turn, the legalization of WTO dispute settlement procedures and the right to the establishment of a panel with standard terms of reference and the automatic adoption of dispute settlement reports created a powerful enforcement mechanism. These changes transformed WTO accession

¹ WTO Documents: *Report of the Working Party on the Accession of Ecuador*, 14 July 1995 (WT/L/77).
Report of the Working Party on the Accession of Mongolia, 27 June 1996 (WT/ACC/MNG/9).
Report of the Working Party on the Accession of Bulgaria, 20 September 1996 (WT/ACC/BGR/5).
Report of the Working Party on the Accession of Panama, 2 October 1996 (WT/ACC/PAN/19).
Report of the Working Party on the Accession of the Kyrgyz Republic, 31 July 1998 (WT/ACC/KGZ/26).
Report of the Working Party on the Accession of Latvia, 30 September 1998 (WT/ACC/LVA/32).
Report of the Working Party on the Accession of Estonia, 9 April 1999 (WT/ACC/EST/28).
Report of the Working Party on the Accession of Jordan, November 1999 (WT/ACC/JOR/33).
Report of the Working Party on the Accession of Albania, 13 July 2000 (WT/ACC/ALB/51).
Report of the Working Party on the Accession of Oman, September 2000 (WT/ACC/OMN/26).
Report of the Working Party on the Accession of Croatia, 29 June 2000 (WT/ACC/HRV/59).

into a process that relies on making the legally binding commitments by the candidate countries. The example of Ecuador illustrates a first-time case of using the legally binding commitment approach to WTO accession.

At the end of the accession process, the commitments made with respect to tariff concessions, together with the commitments to comply with WTO rules and regulations, are linked with the commitments to fully implement the results of accession negotiations. A critical aspect of each WTO accession concerns consolidation of the relevant regulatory and administrative changes necessary to ensure the practical implementation of all the commitments. This means that each of the final reports of the Working Party on accession contains a list of all the commitments made with respect to the trade regime of an acceding country. The list gains a treaty-like status upon finalizing the accession process. In the event any of the commitments are broken or the new Member simply procrastinates about removing any of its WTO-inconsistent regulations, the country can be then taken to WTO dispute settlement and threatened with possible trade retaliation. This can easily happen since the implementation process is guided by legal considerations of expeditiousness rather than by economic considerations that may require a slower process of dismantling the WTO-inconsistent legislation.

It is important to remember that just as the WTO consists of three main pillars, the outcome of accession negotiations can be divided into the three distinct sets of subjects. The three fundamental pillars of the WTO are the following: the Agreements relating to trade in goods², the General Agreement on Trade in Services (GATS) and the Agreement

² There are 13 such agreements in total including the original GATT 1947. They are the following: Agreement on Agriculture, Agreement on SPS Measures, Agreement on Textiles and Clothing, Agreement on Technical Barriers to Trade, Agreement on Trade-Related Investment Measures, the Anti-Dumping Agreement, Agreement on Customs Valuation, Agreement on Preshipment Inspection, Agreement on Rules

on Trade-Related Aspects of Intellectual Property Rights (TRIPS). In this chapter we concentrate on the aspect of the accession of Ecuador that relates to trade in goods. The goods negotiations include the bargaining over the tariff rates, but they also concern the overall trade regime of the acceding country.

The new WTO legal commitment approach: Accession of Ecuador

Historical background

Ecuador, a developing country in Latin America,³ pursued for decades the import substitution model of development. In the post-war period the policy-makers and economists in Ecuador were fearful that integration into the world economy would lead to disintegration of the national economy. The notion that free trade and direct foreign investment would prevent industrialization by confining the poorer countries to agricultural production led to pursuing an autarkic development strategy⁴. Such a strategy, however, did not produce the expected results but rather it increased Ecuador's dependence on foreign supplies while creating major imbalances in the balance of payments. By the end of the 1980s, Ecuador was facing a huge foreign debt, growing unemployment, an inefficient industrial sector, an obsolete infrastructure, shortages of food and basic industrial parts, and rising inflation⁵.

of Origin, Agreement on Import Licensing Procedures, Agreement on Subsidies and Countervailing Measures and Agreement on Safeguards.

³ Ecuador's population was 9,698,189 in 1990 with a demographic growth rate of 2.2 per cent. The results of the Fifth Population Census carried out in 1990. See the GATT Document (1992) *Memorandum of Ecuador* (L/7202), 10 September.

⁴ W. Arthur Lewis (1955) *The Theory of Economic Development*. Homewood, IL: Irwin. pp. 33-38.

⁵ Shahid Javed Burki and Guillermo E. Perry (1997) *The Long March: A Reform Agenda for Latin America and the Caribbean in the Next Decade*, Washington, DC: The World Bank, p. 7 and pp. 19-25.

Ecuador's economic decline can at least be partially attributed to its adherence to an import substitution model. From World War II until the 1970s, many developing countries were strongly influenced by the belief that the key to economic development was to limit imports of manufactured goods in order to foster a manufacturing sector serving the domestic market⁶. One of the biggest problems associated with such strategies was lack of competition and thus absence of incentives for innovation. Furthermore, the economies that adopted the import-substitution model became increasingly dependent on government subsidies and were characterized by a heavy state intervention in the overall functioning of the economy⁷.

In addition to import substitution, various attempts to undertake long-term economic planning were made. Unfortunately, in terms of performance, central planning in Ecuador was almost totally ineffective. There was never any successful administrative connection between the planning bureaucracy and the executive sections of government, therefore no plan was ever fully implemented and most were abandoned after quickly running huge budgetary deficits. Overall, central planning in Ecuador deepened the severity of economic mismanagement and further distorted the economy⁸.

The Ecuadorian economy had historically been dominated by the agricultural sector (mainly: cocoa, coffee, and banana), and by the export of one commodity: oil. The economy underwent a significant structural transformation in the 70s when new

⁶ This view was consistent with writings by Raul Prebisch who defined countries like Ecuador to be the 'periphery' exploited by the industrialized 'center.' Prebisch hypothesized that developing countries on the periphery of the world economy were destined to remain suppliers of food and raw materials to advanced countries at the center unless they adopted special autarkic measures to foster manufacturing industries. For more details about the import-substitution strategy read: Paul R. Krugman and Maurice Obstfeld (1997) *International Economics – Theory and Practice*. Addison-Wesley: New York, pp. 254-260.

⁷ Anne O. Krueger (1984) "Trade Policies in Developing Countries," in Ronald W. Jones & Peter B. Kenen (eds.) *Handbook of International Economics*, Vol. 1, Amsterdam: North-Holland.

⁸ Robert J. Bromley (1977) *Development Planning in Ecuador*. Center for Development Studies University College at Swansea: UK, pp. 69-72.

discoveries made oil Ecuador's most important export commodity. The rise in oil exports fueled economic growth that was accompanied by a sharp increase in government spending, which, in turn, was financed principally by external borrowing and oil revenues⁹. A short period of prosperity occurred at the beginning of the 1970s when Ecuador benefited from a rapid increase of crude oil on the world's markets. However, during the oil boom of the 1970s, the government of Ecuador borrowed heavily from abroad, increased subsidies, and expanded the state's economic role. Such policies became unsustainable, leading to chronic macroeconomic instability in the 1980s after the price of oil fell.

From 1982 to 1987, Ecuador experienced a slowdown in economic growth. The Ecuadorian economy was exposed to external shocks that affected Latin American nations generally throughout this period. The collapse of world oil prices in 1986 reduced Ecuador's oil export revenues by half. An earthquake in March 1987 destroyed a large stretch of Ecuador's only oil pipeline. The period from 1988 to 1992 was characterized by increasing oil export prices and reductions in government spending in real terms. Throughout this period, the government pursued a gradual stabilization policy. Despite the government's policies, inflation rose sharply, averaging 59.7% annually¹⁰.

In 1982-83 Ecuadorian President Hurtado undertook a number of stabilization policies to reduce macroeconomic imbalances. He lowered civil service wages, reduced industrial subsidies, increased sales taxes and tried to adopt a tight monetary policy. These policies, however, provoked strong opposition and civil unrest. Unable to gain

⁹ Christian Morrisson (1994) *The Political Feasibility of Adjustment in Ecuador and Venezuela*, Paris: OECD, pp. 21-53.

¹⁰ IMF Document (1995) *Ecuador – Recent Economic Developments*, IMF Staff Country Report No. 95/96, 3 October.

public support, the government was forced to withdraw its reformist policies. The Ecuadorian economy continued to deteriorate throughout the 1980s until the situation became critical in 1991. President Duran-Ballen took office in 1992 promising to stabilize the economy, modernize the state, and expand the free market. He immediately introduced a number of macroeconomic measures to liberalize the economy¹¹. A sizable devaluation of the *sucre* in 1992, large public-sector price hikes, market pricing of fuel, and spending reductions - together with monetary, budget, and tax reforms - reduced the public deficit¹². The overall economic performance was poor and it was becoming clear that Ecuador had to overcome serious structural problems caused by ineffective state interventionism.

Striving to overcome the growing underdevelopment at the beginning of the 1990s, Ecuador decided to open itself to the world. The immediate goal was to improve its economic conditions and eradicate the serious problem of critical poverty. Ecuador applied for GATT membership in 1992 because, in the words of its representative: "Ecuador became convinced that its participation in international trade networks, carried out within an environment that is transparent, non-discriminatory and equitable, would serve as a major force to reactivate its economy."¹³

In September 1992, the Government of Ecuador requested accession to the General Agreement on Tariff and Trade (GATT 1947). The request was circulated to the GATT

¹¹ Christian Morrisson (1994) *The Political Feasibility of Adjustment in Ecuador and Venezuela*, " op. cit., pp. 5-7.

¹² WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, op. cit.

¹³ The statement was made by the representative of the government of Ecuador in its *Memorandum of Foreign Trade Regime*, the WTO Document (L/7202) Sept 1992, op. cit.

Contracting Parties and soon afterwards, the GATT Working Party on Accession of Ecuador was established¹⁴.

Given the fact that the GATT was only a provisional agreement, and not an international organization, it did not have 'members.' Instead one would talk of 'GATT Contracting Parties'. The twenty-three countries that first signed the General Agreement were original GATT Contracting Parties¹⁵. However, with the establishment of the WTO as a formal organization, GATT Contracting Parties became WTO Members.¹⁶ This move necessitated a legal transformation of the existing Accession Working Parties. Thus, on 31 January 1995, the existing GATT 1947 Working Party on the Accession of Ecuador was transformed into a WTO Accession Working Party, subjecting the government of Ecuador to much more demanding negotiations under the enlarged legal scope of the new organization.

The government of Ecuador anticipated that the challenges of implementing the accession commitments would become much greater under the WTO. Thus, its negotiating team in Geneva was given directions to complete the accession process under the old GATT system¹⁷. A successful GATT accession would provide Ecuador with more flexibility in terms of implementing its obligations under the multilateral agreements. Unfortunately, despite the efforts of the Ecuadorian officials, this turned out to be a politically unattainable goal. Some developed members of the Working Party insisted on extending the Ecuadorian accession negotiations until the new organization was

¹⁴ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador*, 14 July 1995 (WT/L/77), Paragraphs 1-5.

¹⁵ John H. Jackson (1997) *The World Trading System: Law and Policy of International Economic Relations*, op. cit., p. 59.

¹⁶ WTO Document (1994) *Transitional Arrangement* (PC/W/16), 7 December.

¹⁷ Interview with an Ecuadorian official, Geneva 1999.

operational. Ecuador was to set an example of a new type of institutional accession based on legally binding commitments under the new Dispute Settlement Mechanism¹⁸.

If Ecuador had joined the GATT and had become its Contracting Party, the government would have been given much longer and automatic transitory periods to implement some of the most difficult WTO Agreements, once the organization was finally established. For example, all the existing GATT Contracting Parties that were regarded as developing countries during the Uruguay Round became automatically WTO Members when the organization came into existence in 1995. Afterwards, developing countries were given a number of privileges to facilitate their implementation process. The privileges were negotiated during the Uruguay Round as a means of ensuring that those developing countries would support the establishment of the WTO. This explains why after the existence of the WTO was finally assured, the industrialized countries were unwilling to extend the preferential provisions intended for developing countries on any future WTO Members.

However, when the Uruguay Round was ending, Ecuador was still in the middle of its accession process. In reality, it was an economically deprived country that had very little bargaining power. Thus its support for the WTO was irrelevant at the late stage of multilateral negotiations. In the eyes of the major trading actors, Ecuador was not a part of the deal reached with the group of developing countries during the Round. The powerful players had no incentives to speed up its accession process. On the contrary, the quiet consensus had emerged that it was not in their interest to grant Ecuador a status of developing country. Rather, the industrial countries decided that Ecuador would be the first country to join the WTO under the completely new approach.

¹⁸ Interview with a participant, Geneva 1999.

In consequence, Ecuador was denied some of the most fundamental exemptions and privileges awarded to those developing countries that were the original WTO Members¹⁹. For example, developing countries were given until January 2000 to implement the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Also, under Article 4 of the Agreement on Trade-Related Investment Measures (TRIMs) they were allowed special treatment.²⁰ And under the Agreement on Agriculture²¹ they were permitted to maintain a much higher level of domestic subsidies than the developed countries and extended implementation periods for various obligations under the WTO agreements, such as under Article 15 of the Agreement on Agriculture, Article 10 of the SPS Agreement, Article 12 of the TBT Agreement, etc.

All these provisions raise the obvious question of which countries should be considered *developing* and thus be allowed to benefit from more favorable treatment. However, there is no clear definition of *developing country* within the body of WTO agreements. Remarkably such criteria have never been determined either by the

¹⁹ These developing countries that joined the world trading body under the GATT system.

²⁰ Agreement on Trade-Related Investment Measures (TRIMs)

Article 4

Developing Country Members

A developing country Member shall be free to deviate temporarily from the provisions of Article 2 to the extent and in such a manner as Article XVIII of GATT 1994, the Understanding on the Balance-of-Payments Provisions of GATT 1994, and the Declaration on Trade Measures Taken for Balance-of-Payments Purposes adopted on 28 November 1979 (BISD 26S/205-209) permit the Member to deviate from the provisions of Articles III and XI of GATT 1994.

²¹ Agreement on Agriculture

Preamble.

Commitments under the reform programme should be made in an equitable way among all Members, having regard to non-trade concerns, including food security and the need to protect the environment; having regard to the agreement that special and differential treatment for developing countries is an integral element of the negotiations, and taking into account the possible negative effects of the implementation of the reform programme on least-developed and net food-importing developing countries.

Contracting parties to GATT 1947 or by WTO Members²². Whether a country is considered *developing* depends on a unilateral decision of the country granting tariff preferences or on self-selection approved by all major trading powers. However, after the establishment of the WTO, a consensus among the Membership has emerged that every new candidate should join the organization without receiving any special exemptions. Indeed, even a cursory examination of the Working Party Reports on accessions shows that obtaining developing country status by the acceding countries is routinely discouraged, regardless of their level of economic development.²³ In fact, the accession process becomes an unpredictable exercise of power by the existing WTO Members.

Ecuador was the very first developing country to experience the complexity of the new and demanding WTO accession. The negotiations were eventually completed in the fall of 1995 under the WTO legal framework. Ecuador was not allowed to join with full benefits of developing country status. Rather, such status was applied selectively to Ecuador, mainly with respect to negotiating the level of tariff bindings²⁴. As a political compromise, Ecuador was permitted to delay the implementation of some of the agreements. However, Ecuador was not allowed to obtain developing country status in the context of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Such status would allow Ecuador to delay the implementation of TRIPS until January 2000. Instead, Ecuador was told to implement TRIPS no later than July 31, 1996. Notably, even such a limited preferential treatment of an acceding country was abandoned

²² Only the term 'Least Developed Country' is clearly defined in the WTO context in accordance with the list drawn up by the United Nations. As of May 2001, the list officially identifies 49 Least Developed Countries.

²³ WTO Document (2000) *Technical Note on the Accession Process*, (WT/ACC/7/Rev. 2), 1 November, op. cit., pp. 3-5.

²⁴ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 15.

all together in the subsequent accessions. Ecuador became a WTO member in January 1996.²⁵

Outcome of the Ecuadorian accession – the commitments

As a basic condition to join the WTO, acceding countries are required to bind their import tariffs, i.e. to commit themselves to not setting tariffs above specified levels. Negotiations between applicants and incumbent members focus on the import-weighted average tariff level, the dispersion of tariff rates across products and the number of zero-rated products. At the beginning of its accession process, Ecuador lowered its tariffs both on industrial and agricultural products, started to liberalize some of its services sectors, promised to reform its intellectual property rights regime and, most importantly, began to implement a variety of pro-market reforms. The regulatory changes were quite extensive and even revolutionary in scope since they attempted to completely reverse the policies of the past.

When the accession negotiations commenced, the government of Ecuador was immediately pressured to introduce the reforms quickly, effectively and without any prior consultations with the societal groups concerned²⁶. Facing a collapsing economy, the government felt it had no choice but to pursue WTO membership. Following a new pattern of accession, Ecuador made 21 commitments that were listed in its Protocol of Accession. If any of these commitments is broken, the affected WTO Member can immediately initiate legal proceedings against Ecuador under the WTO dispute settlement system. In a way then the commitments that are made during the accession negotiations

²⁵ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, op. cit.

²⁶ Interview with an Ecuadorian official. Geneva 1999.

become a mechanism of perpetual control that can be exercised at any time by the concerned WTO Members.

The first²⁷ of the 21 commitments that the government of Ecuador made in response to the demands of WTO Members was to comply and cooperate with the IMF concerning the maintenance of a stable foreign exchange regime²⁸. This commitment referred to Article XV of the original GATT 1947. However, before the WTO was established, this Article was never seriously considered within the activities of the GATT. This is because Article XV was contained within Part II of the General Agreement.²⁹ All GATT accession Protocols stated that acceding countries would have to apply provisionally Parts I, III, and IV of the General Agreement, but Part II only “to the fullest extent not inconsistent with its legislation existing on the date of this Protocol”.³⁰ As it was explained in the previous chapter, this practice of limited application of Part II in the GATT was consistent with a long established tradition. When GATT was first brought into existence, the countries that signed it adopted a Protocol of Provisional Application subject to limitation by the existing legislation. The principle of Provisional Application was naturally immediately abandoned once the WTO was established as a formal institution, which the General Agreement never was. Thus, the WTO not only

²⁷ See Annex at the end of this chapter.

²⁸ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 10.

²⁹ Part II includes GATT Articles III to XXIII (For example: Article III on National Treatment, Article V on Freedom of Transit, Articles VI on Anti-Dumping, Article VII on Customs Valuation, Article X on Publication and Administration of Trade Regulations, Article XV on Exchange Arrangements and on Cooperation with IMF, Article XVI on Subsidies, etc.)

³⁰ GATT Document (1968) *Protocol for the Accession of Poland*, GATT: Basic Instruments and Selected Documents (BISD) Fifteen Supplement, op. cit., p. 47.

contains GATT 1947 but it also enforces the application of all its parts by permanently removing the provisional character of the General Agreement³¹.

The commitment that Ecuador would always cooperate with the IMF, as pointed out by Article XV, was requested by the Members of the Working Party as a result of bargaining over Ecuador's foreign debt situation and rates of inflation³². In the 1960s the government of Ecuador took control of the private financial system and set up specialized banks for agriculture and industry under public ownership and control. The state directed financial institutions to lend to selective industries on subsidized terms³³. The limitation of this approach was not apparent as long as there was a steady inflow of export revenues. However, following the collapse of world oil prices in 1986, a debt crisis in Ecuador became imminent³⁴. Rising interest rates, low commodity prices, and currency devaluations increased the burden of foreign currency borrowing for domestic firms and for the government. The inflationary pressures, combined with a large number of bad loans, led to the virtual breakdown of the banking system.

³¹ John H. Jackson (1997) *The World Trading System: Law and Policy of International Economic Relations*, op. cit., pp. 47-49.

³² Article XV of the GATT 1947 (on Exchange Arrangements and on Cooperation with IMF) and Article XI of the GATS (on Payments and Transfers and IMF Obligations):

Article XV *Exchange Arrangements*

1. The CONTRACTING PARTIES shall seek co-operation with the International Monetary Fund to the end that the CONTRACTING PARTIES and the Fund may pursue a co-ordinated policy with regard to exchange questions within the jurisdiction of the Fund and questions of quantitative restrictions and other trade measures within the jurisdiction of the CONTRACTING PARTIES.

2. In all cases in which the CONTRACTING PARTIES are called upon to consider or deal with problems concerning monetary reserves, balances of payments or foreign exchange arrangements, they shall consult fully with the International Monetary Fund. In such consultations, the CONTRACTING PARTIES shall accept all findings of statistical and other facts presented by the Fund relating to foreign exchange, monetary reserves and balances of payments, and shall accept the determination of the Fund as to whether action by a contracting party in exchange matters is in accordance with the Articles of Agreement of the International Monetary Fund, or with the terms of a special exchange agreement between that contracting party and the CONTRACTING PARTIES.

³³ For more details read, Alain de Janvry, Elisabeth Sadoulet, André Fargeix (1991) *Adjustment and Equity in Ecuador*, Paris: OECD.

³⁴ Christian Morrisson (1994) *The Political Feasibility of Adjustment in Ecuador and Venezuela*, Paris: OECD. Particularly this Chapter: "Ecuador before the Debt Crisis: Oil Boom and Transition to Democracy."

In 1992 the government of Ecuador adopted a Macroeconomic Stabilization plan, supported by the IMF³⁵. The financial sector reforms were staged simultaneously with other structural reforms, and were conducted in the context of WTO accession negotiations that aimed to liberalize Ecuador's trade regime and accelerate economic growth with price stability and external viability. The objectives of the financial sector reforms were to improve monetary control, the efficiency of financial intermediation, and the safety and soundness of the financial system. Inflation decreased from 60.2% in 1992 to 31% in 1993 and to 25.4% in 1994, international reserves increased from a low of US\$ 224 million in August 1992 to US\$ 1.2 billion in December 1993 and to US\$ 1.7 billion in December 1994. The consolidated non-financial public sector deficit decreased from 1.2% of GDP for 1992 to 0.1% of GDP for 1993 and to 0.2% of GDP for 1994, and GDP grew by 2% in 1993 and by 4.3% in 1994³⁶.

The reform of the exchange system was completed in 1994. By that year, a free exchange system had been adopted in which the private sector could acquire the foreign exchange needed for its activities at the market rate. Foreign exchange transactions for foreign trade purposes were no longer carried out through the Central Bank of Ecuador³⁷. The results of financial sector reforms were generally favorable for maintaining appropriate real interest rates but inflation continued to be a significant problem.

While there was no overt financial sector crisis in 1995, the situation remained fragile in Ecuador as a result of slow progress made in the capitalization, restructuring,

³⁵ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 8.

³⁶ IMF Document (1995) *Ecuador – Recent Economic Developments*, IMF Staff Country Report No. 95/96, 3 October.

³⁷ Shahid Javed Burki and Guillermo E. Perry (1997) *The Long March: A Reform Agenda for Latin America and the Caribbean in the Next Decade*, op. cit., pp. 12-24. Central Bank of Ecuador, INEC, "Análisis Semanal (Annual Report)", "El Comercio" January 1995 at www.elcomercio.com

and privatization or liquidation of financial institutions. The main recommendation of the IMF at the end of 1995 was that Ecuador should persevere with policies to improve the conduct of monetary policy through market-oriented indirect monetary policy instruments, and it should substantially strengthen prudential regulation and supervision and promptly restructure and privatize or liquidate ailing financial institutions³⁸.

Upon the accession of Ecuador, WTO Members welcomed the fiscal adjustment it made in 1993, but stressed the need for a tight fiscal stance for the foreseeable future in order to achieve a sustainable fiscal and external position over the medium term. A number of measures were suggested to accomplish this, including a comprehensive tax reform to broaden the tax base and increase non-oil tax revenues. Further reductions in the subsidies on domestic fuels, tight control over expenditures, and elimination of domestic payment arrears were also considered important fiscal objectives.

To sum up, as a necessary condition of WTO accession, Ecuador made a contractual commitment to fully cooperate with the IMF with regard to exchange questions. Ecuador accepted an obligation to consult with the IMF in all cases dealing with problems concerning monetary reserves, balances of payments or foreign exchange arrangements³⁹. This commitment had a great political significance as it permanently linked the international trade policy issues with the domestic monetary policy in Ecuador. Essentially, the government permanently restricted itself from pursuing its own independent monetary policy. The international organizations had received a legal

³⁸ IMF Document (1995) *Financial Sector Reforms in Eight Countries: Issues and Results*, Working Paper (WP/95/141-EA) Prepared by Vicente Galbis.

³⁹ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 10.

mandate to constrain and supervise all the monetary policy initiatives undertaken by the government of Ecuador.

Commitments relating to application of tariffs

The next five of the 21 commitments⁴⁰ that Ecuador made related to import tariffs, internal taxes and customs valuation⁴¹. Until 1992, Ecuador's tariffs were very high. As a result of bilateral negotiations and its bid to join the WTO, Ecuador considerably reduced its tariffs. In 1992, the highest tariff rates were reduced from 290 per cent to 40. The average tariff bindings at the time Ecuador acceded to the WTO were 20.1 per cent on industrial products and 25.8 per cent on agricultural products.⁴² The Ecuadorian average tariff bindings were one of the highest among the twelve newly acceded countries. This happened for two reasons. First, Ecuador was allowed to bind its tariffs on the level that reflected its developing country status⁴³. Secondly, the accessions that took place after Ecuador tended to become more and more demanding in terms of extracting the tariff concessions from the candidate countries⁴⁴.

The demands by existing WTO Members for all tariffs to be bound can be defended on the grounds that bindings enhance the transparency of the trade regimes in applicant countries. However, the demands for a very low average bound rate amounts to applying a double standard in that far more stringent liberalization is required of applicants than has

⁴⁰ See Table 3 at the end of this chapter. Commitments: 2, 3, 4, 5 and 6.

⁴¹ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraphs 14, 17, 19, 21 and 29.

⁴² WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Also containing (WT/L/77/Add.1) Tariff Schedules.

⁴³ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador*, (WT/L/77), 14 July, Paragraph 15.

⁴⁴ See Table 4 at the end of this chapter.

been accepted by current members at a similar stage of economic development⁴⁵. Furthermore, most candidates do not have a reliable tax system, and since import duties are generally easier to apply from a political point of view, they often constitute an important source of government revenue. Such an important fiscal role of tariffs deters the governments of the acceding countries from their rapid reduction.

Furthermore, and despite the fact that Ecuador made remarkable tariff reductions, WTO Members continued to be concerned about the duty exemptions granted to certain categories of public and private sector institutions. Members of the Working Party maintained that applied duty exemptions distorted trade and introduced uncertainty about the applicable duties since tariffs varied for the same product, depending on whether the product was eligible for an exemption. The representatives of the Ecuadorian government, on the other hand, maintained that these duty exemptions were crucial for continuation of many of the social programs. For example, they were intended to lower the costs of new schools, utilities, roads, retirement homes, hospitals and so forth.⁴⁶

WTO Members, however, considered these exemptions as unfairly favoring the public sector and thus they insisted on Ecuador making a commitment that imports by the public sector under duty free exemptions did not compete with ordinary private sector trade, and that there was no discrimination among supplying countries through the application of duty exemptions. This effectively meant that the list of the projects to which the duty exemptions applied was shortened and subject to review. Ecuador was allowed to maintain duty-free imports for development projects or works of national priority, which

⁴⁵ Dale E. Hathway and Merlinda D. Ingco (1995) "Agricultural liberalization and the Uruguay Round" Marcelo de Paiva Abreu "Trade in manufactures: the outcome of the Uruguay Round and developing country interests" in Martin, Will and L. Allan Winters (eds.) *The Uruguay Round and the developing countries*, op. cit.

⁴⁶ Interview with the WTO official, Geneva 2000.

effectively meant those projects that were classified as having priority by the National Development Council (CONADE). These included only the construction of social housing, hydro-electric power stations, highways, irrigation systems and canals, drinking water infrastructure, hospital equipment and schools⁴⁷.

Another problematic issue for Ecuador had to do with the leveling of the application of customs control fees⁴⁸. This issue was a part of broader negotiations concerning the nature, application, coverage and justification of various taxes and charges such as surcharges, control fees, transfer fees, transit fees, storage fees, consumption taxes, and value added taxes. WTO Members successfully opposed control fees of 1 per cent and 0.5 per cent for goods entering Ecuador under a special customs regime and the transit fees as not consistent with the WTO provisions⁴⁹. They also contested the 1 and 2 per cent import taxes for the Children's Development Fund and the National Fund for Nutrition and Protection of Children. It was eliminated as a condition of the WTO accession⁵⁰. In fact Ecuador had to eliminate all the tariff surcharges, even the tax on the importation of luxury goods, which provided the government with a sure source of revenue. Clearly, this commitment further eroded the government's capacity to conduct its fiscal policy independently and outside the influence of multilateral obligation.

⁴⁷ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 14.

⁴⁸ To bring them into conformity with Article VIII - *On Fees and Formalities Connected with Importation and Exportation* - of the GATT 1947.

1. (a) All fees and charges of whatever character (other than import and export duties and other than taxes within the purview of Article III) imposed by contracting parties on or in connection with importation or exportation shall be limited in amount to the approximate cost of services rendered and shall not represent an indirect protection to domestic products or a taxation of imports or exports for fiscal purposes.

⁴⁹ Article VIII of the GATT 1947, *op. cit.*

⁵⁰ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 16.

The overall efficiency of the tax regime was a weighty issue during the accession negotiations. WTO Members paid particular attention to the application of internal taxes in Ecuador. There were various forms of discretionary tax exemptions. More generally, the system lacked transparency and uniformity with many exemptions favoring particular industries and causing serious trade distortions. For example, Ecuador had very generous depreciation rules for capital, as such rules favored capital-intensive manufacturing industries, thereby causing these sectors to grow relatively faster. The relative advantage of such a tax policy for some industries could be further enhanced when tariffs were eliminated, in turn distorting the terms of a fair competition in favor of these industries⁵¹. Thus, the negotiating WTO members consistently pressured the government of Ecuador to overhaul its tax system as a condition to join the organization.

Indeed, in parallel with the WTO accession process, Ecuador reformed considerably its tax system, driven both by the requirements of trade and financial opening, and by the need for fiscal adjustment. As a result of these reforms, export taxes have been mostly eliminated and revenue from import taxes declined sharply. At the same time the competition for foreign direct investment (FDI) and other capital flows let Ecuador reduce the marginal rates for both personal and corporate income taxes and to introduce regulations aimed at improving tax administration, removing tax exemptions, and closing loopholes to ensure uniform application of taxes⁵².

⁵¹ For an excellent analysis of the issue read: Joel Slemrod (1996) "Tax Cacophony and the Benefits of Free Trade" in *Fair Trade and Harmonization – Prerequisites for Free Trade?* Jagdish Bhagwati and Robert Hudec (eds.), Cambridge, MA: The MIT Press, pp. 283-310.

⁵² For an overview of tax reform in Ecuador, see Guillermo E. Perry and Ana Maria Herrera (1994) *Public Finances, Stabilization, and Structural Reforms in Latin America*. Washington DC: Inter-American Development Bank and John Hopkins University Press.

While the above accession demands can be defended from a point of view of international trade as a necessary move to dismantle discriminatory trade practices, the immediate high costs of it are seldom offset by any tangible benefits. In fact, in the particular example of Ecuador, the implementation of the commitment immediately affected the country's budget by significantly lowering the inflow of tax money⁵³.

Incumbent WTO Members were determined to bring Ecuador in full compliance with all multilateral agreements. Thus, with respect to the application of internal taxes, WTO Members also pressured the government of Ecuador to eliminate the Special Consumption Tax. The special consumption tax was an excise tax levied on cigarettes, alcohol and alcoholic beverages, beer, carbonated beverages and mineral and purified water. The level of taxation ranged from 5 per cent on mineral and purified water to 260 per cent on foreign brands of cigarettes. WTO Members argued that the tax was applied to a number of imported products at rates in excess of those applied to similar domestically produced goods, and thus this practice was not in conformity with Article III of the GATT 1947⁵⁴. The Ecuadorian negotiators argued that an elimination of the tax would have a devastating budgetary effect and that equalization could destroy the domestic industries. Since this legally justified demand was non-optional, Ecuador requested a transitory period to introduce the relevant changes. It was granted and Ecuador made a commitment to equalize the application of the tax no later than 31 July 1996⁵⁵. Ecuador also made a commitment that the Value Added Tax (VAT) would be

⁵³ Interview with an Ecuadorian official. Geneva 1999.

⁵⁴ Article III deals with National Treatment on Internal Taxation and Regulation. National Treatment means that foreign products (and services) receive the same treatment as domestic ones.

⁵⁵ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador*, (WT/L/77), 14 July, Paragraph 19.

applied equally on domestically produced goods and imported items in all cases in accordance with the relevant WTO provisions⁵⁶.

From the beginning of the accession negotiations, Ecuador was criticized for its unwieldy customs procedures and practices. Members of the Working Party questioned the requirements for temporary admission, cumbersome customs procedures, excessive paper work for customs declarations and most importantly, the apparent lack of uniformity in customs valuation practices. Further complications were caused by discretionary tariff collection practices and a weak customs administration that resulted in unpredictable tariff collection rates. Thus, the reduction of distortions with respect to tariffs could be less a matter of cutting the average tariff than of increasing transparency in the enforcement of tariff regulations. To address this problem, the sixth⁵⁷ of the 21 commitments that the government of Ecuador made was to ensure full compliance (from the date of accession) with the WTO Agreements on Preshipment Inspection and Customs Valuation⁵⁸. However, not only does the Customs Valuation Agreement address only a part of the customs process, the valuation process it prescribes presumes an administrative environment that did not exist in Ecuador. Most importantly, both agreements require the introduction of vast administrative and regulatory changes without any recourse to a transitory period.

The customs Valuation Agreement i.e., Agreement on Implementation of Article VII,⁵⁹ is concerned with ensuring an objective and uniform basis for the process of estimating the value of imported goods by the customs authority. All fees in connection

⁵⁶ Articles III and Article VIII of the GATT 1947. See: *Report of the Working Party on the Accession of Ecuador*, 14 July 1995 (WT/L/77), Paragraph 21.

⁵⁷ See Annex at the end of this chapter.

⁵⁸ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 29.

⁵⁹ Article VII of the GATT 1947.

with the importation or exportation of products are to be levied in such a way as not to accord indirect protection to domestic products, or to impose a charge having the character of a tax.⁶⁰ The agreement provides that upon written request the importer has the right to a written explanation of how customs value was determined. The agreement also explicitly states that nothing in it may be interpreted as restricting the authority of customs officials to satisfy themselves that statements or documents presented are true and accurate. It also requires that national legislation provide for the right of appeal, without penalty.⁶¹

Pre-shipment inspection refers to the activities carried out by private-sector companies in the territory from which the goods are exported. These activities relate to such matters as the verification of the quality, quantity, and price of goods to be exported. The WTO Agreement on Pre-shipment Inspection for the first time brings international regulation to this area of activity. The obligations in relation to pre-shipment activities, in so far as they concern the user Member country (the Member requiring the inspection), are as follows: pre-shipment activities are conducted in a non-discriminatory fashion, the quality is ensured in accordance with agreed standards, any confidential information is kept secret, proper price verification follows, and there is no delay in the inspection.

⁶⁰ WTO Document (1998) *Implementation of the Agreement on Implementation of Article VII of the GATT 1994* (WT/GC/W/124), 16 December.

⁶¹ *The Agreement on Implementation of Article VII of the GATT 1994*,
Article 11

1. The legislation of each Member shall provide in regard to a determination of customs value for the right of appeal, without penalty, by the importer or any other person liable for the payment of the duty.
2. An initial right of appeal without penalty may be to an authority within the customs administration or to an independent body, but the legislation of each Member shall provide for the right of appeal without penalty to a judicial authority.
3. Notice of the decision on appeal shall be given to the appellant and the reasons for such decision shall be provided in writing. The appellant shall also be informed of any rights of further appeal.

As a result of implementation of the above agreements, Ecuador had to introduce substantial administrative changes and draft new legislation in an attempt to bring its customs duty regime into line with WTO standards. For example, the government introduced a new Customs Law⁶² providing for the modernization of customs services. In addition, Ecuador introduced a new law on the National Customs Service, which entered into force on 9 March 1994. This law aimed at simplifying procedures and improving the efficiency of customs services, as well as regulating the legal relationship between the state and persons involved in international trade. The law unified all provisions relating to the Customs Service previously contained in various legal instruments.

In the course of the accession process, Members of the Working Party demanded that Ecuador abolish its customs system that maintained minimum customs values for textiles. Ecuador had established a system of minimum customs valuation prices for a wide range of fabrics in view of the increasing tendency to undervalue the declared prices of textiles for the purpose of evading customs duty. The government claimed that the system of pre-established minimum values for textiles was aimed principally at stabilizing the market. Nevertheless, as a result of WTO accession negotiations, Ministerial Decision 752 of 14 October 1994 repealed this system⁶³.

The 1997 review of the implementation of the commitments by Ecuador demonstrated that the relevant legislation on pre-shipment inspection was introduced in conformity with provisions such as transparency, price verification, submission of information, protection of information, and non-discrimination, as well as the customs

⁶² Customs Tariff Law Number 72, in WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 3, op. cit.

⁶³ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 27.

valuation rules provided for in Article VII of GATT 1994⁶⁴. In practical terms, however, the introduced changes cost the government of Ecuador millions of dollars and led to considerable budgetary problems and subsequent reductions in customs jobs and in a number of border crossings. Moreover, since the government had no additional money to properly train the remaining customs officials about the new customs procedures, or to fully computerize the system, the reforms did not produce an effective customs administration as they were designed to do. On the positive side, however, the reforms established a good institutional framework of a transparent system. It was very unfortunate that Ecuador was not given sufficient time to implement the massive reforms of its customs regime. Time pressures prevented the government from working out a sensible plan of action. Also, instead of completely dismantling the old system, the government could have saved a lot of money by reforming only the relevant aspects of the old regime⁶⁵.

Other commitments relating to goods

The seventh⁶⁶ of the 21 commitments that the government of Ecuador made was to eliminate by the date of accession all the non-tariff import and export restrictions that could not be justified under WTO provisions with respect to quantitative restrictions.⁶⁷ Members of the Working Party praised the considerable progress that Ecuador had made towards the

⁶⁴ WTO Document (1998) *Ecuador: WTO Accession Commitments* (WT/ACC/ECU/9), 25 February.

⁶⁵ Interview with an Ecuadorian official, Geneva 1999.

⁶⁶ See Table 3 at the end of this chapter.

⁶⁷ Article 4 of the Agreement on Agriculture and Article XI of the GATT 1947.

Article XI, General Elimination of Quantitative Restrictions

1. No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party.

liberalization of trade in the context of its accession negotiations. The outstanding issue, however, was a system of controls, bans, restrictions and arbitrary authorizations⁶⁸. WTO Members believed that this system not only impeded the free flow of trade but could also lead to significant trade distortions. In this respect particular complaints were made with respect to import restrictions concerning used textiles and clothing, and tires and automobiles, along with price controls on pharmaceuticals, and restrictions affecting a significant number of agricultural products and raw materials. Ecuador made a commitment to ensure that such measures would not be applied or re-introduced after accession to the WTO unless specifically provided for in the WTO Agreements⁶⁹.

Ecuador also committed itself (the eighth⁷⁰ of the 21 commitments) to eliminate by the date of accession all non-tariff import and export restrictions (including all quantitative restrictions in the agricultural sector) that could not be justified under other WTO provisions⁷¹. The government of Ecuador insisted during the negotiations that the system of prohibitions in force was for the protection of human and animal life, the maintenance of ecological balance (preservation of species) and for reasons of national security⁷².

⁶⁸ Interview with a WTO official, Geneva, 2000.

⁶⁹ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 31.

⁷⁰ See Table 3 at the end of this chapter.

⁷¹ The WTO Agreements on Agriculture and Import Licensing Procedures; Article XI of the GATT 1947.

⁷² The government of Ecuador maintained that it was free to conduct its own domestic policy in a way inconsistent with the basic principle of non-discrimination because of the exemption under Article XX

Article XX of the GATT 1947 - *General Exceptions*

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

- (a) necessary to protect public morals;
- (b) necessary to protect human, animal or plant life or health;
- (c) relating to the importations or exportations of gold or silver;
- (d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement.

Members of the Working Party disagreed with this interpretation and requested that the government of Ecuador eliminate by 1 July 1996 its import bans on used articles and replace them as necessary with regulations uniformly applied to domestic and imported goods for the protection of plant, animal and human health and safety administered in conformity with the provisions of the Agreements on Agriculture and on Import Licensing Procedures⁷³. This commitment could have potentially serious long-term consequences as it effectively limited the government's ability to use a broader interpretation of Article XX to introduce restrictive trade measures in response to future domestic demands. Instead, the government was to apply a narrow interpretation of the two highly technical agreements under the supervision (via notification requirements) of WTO Members.

The previous commitment was further reinforced in the one particular context. The ninth⁷⁴ of the 21 commitments referred specifically to the WTO Agreement on Import Licensing Procedures. Members of the Working Party expressed concern that the prior authorization system for some agricultural and non-agricultural products did not afford exporters adequate notification of Ecuador import standards. Furthermore it was not applied to protect human, animal or plant life or health, nor it was based on scientific principles, and supported with sufficient scientific evidence, as required by the Agreement on application of Sanitary and Phytosanitary Measures (SPS)⁷⁵. WTO Members further insisted that Ecuador introduce relevant legislation to ensure that the prior authorization system in Ecuador was up to the WTO standards. The legislation was to guarantee the

⁷³ The legal requirements of the Agreement on Import Licensing Procedures regarding "adequate notifications requirements."

⁷⁴ See Table 3 at the end of this chapter.

⁷⁵ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraphs 35 and 36.

application of the so-called 'risk-assessment test.' This test is connected with the SPS agreement and delineates criteria for WTO-legitimate SPS measures. Since one of the criteria required a prolonged past-risk evaluation, it immediately rendered most of the current measures in Ecuador as WTO-inconsistent because they were not supported by the relevant research and documentation⁷⁶.

As a result of difficult negotiations, Ecuador submitted a document with information on import licensing procedures⁷⁷. This document included a detailed summary of the national legislation justifying the licensing procedure in a manner that was consistent with the WTO Agreement on Import Licensing Procedures. The government of Ecuador made a commitment that any authorizations or license requirements incompatible with the WTO provisions would be eliminated at the time of accession.⁷⁸ In addition, Ecuador ensured that all remaining restrictions and import permit requirements would be applied in a way consistent with Article XIII of the GATT 1994⁷⁹ and in accordance with the principle of non-discrimination. As a result of this commitment, the power of the government to use import restrictions was limited despite the various safety contingency provisions permitted under Article XX⁸⁰.

⁷⁶ Interview with an Ecuadorian official, Geneva 1999.

⁷⁷ GATT Document (1994) *Import Licensing Procedures in Ecuador* (L/7523/Add.1), 23 September.

⁷⁸ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 38.

⁷⁹ Article XIII of GATT 1994 deals with Non-discriminatory Administration of Quantitative Restrictions.

Article XIII *Non-discriminatory Administration of Quantitative Restrictions*

I. No prohibition or restriction shall be applied by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation of any product destined for the territory of any other contracting party, unless the importation of the like product of all third countries or the exportation of the like product to all third countries is similarly prohibited or restricted.

⁸⁰ Article XX of the GATT 1947 - *General Exceptions*, op. cit.

The tenth⁸¹ commitment stated that all agricultural restrictions in Ecuador would be brought into conformity with the rules of the General Agreement 1994 and the WTO Agreement on Agriculture⁸². The main objective of the agreement has been to discipline and reduce domestic support while at the same time leaving great scope for governments to design domestic agricultural policies in the face of, and in response to, the wide variety of the specific circumstances in individual countries and individual agricultural sectors. The approach agreed upon is also aimed at helping ensure that the specific tariff commitments in the areas of market access and export competition are not undermined through domestic support measures.

Given that WTO rules reflect the market-oriented nature of its member countries' economies, some aspects of Ecuador's agricultural policy required immediate reforms as part of its accession process. One such area was the status of state-trading and the issue of domestic subsidies and export subsidies. Many of the acceding countries are former centrally run economies. Under such systems, state-trading enterprises handled all of the country's foreign trade. Under the old regimes, the governments would set both the quantity and price of traded agricultural products, which were often heavily subsidized.

One of the primary achievements of the UR concerning market access for agricultural trade was to replace all existing non-tariff quantitative restrictions with bound tariffs. Regarding export subsidies, the WTO Agreement on Agriculture requires countries to reduce existing subsidies and prohibits subsidies for new products. The agreement also significantly limits government farm support that can distort trade. The

⁸¹ See Table 3 at the end of this chapter.

⁸² WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 41.

agreement identifies basically two categories of domestic support⁸³: support with no, or minimal disruptive effect on trade on the one hand (*Green Box* measures⁸⁴) and trade-distorting support on the other hand (referred to as *Amber Box* measures). For example, government provided agricultural research or training is considered to be of the former type, while government buying-in at a guaranteed price falls into the latter category.

The agreement provides that certain domestic support measures in the "green box" are not subject to limitation, but that non-product-specific and product-specific domestic support measures in the "amber box" maintained in the base period must be reduced and bound if they are above the relevant "*de minimis*" levels laid down in the Agreement⁸⁵. However, under the *de minimis* provisions of the Agreement there is no requirement to reduce such trade-distorting domestic support in any year in which the aggregate value of the product-specific support does not exceed 5 per cent of the total value of production of the agricultural product in question. In addition, non-product specific support, which is less than 5 per cent of the value of total agricultural production is also exempt from reduction. Ecuador undertook *de minimis* domestic support commitments.

The reduction commitments are expressed in terms of a "Total Aggregate Measurement of Support" (Total AMS), which includes all product-specific support and

⁸³ Agreement on Agriculture: *Article 6*

Domestic Support Commitments

1. The domestic support reduction commitments of each Member contained in Part IV of its Schedule shall apply to all of its domestic support measures in favour of agricultural producers with the exception of domestic measures, which are not subject to reduction in terms of the criteria set out in this Article and in Annex 2 to this Agreement. The commitments are expressed in terms of Total Aggregate Measurement of Support and "Annual and Final Bound Commitment Levels".

⁸⁴ *The Legal Texts – The Results of the Uruguay Round of Multilateral Trade Negotiations*. Agreement on Agriculture (Annex 2). "*The Legal Texts....*" are also available at <http://www.wto.org>

⁸⁵ "*de minimis*" level is 5 per cent of the value of total agricultural production for developed countries and 10 per cent for developing economies.

non-product-specific support in one single figure. The total AMS⁸⁶ is a means of quantifying the aggregate value of domestic support or subsidy given to each category of agricultural products. Each WTO member has made calculations to determine its AMS wherever applicable⁸⁷. However, this was not an issue in the accession of Ecuador since its domestic support level were negligible and well within that permitted by the agreement levels.

The agricultural commitments on domestic support and export subsidies were negotiated bilaterally and then plurilaterally at meetings attended by the government of Ecuador and interested members of the Working Party. Prior to the WTO accession negotiations, Ecuador's legislation provided for the application of quantitative and other non-tariff measures on imports - e.g., import quotas for fruit, sugar and other agricultural raw materials, and seasonal import permits. As a result of the accession process, Ecuador promised to repeal Ministerial Agreement 067 of 20 February 1978, which was the remaining provision in force which allowed official bodies to set quotas or other restrictions for the import of agricultural products⁸⁸.

⁸⁶ Agreement on Agriculture:
Article 1 Definition of Terms

In this Agreement, unless the context otherwise requires:

(a) "Aggregate Measurement of Support" and "AMS" mean the annual level of support, expressed in monetary terms, provided for an agricultural product in favor of the producers of the basic agricultural product or non-product-specific support provided in favor of agricultural producers in general, other than support provided under programs that qualify as exempt from reduction under Annex 2 to this Agreement.

⁸⁷ Commitments made require a 20 per cent reduction in total AMS for developed countries over six years. For developing countries, the reduction commitment is 13 per cent over the ten years, while there is no reduction required of least-developed countries.

⁸⁸ Under pressure of WTO Members Ecuador already eliminated seasonal restrictions on fruit imports in 1991. See WTO Document, *Report of the Working Party on the Accession of Ecuador*- 14 July 1995 (WT/L/77) Paragraph 41.

The Agreement on Agriculture lays down that export subsidies maintained in the base period⁸⁹ must be reduced and bound. Ecuador did not grant export subsidies during the relevant period, so its Agricultural Schedule binds these at zero. Below is the table illustrating Ecuador's tariff bindings of agricultural products as a result of WTO accession negotiations.

Tariff bindings of agricultural products.⁹⁰

Ecuador	
No. of Tariff Items	1,019
No. of Tariff Items Bound Individually	1,019
Specific + Compound Rates	None
0	0
0-5	30
6-10	11
11-15	110
16-20	230
21-30	509
31-40	61
41-50	43
51+	25
Simple Average of Individual Tariff Bindings	25.8%
Minimum	5%
Maximum	86%
Other Tariff Items	None

⁸⁹ One of the most difficult issues in agricultural talks is reaching an understanding on the base period to be used in the negotiations. The most recent period for which data are available is normally used. This happened in all accession cases except Bulgaria.

⁹⁰ WTO Document (2000) *Technical Note on the Accession Process*, (WT/ACC/7/Rev. 2) 1 November, op. cit., p. 25.

The outcome of the WTO accession introduced moderate changes in the agricultural sector. There were no excessive tariffs to begin with. The new bound tariff levels were welcomed mainly as instruments enhancing greater predictability. Ecuador had not provided any relevant export subsidies because of insufficient financial resources. Its domestic support measures were not a problem either. They were also below the *de minimis* allowable level as a result of a lack of financial resources. Nevertheless, incumbent WTO Members pressed Ecuador to make very specific commitments with respect to agriculture. The main reason was to use the example of Ecuador as a precedent in future accession negotiations. Agriculture was a crucial issue in more than a half of the completed accession processes. The disagreements over the level of domestic support delayed the accessions of Bulgaria, Croatia, Latvia and Lithuania. And the inability to reach satisfactory agreements on agricultural trade with China and Russia seriously affects the progress in their accession negotiations⁹¹. By setting the standards high with the accession of Ecuador, WTO Members ensured a high entry level for the subsequent candidates.

Although Ecuador did not apply any excessive agricultural support measures prior to its accession to the WTO, there was one particular mechanism in place that caused a lot of problems during negotiations. Unable to subsidize its farmers and its agricultural production because of the persistence of difficult economic conditions throughout the 1980s, the government of Ecuador sought to create more favorable trading conditions for its farmers. The initiative became known as the price-band system. It was shaped by Ecuador's budgetary constraints because once the government ran out of money it was unable to support its domestic producers, even in a time of emergency. Thus, the only

⁹¹ WTO Document (2000) *Accession of the Russian Federation* (WT/ACC/SPEC/RUS/15), 12 July. WTO Document (2000) *Draft Report of the Working Party on the Accession of China to the WTO*, (WT/ACC/SPEC/CHN/1/Rev.5), 15 November.

policy option left was a protectionist measure that would shield domestic farmers from outside competition⁹². The agricultural price-band system, however, was clearly discriminatory and thus WTO-inconsistent.

Thus, the eleventh⁹³ commitment the government of Ecuador made was a result of particularly difficult negotiations over the price-band system. Under this system, variable levies were imposed on imports of certain agricultural products. The functioning of the price-band system was as follows: (a) if the international price of an agricultural product on importation was below the established lower price, it was subject to an additional charge over and above the *ad valorem* duty; (b) if the world price was somewhere between the highest and lowest prices of the established band, then the importer paid only the *ad valorem* duty; and (c) if the world price was above the highest price of the established band, then the import was subject to a reduction in the *ad valorem* duty⁹⁴.

Ecuador argued that the price-band system was a necessary tariff adjustment mechanism that acted as a means of stabilizing the impact of international prices in Ecuador's market. Its purpose was to counteract the distortions and variations in international prices caused by the guaranteed prices, buying-in of surpluses, storage subsidies, import quotas, stabilization mechanisms, and export bonuses and subsidies which, among others, were part of the agricultural policies of many exporting countries. The abolition of the price-band system would naturally lead to the decline in income growth and remove the only governmental program protecting the farmers from unpredictable economic and weather conditions. The government further argued that the

⁹² Interview with an Ecuadorian official. Geneva 1999.

⁹³ See Table 3 at the end of this chapter.

⁹⁴ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 44.

removal of the price-band system would hinder Ecuador's overall economic development and even undermine social stability since the rural economy was essential for this primarily agricultural nation⁹⁵.

Stressing that the price band system was against the spirit of the Final Act of the Uruguay Round, WTO members opposed the system, the products to which it was applied, the justification of the system under the GATT, and the existence of plans for phasing it out. WTO negotiators maintained that the use of minimum import prices and variable charges was in conflict with WTO provisions, especially Article II 1(b), which requires Members not to apply customs duties in excess of those set forth in their Schedules.⁹⁶ In the end, the government of Ecuador made a commitment to gradually eliminate the price band system within a seven-year period in accordance with the time-table annexed to Ecuador's Protocol of Accession⁹⁷.

The public finance system of Ecuador was undermined in the 1980s by extensive quasi-fiscal activities on both sides of the government's balance sheet. All governments are tempted to use quasi-fiscal tools, since under traditional cash-budgeting practices their cost appears to be zero. For this reason, quasi-fiscal instruments may appear politically more attractive than cash expenditure items. Transition and developing economies are particularly vulnerable to losses from quasi-fiscal practices, due to non-transparent and shifting ownership structures and weak contract enforcement⁹⁸.

⁹⁵ Interview with a participant of the meeting, Geneva 1999.

⁹⁶ This is important for two reasons: (1) all agricultural duties are bound after the Uruguay Round and (2) Ecuador's price-band system would violate the notion of bound duties, which would threaten the UR understanding, and also create great uncertainty for exporters to Ecuador. See in WTO document *Report of the Working Party on the Accession of Ecuador*, 14 July 1995 (WT/L/77), Paragraph 42.

⁹⁷ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 48.

⁹⁸ Leszek Balcerowicz (1995) *Socialism, Capitalism, Transformation*. op. cit., pp. 213-214.

Commitments relating to other issues

During the 1980s, while income per capita was falling rapidly, quasi-fiscal activities were used in Ecuador to support either vulnerable or politically influential social groups and organizations. Most of these activities were arbitrary and not fully transparent, they undermined market discipline and creditor rights, and led to the accumulation of hidden debt. As a result, the fiscal sphere spun increasingly out of control. While insiders could thrive on arbitrage, the less connected and disadvantaged social groups eventually lost out, since they lacked the leverage to distort resource flows to their advantage. Among the more pervasive quasi-fiscal problems in Ecuador were: the economy-wide chain of non-payments, including budgetary arrears; price controls for a plethora of goods and services through which extensive subsidies were provided to households and to certain enterprises; financial system distortions, such as directed credit, or pressure on banks to lend at below-market rates to "strategic" enterprises; liquidity support to these banks; and rigid barriers to shedding excess labor.⁹⁹

The twelfth¹⁰⁰ commitment the government of Ecuador was requested to make concerned the liberalization of price controls. By the time it applied for WTO membership, the price-setting policy Ecuador had established in the 1970s had been virtually dismantled. The exceptions were fuels and gas for household use, where prices were set by the Ministries of Finance, Energy and Mining; and medications for the lower income groups of the population. WTO Members wanted assurances that the government will continue to

⁹⁹ Interview with an Ecuadorian official, Geneva 1999.

¹⁰⁰ See Table 3 at the end of this chapter.

dismantle the price controls and would never extend its the price setting policy to other sectors of the economy beyond the pharmaceutical sector¹⁰¹.

The thirteenth¹⁰² commitment concerned anti-dumping measures in Ecuador. A significant part of the accession process was spent on bargaining over so-called unfair trade practices. WTO members were concerned about potential anti-dumping actions undertaken by Ecuador against imports. At issue were the material injury tests to determine dumping, the methodology employed for determining serious injury, and whether hearings were open to all interested parties. WTO Members were concerned whether the final report was made available to the public, and whether Ecuador's participation in regional trade agreements could lead to the imposition by Ecuador of anti-dumping duties on imported products, affecting the competitive position of other regional group members¹⁰³.

Indeed, some regional agreements have successfully addressed this topic in the past. For example, Australia and New Zealand successfully meshed their competition policies in a manner that also enabled them to eliminate antidumping duties¹⁰⁴. WTO Members were concerned that there would be a serious risk of inconsistency if anti-dumping issues were addressed differently in the different regional agreements, thereby possibly leading to anti-dumping regional trade wars. As a result of WTO accession negotiations on this issue, Ecuador made a commitment that from the date of accession to

¹⁰¹ WTO Document, *Report of the Working Party on the Accession of Ecuador*, 14 July 1995 (WT/L/77), Paragraph 53.

¹⁰² See Table 3 at the end of this chapter.

¹⁰³ For an excellent discussion on this issue read: J. Michael Finger (1996) "Legalized backsliding: safeguard provisions in GATT" in *The Uruguay Round and the developing countries*. Will Martin and L. Allan Winters (eds.), op. cit., pp. 328-337.

¹⁰⁴ Compare the analysis of the issue in C. Fred Bergsten (1999) *The Global Trading System and the Developing Countries in 2000*. Working Paper 99-6, Washington, DC: Institute for International Economics, pp. 9-10.

the WTO it would fully apply the provisions of the WTO Agreement on Implementation of Article VI¹⁰⁵ in cases involving allegations of dumping by imports¹⁰⁶.

The fourteenth¹⁰⁷ commitment concerned very important negotiations that evolved around subsidies and other export incentives awarded to domestic producers in Ecuador. Members of the Working Party contested the Law for the Facilitation of Exports enacted by Decree No. 147 of 23 March 1992 and the duty draw-back system introduced through Executive Decree No. 762 on 19 May 1993, which benefited natural or legal persons whose activity was oriented towards the exportation of products comprising imported foreign components. The government of Ecuador argued that some export subsidies were necessary to facilitate its development strategy for a developing country¹⁰⁸.

WTO Members maintained that the entire accession process was aimed at transforming the Ecuadorian economy into a market economy and ensuring that producers acted in a competitive environment, in order to ensure the active involvement of the Ecuadorian economy in the globalization process. Among the most important steps taken to attain this objective was to give emphasis to the transparency of trade policy and non-discrimination of the measures taken. WTO argued that maintaining export subsidies by Ecuador was discriminatory. Furthermore, they were administered in an unclear and discretionary manner. Consequently, Ecuador was pressured to get out of all subsidies before acceding to the WTO¹⁰⁹.

¹⁰⁵ The so-called Anti-Dumping Agreement.

¹⁰⁶ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 57.

¹⁰⁷ See Table 3 at the end of this chapter.

¹⁰⁸ Interview with an Ecuadorian official, Geneva 1999.

¹⁰⁹ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 58.

From a theoretical (economic) point of view, it can be argued that such an approach should have only positive impacts on the national economy, but in reality the effects were different in some respects. However, as Ecuador lacked enough financial resources to support sectoral development and restructuring or did not maximize the effect of the existing ones, domestic producers had to compete with foreign products at prices distorted by their trading partners' own domestic support and direct export subsidies permitted under the preferential agreements like the EU. The government of Ecuador argued during the negotiations that, under these circumstances, even if those exporting countries (like the EU) were not breaking their commitments under WTO, at least a part of their exports were causing serious difficulties for the Ecuadorian producers. As a result, Ecuador's producers were in need of export subsidies.¹¹⁰ The demand of WTO Members that Ecuador should dismantle all of its export subsidies schemes amounted to applying a double standard in that far more harsh liberalization would be required of Ecuador than had been accepted by incumbent WTO Members.

The arguments presented by the representatives of Ecuador did not make an impact as the issue of eliminating all subsidies in Ecuador turned out to be a non-optional demand by existing WTO Members. Thus, as a necessary condition of WTO membership Ecuador made a commitment to eliminate all existing export subsidies no later than November 1995 and not to have any subsidies after this date¹¹¹.

Commitment number fifteen¹¹² related to the operation of special economic free zones on the territory of Ecuador. Law No.001 of 19 February 1991 provided for free zones

¹¹⁰ Interview with an Ecuadorian official, Geneva 1999.

¹¹¹ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 59.

¹¹² See Table 3 at the end of this chapter.

with special investment incentives for taxes, tariffs and capital¹¹³. Ecuador agreed to make a commitment to make some changes to the law and to establish the payment of normal taxes and tariffs on the imported component of sales from the zones into the rest of Ecuador.

The sixteenth¹¹⁴ commitment concerned state trading. Difficult bargaining accompanied the discussions on state-trading enterprises in Ecuador. During the accession negotiations Members of the Working Party repeatedly reviewed the nature of the activities of state-owned enterprises. They requested a listing of such enterprises, their share in the economy in general and in trade in particular, sectors of activity, monopolies exercised by them, and compliance of their operations with the provisions of Article XVII of the GATT 1994, as well as future plans and priorities concerning privatization¹¹⁵.

Although state trading exists with respect to both industrial and agricultural goods, agriculture is by far the most important category of state trading in the developed and developing countries alike. The notifications suggest that the heavy emphasis on agriculture in state trading activities stems from the belief that state trading is an appropriate means by which governments can meet agriculture-related policy objectives, e.g. providing price support for important agricultural products or ensuring food security¹¹⁶. With respect to industrial goods, state trading appears to arise either as a by-product of the nationalization of an ailing industry or as a mechanism for pursuing

¹¹³ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 60 and 61.

¹¹⁴ See Table 3 at the end of this chapter.

¹¹⁵ The Understanding on the Interpretation of Article XVII of the General Agreement on Tariffs and Trade 1994 (hereinafter the "Understanding") and in accordance with decisions taken by the Working Party on State Trading Enterprises at its meeting on 6 April 1995 (G/STR/M/1).

¹¹⁶ WTO Document (1995) *Operations of State Trading Enterprises as they Relate to International Trade - Background Paper by the WTO Secretariat* (G/STR/2), 26 October.

government policies pertaining to products and industries considered to have strategic importance¹¹⁷.

The foreign trade monopoly was one of the key features of the state-run economy of Ecuador in the 1970s and 1980s, as it shielded the economy from the influence of the world market. Thus, all state trading enterprises were subject to central control/guidance through orders, which determined the level and direction of trade¹¹⁸. The targets might be general, determining the level of exports and imports without regard to origin or destination; or specific, with individual levels of trade determined for particular countries or areas. Such a system lent itself to protectionist and/or discriminatory trading practices.

In Ecuador the state-owned sector was receiving huge government subsidies and was employing thousands of people for decades. The thirty years of this involvement of the state in the economy resulted in some 165 enterprises covering sectors such as transport and storage, energy, communications, agriculture, industry, mining, tourism, internal trade, financing and services¹¹⁹. As these enterprises became increasingly inefficient and obsolete, the government of Ecuador adopted a policy of decentralization of public sector activities, elimination of state monopolies and privatization of public services¹²⁰.

The modernization programs started in 1991, and by 1992 there were no state monopolies in Ecuador except in the case of natural gas and some petroleum products.

¹¹⁷ Leszek Balcerowicz (1995) *Socialism, Capitalism, Transformation*. op. cit., pp. 99-102.

¹¹⁸ Interview with an Ecuadorian official, Geneva 1999.

¹¹⁹ For a good historical analysis read: Christian Morrisson (1994) *The Political Feasibility of Adjustment in Ecuador and Venezuela*, " op. cit., pp. 17-88.

¹²⁰ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador (WT/L/77)*, 14 July, Paragraph 63.

However, according to the Law on the Modernization of the State, Privatization and Provision of Public Services by Private Enterprise, which had entered into force on 31 December 1993¹²¹, the following activities were reserved for the state under Article 46 of the Constitution and could be delegated by concession to private enterprises:

- (a) production, transport, storage and marketing of hydrocarbons and other minerals,
- (b) generation and distribution of electricity,
- (c) telecommunications services,
- (d) production and distribution of drinking water.

In addition, and as a result of the accession negotiations, Ecuador agreed to continue with a progressive privatization of the state-trading sector and to observe all the relevant WTO provisions, including sending to Members notifications and descriptions of the remaining state trading activities¹²².

The seventeenth¹²³ commitment was to ensure that the WTO provisions for notification, consultation, and other requirements concerning preferential trading systems, free trade areas, and customs unions of which Ecuador was a member were met¹²⁴. This commitment was an outcome of difficult discussions in the Working Party over the Latin American Integration Association (LAIA) and the Cartagena Agreement and their justification under Article XXIV of the GATT 1994, the operation of various mechanisms in force in the context of the integration processes, and the fulfillment of the notification requirements under the GATT.

WTO Members were particularly concerned about the participation of Ecuador in the Andean Group. In 1966 Bolivia, Chile, Colombia, Ecuador, Peru, and Venezuela, all

¹²¹ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 63.

¹²² Article XVII of the GATT 1994 and Article VIII of GATS, see *Report of the Working Party on the Accession of Ecuador*, 14 July 1995 (WT/L/77), Paragraph 63.

¹²³ See Table 3 at the end of this chapter.

¹²⁴ Article XXIV of the GATT 1994, Article V of GATS and paragraph 3 of the Enabling Clause.

members of the Latin American Free Trade Association, agreed to form a regional subgroup. The Andean Group, formed in 1969 by the Cartagena Agreement, was founded to encourage industrial, agricultural, social, and trade cooperation among members. The group originally consisted of Bolivia, Colombia, Ecuador, Peru, and Chile; Venezuela joined in 1973, and Chile withdrew in 1977. Several subgroups include the Andean Group Commission, the Andean Reserve Fund, the Andean Development Corporation, and various councils dealing with such issues as trade, monetary exchange, economic planning, tourism, and social affairs¹²⁵. Ecuador has been a member of the Andean Community and as a result import duties are not paid on goods from the other member countries. However, Peru has special sectoral preferential agreements with a large number of goods being subject to a 0% tariff and others to reduced rates, while some other Latin American countries enjoy preferential treatment for specific products. Members of the Working Party expressed concern that participation in this regional agreement was limiting Ecuador's flexibility in the market access negotiations because of the uncertain relations in the Andean community. The commitment made was to ensure the predictability of Ecuador's obligations under the regional agreement.¹²⁶

The eighteenth¹²⁷ commitment concerned reform of the investment regime in Ecuador. Before the launch of the Uruguay Round, the US was one of the main advocates of designing multilateral discipline over practices that distort or restrict international

¹²⁵ Joseph M. Grieco (1997) "Sources of Variation in Regional Institutionalization," in *Political Economy of Regionalism*, Edward D. Mansfield and Helen V. Milner (eds.) New York: Columbia University Press, pp. 166-167.

¹²⁶ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 73.

¹²⁷ See Table 3 at the end of this chapter.

investment flows¹²⁸. However, the final agreement that emerged from the Uruguay Round substantially reduced and rearranged the agenda proposed by the US. Some aspects of investment were dealt with under the Agreement on Subsidies, while others were addressed in the services negotiations, and still others were considered through the agreement on intellectual property. Nevertheless, some elements of the US initial proposal to the GATT with respect to trade-related investment measures (TRIMs) were accepted and recognized in the WTO agreement on TRIMs.

The TRIMs agreement is very limited in terms of number of prohibited restrictions and it only applies to goods. However, its inclusion in the WTO package of agreements has a great significance for developing countries. The agreement prohibits a host government to impose on foreign companies local content requirements and trade-balancing and domestic-sales restrictions¹²⁹. These TRIMs have been widely employed by developing countries to extract rents from multilateral corporations. Quite often one of the principal reasons the multinationals move their subsidiaries to developing countries is because these countries are known as low-tax jurisdictions¹³⁰. Unable to tax the multinationals for the fear of losing them, developing countries have used TRIMs in the attempt to capture some of the profits the foreign companies make while on their territory.

Ecuador used extensively a number of performance requirements with respect to foreign corporations prior to its decision to join the WTO. For example, Ecuador forbade

¹²⁸ John Mutti (1994) "TRIMS, Policy Change, and the Role of the GATT" in *Analytical and Negotiating Issues in the Global Trading System* Alan V. Deardorff and Robert M. Stern (eds.) Ann Arbor: The University of Michigan Press.

¹²⁹ Patrick Low and Arvind Subramanian (1996) "Beyond TRIMs: a case for multilateral action on investment rules and competition policy?" in Martin, Will and L. Allan Winters (eds.) (1996) *The Uruguay Round and the developing countries*, Cambridge University Press.

¹³⁰ Joel B. Slemrod (1990) *North South Model of Taxation and Capital Flows*. Working Paper No. 3238, National Bureau of Economic Research, January.

foreign investment in some industries and required local partnership in others¹³¹. These regulations were in clear violation of WTO's National Treatment principle. Also, by placing requirements on foreign investment, such as minimum local content requirements, Ecuador was apparently jeopardizing its obligation under the TRIMs Agreement.

A crucial part of the accession negotiations evolved around the legal framework for investment in Ecuador. WTO Members were concerned about whether there existed a preferential taxation treatment for export related investments, restrictions on remittance of profits, barriers to foreign investment, and so forth. The legislation introduced in the January 1993 Decree 415 lifted most of the barriers to foreign investment in Ecuador¹³². The new rules allowed the unrestricted repatriation of profits, removed the restriction on foreign shareholdings in excess of a limit of 49 per cent in any enterprise, and eliminated the requirement for prior approval of investment by the competent Ministry for most sectors. The restrictions on investments related to local content requirements were also lifted and foreign investment was allowed in the financial sector.

Despite these new measures, the EU and the US continued to have problems with a set of trade-related investment measures introduced by Ecuador because of an apparent inconsistency with the WTO provisions¹³³. Those measures resulted from an Andean

¹³¹ Interview with an Ecuadorian official, Geneva 2000.

¹³² See Document: "1997 Investment Climate Statement for Ecuador" U.S. Foreign Commercial Service, Quito, 14 July 1997.

¹³³ The Agreement on Trade Related Investment Measures (TRIMs) "*The Legal Texts - The Results of the Uruguay Round of Multilateral Trade Negotiations*." First published in 1994 by the GATT Secretariat in Geneva. Reprinted several times, most recently (2000) by the Cambridge University Press. "*The Legal Texts....*" are also available at <http://www.wto.org>

Article 2 National Treatment and Quantitative Restrictions

1. Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994.

Group agreement between Colombia, Venezuela and Ecuador for the automotive sector, signed on 13 September 1993 with the goal of adopting a common policy in order to promote the efficiency of the automobile industry and to take advantage of the sub-regional market in equal conditions of competitiveness. The agreement called for a national content requirement for assembly enterprises of 35 per cent that should be increased to 40 per cent by December 1995¹³⁴. Under the pressure of the accession negotiations, the government of Ecuador made a commitment to eliminate all such WTO-inconsistent measures prior to 1 January 2000 and to provide any relevant information to the Council for Trade in Goods for the information of the TRIMS Committee¹³⁵.

Although the Ecuadorian government had been pursuing regional and global trade liberalization agreements (i.e. the Andean Pact and the World Trade Organization), there was no proper legislation to regulate trade and foreign investment. It was not until June 09, 1997 when a Foreign Trade and Investment Law was finally approved by Congress and issued on Official Register No. 82¹³⁶. The law regulates and promotes trade and direct investment in an effort to generate an efficient use of Ecuador's resources. Furthermore, it allows for a diversification of exports and advancement of integration processes, bilateral and multilateral agreements, in order to expand investment and foreign trade within the WTO framework. The law forbids any administrative or

2. An illustrative list of TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 and the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994 is contained in the Annex to this Agreement.

¹³⁴ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 75.

¹³⁵ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 78.

¹³⁶ USFCS Document (1997) "Ecuador Approves Law to Regulate and Promote Trade and Direct Investment" U.S. Foreign Commercial Service – Quito, 15 August 1997.

economic practice that limits free competition or blocks development of foreign and domestic trade and production of goods and services.

The next commitment¹³⁷ (nineteenth) related to the intellectual property rights regime. Ecuador was able to negotiate a transitional period for the implementation of the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS). The commitment stated that the date of application of the TRIPS provisions for Ecuador would be no later than 31 July 1996¹³⁸. Ecuador was denied developing country status with respect to implementation of its obligations under TRIPS. A negligible extension that was allowed did not compare to a five-year automatic transitory period granted to all existing developing country members.

Strangely enough, Ecuador remains the only newly acceded country that was allowed any transitory period at all. The countries that acceded to the WTO after Ecuador had to implement TRIPS without recourse to any transitory period. The implementation of TRIPS encounters problems in both transition economies and in developing countries because both traditionally tended to view intellectual property as a public, rather than a private good. Thus, there was no need in those countries to establish institutions for protection of intellectual property rights. However, under their new WTO obligations, developing countries and transition economies had to create a whole new administrative and legal system to implement TRIPS.¹³⁹

During the post-war period the government of Ecuador governed the state in a non-transparent manner. Under the WTO rules, all governments need to strengthen their

¹³⁷ See Table 3 at the end of this chapter.

¹³⁸ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 78.

¹³⁹ Chapter 7 deals in details with TRIPS and especially it addresses the problems with its implementation.

policy-making accountability, fiscal responsibility and control procedures. The past governments of the acceding countries were often charged with the spending of scarce public resources in accordance with arbitrarily legislated priorities. Spending and decision-making systems were non-transparent and had weak enforcement mechanisms that led to the misuse of public funds. The existing system of fiscal and legislative reports did not allow the government to evaluate the real outcomes of public spending and new legislative initiatives¹⁴⁰.

In order to meet the general WTO requirements for transparency, Ecuador made a twentieth commitment¹⁴¹ to submit within three months of its accession, notifications about its new laws and regulations that are required by the following WTO Agreements: Agreement on Implementation of Article VI of GATT 1994, Agreement on Safeguards, Agreement on Subsidies and Countervailing Measures, Agreement on Technical Barriers to Trade, Agreement on Textiles and Clothing¹⁴². Ecuador also made a commitment (the twenty first¹⁴³) to notify the WTO Secretariat annually of the implementation of the commitments and to identify any delays in implementation together with the reasons therefore. That was the last commitment as listed in Ecuador's Protocol of Accession¹⁴⁴.

Concluding remarks about the WTO commitment approach

Ecuador's Protocol of Accession was a novelty to practitioners accustomed to an old GATT pattern that would only indicate the specific terms of every accession and the

¹⁴⁰ Interview with an Ecuadorian official, Geneva 2000.

¹⁴¹ See Table 3 at the end of this chapter.

¹⁴² WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 79.

¹⁴³ See Table 3 at the end of this chapter.

¹⁴⁴ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 80.

negotiated obligations. The GATT accession protocols did not contain a comprehensive list of commitments that were undertaken by every new Contracting Party. In addition, the provisional nature of the GATT provided for greater flexibility with respect to domestic implementation of GATT obligations. The establishment of the WTO significantly changed the accession process. Ecuador became the first country to join an international organization by making legally enforceable commitments and, most importantly, commitments that also meant introducing domestic reforms.

The following pattern emerges when analyzing the economic reforms introduced by Ecuador in parallel with its WTO accession negotiations. First, at the outset of the accession process, the reforming government had to ensure macroeconomic stabilization, which meant managing the budget to avoid excessive fiscal deficits. Of particular importance was the role of money, prices and wages, since the governments had to stabilize exchange and interest rates. The financial reorganization included the introduction of a stable national currency. Furthermore, the government of Ecuador performed the following tasks as part of its WTO accession process: (i) established the fundamental institutions to enable the economy to function on a free market basis and to allow the government to regulate that economy through fiscal and monetary policies; (ii) expanded the opportunities available to foreign investors by ensuring the security of their investments in order to attract foreign direct investment; (iii) utilized in an efficient manner foreign loans and credits; (iv) diversified the domestic economy through privatization of state property, (v) reorganized or liquidated unprofitable and insolvent state enterprises; and (vi) establishing a system of law intended to protect property to

permanently secure economic reforms. All of these tasks were linked together and contributed to the establishment of the regulatory framework of the state.

The eleven countries that followed Ecuador repeated the same pattern of commitments. This pattern, however, became gradually enlarged and detailed as the commitments themselves were deepened. Furthermore, since special exemptions for developing countries have been either reduced or have already expired, the new Members are asked to fulfill stricter conditions. For example, the Kyrgyz Republic made 29 commitments, which was the largest number to date. This accession also seemed to establish a precedent that membership in the two Plurilateral Agreements (the Agreement on Government Procurement and Civil Aircraft Agreement) would be a condition of accession to the WTO. However, Article XII itself made it quite clear that the procedures for accession to these Plurilateral Agreements were quite separate from accession to the WTO itself.

The Kyrgyz government also confirmed that, from the date of accession, it would ensure that all of its laws and regulations relating to the right to trade in goods would support an investment-friendly environment. In yet another commitment, the Kyrgyz Republic promised to adopt the Harmonized Rules of Origin once finalized by the WTO in co-operation with the World Customs Organization. The Kyrgyz Republic committed itself to introduce special legislation in order to provide a right of appeal to an independent body for foreign and domestic importers and exporters of official measures affecting trade. The Kyrgyz government also made a new commitment to apply the WTO Agreement on Technical Barriers to Trade from the date of accession without recourse to any transition period. In particular, the Kyrgyz Republic committed to apply the same controls, criteria,

and rules regarding technical regulations, standards, certification, and labeling requirements to imported and domestic goods. The commitment was made to introduce regulations aimed to harmonize Kyrgyz sanitary and phytosanitary standards with international standards. The Kyrgyz Republic would report annually on progress in the work on harmonization until its standards were in conformity with WTO requirements. All these commitments set a firm precedent for future WTO accessions¹⁴⁵.

The WTO accession process is a test of what it means to be a WTO member. Since the organization has changed dramatically the criteria for joining it reflect the magnitude of these changes. The outcome of the Ecuadorian accession is an important case study. With Ecuador, the organization set a precedent for any future WTO accession negotiations but it also delineated the boundaries of WTO membership. This is particularly relevant with respect to implementing WTO regulations by developing countries. Although they already are WTO Members, they must complete a demanding process of regulatory reforms to fully comply with the WTO rules and regulations.

The twelve acceded countries shared a very similar experience. Their first attempts at reform took place in the presence of at least two legacies of state-run economies. One was the presence of an ineffective, and poorly trained bureaucratic sector that lacked coordination mechanisms among its many branches and outlets. The other was the presence of unclear, if not conflicting, economic directives and regulations accumulated over many years of arbitrary central planning or state controlled economy. These two legacies posed serious obstacles to economic and political restructuring, and created

¹⁴⁵ WTO Document (1998) *Report of the Working Party on the Accession of the Kyrgyz Republic* (WT/ACC/KGZ/26), 31 July, Paragraphs, 26, 30, 66, 94, 100, 120 and 122.

institutional paralysis at the beginning of the reform period¹⁴⁶. The economic reforms in the acceding countries were often protracted by the existence of a large and inefficient bureaucracy unable to draft needed laws and to administer new macroeconomic policies and regulations. The WTO accession process served as a crucial step in breaking down such institutional disorder.

The discussions on domestic institutions, laws and regulations arise naturally from the fact-finding stage of accession negotiations in the Working Party. The main aim of these discussions is to determine if the applicant's trade regime, and the overall regulatory framework of the country, complies with the WTO regime, and, in particular, how it is to be brought into conformity where necessary. In practical terms it means that once a country decides to apply for a WTO membership, its government is under pressure to meet assigned deadlines to implement its reform program. Quick implementation of the reformist changes and ratifications of introduced new laws and regulations are the necessary conditions to move the accession process forward. Acceding governments are asked to present a plan and timetable showing, for each of the main economic activities relevant to the WTO Agreements, what steps they have taken towards conformity with the WTO rules, what remains to be done and how and when they expect to complete the reform process. Furthermore, where existing legislation is deficient or lacking, draft laws and regulations in full conformity with WTO rules must be presented to the Working Party for examination, together with a timetable for their implementation¹⁴⁷.

¹⁴⁶ Panel Discussion (John Williamson). "In Search of a Manual for Technopols" in John Williamson (ed.) *The Political Economy of Policy Reform*, Washington, DC: Institute for International Economics, 1994, pp. 15-24.

¹⁴⁷ WTO Document (1995) *Accession to the World Trade Organization* (WT/ACC/1), 24 March.

Some of the acceding governments requested that they be granted transitional periods of the kind provided in WTO Agreements for developing Members. It is the position of many WTO Members that only original Members of the WTO are entitled to use the transitional periods referred to, which form part of the single undertaking of the WTO Agreements and thus a transitional period should not ordinarily be granted¹⁴⁸. The transition periods granted to original WTO Members have not been made readily available to governments acceding under Article XII, regardless of their level of economic development. Only a few transition periods have been granted in limited areas and for short periods of time following submission of a detailed plan ensuring WTO consistency (by enactment of needed legislation, training of personnel responsible for implementation, etc.) by the date of accession in all other areas¹⁴⁹.

Problems with implementing the comprehensive set of WTO agreements were anticipated from the start. Many developing countries resisted the profound transformation that came about with the establishment of the WTO. Their governments had reservations about the capabilities of developing countries to introduce the necessary regulatory changes in order to comply with the demanding requirements of the new WTO agreements. To facilitate implementation of the WTO agreements developing countries were granted special transitory periods and certain preferential provisions. However, during the implementation period following the establishment of the WTO, it has become

¹⁴⁸ WTO Document (2000) *Technical Note on the Accession Process* (WT/ACC/7/Rev. 2), 1 November, p.3.

¹⁴⁹ There were four transitory periods granted to Ecuador. Ecuador was granted a transitory period until 31 July 1996 to equalize the application of the domestic taxes. It was also allowed to eliminate the price band system within a seven-year period in accordance with the table annexed to Ecuador's Protocol of Accession. Ecuador was given a transitory period until 1 January 2000 to eliminate those trade related investment measures that were inconsistent with the provisions of the Agreement on TRIMS. Also, the date of application of the provisions of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) for Ecuador was extended until 31 July 1996. See WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraphs 11, 18, 19, 78.

clear that provisions existing in favor of developing countries have remained ignored by the industrialized nations. The accession process especially demonstrates this well because every new Member is expected to join the organization without any recourse to transitory periods and without any recourse to deferential provisions¹⁵⁰. The acceding countries are expected to complete a series of comprehensive regulatory changes and introduce a full-scale liberalization of their trade regime. Such comprehensive reformist changes are a pre-condition to becoming a WTO Member for the acceding countries.

The WTO accession negotiations in principle relate only to three main areas: concessions and rules for trade in goods, services, and trade-related aspects of intellectual property rights. However, during the crucial multilateral stage of the process, the implementation of the agreements is also at issue. WTO Members examine the three trade areas in terms of compliance with WTO obligations. Hence the overall regulatory framework of the country, its administrative institutions, and its capacity to consolidate the promised reforms, comes under scrutiny¹⁵¹. Consequently, Working Party Members request specific commitments to ensure compliance. The commitments oblige the acceding country to behave predictably in fulfilling its WTO obligations since it is bound by the formal WTO dispute settlement mechanism. The stakes are high. Countries that are struggling with implementation of their WTO obligations understand the threat of being taken to the dispute settlement and the subsequent risk of facing retaliatory

¹⁵⁰ WTO Document (WT/ACC/7/Rev. 2) *Technical Note on the Accession Process*, November 01, 2000, p. 4.

¹⁵¹ For example, read the following sets of questions and answers addressed during the multilateral meetings of the Working Party on the accession of Croatia. Note that these documents are on average 30 pages long : 29 August 1995 (WT/ACC/HRV/3/Cor.1); 29 March 1996 (WT/ACC/HRV/5); 1 April 1996 (WT/ACC/HRV/7 and Add.1); 6 August 1996 (WT/ACC/HRV/11); 8 November 1996 (WT/ACC/HRV/11/Add.1); 22 January 1997 (WT/ACC/HRV/27); 28 July 1997 (WT/ACC/HRV/27/Add.1); 11 August 1997 (WT/ACC/HRV/30); 3 August 1998 (WT/ACC/HRV/39Add. 1 and 2); 19 January 1999 (WT/ACC/HRV/45).

measures for failing to observe the commitments they made. Thus, when the WTO accession is completed, its conclusion not only signifies the reaching of compromises over market access concessions for and by the new member, but it also tells a story about the completion of a certain threshold of economic transformation by an acceding country.

Sadly, this transformation is only monitored in terms of legal rules and economic indicators. At no time is the impact of the reforms on the population at large being examined. In fact, WTO accessions usually take place behind the closed doors in Geneva and the capital city with very little public awareness of the process, even in the acceding country. Since all the acceding governments possess a democratically justified legal mandate to negotiate international agreements, they are not obliged to seek approval or even consult any authorities outside the government. It remains to be seen in the years to come whether the legal constraints of binding commitments imposed on the countries during the accession process can truly benefit them. By acceding to the WTO, countries do lose a certain degree of autonomy when it comes to conducting their domestic policies. WTO puts limits on what kind of domestic policy measures its Members can introduce. This is done because the rules-based system is considered to be neutral in enhancing economic performance and also egalitarian in allowing all countries, big and small alike, to fully participate in the global economy. The problem, however, is that the system remains inherently uneven, with larger actors often dictating the terms of the game. And this is why, in separating the economy from the social fabric of the country, the legal framework of the WTO can potentially become a rigid legal cage, insensitive to the fact that many smaller countries are simply not capable of implementing all the agreements.

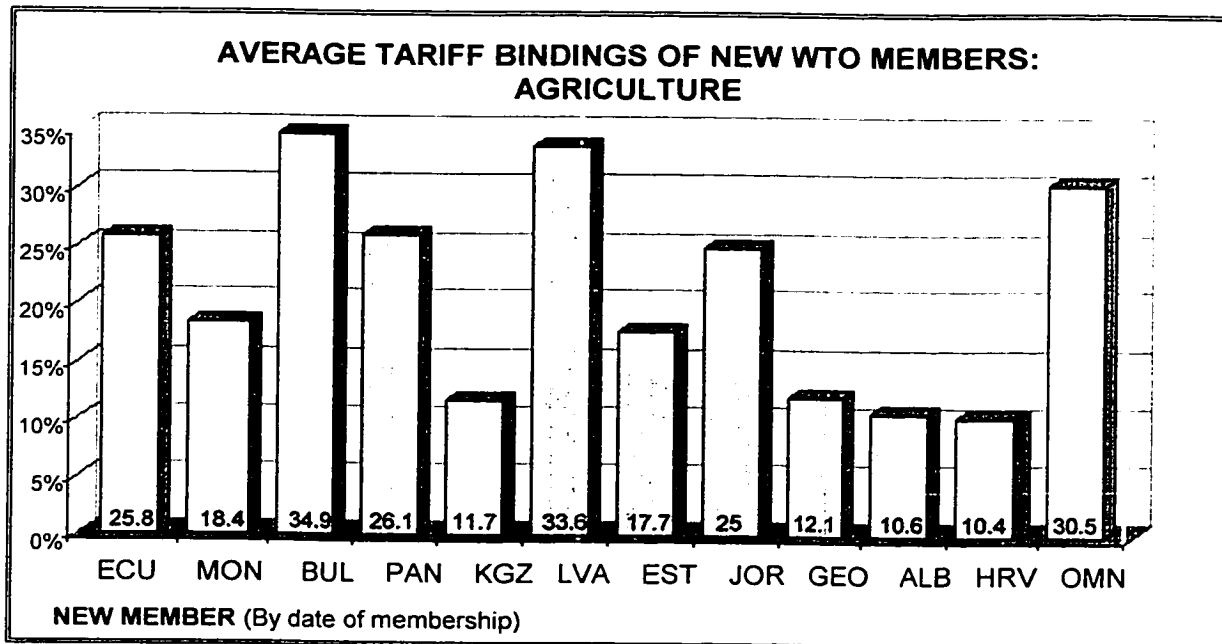
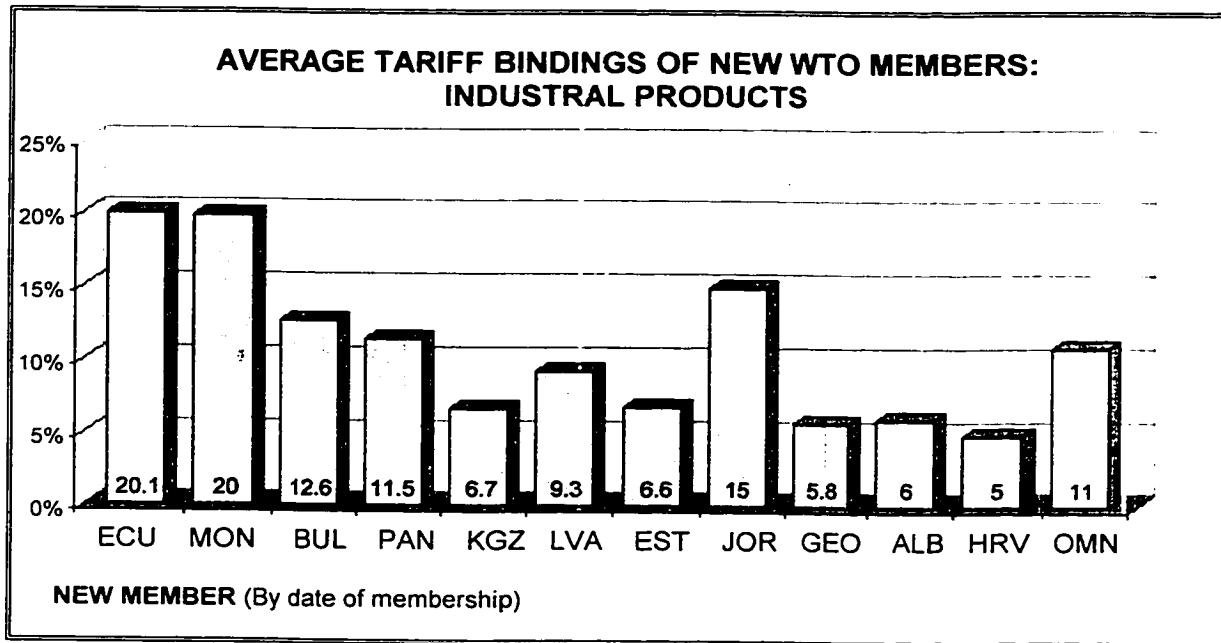
Table 3a: Brief Description of the Commitments Made by Ecuador

Ecuador's 21 Commitments		Brief Description of the Commitments Made
1.	Stable Exchange Rate	Full cooperation with IMF in all future cases dealing with problems concerning monetary reserves, balances of payments or foreign exchange arrangements
2.	Duty Exemptions	Fair competition between the public and private sectors, and between the foreign suppliers – Non-discriminatory application of duty exemptions
3.	Customs Control Fees	Revision of the procedures of application of the customs control fees
4.	Special Consumption Tax	Equalization of the application of the Special Consumption Tax no later than 31 July 1996 in compliance with National Treatment principle
5.	Application of VAT	Non-discriminatory application of the VAT with respect to domestically produced goods and imported items
6.	Customs Valuation	Full compliance with the provisions of the WTO Agreements on Pre-shipment Inspection and Customs Valuation – elimination of the system of minimum customs values
7.	Non-Tariff Restrictions	Elimination by the date of accession all non-tariff (quantitative) import and export restrictions which cannot be justified under WTO provisions, in particular the Agreement on Agriculture
8.	Elimination of Import Bans	Elimination by 1 July 1996 import bans on used clothing, automobiles and tires and replacing them if necessary with the non-discriminatory application of objective criteria for the protection of plant, animal and human health and safety
9.	License Requirements	Elimination by the date of accession of any prior authorizations or license requirements incompatible with the provisions of the WTO Agreements
10.	Elimination of Agricultural Quotas	All agricultural restrictions (seasonal imports permits, import quotas for fruit, sugar, and etc.) to be brought into conformity with the GATT 1994 and the WTO Agreement on Agriculture.

Table 3b: Brief Description of the Commitments Made by Ecuador

Ecuador's 21 Commitments		Brief Description of the Commitments Made
11.	Elimination of the Price Band System in Agriculture	Elimination of the price band system within a seven-year period in accordance with the table annexed to Ecuador's Protocol of Accession.
12.	Price Setting Policy in the Pharmaceutical Sector.	Not to extend the price setting policy to other sectors of the economy beyond the pharmaceutical sector
13.	Anti-Dumping Measures	Full application of the relevant WTO provision with respect to the anti-dumping regime of Ecuador in cases involving allegations of dumping by imports.
14.	Elimination of Export Subsidies	Elimination of all existing export subsidies no later than November 1995
15.	Legislation Concerning Domestic Free Trade Zones	As of the date of accession to the WTO the imported component of sales from the zones into the rest of Ecuador would be assessed normal taxes, tariffs and other border measures.
16.	Notification about State Owned Enterprises	The nature of operations of the activities of a number of State trading enterprises - Notification and the description
17.	Participation in Preferential Regional Agreements	Compliance with the WTO provisions for notification, consultation, and other requirements concerning preferential trading systems, free trade areas, and customs unions of which Ecuador is a member
18.	Investment Regime	Elimination of the trade related investment measures (TRIMs) inconsistent with the provisions of the WTO Agreement on TRIMs prior to 1 January 2000
19.	Intellectual Property Rights Regime	Full application of the provisions of the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) for Ecuador will be no later than 31 July 1996
20.	Notifications about the Implementation of the WTO Agreements	No later than the earlier of the date of entry into force of the Protocol of Accession or the date specified for the relevant provision, Ecuador shall submit notifications pursuant to the respective WTO Agreements
21.	Annual Notifications with Respect of the Implementation of the Phased Commitments	Commitment to notify the WTO Secretariat annually of the implementation of the phased commitments with definitive dates for compliance

Table 4: Average Tariff Bindings of New WTO Members.



Chapter 5

The Second Pillar of the WTO – Liberalization of Domestic Services Sectors under the Global Framework

Introduction

The steady growth of the world's trade in services has led to international negotiations on designing the first multilateral agreement to cover global trade in services. The General Agreement on Trade in Services (GATS) was one of the key results of the Uruguay Round. The other important outcome of the Uruguay Round was an international agreement with respect to global protection of intellectual property rights, an Agreement on Trade Related Intellectual Property Rights (TRIPS). Both services and intellectual property rights were completely new to the GATT and their inclusion in an increasingly legalistic global trade regime was a radical move. These two issue areas were considered to belong to the domain of domestic policies under the GATT tradition. WTO accession negotiations on services are particularly difficult because they encompass a wide range of activities relating to the domestic investment regime.

There are many problems that arise in accession negotiations on services. In the past, most of the candidates did not have very well developed services sectors. This is not surprising bearing in mind that under central planning even the most common activities such as wholesaling and retailing, or accounting and banking, were part of state monopolies and often had quite different functions. Generally speaking, under

interventionist economic systems resources tended to be allocated to the production of physical goods so when economic transition started, the countries were over-industrialized and their services sectors under-developed. Financial insurance and securities markets were absent all together. Developing the services sector requires an enormous amount of regulatory activity. Most of the acceding countries have only a few laws regulating the services economy. Regrettably, their governments lack the expertise and resources needed to draft the necessary legislation. This means that the services sectors remain unregulated, as they are about to face foreign competition.

WTO Members expect candidate countries, as a necessary prerequisite for WTO membership, to offer economically significant commitments at least for a number of important services sectors. Across services sectors, access to financial services, professional services, audio-visual and health services are of particular interest to WTO Members. Demanding commitments are expected from the newly acceding countries despite the fact the original Members have themselves negotiated only limited liberalization in these sectors.

This chapter explains the main provisions of the GATS agreement and then analyses the outcome of the services liberalization in the four mentioned sectors. The focus is on the first twelve countries that have acceded to the WTO since its establishment in 1995. The commitments made by the acceding countries are far more extensive than those made by other WTO Members at the same stage of economic development. Although the acceding countries are required to liberalize fewer sectors, in reality major WTO Members insist on high levels of commitments from the candidates in specific and politically sensitive sectors. Moreover, the accession negotiations on

services have been conducted under highly intrusive demands to create transparent and open investment rules. Such disproportionate demands have been justified on the grounds that without an appropriate investment climate all GATS commitments are worthless. Future implications arising from the implementation of extensive services-related accession commitments can be quite significant. Through an integrated WTO dispute settlement system, the possibility exists for retaliation in goods if a violation of obligations is perceived to have occurred in the services sector.

A cautionary note must be given at this point. Trade in services includes many diverse activities. Hardly any generalization can be made which can apply to all service industries, and it is precisely because of this diversity that we can only concentrate on a few selective sectors. The sectors that are chosen reflect a wide range of issues brought about by opening services to foreign competition. For example, liberalization of financial services has the potential to consolidate financial sector reform and promote capital mobility. It can also permanently influence domestic monetary policy. Removing barriers to professional services involves making decisions concerning labor regulations and setting a reference for international harmonization of accreditation standards. Opening of the health and hospital sectors to foreign competition provokes ethical questions about the right to universally administered health care. Finally, liberalization of the audio-visual service creates cultural controversy as it ignites national debates about the need to preserve national cultural identity. Therefore, as the WTO accession process unfolds, the negotiations over liberalization of the services sectors often become the most difficult stages of the whole process.

Services Liberalization and the GATS Agreement

Services production is rapidly becoming a core economic activity in virtually all countries, developing and developed alike. In 1995, world trade in services accounted for around one-fifth of all world exports and imports of goods and services.¹ Technological changes have improved supply conditions across a wide range of countries and sectors. New transmission technologies have overturned traditional concepts of distance - banking, education and medical services may now be provided over the Internet - and many governments have sought to open long-entrenched monopolies so as to promote efficiency and mobilize new capital and expertise. These developments have contributed to rapid trade expansion. While trade in merchandise increased at about 6 per cent, services trade expanded at an annual rate of 8 per cent between 1980 and 1995. In 1996, the services share in total value-added ranged from 37 per cent in low-income economies, to 53 per cent in middle-income economies, and up to 70 per cent and above in high-income countries². Services and goods liberalization differ in some key respects. In services, attaining efficiency is not just a matter of liberalizing trade barriers, but also of instituting an appropriate domestic regulatory framework.

World exports of commercial services rose by 1.5 per cent to US\$1359 billion in 1999. As in 1998, this globally modest trade expansion conceals rather large regional variations. Particularly strong export and import growth in services was achieved in

¹ To find out more about the relative importance of different services sectors read: Philip Chang, Guy Karsenty, Aaditya Mattoo and Jurgen Richtering (1999) "GATS, the Modes of Supply and Statistics on Trade in Services," *Journal of World Trade*, Vol. 33, No. 3, pp. 93-115.

² WTO (1997) *Annual Report 1997 - International Trade Statistics*. Published by the WTO, Geneva Switzerland.

North America and the Asian developing countries, while the transition economies, most notably Russia, recorded a sharp contraction in both exports and imports³. In a number of countries, services have been even more important for employment - and employment growth - than the above figures suggest. This is because many traditional services, including distribution, education and social services, are labor intensive. In many services sectors it has also proved more difficult to substitute capital for labor than in manufacturing. Thus, in sharp contrast with trade in goods, services liberalization efforts rely much more on domestic decision-making as opposed to the negotiating process because they are conceived as an effective tool for economic development⁴.

The WTO General Agreement on Trade in Services (GATS) is designed to secure progressively higher levels of liberalization of trade in services through successive rounds of negotiations, which should aim at promoting the interests of all Members of the WTO and at achieving an overall balance of rights and obligations⁵. The GATS is structured in two parts⁶. The first part is the text of the Agreement - its Articles and Annexes. The second part is composed of the schedules of specific commitments undertaken by WTO Members. The schedules are an integral part of the Agreement, as tariff schedules are an integral part of the GATT. While the text of the Agreement applies uniformly to all Members of the WTO, the scheduling of commitments is decided by the Member concerned and subject to negotiation and agreement with other

³ WTO (2000) *International Trade Statistics 2000*, published by the WTO, Geneva: Switzerland.

⁴ Bernard Hoekman and Patrick A. Messerlin (1999) *Liberalizing Trade in Services: Reciprocal Negotiation and Regulatory Reform*, Washington, DC: World Bank and CEPR Working Paper July 5, p. 9.

⁵ Bernard Hoekman (1996) "Assessing the General Agreement on Trade in Services," in *The Uruguay Round and the developing countries*, edited by Will Martin and L. Allan Winters, op. cit., pp. 88-122.

Members. It is a principle of the Agreement that each Member may undertake specific commitments in a manner commensurate with its level of development.

Obligations contained in the GATS may be categorized into two groups: (1) general obligations which apply directly and automatically to all WTO Members, regardless of the existence of sectoral commitments; and (2) specific commitments whose scope is limited to the sectors and activities where a Member has decided to assume market access and national treatment obligations.

Under Article II of the GATS⁷, WTO Members are obliged to extend immediately and unconditionally to services or services suppliers of all other Members "treatment no less favorable than that accorded to like services and services suppliers of any other country". The only possible derogation from the MFN principle exists in the form of a so-called Article II-Exemption. Members were allowed to take such exemptions at the time of acceptance of the GATS. Also, exemptions may be granted either at the time of a country's accession or, for current Members, through negotiating a waiver under Article IX of the Marrakesh Agreement Establishing the WTO. Any such exemption is subject to review and should in principle not last longer than 10 years.

⁶ *The Legal Texts - The Results of the Uruguay Round of Multilateral Trade Negotiations*. The General Agreement on Trade in Services (GATS) is Annex 1B.

⁷ Article II of the GATS: *Most-Favoured-Nation Treatment*:

1. With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country.
2. A Member may maintain a measure inconsistent with paragraph 1 provided that such a measure is listed in, and meets the conditions of, the Annex on Article II Exemptions.
3. The provisions of this Agreement shall not be so construed as to prevent any Member from conferring or according advantages to adjacent countries in order to facilitate exchanges limited to contiguous frontier zones of services that are both locally produced and consumed.

Under the principle of transparency (Article III⁸), WTO Members are also required to publish all measures of general application and establish national enquiry points mandated to respond to other WTO Members' information requests. Other unconditional obligations include the establishment of administrative review and appeals procedures and disciplines on the operation of monopolies and exclusive suppliers.

The granting of market access is a negotiated commitment undertaken by individual WTO Members in specified services sectors. It may be made subject to one or more limitations enumerated in Article XVI(2) of the GATS⁹. For example, limitations may be imposed on the number of services suppliers, service operations or employees in a sector, the value of transactions, the legal form of the service supplier, or the participation of foreign capital. In any sector included in its Schedule of Specific

⁸ Article III of GATS: *Transparency*

- 1 Each Member shall publish promptly and, except in emergency situations, at the latest by the time of their entry into force, all relevant measures of general application which pertain to or affect the operation of this Agreement. International agreements pertaining to or affecting trade in services to which a Member is a signatory shall also be published.

⁹ Article XVI of GATS: *Market Access*

1. With respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule.
2. In sectors where market-access commitments are undertaken, the measures which a Member shall not maintain or adopt either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in its Schedule, are defined as:
- (a) limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;
 - (b) limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test;
 - (c) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test;
 - (d) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test;
 - (e) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and
 - (f) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.

Commitments, a WTO Member is obliged to grant foreign services and service suppliers treatment no less favorable than that extended to its own like services and service suppliers. In this context, the key requirement is to abstain from measures, which are liable to modify, in law or in fact, the conditions of competition in favor of a Member state's own service industry. WTO Members are entitled to make the extension of national treatment in any particular sector subject to conditions and qualifications. However, such treatment does not need to be identical to that applying to domestic firms¹⁰. This means that the foreign firm cannot be treated less favorably than domestic. They can, however, be granted some special status or more favorable conditions than the domestic firms receive.

The scheduling of specific commitments triggers further obligations concerning the objective administration of domestic regulations and the avoidance of restrictions on international payments and transfers. WTO Members are committed to put immediately into effect paragraph 4 of Article VI¹¹ of GATS on domestic regulation to ensure that domestic regulatory requirements are based on objective and transparent criteria and are not more burdensome than necessary to ensure the quality of the service. WTO

¹⁰ Aaditya Mattoo (1997) "National Treatment in the GATS: Corner Stone or Pandora's Box?" *Journal of World Trade*, Vol. 31, No.1, pp. 107-35.

¹¹ Article VI of GATS: *Domestic Regulation*

1. In sectors where specific commitments are undertaken, each Member shall ensure that all measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner.

4. With a view to ensuring that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services, the Council for Trade in Services shall, through appropriate bodies it may establish, develop any necessary disciplines. Such disciplines shall aim to ensure that such requirements are, *inter alia*:

- (a) based on objective and transparent criteria, such as competence and the ability to supply the service;
- (b) not more burdensome than necessary to ensure the quality of the service;
- (c) in the case of licensing procedures, not in themselves a restriction on the supply of the service.

Members must deal with the three elements identified in Article VI.4, i.e. qualification requirements and procedures, technical standards, and licensing requirements and procedures, which all play a critical role in regulating the practice of the profession, for nationals as well as for foreigners, in every country.

The GATS does not define "services" but does define "trade in services". The definition covers not only the cross-border supply of services but also transactions involving the cross-border movement of capital and labor. This is necessary because services must very often be supplied through a commercial presence in the export market or through the presence of an individual service supplier. Paragraph 2 of Article I defines trade in services as the supply of a service through any of four modes of supply: Cross-border supply¹²; Consumption abroad of a service¹³; Supply through commercial presence¹⁴; Supply through the presence of natural persons¹⁵.

The expanded definition of international trade under the GATS, to encompass cross-border movement of factors of production, means that the GATS has an impact on a far wider range of domestic policy and regulation than the GATT. For example, the national treatment obligation in the GATS concerns not only the treatment of the service (the product) but also the treatment of the business or person supplying the service. Therefore, domestic regulations relating to the treatment of foreign investment and

¹² Cross-border supply of a service happens from the territory of one country into the territory of another. For example: mail and telecommunication services.

¹³ This happens when the consumer moves to the territory of another country and buys services there. It may also happen when the property of a consumer is sent abroad for servicing, as in the case of ship repair.

¹⁴ Supply through commercial presence involves direct investment in the export market through the establishment of a business there for the purpose of supplying a service.

foreign personnel in their service-supplying activities are directly relevant to the obligations of Members under the GATS. The GATS is the first multilateral agreement containing obligations on the treatment of foreign investors. It does not cover investment policies *per se* but does so to the extent that they relate to the supply of services.

It is important to note that GATS does not impose the obligation to assume market access or national treatment commitments in a particular sector. In scheduling commitments, WTO Members are free to tailor the extent of the commitments they take so as to avoid or modify obligations that they consider too demanding at present. However, Article XIX¹⁶ stipulates a common obligation of WTO Members to enter into successive rounds of trade negotiations with a view to achieving a progressively higher level of liberalization. The following services sectors have been subject of the most intense discussions during the twelve, so far¹⁷ completed WTO accession negotiations.

Financial Services Sector

State control over financial policy was a hallmark of the political economy of a number of countries throughout much of the twentieth century. Given the fact that the financial system constitutes a basic infrastructure of the economy, and the strong

¹⁵ This means the temporary presence in the export market of an individual for the purpose of supplying a service. This person could be the service supplier himself or an employee of the service supplier. In both cases, the GATS definition covers only the temporary stay of such persons.

¹⁶ *Article XIX of GATS: Negotiation of Specific Commitments*

1. In pursuance of the objectives of this Agreement, Members shall enter into successive rounds of negotiations, beginning not later than five years from the date of entry into force of the WTO Agreement and periodically thereafter, with a view to achieving a progressively higher level of liberalization. Such negotiations shall be directed to the reduction or elimination of the adverse effects on trade in services of measures as a means of providing effective market access. This process shall take place with a view to promoting the interests of all participants on a mutually advantageous basis and to securing an overall balance of rights and obligations.

¹⁷ As of March 2001: Ecuador, Mongolia, Bulgaria, Panama, Kyrgyz Republic, Latvia, Estonia, Jordan, Georgia, Albania, Oman and Croatia.

prudential concerns of countries, the public sector has traditionally played a large role in the financial services sectors of countries. In recent years, however, rapid and significant changes have occurred in the structure of financial services industries around the world. Financial markets have become global and the tradition of territorial money is being seriously contested¹⁸. Furthermore, competition among different types of financial institutions has become intense. In addition, there is a clear trend towards privatization.

In part, the globalization of financial markets can be attributed to a growing volume of international trade and a growing demand for commercial credit in foreign currency. Evidence of the globalization of financial markets can be seen from various data, especially for the OECD countries.¹⁹ Although existing rankings of the world's top banks are still dominated by institutions from the major industrialized countries, the influence of the banks from China, Brazil and Singapore appears to be growing.²⁰

At the end of the Uruguay Round, negotiations on financial services along with those on basic telecommunications and maritime transport, remained unfinished. Specific commitments to provide market access and national treatment were made in the sector, but they were not considered enough to conclude the negotiations²¹. Broad MFN

¹⁸ Benjamin J. Cohen (1998) *The Geography of Money*. Ithaca, NY: Cornell University Press, pp. 147-149.

¹⁹ See, for example, Table IV.23 in the WTO Document (1996) *Trade Policy Review of the United States*; WTO Document (1998) *Trade Policy Review of Japan*, p. 130. The data are showing the growing activities and shares of foreign banks in the U.S. and Japanese markets. The European Commission's market access database (<http://www.mkacadb.eu.int>) also provides information on foreign participation in the financial services markets of selected non-EU countries.

²⁰ See, for example, *The Banker*, July 1998 and *Euromoney*, June 1998. It may be noted that many of the banks from industrialized countries ranking high on the list are those with extensive operations in emerging markets, such as HSBC Holdings, Citicorp and Deutsche Bank.

²¹ See the following WTO documents: (MTN.GNS/W/68) of 4 September 1989 provides an overview of trade in financial services and regulations affecting trade, while (S/FIN/W/9) of 29 July 1996 lists some technical issues concerning financial services schedules.

(most-favored-nation) exemptions based on reciprocity remained²². *The Second Annex on Financial Services to GATS* and the *Decision on Financial Services*²³ adopted at the end of the Round provided for extended negotiations in this sector. The negotiations were to be held during a six-month period following the entry into force of the GATS: i.e. until the end of June 1995.

The 1995 negotiations were actually concluded on 28 July 1995²⁴. The agreement was called the "interim" agreement, since negotiators again decided that the results of the negotiations were not satisfactory and envisaged further negotiations in two-years' time; i.e. in 1997. As a result of the 1995 negotiations, 29 WTO Members (counting the fifteen EU members as one) improved their schedules of specific commitments and/or removed, suspended or reduced the scope of their MFN exemption in financial services²⁵. Those improved commitments were annexed to *the Second Protocol* to the GATS. Three other countries - Colombia, Mauritius and the United States - decided not to improve their commitments, but they used the July 1995 deadline to take broad MFN exemptions based on reciprocity. The most serious limitation in this group is the MFN exemption by the United States. All new market access for foreign investors was subject

²² In a bilateral trade agreement, the parties make reciprocal concessions to put their trade relationships on a basis deemed equitable by each. The concessions may, however, be in different areas. In the Anglo-French Agreement of 1860, for example, France pledged itself to reduce its duties to 20 percent by 1864. In return, Britain granted duty-free imports of all French products except wines and spirits. The principle of reciprocity implies only that the gains arising out of foreign trade are distributed fairly among the interested actors. Reciprocity implies a preferential agreement. Thus it contradicts the very principle of non-discrimination (MFN) the WTO system is based on.

²³ *The Legal Texts - The Results of the Uruguay Round of Multilateral Trade Negotiations- General Agreement on Trade in Services (GATS)*, op. cit.

²⁴ Instead of 30 June 1995 as initially planned.

²⁵ The WTO Members concerned are: Australia; Brazil; Canada; Chile; Czech Republic; the Dominican Republic; Egypt; the European Communities (15 Member States); Hong Kong, China; Hungary; India; Indonesia; Japan; Korea; Kuwait; Malaysia; Mexico; Morocco; Norway; Pakistan; Philippines; Poland; Singapore; Slovak Republic; South Africa; Switzerland; Thailand; Turkey and Venezuela.

to reciprocity via bilateral agreements²⁶. Similarly Canada, EU and Switzerland maintain different MFN exemptions with respect to opening their financial sectors²⁷. This cautious liberalization by major developed nations in the financial sector reflects an attempt to limit potential risks from the introduction of unsound foreign financial institutions into one's own market.

As a result of the extended negotiations, and with new accessions, 83 Members of the WTO had commitments in financial services by early 1997 in the area of financial services. *The Second Protocol*²⁸ and the commitments annexed to it entered into force on 1 September 1996. The negotiations were reopened in April 1997. Members again had an opportunity to improve, modify or withdraw their commitments in financial services and to take MFN exemptions in the sector from 1 November until 12 December 1997.²⁹ As a result of the negotiations, a new and improved set of commitments in financial services under the GATS was agreed on 12 December 1997. A total of 56 schedules of commitments representing 70 WTO Member governments³⁰ and 16 lists of MFN exemptions (or amendments thereof)³¹ were annexed to *the Fifth Protocol to the GATS*³².

²⁶ It was apparently done to encourage market openings in emerging markets. However, few of the emerging market economies are likely to become competitive in financial services to the point of meeting the high entry standards to establish themselves in the United States.

²⁷ Piritta Sorsa (1997) "The GATS Agreement on Financial Services - a Modest Start to Multilateral Liberalization," *IMF Working Paper (WP/97/55)*, Washington, DC: IMF.

²⁸ WTO Document (1996) *Second Protocol to the General Agreement on Trade in Services (Financial Services) - Done at Geneva on 6 October 1995*. (WT/Let/93), 21 June.

²⁹ Korea has submitted on 20 January 1999 an improved schedule of commitments. This schedule will enter into force on completion of a certification procedure.

³⁰ The WTO Members concerned are: Australia; Bahrain; Bolivia; Brazil; Bulgaria; Canada; Chile; Colombia; Costa Rica; Cyprus; Czech Republic; the Dominican Republic; Ecuador; Egypt; El Salvador; the European Communities (15 Member States); Ghana; Honduras; Hong Kong, China; Hungary; Iceland; India; Indonesia; Israel; Jamaica; Japan; Kenya; Korea; Kuwait; Macau; Malaysia; Malta; Mauritius; Mexico; New Zealand; Nicaragua; Nigeria; Norway; Pakistan; Peru; Philippines; Poland; Romania; Senegal; Singapore; Slovak Republic; Slovenia; South Africa; Sri Lanka; Switzerland; Thailand; Tunisia; Turkey; the United States; Uruguay and Venezuela.

³¹ Submitted by Australia, Canada, Honduras, Hungary, India, Mauritius, Nicaragua, Pakistan, Peru, Philippines, Senegal, Switzerland, Thailand, Turkey, the United States and Venezuela.

With five countries making commitments in financial services for the first time, the total number of WTO Members with commitments in financial services increased to 104³³ upon the entry into force of *the Fifth Protocol*³⁴. As a result of the negotiations, several countries, including the United States, India, Thailand, Hungary, Mauritius, the Philippines and Venezuela, reduced the scope of their MFN exemptions. However, the United States submitted a limited new MFN exemption in the insurance sector. The *Fifth Protocol to the GATS Agreement* set standards with respect to a level of liberalization of the financial sector around the world. The countries that acceded to the WTO later were expected to follow this path of financial liberalization.

Financial services include two broad categories of services: insurance (and insurance-related) services and banking services. These two categories are further broken down into the following³⁵: (1) Insurance and insurance-related services; and (2) Banking and other financial services. Insurance and insurance-related services cover life and non-life insurance, reinsurance, insurance intermediation such as brokerage and agency services, and services auxiliary to insurance such as consultancy and actuarial services.

Banking includes all the traditional services provided by banks such as acceptance of deposits, lending of all types, and payment and money transmission

³² It was open for ratification and acceptance by Members until 29 January 1999.

³³ Including the Kyrgyz Republic and Latvia, both new Members of the WTO.

³⁴ WTO Document (1998) *Fifth Protocol to the General Agreement on Trade in Services (Financial Services) - Done at Geneva on 27 February 1998*, (WT/Let/221), 21 May and (WT/Let/223), 27 May.

³⁵ GATT Document (1991) *The Services Sectoral Classification List* (MTN.GNS/W/120), 10 July.

services³⁶. Other financial services include trading in foreign exchange, derivatives and all kinds of securities, securities underwriting, money broking, asset management, settlement and clearing services, provision and transfer of financial information, and advisory and other auxiliary financial services.

The peculiar nature of services required that negotiators and crafters of the GATS agreement had to break a lot of new ground. Multilateral liberalization of financial services was an innovation of the WTO³⁷. To be meaningful, the scope of the agreement was extended beyond border trade (external liberalization) to investment (internal liberalization), and the GATS became the first multilateral framework to cover elements of investment rules. Most importantly, the GATS agreement contains the first multilateral rules on capital transfers. The consequences of these provisions gain particular significance in the context of WTO accessions. By making specific access commitments under GATS, candidates for accession, and Members by definition, make express commitments regarding the movement of capital.

Article XVI of the GATS (Paragraph 1, footnote 8) states³⁸:

If a Member undertakes a market-access commitment in relation to the supply of a service through the mode of supply referred to in subparagraph 2(a) of Article I and if the cross-border movement of capital is an essential part of the service itself, that Member is thereby committed to allow such movement of capital. If a Member undertakes a market-access commitment in relation to the supply of a service through the mode of supply referred to in subparagraph 2(c) of Article I, it is thereby committed to allow related transfers of capital into its territory.

³⁶ WTO Document (1998) *Economic Effects of Services Liberalization (S/C/W/26/Add.1)*, 29 May, reviews a large number of empirical studies on the economic effects of services liberalization, especially in the banking sector.

³⁷ Although experiments with similar schemes were already introduced in regional trade arrangements: the EU single market and NAFTA.

³⁸ *The Legal Texts - The Results of the Uruguay Round of Multilateral Trade Negotiations. - Annex 1B* - The General Agreement on Trade in Services (GATS)- Article XVI, Paragraph 1, footnote 8, op. cit.

The practical implications of this footnote are far reaching. Since the provision has not been subject to interpretation by a panel, there is no jurisprudence to act as a guide. From a legal point of view, there are no clearly defined limits with respect to interpretations of the footnote 8. It is useful to remember that overall the WTO accession process lacks a clear legal and procedural framework. The accession negotiations are conducted according to the rules dictated by the powerful WTO Members. As a result, those Members have traditionally used their unchecked bargaining power to interpret the above obligation in very broad terms. It is precisely because of such small-print provisions that the acceding countries have been facing excessive demands for internal reforms to establish a FDI friendly environment³⁹.

Paradoxically, the vague language of the footnote 8 to Article XVI has been interpreted as not implying any general obligations at all on the very same WTO Members that use it to extract excessive commitments from the acceding countries. In fact, this provision has served to limit the meaning of the EU commitments, especially in financial services⁴⁰.

In this context, it is important to note that, in principle, commitments under GATS need not compromise the ability of governments to pursue sound regulatory and macroeconomic policies and leave them considerable freedom to achieve other domestic policy objectives. The liberalization commitments of the original WTO Members in the

³⁹ David M. Blumental (1999) "Applying GATT to Marketizing Economies: The Dilemma of WTO Accession and Reform of China's State-Owned Enterprises (SOEs)" *Journal of International Economic Law*, No. 1, pp. 126-127. Roman Grynberg and Roy Mickey Joy (2000) "The Accession of Vanuatu to the WTO – Lessons for the Multilateral Trading System" *Journal of World Trade*, Vol. 34, No. 6, pp. 164-165.

⁴⁰ EC Document (1995) *GATS - A Guide for Business*, European Commission: Luxemburg. While payments on current account transactions related to supplied/received services are free of restrictions in the EU, those related to capital account transfers are very restricted.

financial sector well illustrate this point⁴¹. First consider prudential regulation. In financial services, specific commitments are made in accordance with the Annex on Financial Services⁴², which complements the basic rules and definitions of the GATS, taking into account the specific characteristics of financial services. Of particular significance is Paragraph 2(a), which states:

Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system.

The same paragraph goes on to say that where prudential measures do not comply with other provisions of the GATS, they must not be used as a means of avoiding commitments or negotiated down. Nevertheless, regulators would seem to have considerable discretion in their choice of prudential measures – especially since no definition or indicative list of such measures is provided in the Annex on Financial Services. Such measures presumably include capital adequacy requirements, restrictions on credit concentration or portfolio allocation, and disclosure and reporting requirements, as well as licensing criteria imposed on financial institutions, which are not more burdensome than necessary to ensure the solvency and the healthy operation of those institutions.

In general, WTO Members retain considerable freedom to pursue their own national macroeconomic policy. When a central bank conducts open market operations, for example, conditions in the financial sector could be affected through the impact of

⁴¹ Kono, M., P. Low, M. Luanga, A. Mattoo, M. Oshikawa and L. Schuknecht (1997) *Opening Markets in Financial Services and the Role of the GATS*. Published by the WTO, Geneva: Switzerland.

such interventions on the money supply, interest rates or exchange rates. It is notable that services supplied in the exercise of governmental authority, including activities conducted by a central bank or monetary authority or by any other public entity in pursuit of monetary or exchange rate policies are excluded from the scope of the GATS⁴³. In practice, however, the operations of the government are severely constrained by the performance of the private financial institutions also operating on the domestic front. Overall, under a free market economy it is virtually impossible to conduct two separate sets of monetary policies with respect to governmental activities and with respect to the private sector. Thus, although governments remain autonomous under GATS, the progressive liberalization of the world's financial markets forces them to coordinate their monetary policies with those markets.

Finally, there are other domestic regulations that governments can maintain, for example, a requirement to lend to certain sectors or individuals, or lending mandated on the basis of preferential interest rates. Even though such measures may not be the most efficient means of achieving particular objectives, these policies are not necessarily subject to commitments made under the GATS. If they are neither discriminatory nor

⁴² *The Legal Texts – The Results of the Uruguay Round of Multilateral Trade Negotiations*- The General Agreement on Trade in Services (GATS) – Annex on Financial Services. op. cit.

⁴³ Under Article I:3 of the GATS and the Annex on Financial Services. 3.

Article I:3: For the purposes of this Agreement:

- (a) "measures by Members" means measures taken by:
 - (i) central, regional or local governments and authorities; and
 - (ii) non-governmental bodies in the exercise of powers delegated by central, regional or local governments or authorities;

In fulfilling its obligations and commitments under the Agreement, each Member shall take such reasonable measures as may be available to it to ensure their observance by regional and local governments and authorities and non-governmental bodies within its territory:

- (b) "services" includes any service in any sector except services supplied in the exercise of governmental authority:

- (c) "a service supplied in the exercise of governmental authority" means any service which is supplied neither on a commercial basis, nor in competition with one or more service suppliers.

intended to restrict the access of suppliers to a market, then such domestic regulatory measures would be permitted provided they met certain basic criteria, such as impartiality and objectivity

The necessity test — especially the requirement that regulatory measures be no more trade restrictive than necessary — is the means by which an effort is made to balance between two potentially conflicting priorities: promoting trade expansion versus protecting the regulatory rights of governments⁴⁴. GATS Article VI:4 specifies that Members shall develop any necessary disciplines to ensure that “measures relating to qualification requirements and procedures, technical standards and licensing procedures do not constitute unnecessary barriers to trade in services⁴⁵.” *The necessity test* is thus the principle that measures affecting trade should not be more restrictive than is necessary to achieve the objective they seek. That is, if two or more measures exist which can achieve the same objective, the one with the least restrictive impact on trade should be chosen. Some critics observe, however, that as a consequence of applying *the necessity test* the governments have to compromise the objective they are pursuing⁴⁶.

In the final analysis, it appears that the issue has a different meaning for prosperous and administratively stable industrialized economies that are characterized by experienced bureaucracies. For developing countries that lack the most basic administrative laws, liberalization of financial services can mean opening their borders to unregulated foreign investment. It has been documented, however, that foreign

⁴⁴ WTO Document (1999) *Application of the necessity test: issues for consideration*. (Informal Note by the Secretariat - Job No.5929) 8 October.

⁴⁵ Sub-paragraph (b) of Article VI:4 (GATS) further specifies that such disciplines shall aim to ensure that regulatory measures are “not more burdensome than necessary to ensure the quality of the service”.

investors prefer dealing with a stable and predictable set of demanding rules than to dealing with a lax and uncertain system⁴⁷. Thus, the developing countries that are not able to design an effective commercial regulatory framework but still chose to liberalize their services – especially their financial services – often end up attracting only short-term speculative foreign capital and questionable foreign direct investment.

This underlines the fact that both foreign direct investment flows, and trade (goods, services and capital) flows are influenced by all those factors that determine being able to profit from efficient operations in a predictable, transparent administrative and legal regime. That is, it is essential for the future development of reforming countries to ensure that effective regulatory frameworks are established in those countries. The WTO accession process is supposed to help establish precisely such a framework. As a rule the acceding countries have few commercial regulations in place. As the accession process unfolds they must produce a legislative action plan to ensure the implementation of WTO obligations.

Unfortunately, WTO Members focus specifically on those new laws and regulations that ensure the enforcement of the WTO agreements. Other regulations that are meant to protect the autonomy of the state with respect to independent policy-making are only looked at to determine whether they do not constitute unnecessary barriers to trade. As a result, governments of acceding countries proceed with opening their services sectors despite the fact that there are no sufficient regulations guarding

⁴⁶ *The Observer* (2001) "The WTO Agreement on Services," by Gregory Palast, April 15.

⁴⁷ Ha-joon Chang (1998) "Globalization, transnational corporations, and economic development: can the developing countries pursue strategic industrial policy in a globalizing world economy?" In *Globalization and Progressive Economic Policy* Dean Baker, Gerald Epstein and Robert Pollin (eds.) Cambridge: Cambridge University Press, 1998, pp. 97-113.

those sectors. Once, however, a particular sector is being liberalized in such an unregulated way, the newly acceded government becomes bound by its commitment not to introduce any new discriminatory regulations that can adversely affect foreign direct investment and the foreign capital transfers with respect to the sector. The first twelve countries that have acceded to the WTO made substantial liberalization commitments in the financial sector despite having only a limited number of laws regulating the sector⁴⁸.

The relationship of accession liberalization commitments under GATS to domestic decisions about opening of financial services to foreign competition is complex. GATS commitments can be an important complement to domestic financial liberalization by consolidating policy reform in a binding multilateral framework. GATS commitments can also advance financial sector reform in the acceding countries. However, the uneven and power-based nature of accession negotiations may ignore some socio-economic aspects of financial sector reform. The hasty and excessive opening of under-developed banking sectors to foreign competition can lead to costly systemic failures or hamper macroeconomic management. Under the pressure of the WTO accession negotiations, an attempt by the government to quickly liberalize financial services can lead to financial instability. This instability can be exacerbated by violent movements of speculative capital in and out of the local economy via a liberalized capital account as required by GATS.

⁴⁸ See Table 7 at the end of this chapter.

Audio-visual services sector

Global trade liberalization, and its impact on the way in which cultural services are distributed using the new media technologies, have caused many countries to express their fears about losing national identity and cultural values⁴⁹. Some countries concerned about the socio-cultural impact of global market integration want to limit the liberalization of certain services sectors related to the issue of cultural identity. Traditionally, governments around the world have attempted to protect their national cultures through a range of policies that apply to different sorts of artistic and linguistic products and services. In the WTO jargon the restrictive cultural policies of national governments usually correspond to protection and subsidization of the audio-visual services sector, which is regarded as having great social and political importance. For these reasons, government regulations and public support programs play a major role.

There is no specific sector under GATS identified as a cultural sector⁵⁰. In practice, however, the audio-visual services category has been used to negotiate liberalization of services that are connected with various aspects of cultural policy. During the WTO accession negotiations, the cultural issues constitute a very sensitive issue area. As was the case in the financial sector, before their WTO application the majority of the acceding countries had only a few rules regulating access to their cultural industries. Furthermore, and in contrast to the developed world where such policy had been established for decades, the acceding countries did not have any competition policy. Such policy could promote maintenance of indigenous culture through, for

⁴⁹ The United Nations World Commission on Culture and Development has attempted to define culture in the context of economic development in its 1995 report: UNESCO Document (1995) *Our Creative Diversity: Report of the World Commission on Culture and Development*, Paris: UNESCO.

example, barriers to ownership of publishing enterprises and mass media by foreigners. Competition policy was not relevant under a centrally run economy. Prior to their accession negotiations, all twelve of the newest WTO Members had their cultural industries supervised and organized by the state. The accession demands would appear then particularly intrusive for governments used to exercising absolute control over the decisions of who, and when, and where was allowed to publish their artistic creations.

Audio-visual services constitute one of the identified sectors that are subject to negotiations under the WTO Agreement on Trade in Services. The regulations on audiovisual services concern not only social and cultural issues, but also the promotion of domestic industry and foreign content restrictions. The OECD report on audio-visual services suggests that in order to accommodate rapid technological change and the new multimedia services, governments need to modify their regulatory structures. The social and economic issues at stake, however, are both important and complex.⁵¹ The gravity of the issues was clear during the Uruguay Round. A Working Group on Audiovisual Services held a number of meetings during the Round, and at its request the Secretariat produced a note on "Matters Relating to Trade in Audiovisual Services" which examined the drafting history of GATT Article IV and the applicability to this sector of concepts and principles such as market access, national treatment and the content of relevant international agreements⁵².

⁵⁰ WTO Document (1991) *The Services Sectoral Classification List* (MTN.GNS/W/120) July 10.

⁵¹ See the following documentation: OECD Document (1998) *Content as a New Growth Industry*, (DSTI/ICCP/IE(96)6/FINAL) May 22, OECD: Paris. Also, OECD Document (1997), *Policy and Regulatory Issues for Network-Based Content Services*, (DSTI/ICCP/IE(96)9/REV1) August 4, OECD: Paris; EC Document (1997) *Panorama of EU Industry 1997*, European Commission; EC Document (1997) *Statistical Yearbook 1997*, European Audiovisual Observatory: Strasbourg.

⁵² This paper was circulated on 4 October 1990 as GATT Document (1990) *Matters Relating to Trade in Audiovisual Services* (MTN.GNS/AUD/W/1).

As defined in the Services Sectoral Classification List⁵³, Audiovisual services are a sub-sector of "Communication Services". The six sub-categories listed are as follows: a. Motion picture and video tape production and distribution services; b. Motion picture projection service; c. Radio and television services; d. Radio and television transmission services; e. Sound recording; and f. Other⁵⁴. Especially for the sub-category of Radio and television transmission services, it sometimes becomes difficult to determine exactly the boundary between services classified under telecommunications and those classified under audiovisual services. As a general rule of thumb, however, it has become accepted that commitments involving programming content are classified under audiovisual services, while those purely involving the transmission of information are classified under telecommunications⁵⁵.

There is only limited statistical information available about the audiovisual sector, even from OECD countries.⁵⁶ According to the European Commission, the audiovisual industry in the EU employs an estimated 1.8 million people, and may reach 4 million by 2005, an indicator of the high growth potential resulting from rapid technological change. Total employment in the U.S. motion picture and videotape industries for 1995 was listed at about 590,000. In Japan, broadcasting, motion picture and video production as of 1994 were listed as employing about 111,000 persons, with annual sales of nearly ¥4 trillion.⁵⁷

⁵³ WTO Document (1991) *The Services Sectoral Classification List* (MTN.GNS/W/120) July 10.

⁵⁴ No categories are specified here. This sub-category could cover, for example, the contents of multimedia products.

⁵⁵ Interview with a WTO official, Geneva, 2000.

⁵⁶ OECD (1997) *Services: Statistics on Value Added and Employment*, Paris: OECD

⁵⁷ Internet site of the Japan Information Network (<http://jin.jcic.or.jp/stat/data/07IND86.html>)

More information is available concerning the output of audiovisual products, at least in regard to selected countries and markets, as well as in regard to related infrastructure such as the number of movie screens. Information from the United Nations indicates that China has by far the greatest number of cinemas, at nearly 140,000, followed by the United States (nearly 25,000) and India (about 13,500). In regard to the diffusion of television and radio receivers, the United States has by far the greatest number, at 210 million and 547 million, respectively. Following in regard to television are Japan at 77 million and the Russian Federation at 55 million; for radio receivers, China is second at nearly 220 million and Japan is third at 113 million.⁵⁸

The evidence of international tension in the audio-visual sector can be traced back to the interwar years, that is, to the early film production. During that era an American motion picture industry pressured the State Department to address the protective European screen quotas⁵⁹. The subsequent international conflicts over trade and culture arrived with the growth and spread of television broadcasting in the 1960s. The disagreements between the US and Europe led to the establishment of a Working Party to investigate various international restrictions imposed on the broadcasting of television programs. Its report was published in 1962⁶⁰. During the Tokyo Round of Multilateral Negotiations (1973-1979) the US officially complained about the subsidization of the movie industry and television in a number of countries⁶¹.

⁵⁸ UN Document (1999) *United Nations - Statistical Yearbook*, Forty-First Issue, New York: UN.

⁵⁹ Mary E. Footer and Christoph Beat Graber (2000) "Trade Liberalization and Cultural Policy," *Journal of International Economic Law*, Vol. 3, No.1, p. 117. An eventual solution to this dilemma was the inclusion of Article IV of the GATT 1947, which specifically authorized screen quotas.

⁶⁰ GATT Document (1962) *Application of GATT to International Trade in Television Programs*.

⁶¹ GATT Document (MTN/3B1) cited in Mary E. Footer and Christoph Beat Graber (2000) "Trade Liberalization and Cultural Policy," *op. cit.*, p. 118.

Presently, in many countries, audiovisual media have been regulated far more heavily than text media. Most countries promote domestic audiovisual content production through a variety of policy measures and institutions. But the most comprehensive policy frameworks are usually contained in legislation concerning broadcasting markets, content ownership and programming.⁶² The "Television without Frontiers" Directive of the EC, for example, adopted in 1989 and amended in 1997, establishes basic rules for advertising, protection of minors, broadcasting of major sporting and other events, protecting the right of reply and the promotion of European works. In India the cinema industry benefits from the freedom of expression provisions of the Indian Constitution. This right, however, is subject to "reasonable restrictions" imposed (under Article 19(2) of the Constitution) in the interest of the sovereignty and integrity of the State⁶³, friendly relations with foreign states, public order, decency or morality or in relation to contempt of court, defamation or incitement to an offence. Similar concerns underlie the regulation of the industry in many other countries.

The social concerns underlay the discussion of audiovisual services in the Uruguay Round, in which there was a heavy focus on the cultural specificity of the film and television industries, in particular. In 1991 the US challenged the European Community restrictions on the televised showing of non-European films by invoking Article IV of the GATT 1947 specifying the quota restrictions. This is when the Europeans contested the challenge by arguing, for the first time, that television broadcasting was a service and thus it was not covered under the goods regime of the

⁶² OECD Document (1997) *Policy and Regulatory Issues for Network-Based Content Services*, (DSTI/ICCP/IE(96)9/REV1), 4 August, p. 5.

GATT. At issue was the question of national identity, and to what extent “the term ‘culture’ became synonymous with the word ‘audiovisual’.”⁶⁴ The European Communities and its allies⁶⁵ pushed for maintaining the subsidies in the audiovisual sector in the name of cultural identity. The US opposed this position on the grounds that it was a protectionist measure in disguise.

The conflict continued to plague the Uruguay Round negotiations, increasingly involving other countries, most notably Canada⁶⁶. The Canadian delegation tried to secure an exemption in the draft negotiating text on services. In fact, the cultural community in Europe, encouraged by Canada’s earlier success in achieving a cultural *carve-out* in article 2005 of the 1988 Canada-US Free Trade Agreement, mobilized many artists, intellectuals, and cultural activists to persuade the Uruguay Round negotiators to fight for a permanent exclusion of the audiovisual sector from trade disciplines⁶⁷.

Despite the continuing disagreements, the audiovisual sector was included in the GATS schedules, although WTO Members were allowed to put severe limitations on its liberalization by refraining from making commitments in this sector. There was no specific recognition of these concerns in the text of the Agreement, but at the end of the Round only 13 countries made commitments in this sector and an additional 5 countries

⁶³ As explained on internet site of the Indian National Film Development Corporation, Ltd. (<http://www.nfcdindia.com/censor.htm>).

⁶⁴ Mary E. Footer and Christoph Beat Graber (2000) “Trade Liberalization and Cultural Policy,” *op. cit.*, p. 119.

⁶⁵ Mainly: Canada, Australia, India, Egypt and Brazil.

⁶⁶ John Croome (1995) *Reshaping the World Trading System – A history of the Uruguay Round*, *op. cit.*, pp. 248-251 and 355-357.

⁶⁷ Karl F. Falkenberg (1995) “The Audiovisual Sector” in Jacques H.J. Bourgeois, and al. (eds.) *The Uruguay Round Results*, Brussels: Harman, pp. 429-434.

made commitments soon after. However, as a result of WTO accessions, the number of countries making commitments in the audiovisual sector has since risen to 23.

Table 5 lists shows the degree of liberalization in different sub-categories of the sector by the 23 WTO Members that have opened their audio-visual services to foreign competition⁶⁸. It reveals that of the 23 countries that have made commitments in the audio-visual-sector only two – the United States and the Central African Republic- made unrestricted commitments (full liberalization) in all six-sub-categories of audiovisual services relating to market access and national treatment. New Zealand, Georgia and Kyrgyz Republic, have made commitments in five sub-categories; Panama, Lesotho and Gambia in four; and Hong Kong, Japan and Jordan in three. Oman has made commitments in two sub-categories. This implies that most countries feel the necessity to refrain from GATS obligations in the audio-visual sector in order to be able to continue to pursue their own independent cultural policies. Table 5 also reveals the apparent pressure the acceding countries are facing. Almost half of them made very substantial commitments in this sector.

Table 5: Six sub-categories:⁶⁹

1. Motion Picture and Video Tape Production and Distribution;
2. Motion Picture Projection Service (Cinema operation)
3. Radio and Television Service.
4. Radio and Television Transmission Services⁷⁰.
5. Sound Recording
6. Other

⁶⁸ As of April 2001.

⁶⁹ WTO Document (1991) *The Services Sectoral Classification List* (MTN.GNS/W/120) July 10.

⁷⁰ For the sub-category of Radio and Television transmission services, it sometimes becomes difficult to determine exactly the boundary between services classified under telecommunications and those classified under audiovisual services. As a general rule of thumb, however, it has become accepted that commitments involving programming content are classified under audiovisual services, while those purely involving the transmission of information are classified under telecommunications.

Table 5: Summary of Specific Commitments – Audio-Visual Services

Countries	1	2	3	4	5	6
Centr. Af. Rep.	X	X	X	X	X	X
Dominican Rep				X		X
El Salvador				X		X
Gambia	X	X	X	X		
Georgia *	X	X	X	X	X	
Hong Kong	X				X	X
India	X					
Israel	X					
Japan	X	X			X	
Jordan *	X	X	X			
Kenya	X	X				
Kyrgyz Rep *	X	X	X	X	X	
Korea RP	X				X	
Lesotho	X	X	X	X		
Malaysia	X			X		
Mexico	X	X				
New Zealand	X	X	X	X		X
Nicaragua	X	X				
Oman *	X	X				
Panama *	X	X	X		X	
Singapore	X				X	
Thailand	X		X			
USA	X	X	X	X	X	X

Out of the twelve countries that acceded to the WTO under Article XII, the following seven did not make any commitments in the audiovisual sector: Ecuador, Mongolia, Bulgaria, Latvia, Estonia, Croatia and Albania⁷¹. However, in the case of five of them (Bulgaria, Latvia, Estonia, Croatia, Albania) the negotiations over the opening to foreign competition of the audio-visual sector created havoc and stalled the whole process for months. In fact, the liberalization of the audio-visual sector eventually remained the last unresolved issue of the accession negotiations. The problem was that all five had preferential agreements with the European Communities preventing them from opening the sector to international competition on a MFN basis. Despite the pressure put on those five countries by other WTO Members, they had little room to maneuver since they remained bound by the provisions of the preferential agreements in place. After months of intense discussions, they were eventually given a green light to maintain those preferential obligations as a rarely allowed MFN-exemption.⁷² Hence, they acceded to the WTO without making any multilateral commitments in the audio-visual sector.

However, most of the newly acceded Members do not have any competition policy or other legislation banning or sanctioning collusive or restrictive business

⁷¹ This analysis and Table I rely upon the following documentation: OECD Document (1998) *Content as a New Growth Industry* (DSTI/ICCP/IE(96)6/FINAL) May 22; OECD Document (1997) *Policy and Regulatory Issues for Network-Based Content Services*, DSTI/ICCP/IE(96)9/REV1 (and CORR1), August 04 (and October 14); WTO Document (1998) *Background Note by the Secretariat* (S/C/W/40) June 15; EC Document (1997) *Panorama of EU Industry 1997* European Commission; EC Document (1997) *European Audiovisual Observatory- Statistical Yearbook 1997*, Strasbourg; And The Europa Server (<http://europa.eu.int>). Also, the following WTO Documents: *Schedules of Specific Commitments on Services: Ecuador*, 14 July 1995 (WT/L/77); *Mongolia*, 27 June 1996 (WT/ACC/MNG/9); *Bulgaria*, 20 September 1996 (WT/ACC/BGR/5); *Panama*, 2 October 1996 (WT/ACC/PAN/19); *The Kyrgyz Republic*, 31 July 1998 (WT/ACC/KGZ/26); *Latvia*, 30 September 1998 (WT/ACC/LVA/32); *Estonia*, 9 April 1999 (WT/ACC/EST/28); *Jordan*, November 1999 (WT/ACC/JOR/33); *Georgia*, October 1999 (WT/ACC/GEO/31); *Croatia*, 29 June 2000 (WT/ACC/HRV/59); *Albania*, 13 July 2000 (WT/ACC/ALB/51); *Oman*, September 2000 (WT/ACC/OMN/26).

practices, such as price cartels, price maintenance, or private monopolies that are not subject to restrictions or controls. In a way then, it does not matter whether they liberalized their audio-visual services on the preferential basis with the EU or whether they made multilateral commitments under GATS. Both types of liberalization can put the acceding countries at a disadvantage. Having a very limited administrative structure capable of advancing independent cultural policy, the newest WTO Members were only given a very limited choice during the accession negotiations. They were forced to choose between giving preference to the EU or to the US. In practical terms, the outcome of the WTO accession still translates to unregulated liberalization of their audio-visual sector. And such unregulated liberalization can lead to rapid monopolization of the new Members' cultural industries by the more attractive and well-funded foreign productions.

The Professional Services - Legal

The practice of law has been experiencing extraordinary changes as a result of global market integration and the growing legalization of world politics. Increasingly, lawyers are required to provide services and advice in more than one jurisdiction. The demand for lawyers to be involved in foreign jurisdictions often comes from their corporate clients, who do business across borders and choose to rely on the services of professionals who are already familiar with the firm's business. Progressive codification of international economic law has also created the demand for lawyers as trade policy

⁷² Interview with a WTO official, Geneva 1999.

consultants. Increasingly lawyers complement economists in assisting the transition economies with their reform processes.

These developments have had a lasting impact on the structure of the legal profession and the ways in which lawyers approach their practices. Already the legal services sector is a very profitable part of global services economy. Within the next few years, the practice of law can change even more because of new information and communications technologies, which will enable anyone to market and sell legal services essentially without paying attention to state borders. However, lawyers who take advantage of this new global market for legal services mostly reside in the developed economies.

As we are witnessing astonishing legalization of world politics, it is difficult not to notice that this tendency has a strong Western element. The doctrine of international law was first conceived in Europe (in the 17th century), by writers such as Grotius and Pufendorf. This tradition was further enriched by the principle of state sovereignty first articulated by Hobbes.⁷³ The present international legal rules are very much rooted in this long established tradition. The two main overarching influences are the continental practice of civil law and the British/American tradition of common law. The increased demand for trade lawyers who are trained in one of these traditions comes from a need for legal advices about the proper interpretation of WTO agreements. The Western lawyers have definitely become the custodians of international legal rules. However, when developing countries around the world open their legal services to foreign

⁷³ Ernst-Ulrich Petersmann (1998) "From the Hobbesian International Law of Coexistence to Modern Integration law: The WTO Dispute Settlement System." *Journal of International Economic Law*, Vol. 1, No.2, pp. 175-198.

competition, there is no basis for reciprocity arrangements. The local lawyers simply cannot compete with their counterparts from the industrial nations. In reality then, liberalization of this services sector under GATS corresponds to a one-way movement of lawyers from industrial countries to the developing world.

Ironically, the need for such services is particularly immense in developing countries and in the candidates for WTO membership. In truth, the acceding countries liberalize this sector almost immediately after sending their application for WTO accession⁷⁴. Invitation of foreign lawyers is not only a matter of learning to interpret the newly established rules of the WTO, it is also a matter of acceding countries desperately needing the expertise of Western lawyers to draft relevant laws and regulations necessary to establish the essential regulatory framework of the state.

In contrast to other sectors, WTO Members have no problem with persuading the acceding countries to fully liberalize their legal services sector. We are dealing here with different kinds of problematic issues. By opening their borders to foreign lawyers, the acceding countries surrender themselves into the hands of foreign experts. These experts eventually create the most fundamental domestic laws without knowing the specific characteristics of the local economy and domestic politics. Foreign lawyers may draft essential regulations in the acceding countries, although their legitimacy solely rests upon their proficiency in understanding and interpreting the legal texts of the WTO agreements.

The new technological innovations, cheaply available in the developed countries, are helping the legal experts to spread their influence globally. We have already entered

⁷⁴ Interview with a WTO official, Geneva 2000.

a stage where legal advice is given via new media and in digital format. This tendency will eventually breed a new class of legal service suppliers who will fashion new kinds of legal services. Consider the potential for interactive multimedia legal documents delivered over the Internet as an innovative new legal information service⁷⁵. A legal document could be considered a kind of software, particularly when it is in electronic form and incorporates multimedia properties. Currently existing computer programs can take variety of actions such as sending a notice to the client, directing the client to file a document with a court, or publishing a notice annotated with voice, video, and graphics, so that they teach the reader as well as accomplish a legal result. Already, the aggressively entrepreneurial law firms in the industrialized countries are marketing and selling their advisory services across international borders⁷⁶. It is important to remember that similar innovations are not easily accessible for the local lawyers and other professionals in developing countries, who simply find them too expensive to purchase.

Despite the emergence of new technologies that increasingly allow legal advice to be sent around the world in a matter of seconds, domestic regulations continue to play an important role in increasing or limiting the ability of foreign law firms to provide their services in the developed countries. The OECD countries have developed complex administrative schemes to ensure that their own standards are maintained. Many of these relate to qualification requirements and accreditation recognition procedures. Such regulations, however, are virtually absent in developing countries. The only regulations

⁷⁵ Richard Susskind (1996) *The Future of Law: Facing the Challenges of Information Technology* Oxford: Oxford Press, pp. 288-290.

⁷⁶ See for example, Ladas&Parry Law Firm at www.ladas.com

in place are those that supervise the performance of local professionals, as it is often assumed that foreign lawyers represent the highest international standards. However, with the emergence of international consultancy and e-commerce, this situation can create many problems. There is nothing to stop the unqualified and sometimes questionable experts from the developed countries from misleading the policy makers in developing countries.

The developed countries forcefully support increased harmonization of such standards and global free trade in legal services because they consider the establishment of foreign lawyers' firms in the reforming economies as a catalyst for foreign investment. It is believed that the ongoing presence of experienced legal experts contributes to the security and predictability of the local business environment⁷⁷.

We must remember, however, that there are practising local lawyers in every country. The legal profession is still divided across national lines. Different national laws are grouped in legal families, sharing common legal principles, and similarities in the structure of the legal profession. Comparative lawyers have identified the following main legal families: Romano-Germanic Law, Common Law, Socialist Law, Hindu Law, Muslim Law, Laws of the Far East, Black Africa and Malagasy Law.⁷⁸ The Romano-Germanic and the Common Law families stretch well beyond the countries in which they originated and are the families of laws which bring together the largest number of national laws. Moreover, other legal traditions, which constitute separate legal families,

⁷⁷ Charles Cadwell (1997) "Implementing Legal Reform in Transition Economies" in *Institutions and Economic Development – Growth and Governance in Less-Developed and Post-Socialist Countries*, Christopher Clauge (ed) Baltimore, MA: The John Hopkins University Press.

⁷⁸ David, René (1985) "Major legal systems in the world today: An introduction to the comparative study of law," (*Les grands systemes de droit contemporains*) translated and adapted by John E.C. Brierley, London: Stevens Publishing, pp. 25-33.

have been influenced by the expansion of Romano-Germanic Law and Common Law and share some legal principles with either of these two families or in some instances with both.

The main obstacle to equitable international trade in legal services is believed to be the predominantly national character of the law and the national character of legal education. The national and local character of the legal profession is a reflection of the national character of the law and of the territorial jurisdiction of the courts. The principal role of the lawyer was originally that of advocate, and the legal profession was organized around the courts, with each bar associated with a specific local court. However, this traditionally local application of law has changed with the expansion of trade and with the emergence of new fields of the law, such as business and trade law, for which representation before a local court is relatively less important⁷⁹. In most circumstances these subjects require legal counseling in matters involving transactions, relationships and disputes not necessarily entailing court proceedings. Thus, we can witness a growing tendency to have a two-tier legal system in developing countries. The first one is a judiciary network that takes care of strictly national matters and is mainly attended by the local lawyers. The second network concerns the matters of international law and the questions about the compatibility of the domestic regulatory frameworks with international regulations, quite often with WTO obligations. This network relies on foreign expertise as it mainly employs the Western legal experts⁸⁰. This tendency can dangerously lower the prestige of domestic legal practitioners. Moreover, it can put

⁷⁹ Peter Goldsmith (1997) "Globalisation of laws - tearing down the walls," in Harper, Ross (ed.), *Global law in practice*, London: Kluwer International and International Bar Association.

domestic lawyers in developing countries at a permanent disadvantage because they lack access to the adequate level of the Western legal education and to the practice of international law.

This change in the practice of law also led to the emergence of a new type of lawyer mainly involved in counseling⁸¹. While the profession of domestic advocate is almost always regulated and is reserved to qualified members of a professional association (often the local bar), in many industrialized countries there is no monopoly by lawyers on legal advice so that members of other professions, such as accountants, bankers or estate agents, can offer legal advice in relation to economic activities covered by their respective professions. Trade-restrictive aspects of the regulation of advocates include nationality requirements, residency requirements, local qualification requirements and local language requirements. In contrast, lower regulatory barriers for counseling lawyers in many countries have facilitated trade in legal services and, in particular, the establishment of foreign lawyers as foreign legal consultants⁸².

In the WTO "*Services Sectoral Classification List*"⁸³ "Legal services"⁸⁴ are listed as a sub-sector of "Professional services"⁸⁵. From the point of view of international

⁸⁰ Interview with an Ecuadorian official, Geneva 1999. And interviews with a Latvian official and a Georgian official, Geneva 2000.

⁸¹ As opposed to the traditional lawyer/advocate, whose main role is representation before a court.

⁸² OECD (1996) *International trade in professional services: assessing barriers and encouraging reform*. Paris: OECD.

⁸³ WTO Document (1991) *Services Sectoral Classification List* (MTN.GNS/W/120), July 15.

⁸⁴ The category "Legal Services" is further sub-divided in the following sub-categories: "Legal advisory and representation services concerning criminal law"; "Legal advisory and representation services in judicial procedures concerning other fields of law"; "Legal advisory and representation services in statutory procedures of quasi-judicial tribunals, boards, etc."; "Legal documentation and certification services"; and, "Other legal and advisory information".

⁸⁵ Professional services as a GATS category includes legal services, accounting, auditing and book-keeping services, taxation services, architectural services, engineering and integrated engineering

trade, the legal services sector has experienced a steady and continuous growth in the past decades as a consequence of trade liberalization and of the emergence of new fields of practice, in particular in the area of business law. Sectors such as corporate restructuring, privatization, cross-border mergers and acquisitions, intellectual property rights, new financial instruments and competition law have generated an increasing demand for more and more sophisticated legal services in the past years. In the early 1990s the output of legal services represented 14% of all professional services and 1.1% of the economy in a "representative" industrialized country.⁸⁶ In 1992 the output of legal services in the United States was \$US 95 billion, while in the European Community it reached \$US 52 billion.⁸⁷

The two major international associations of lawyers are the International Bar Association (IBA) and the International Union of Lawyers (UIA). The IBA is closer to the Common Law/Anglo-Saxon legal tradition, while the UIA is closer to the Civil Law/Latin tradition⁸⁸. The UIA claims to be the most representative international association of lawyers in Europe, South America and Africa. Both associations, however, have a worldwide coverage and their membership includes national

services, urban planning and landscape architectural services, medical and dental services, veterinary services and services provided by mid-wives, nurses, physiotherapists and para-medical personnel.

⁸⁶ UNCTAD/ World Bank Document (1994) *Liberalizing international transactions in services: a handbook*, New York and Geneva: United Nations. The data reflect averages for Canada, France and the United States.

⁸⁷ OECD (1997) *International Trade in Professional services: advancing liberalization through regulatory reform*, OECD Proceedings, Paris: OECD.

⁸⁸ Edwin Godfrey (1995) (ed.), *Law without frontiers: a comparative survey of the rules of professional ethics applicable to the cross-border practice of law*, London: Kluwer International and International Bar Association, pp. 15-18.

professional organizations and individual lawyers. Their membership predominantly consists of lawyers from the OECD countries.⁸⁹

The International Bar Association (IBA) is the world's largest international organization of Law Societies, Bar Associations and individual lawyers engaged in international practice. Founded in 1947, it is composed of over 16,000 individual lawyer members in 183 countries and 178 Law Societies and Bar Associations together representing more than 2.5 million lawyers⁹⁰. Among the aims stated in the IBA constitution three are of particular relevance to trade in legal services: (a) to establish and maintain relations and exchanges between Bar Association and Law Societies and their members throughout the world; (b) to assist members of the legal profession throughout the world, whether in the field of legal education or otherwise, to develop and improve their legal services to the public; and (c) by common study of practical problems to promote uniformity and definition in appropriate fields of law⁹¹. Although the IBA membership has often been divided over liberalization issues, these aims have allowed the IBA to undertake work in the areas of ethical standards, foreign legal consultants and multidisciplinary practices.

The International Union of Lawyers (UIA) was founded in Charleroi (Belgium) in 1927 by the bars of Charleroi, Luxembourg and Paris. The UIA has expressed interest in the work of the WTO in the field of international trade in legal services, but, like the IBA, its membership is divided over the issue of liberalization and it has not

⁸⁹ Ross Harper (1997) *Global law in practice*, London: Kluwer International and International Bar Association, pp. 23-26.

⁹⁰ To find out some more detailed statistics go to: <http://www.ibanet.org>

⁹¹ International Bar Association (IBA) Document (1998) *Statement of general principles for the establishment and regulation of foreign lawyers*. Vienna: IBA, June 06.

been actually involved in negotiations. Although the UIA has not taken yet a final position on the matter, it favors access by foreign lawyers on the basis of an aptitude test. It further supports the exclusion from the scope of practice of host country law and court representation, as in many countries advocates constitute an integral part of the national judicial system⁹². Gaining a membership in one of these two organizations is a necessary prerequisite to work as a lawyer across borders. Their inherently western nature poses an interesting question about the growing reach of the Western law principles around the world⁹³.

Despite the growing importance of new technologies, most trade in legal services still takes place on a cross-border basis (mode one) or via the temporary stay of natural persons traveling as individual professionals or as employees/partners of a foreign established law firm (mode four). Affiliate trade of legal services is still limited as suppliers often find the costs and the difficulties associated with establishing a commercial presence too high, especially if compared to the relatively lower barriers to cross-border transactions.⁹⁴ It has been estimated that the number of lawyers who move abroad on a permanent basis (modes three and four of the GATS) is very small, a few thousand, if compared to a total of over 300,000 lawyers traveling abroad occasionally.⁹⁵

By the end of the Uruguay Round in 1993, forty-three Members⁹⁶ (counting the then 12 Member States of the EU as one⁹⁷) had made commitments in legal services.

⁹² For the UIA mission statement and other press releases see <http://www.uianet.org>.

⁹³ For example, the UIA recognizes six official languages: English, French, Spanish, German, Italian and Arabic but only uses three (the so-called working languages): English, French and Spanish.

⁹⁴ US International Trade Commission (1997) *Recent Trends in US Services Trade*, May.

⁹⁵ OECD Document (1995) *Liberalization of trade in professional services*, op. cit.

⁹⁶ Antigua and Barbuda, Argentina, Aruba, Australia, **Austria**, Barbados, Canada, Chile, Colombia, Cuba, Czech Republic, Dominican Republic, El Salvador, European Communities, **Finland**,

Since then eleven of the acceding countries have included legal services in their schedules.⁹⁸ This means that, out of 12 countries that acceded to the WTO under Article XII, only Mongolia did not make any commitments in legal services⁹⁹. As of March 2001, out of 140 WTO Members, only 51 countries have opened their legal services sector to foreign competition. This number (51) includes 40 original Members (counting the 15 members States of the EU as one) and the 11 newly acceded Members.

Presently only four (4) WTO Members have MFN exemptions in legal services,¹⁰⁰ while four (4) other Members have exemptions in professional services of which legal services is a sub-category.¹⁰¹ Three of the legal services sector-specific exemptions cover measures pertaining to the provision of legal services and apply to all countries on the basis of reciprocity. The fourth exemption extends full national treatment for mode three and four only to companies and citizens of countries with which preferential arrangements exist. All the professional services exemptions maintain reciprocity as a condition for authorizations to exercise professional activities, including legal services. It appears that in some countries which have undertaken specific commitments, the actual legal services regime is more liberal than the regime bound in the schedules and that some countries who have not scheduled specific commitments and have listed MFN exemptions to maintain rather liberal legal services

Gambia, Guyana, Hungary, Iceland, Israel, Jamaica, Japan, Lesotho, Liechtenstein, Malaysia, Netherlands Antilles, New Zealand, Norway, Papua New Guinea, Poland, Romania, Rwanda, Sierra Leone, Slovak Republic, Slovenia, Solomon Islands, South Africa, **Sweden**, Switzerland, Thailand, Trinidad and Tobago, Turkey, United States, Venezuela.

⁹⁷ In 1995, three of those 43 countries (Austria, Finland and Sweden) joined the European Union.

⁹⁸ Ecuador, Panama, Bulgaria, Kyrgyz Republic, Latvia, Estonia, Jordan, Georgia, Croatia, Albania and Oman.

⁹⁹ See Table 8 at the end of this chapter.

¹⁰⁰ Brunei Darussalam, Bulgaria, Dominican Republic and Singapore.

¹⁰¹ Costa Rica, Honduras, Panama, Turkey.

regimes.¹⁰² We can observe that with the accession of the Kyrgyz Republic no new MFN-exemption was given to a WTO Member. We can also note a progressive liberalization in this services sector occurring with each subsequent accession process.

The most common scheduled limitations on market access in legal services are restrictions on the type of legal entity. In most cases the new Members have limited the choice of legal form to natural persons (sole proprietorship) or partnership, excluding limited companies¹⁰³. The large majority of scheduled national treatment restrictions are residency requirements. In some cases these requirements are linked to a nationality requirement. However, if both nationality and residency are required for the same sub-sector and mode of supply, only the former should be scheduled under market access limitations, while the latter, which is a national treatment limitation in its own right, would not need to be scheduled. When, on the other hand, the requirement is of citizenship or residency, only the second should be scheduled as a national treatment limitation, as foreign service suppliers can hurdle the market access restriction (citizenship) by taking up residency. Overall, the limitations placed by the acceding countries on the legal services sector are mainly cosmetic. Most limitations relate to the immigration requirements and can be easily overcome.

¹⁰² US International Trade Commission (1997) "General Agreement on Trade in Services: examination of the schedules of commitments submitted by Asia/Pacific trading partners." *Investigation no. 332-374*, Washington: DC, August.

¹⁰³ Most legal firms are partnerships, thus this limitation is purely cosmetic. Interview with a WTO official, Geneva 2000.

Health and Social Services Sector

Health and social services may serve a multitude of different – developmental, distributional, social and other – functions. Accordingly, such services may be core instruments in the pursuit of social and distributional justice or could be viewed as important contributors to, or preconditions for, economic development. In short, public services are subject to a variety of economic and non-economic goals, influences and constraints. The decision to open the health and social services sector to foreign investment is thus particularly politically sensitive.

When the GATS agreement was first signed at the end of the Uruguay Round, Members were free to retain domestic policies that restricted or prohibited private investment in traditional areas of public service. The original idea behind the GATS agreement was a voluntary liberalization of selective services sectors. In consequence, by the end of 2000, few of the WTO's then 140 Members states had fully committed their health and social services to foreign investment through GATS¹⁰⁴. Since the Agreement also allowed Member countries to decide how much of each sector should be liberalized - for example, what proportion of a sector's infrastructure is open to foreign competition – WTO Members that decided to liberalize put severe limitations on how it could be done¹⁰⁵. The situation is quite different when it comes to the newly acceded to the WTO countries. The voluntary nature of GATS appears to be irrelevant during the accession negotiations. Already with the first accession of Ecuador, WTO Members

¹⁰⁴ See Table 6.

¹⁰⁵ WTO Document (1998) *Health and Social Services - Background Note by the Secretariat* (S/C/W/50), September 18.

have changed their strategy from persuasion to insistence on opening public sector services to foreign competition.¹⁰⁶

With an advent of the WTO, almost all industrialized countries have maintained tight controls on the role of for-profit providers, and there are heavy regulations of other actors in the system¹⁰⁷. In some countries, for example, hospital expansion is limited by a health-services plan, or limits are put on the number of private medical services that can be subsidized out of public funds. In contrast to the original Members, the newly acceded countries are asked, as a necessary condition for WTO membership, to fully privatize their public services sectors.

It can be argued that the requests for extensive liberalization of the public services sector as expressed during the accession negotiations reflect the future fate of public services under WTO rules. There have been a lot of changes surrounding the politics of health care since the Uruguay Round completed its talks in 1993. In many countries universal health plans have been difficult to manage and too costly to maintain. Health and social services in economically advanced countries have great economic significance because of their size. In the mid-1990s, the OECD countries spent some US\$2,000 billion annually on health, which was close to 90 per cent of total world health expenditure¹⁰⁸. In most OECD economies, health care spending accounts for more than 8 per cent of GDP at present (1.5 to 5.5 per cent in the early 1960s), as

¹⁰⁶ Interview with a WTO official, Geneva 2000.

¹⁰⁷ UNCTAD/WHO (1998) *International Trade in Health Services - A Development Perspective*. Geneva: UNCTAD/WHO.

¹⁰⁸ The OECD brings together 30 industrialized countries. The original 20 members of the OECD are located in Western countries of Europe and North America. Next came Japan, Australia, New Zealand and Finland. More recently, Mexico, Hungary, Poland, the Czech Republic, the Slovak Republic and Korea have joined.

compared to some 5 per cent in developing countries.¹⁰⁹ This includes public and private spending on both goods and services¹¹⁰. While there are wide variations among countries, hospital services tend to account for between 40 and 50 per cent of total health spending in the OECD area, pharmaceuticals between 30 and 40 per cent, with the remainder consisting mainly of out-patient medical and paramedical services.¹¹¹

Prompted by budgetary constraints, governments around the world have increasingly come to propose different initiatives that may lead to greater market orientation. Various countries have also introduced administrative controls and other command-and-control measures to deter new entrants, curtail "excessive" demand for pharmaceuticals or hospital beds, or influence geographic patterns of supply¹¹². Liberalization of the health and social services may play an important role in any market-based reform strategy but it becomes especially crucial in the countries undergoing the process of economic transition¹¹³.

While health and social services have long been considered as (a) non-tradeables to be provided by (b) public institutions, there has been a change in policy perception in a number of countries. More efficient transport and communication technologies have

¹⁰⁹It may be worth noting that health care spending – which includes the inputs provided by other sectors – is significantly higher than the health sector's genuine contribution to GDP. Estimates on a gross value-added basis indicate a share of health services in GDP, in 1994, of 5.6 per cent in the United States (private market and non-market services), 3.6 per cent in France, 2.4 per cent in Germany and 2.1 per cent in Canada (market services only). According to OECD (1997) *Services Statistics on Value Added and Employment*, Paris: OECD.

¹¹⁰ Public health expenditure is defined to comprise recurrent and capital spending from public budgets, external borrowings and grants, including donations, and the spending of social or compulsory health insurance.

¹¹¹ Annual average 1990-95, taken from World Bank Document (1998) *World Development Indicators*, Washington: DC. These figures need to be interpreted with care as they can be subject to serious definition problems.

¹¹² Brian Abel-Smith (1996) "The escalation of health care costs: How did we get there?," in OECD *Health Care Reform - The Will to Change*, Paris: OECD.

enhanced the mobility of both professionals and consumers and enabled the use of new modes of supply (telemedicine), overturning traditional concepts of space and distance. At the same time, new forms of private sector involvement have opened opportunities for increased domestic and foreign participation¹¹⁴.

Furthermore, many analysts, especially in OECD countries, are inclined to see the health sector not predominantly as a "contributor" to GDP but as a drag on economic expansion¹¹⁵. Throughout the OECD area, health expenditure has been on the rise over the past two decades, absorbing increasing shares of private consumption and, in particular, government spending¹¹⁶. In turn, this has gradually narrowed the scope for other policy initiatives, possibly including tax cuts and broader public sector reforms, which may be considered high-priority tasks for governments seeking to stem rising unemployment and flagging economic growth.¹¹⁷ A study for the OECD area notes that, overall, the organization of health care has converged in recent years towards contract-based systems. The study emphasizes the importance of separating purchasers from providers, preferably combined with a significant degree of vertical integration, and increasing the scope for performance-based reimbursement and competition.¹¹⁸

These developments can partially explain the demands for liberalization of health and social services sector placed on the countries acceding to the WTO. The candidates

¹¹³ Carlos M. Correa (2000) "Implementing National Public Health Policies in the Framework of WTO Agreements," *Journal of World Trade*, Vol. 34, No. 5, pp. 89-121.

¹¹⁴ David C. Warner (1998) *The globalization of medical care*, in Simoretta Zarrilli and Colette Kinnon (1998) (eds.) *International trade in health services: a development perspective*, Geneva: UNCTAD/WHO.

¹¹⁵ OECD Document (1996) *Health Care Reform - The Will to Change*, op. cit.

¹¹⁶ Brian Abel-Smith (1996) "The escalation of health care costs: How did we get there," op. cit.

¹¹⁷ OECD (1995) *New Directions in Health Care Policy*, Paris: OECD.

¹¹⁸ Jönsson Bengt (1996) *Making Sense of Health Care Reform*, in OECD Document *Health Care Reform - The Will to Change*, op. cit.

try to resist these demands citing the growing evidence from the industrialized countries suggesting that open market competition does not necessarily entail quality and efficiency gains for all population segments and interested groups. For example, private health insurers competing for members may engage in some form of selective behavior leaving the basic public system, often funded through the general budget, with low-income and high-risk members. New private clinics may well be able to attract qualified staff from public hospitals without, however, offering the same range of services to the same population groups. The combination of space-limited and very expensive education with lucrative remuneration of professionals, may create not necessarily the best qualified medical staff, distort the structure of human capital formation and, given generally rigid price and wage structures, boost health care costs¹¹⁹.

These examples do not argue against market-based reforms. However, they may indicate the potential for misallocation in a sector that often operates at the borderline between the public and private spheres and is subject to a variety of – not necessarily compatible – objectives. The challenge facing health authorities is to define a consistent set of policy goals and, consequently, to create a regulatory framework encouraging efficient resource use in pursuit of these goals. It has been estimated that countries may waste 30 to 60 per cent of their health care spending on ineffective or inappropriate treatment.¹²⁰

Since regulatory regimes in various countries have been moving towards a stronger market orientation, it is important to note that three types of regulation seem to

¹¹⁹ Candace Redden (forthcoming) *Social Rights and the Challenge of Difference: Health Care, Entitlement and Citizenship*, University of Toronto Press.

¹²⁰ Brian Abel-Smith (1996) *The escalation of health care costs: How did we get there?* op. cit.

be particular relevant as they may directly affect supply or demand of medical and health services. These are, first, qualification and licensing requirements for individual health professionals; second, approval requirements for institutional suppliers such as clinics or hospitals; and, third, rules and practices governing reimbursement under mandatory (public or private) insurance schemes¹²¹. While such rules and requirements may have restrictive effects on services trade, they may be covered by the relevant provisions of Article VI of GATS¹²².

There is, however, a fundamental problem encountered by the countries applying for WTO membership. They are simply not given enough time to design the regulations that would protect their strategic services sectors from unregulated foreign competition. The complexity of accession negotiations in a number of different economic areas that come under scrutiny of WTO Members make it impossible for the acceding country to use the relevant WTO provisions to their advantage and establish a comprehensive regulatory framework that could keep foreign investors under regulatory supervision.

Table 6:
Summary of Specific Commitments - Health-Related and Social Services

Members	Health-Related and Social Services				Full Opening
	Hospital Services	Other Human Health S.	Social Services	Other	
Albania *	x	x			
Australia		x			
Belize		x			
Bolivia	x				
Bulgaria *			x		
Burundi	x	x			
Costa Rica	x				
Croatia *	x	x	x		x
Dominican Rep	x	x	x		x

¹²¹ Simonetta Zarrilli and Colette Kinnon (1998) (eds), *International Trade in Health Services: a Development Perspective*, op. cit.

¹²² (Article VI provides that the measures be administered in a "reasonable, objective and impartial manner" and not be "more burdensome than necessary to ensure the quality of the service").

Members	Health-Related and Social Services				Full Opening
	Hospital Services	Other Human Health S.	Social Services	Other	
Ecuador *	x				
Estonia *	x	x	x		x
EU (15)	x		x		
Gambia	x	x	x		x
Georgia *	x	x	x		x
Guinea				x	
Hungary	x	x	x	x	x
India	x				
Jamaica	x				
Japan	x				
Jordan *	x	x	x		x
Kuwait	x	x	x		x
Kyrgyz Rep *	x	x	x		x
Latvia *	x		x		
Malawi	x	x			
Malaysia	x				
Mexico	x	x			
Oman *	x				
Pakistan	x				
Panama *	x				
Poland	x				
Saint Lucia	x				
Saint Vincent and the Grenadines	x				
Sierra Leone	x	x	x	x	x
Slovenia	x	x			
Swaziland	x				
Trinidad Tobago	x				
Turkey	x				
USA	x				
Zambia	x	x			
TOTAL 53	49	18	27	3	10

Note for Table 6:

- * Indicates a recently acceded country under Article XII.
- Of the twelve countries that had acceded to the WTO since its establishment in 1995, all, but one (Mongolia), opened their health and social services sector to foreign competition.
- EU Member States are counted as 15.
- As of March 2001 the WTO has 140 Members.

Of the twelve (12) countries that have acceded to the WTO since its establishment in 1995, eleven (11) countries opened the health and services sector to foreign competition. In total only forty-nine (49) WTO Members have liberalized

“Hospital and Social Services Sector”¹²³. A closer look at Table 6 reveals that many developing countries, including least developed countries, have made broad commitments for various health and medical services. A large majority of the Members with full liberalization commitments are developing countries. Only ten (10) WTO Members have fully liberalized this sector and five (5) of them are the recently acceded Croatia, Estonia, Georgia, Jordan and Kyrgyz Republic.

Limitations put on liberalization of this sector that fall under Article XVI of the GATS typically include quota restrictions or economic needs tests used to regulate the number of hospital beds, doctors, nurses, etc. Measures subject to scheduling under Article XVII may include nationality requirements as well as any other measure, which, while not falling under Article XVI, adversely affects the competitive conditions of foreign services or service suppliers. Albania was able to exclude its Social Services because apparently WTO Members were not interested in this particularly chaotic segment of the Albanian economy¹²⁴. Panama, Bulgaria and Ecuador were allowed to put the mentioned limitations on liberalization of this sector, and even exclude some sub-categories, because WTO Members did not find them attractive enough. A case in point is the non-coverage of health services consumed abroad by certain public insurance schemes in Bulgaria¹²⁵, Croatia,¹²⁶ Latvia¹²⁷ and Jordan¹²⁸. Oman was able to

¹²³ WTO Document (1991) *The Services Sectoral Classification List* (MTN.GNS/W/120), July 10. Also, WTO Document (1998) *Background Note by the WTO Secretariat* (S/C/W/72), 2 December.

¹²⁴ Interview with an Albanian official, Geneva 2000.

¹²⁵ WTO Document (1996) *Schedule of Specific Commitments on Services - Bulgaria*, (WT/ACC/BGR/5) September 20.

¹²⁶ WTO Document (2000) *Schedule of Specific Commitments on Services - Croatia*, (WT/ACC/HRV/59) June 29

¹²⁷ WTO Document (1998) *Schedule of Specific Commitments on Services - Latvia*, (WT/ACC/LVA/32), September 30.

maintain its state control in some sub-categories of the sector on the religious grounds¹²⁹. The rest of the candidates made full liberalization commitments.

The patterns of liberalization in the health and social services sector illustrate the growing tendency of considering the accession process not as an admission on equal terms but rather as a precedent of exercising influence over a weak country. The WTO accession process begins to resemble an asymmetrical power game, where the most dominant actors are demanding commitments that cannot be always justified even on economic terms¹³⁰. Most importantly, the WTO Members that are requesting excessive commitments from much weaker countries have themselves taken all the possible precautions to regulate their economies and only made moderate commitments in the sectors considered strategically important.

Such power-based accession demands put in question the legitimacy of the whole organization. WTO accession paints a picture of a hierarchical system where the dominant actors use and interpret the rules they established only to serve their interests. WTO membership can only promote the establishment of the legal framework that was absent under central planning if WTO Members change their approach to the WTO accession process. Instead of excessive demands for unregulated liberalization, more technical assistance should be afforded to the candidate countries to help them build new institutions in a careful way.

¹²⁸ WTO Document (1999) *Schedule of Specific Commitments on Services - Jordan*. (WT/ACC/JOR/33) November 19.

¹²⁹ Interview with a WTO official, Geneva 2000.

¹³⁰ Interview with a WTO official, Geneva 2000.

In Conclusion: Services, regulatory reforms and the acceding countries

The negotiation of the GATS agreement during the Uruguay Round, in particular, created considerable controversy. At issue in the negotiations on services liberalization are generally regulatory regimes that are difficult to modify in incremental ways. In contrast to tariffs, which can be changed smoothly and continuously, regulatory regimes are ingrained in the domestic politics and thus are difficult to reform. The domestic reform agenda is frequently complex, with progress being hampered by resistance by vested interests, "often serving protectionist purposes."¹³¹ The main concern, however, with respect to domestic reform agenda in the context of services liberalization appeared to be different during the Uruguay Round. The crucial factor was the way in which public interest objectives could be over-ridden by objectives that further trade.

The Uruguay Round services negotiations were primarily driven by the developed nations that sought to incorporate rules on services into the world trading system. Yet, the same developed nations listed widespread exemptions to their obligations under GATS that insulated existing discriminatory measures of WTO Members from challenge¹³². Due to the procedural flexibility of scheduling, the intended flexibility of the GATS agreement only establishes a 'standstill' on new state protectionism in those countries rather than providing any liberalization of existing measures. In fact, it could be argued that some schedules of the industrialized WTO Members do not even provide a 'standstill' on new protectionism because of the way scheduling is permitted under the GATS. Many

¹³¹ Akira Kawamoto (1997) "Regulatory Reform on the International Trade Policy Agenda," *Journal of World Trade*, Vol. 31, No. 4, p. 86.

¹³² See, for example, WTO Document (1995) *Schedule of Specific Commitments on Services Canada* (GATS/SC/16). Matthew Schaefer (1999) "Twenty-First Century Trade Negotiations, the US

conditions and limitations on market access and national treatment appearing in the schedules of the developed nations do not cite to particular measures but rather generally describe measures¹³³. Thus, a new measure that corresponds to greater discrimination against foreign service suppliers, but which still fits within the general description in the schedule, can be held GATS-consistent. However, the new candidates for WTO membership are not allowed to use this method of scheduling under GATS.

In contrast, the acceding countries have been discouraged from listing any exemptions in their schedules of commitments¹³⁴. For example, the Kyrgyz Republic did not use any of the available limitations on liberalization of its services sectors¹³⁵. It opened a large number of sectors to foreign competitions without even placing conditions on foreign firms. Nor it was able to delay liberalization of some sectors in order to enact relevant laws aimed at regulating these sectors in the future. However, by completely opening a given services sector with no limitations and no exemptions listed, the acceding countries prevent themselves from ever introducing any new regulatory measures that could affect such a sector. Once a commitment is made that a sector is open to foreign competition, any new restrictive law would be considered a breach of the full liberalization commitment and a country could be taken to the WTO dispute settlement panel.

Constitution, and the Elimination of US State-Level Protectionism." *Journal of International Economic Law*, Vol.2, No.1, pp. 71-111.

¹³³ For further discussion on scheduling problems see, Bernard Hoekman (1995) "The General Agreement on Trade in Services," in John H. Jackson, William J. Davey, Alan Sykes (eds.) *Legal Problems of International Economic Relations*, London: West Information Publication Group.

¹³⁴ Interview with a Kyrgyz official, Geneva, 1999.

¹³⁵ WTO Document (1998) *Schedule of Specific Commitments on Services - the Kyrgyz Republic*, (WT/ACC/KGZ/26), July 31.

All twelve new Members¹³⁶ have entered commitments in a large number of sectors, unlike some original Members in the Uruguay Round. The broad picture is therefore one of wide sectoral coverage, although there are some relevant exclusions. In those sectors where commitments have been undertaken, the tendency is to have minor or no limitations, while more often a mode of supply is excluded. All twelve have undertaken commitments in professional services (mostly accounting, legal¹³⁷, taxation, architecture and engineering), business services (a very wide range of sectors), communication services (but the coverage of basic telecom is uneven), financial services (in some cases with important modes 1 and 2 exclusions), construction services and distribution services. Construction, distribution and financial services are the sectors where the coverage is most complete. Eleven Members have undertaken commitments in environmental, tourism and transport services; ten Members in health and social services and in education services; nine Members in recreational services and five in audiovisual services. Indeed, as a necessary cost of the WTO accession, the twelve most recent Members have made remarkable liberalizing commitments in services.

Clearly, the most apparent barriers to trade in services are rooted in the regulatory framework of the state. Thus, services liberalization for some countries means easing up current restrictions and only re-drafting existing regulations. In many developing countries, however, the decision to liberalize a particular service sector corresponds to the abolition of a monopoly in favor of competition. Since a majority of the underdeveloped countries, and this is certainly the situation in most of the acceding ones, have

¹³⁶ Ecuador, Mongolia, Bulgaria, Panama, Kyrgyz Republic, Latvia, Estonia, Jordan, Georgia, Albania, Oman and Croatia.

¹³⁷ Mongolia did not make any commitments in Legal Services sector.

a very limited number of relevant laws and regulations pertaining to services, the task of liberalization necessitates an impossible task of simultaneous creating, opening and regulating their services sectors.

The success of regulatory reforms in acceding countries often depends on whether the authorities can deal with the over-developed industrial sectors that characterize the post-interventionist states. The development strategy of import-substitution or state socialism¹³⁸ deliberately placed an emphasis on industrial production¹³⁹. As former state-run economies, the acceding countries have inherited services sectors that were rudimentary at best. Professional services, for example, such as accounting, architectural, and legal services were of poor quality or nonexistent. Insurance, banking, and financial services were underdeveloped and unreliable. Telecommunication services were routinely unavailable and obsolete. The recreational services, like restaurants, hotels, retail, spas, travel agencies, were scarce or poorly developed. Public transportation was unreliable¹⁴⁰.

In the acceding countries with seriously underdeveloped services sectors, demand for services during the early stages of pro-market reforms has been intense. Developing the services sector requires an enormous amount of regulatory activity: qualification requirements and rules of conduct are necessary for the professional services; prudential requirements and supervisory structures have to be established in the financial sector:

¹³⁸ In the Marxist context, services to consumers, ranging from recreation to public transport, were considered nonproductive, and perhaps for that reason largely neglected by the architects of state central planning. Compare in: Josef M. van Brabant (1998) *The Political Economy of Transition*, op. cit., pp. 93-96.

¹³⁹ W. Arthur Lewis (1955) *The Theory of Economic Development*. Homewood, IL: Irwin.

¹⁴⁰ Sabrina Petra Ramet (1995) *Social Currents in Eastern Europe - The Sources and Consequences of the Great Transformation*, op. cit., pp. 24-42, and 262-277. Christian Morisson (1994) (ed.) *The Political Feasibility of Adjustment in Ecuador and Venezuela*, " op. cit., pp. 21-35.

telecommunication regulation has to define the privileges and duties of the main supplier as well as cater to competition, and then legislation is necessary to deregulate distribution restrictions. However, the need for change is probably at its most pressing in the banking sector. In the majority of the acceding countries, this sector is characterized by a weak capital base and by a traditionally collusive relationship between borrowers, lenders and regulators. The services that were provided mostly operated under state monopolies. Thus, the opening of services sectors to international competition, particularly through direct investment by foreign suppliers (commercial presence), has met powerful resistance. Market access (or entry) barriers often support the internal distribution of regulatory rents benefiting domestic monopolistic firms that naturally would have a strong interest in blocking attempts by governments to increase the contestability of their markets. Entry barriers in many service activities tend to be justified by invoking market failure rationales that revolve around fears of excessive entry¹⁴¹. From this perspective the acceding countries should focus their attention on strengthening, identifying, and designing the domestic regulatory reforms that need to be undertaken in services sectors in order to enhance the efficiency of the economy and bolster economic growth prospects¹⁴².

Unfortunately, the governments of the acceding countries routinely lack expertise and sufficient resources to introduce relevant legislative restrictions in order to ensure that liberalization is done in a thoughtful way. Thus, by asking the acceding countries to

¹⁴¹ Josef M. van Brabant (1998) *The Political Economy of Transition – Coming to grips with history and methodology*, op. cit., pp. 90-93, and 122. Also, John Williamson (1994) "In Search of a Manual for Technopols" *The Political economy of Policy Reform*, op. cit., pp. 19-25.

¹⁴² See, for example, Carlos M. Correa (2000) "Implementing National Public Health Policies in the Framework of WTO Agreements," op. cit., pp. 89-121.

rapidly liberalize, WTO Members are adding to the erratic and inconsistent liberalization pattern. At the same time the acceding governments potentially lose supervisory control over a large chunk of their economies by opening their unregulated services sectors to foreign competition. This goes against the very principles the WTO is based on. The WTO accession process should support, not inhibit, careful institution building in the vital economic sectors of each acceding country.

Table 7: Liberalization of the Financial Sector by New WTO members¹⁴³

Ecuador. Insurance Services: full liberalization commitments only in Mode 3 (commercial presence). Banking and other financial services: limited liberalization with some national treatment restrictions.

Mongolia. Insurance Services: full liberalization. Banking and other financial services: limited liberalization (lending, financial leasing, securities, money broking, asset management, and other auxiliary and advisory services – all excluded).

Bulgaria. Insurance services: liberalization commitments phased-in (3 years and 6 years); and some additional limitations: supply of services only through participation in domestic companies, but no limits on foreign equity; some limitations on national treatment. Banking and other financial services: liberalization commitments only in Mode 3 (commercial presence) but subject to licensing and authorization requirements.

Panama. Insurance Services: limited liberalization commitments only in Mode 3 (commercial presence). Banking and other financial services: full liberalization.

Kyrgyz Republic. Insurance Services: limited liberalization in Mode 1 (cross-border supply) and only for insurance of cargo transportation, brokerage and reinsurance; limited liberalization in Mode 3 (commercial presence): 49 per cent foreign equity ceiling until 2002. Banking and other financial services: limited liberalization with restrictions on (Mode 3) commercial presence: capital requirements for banks with more than 20 per cent foreign equity until 2003.

Latvia. Insurance Services: limited liberalization with severe limitations in Mode 1 (cross-border supply) for direct insurance; and with Mode 3 (commercial presence) restriction (no branches allowed until 2003) Banking and other financial services:

¹⁴³ The analysis is based on the following *Schedules of Specific Commitments on Services*: *Ecuador*, 14 July 1995 (WT/L/77). *Mongolia*, 27 June 1996 (WT/ACC/MNG/9). *Bulgaria*, 20 September 1996 (WT/ACC/BGR/5); *Panama*, 2 October 1996 (WT/ACC/PAN/19); *The Kyrgyz Republic*, 31 July 1998 (WT/ACC/KGZ/26); *Latvia*, 30 September 1998 (WT/ACC/LVA/32); *Estonia*, 9 April 1999 (WT/ACC/EST/28); *Jordan*, November 1999 (WT/ACC/JOR/33); *Georgia*, October 1999 (WT/ACC/GEO/31); *Croatia*, 29 June 2000 (WT/ACC/HRV/59); *Albania*, 13 July 2000 (WT/ACC/ALB/51); *Oman*, September 2000 (WT/ACC/OMN/26).

broad liberalization with some minor limitations on cross-border supply (Mode 1) and residency requirement for managers of foreign branches and subsidiaries.

Estonia. Insurance Services: broad liberalization except the limitations on (Mode 3) commercial presence: an insurance joint-stock company with foreign capital participation may include foreigners not exceeding half of the members of the management group and the head of management must reside in Estonia. Banking and other financial services: very broad liberalization except some restrictions in Mode 1 (cross-border supply): authorization requirement for acceptance of deposits and other repayable funds from the public.

Jordan Insurance services: very limited liberalization, with commercial presence (Mode 3) access restricted to public share holding companies. Banking and other financial services: limited liberalization (credit lending and real property in Jordan cannot be mortgaged by banks outside Jordan, severe market access restrictions in (Mode 3) commercial presence)

Georgia. Insurance services: broad liberalization with some limitations on commercial presence (Mode 3) in Marine, Aviation and other Transport Insurance services. Banking and other Financial Services: full liberalization.

Croatia Insurance services: very broad liberalization with minor limitations. Banking and other Financial Services: limited liberalization with severe limitations on market access in all Modes, full commitments on national treatment.

Albania Insurance services: broad liberalization with some limitations but only until 1 January 2005 (none for insurance of non-residents and for foreign investors). Banking and other Financial Services: broad liberalization with some unbound limitations on market access in Mode 1 (cross-border supply), and with limitations on capital controls to be removed no later than in 2010.

Oman Insurance services: broad liberalization with some limitations (foreign equity limited to 70%) on commercial presence (Mode 3), but starting no later than 1 January 2003, commercial presence in the form of wholly foreign-owned subsidiaries and branches permitted. Banking and other Financial Services: limited liberalization with limitations on market access in Mode 3 (commercial presence).

Table 8: Liberalization of the Legal Services Sector by New WTO Members¹⁴⁴

Ecuador. Limited Liberalization of Legal Services - only as advisory services in foreign and international law.

Mongolia. Legal - no commitments

Bulgaria. Limited Liberalization of Legal Services – only as advisory services in foreign and international law: Bulgaria was allowed an indefinite MFN-exemption on national treatment in this sector.

Panama. Limited Liberalization of Legal Services – only on international and home law and no court appearances no drafting of documents. Panama was allowed an MFN-exemption on reciprocity in professional services sector.

Kyrgyz Republic Quite Extensive Liberalization of Legal Services – but only with respect to foreign and international law. Domestic advocate services reserved to Kyrgyz citizens.

Latvia Quite Extensive Liberalization of Legal Services - some limitations on commercial presence.

Estonia Quite Extensive Liberalization of Legal Services - full commitment in mode 2, limited mode 3 (commercial presence) commitments to proprietorships or to law firms with limited liability with permission.

Jordan Quite Extensive Liberalization of Legal Services Legal services – but only as advisory services in foreign law.

Georgia Unrestricted (full) Liberalization of Legal Services

Croatia Quite Extensive Liberalization of Legal Services - essentially full liberalization (limitations on practicing Croatian law).

Albania Quite Extensive Liberalization of Legal Services– but only as consultancy.

Oman Unrestricted (full) Liberalization of Legal Services.

¹⁴⁴ The analysis is based on the following *Schedules of Specific Commitments on Services*: *Ecuador*, 14 July 1995 (WT/L/77); *Mongolia*, 27 June 1996 (WT/ACC/MNG/9); *Bulgaria*, 20 September 1996 (WT/ACC/BGR/5); *Panama*, 2 October 1996 (WT/ACC/PAN/19); *The Kyrgyz Republic*, 31 July 1998 (WT/ACC/KGZ/26); *Latvia*, 30 September 1998 (WT/ACC/LVA/32); *Estonia*, 9 April 1999 (WT/ACC/EST/28); *Jordan*, November 1999 (WT/ACC/JOR/33); *Georgia*, October 1999 (WT/ACC/GEO/31); *Croatia*, 29 June 2000 (WT/ACC/HRV/59); *Albania*, 13 July 2000 (WT/ACC/ALB/51); *Oman*, September 2000 (WT/ACC/OMN/26).

Chapter 6

The Third Pillar of the WTO – The Agreement on Intellectual Property Rights and the Problems with its Implementation

Introduction

Accession to the WTO is complex because of the expansion and intensification of the obligations of accession. In contrast to GATT rules, the WTO also covers trade in services and trade-related aspects of intellectual property rights. To a certain extent the accession process epitomizes the broader dilemmas of implementing the new comprehensive package of WTO Agreements by developing countries. One of the major characteristics of the emerging international economic order is the treatment of intellectual property rights (IPR). Developing country Members and newly acceding countries alike are very concerned about the impact that the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) will have on their economies. In fact, the implementation problems define the situation of developing countries as a group in the multilateral trading system.

The TRIPS Agreement established the minimum global standards of IPR protection as well as rules on enforcement, and most importantly, brought the domestic IPR regimes of WTO Members under the jurisdiction of the WTO dispute settlement system. There is no doubt that a strong global regime for protecting IPR increases the economic strength of developed countries because one can clearly demonstrate a

dominance of these economies in intellectual property ownership¹. However, the developed countries have insisted that high international standards of IPR protection would also vitally benefit the economies in developing countries. The argument has been put forward that foreign investors are more willing to transfer technology when it is protected by law². The TRIPS Agreement establishes standards that are applicable within national legal systems, and since foreign investors are protected by these rules, the TRIPS is inherently investment-related. It should be then expected that foreign direct investment would increase as domestic conditions become more predictable and investment friendly. The implementation of the TRIPS Agreement is thus expected to facilitate an investment friendly environment in developing countries.

This chapter cautiously questions this assumption. There is no clear evidence that a strong IPR protection is a significant determinant of foreign direct investment flows³. In particular, the chapter expresses some pessimistic concerns about the implementation of TRIPS obligations by the existing developing Members of the WTO and by the candidates for WTO accession (which are always developing). The technologically disadvantaged countries fear the adverse impact of the monopolistic nature of patent rights. In addition, the pessimism over TRIPS also stems from the Agreement's requirement to enforce the IPR protection on a level that routinely exceeds these

¹ Keith E. Maskus (1996), "Intellectual Property Rights in the Global Information Economy," in Thomas J. Courchene, ed., *Policy Frameworks for a Knowledge Economy*. (Kingston, ON: John Deutsch Institute for the Study of Economic Policy), pp. 231-270. Also, compare the worldwide statistics on patents collected by the World Intellectual Property Organization (WIPO) at www.wipo.org

² Frederick M. Abbott (1989) "Protecting First World Assets in the Third World: Intellectual Property Negotiations in the GATT Multilateral Framework" in *Vanderbilt Journal of Transnational Law*, No. 22, pp. 688-690. Edwin Mansfield (1994) *Intellectual Property Protection, Foreign Direct Investment, and Technology Transfer*. Discussion Paper No. 19, Washington, D.C: World Bank.

³ Edson K. Kondo (1995) "The Effect of Patent Protection on Foreign Direct Investment" in *Journal of World Trade*, Vol. 29, No. 6, pp. 97-122.

countries' financial and administrative capabilities⁴. When the TRIPS Agreement came into being in 1995, the overwhelming majority of developing countries had a very limited IPR regime, if any regime at all. However, under pressures from industrialized nations, developing countries reluctantly agreed to embrace the IPR agreement as a condition for the successful completion of the Uruguay Round⁵. Presently, developing countries are expected to have implemented all relevant IPR provisions. In a similar fashion, full compliance with the TRIPS agreement is a necessary prerequisite to becoming a WTO member.

It is important to point out the difference for acceding countries between services (the GATS Agreement) and TRIPS. In services, acceding countries sign to the general provisions of GATS, and then negotiate a number of commitments with respect to opening the selective services sectors. In TRIPS, acceding countries are obliged to take on the whole agreement, with no exemptions, and then the issue becomes one of implementing the TRIPS Agreement into domestic legislation. This is an onerous obligation from the very outset. The TRIPS Agreement is supposed to be limited to the minimum standards of protection of intellectual property to be provided by each WTO Member. These standards, however, are modeled on the western legal practice and are set at a level comparable to those in the developed countries. This is why intellectual property is often the most difficult issue to be settled in accession negotiations. The countries acceding to the WTO object to the fact that the western legal tradition of intellectual property rights is imposed on developing countries as the price of admission

⁴ Carlos M. Correa (1999) "Review of the TRIPS Agreement: Fostering the Transfer of Technology to Developing Countries, in *Journal Of World Intellectual Property*, Vol. 2, No. 6, p. 942.

⁵ Carlos M. Correa (2000) *Intellectual Property Rights, the WTO and Developing Countries – The TRIPS Agreement and Policy Options*, Penang, Malaysia: Third World Network, p. 3.

into the world markets. As the candidates strive to implement the TRIPS Agreement, this part of the accession process reveals the key division line between developing country Members and the developed countries, and thus illuminates the problem currently facing the WTO over the implementation of the Uruguay Round Agreements.

Intellectual property rights in historical perspective

Black's Law Dictionary defines *intellectual property* as "(a) category of intangible rights protecting commercially valuable products of the human intellect. The category comprises primarily trademark, copyright, and patent rights, but also includes trade-secret rights, publicity rights, moral rights, and rights against unfair competition." The terminology regarding intellectual property has shifted over time, with the term *industrial property* giving way to the various terms that exist today. This area of law has also expanded to encompass licensing, biotechnology and other legal or non-legal subject areas that are related to conceptions of property that are abstract in nature. Intellectual property rights may be intangible, but they are among the most contentiously debated subjects in international trade.

The preamble of the TRIPS Agreement explains its rationality: "Desiring to reduce distortions and impediments to international trade, and taking into account the need to promote effective and adequate protection of intellectual property rights, and to ensure that measures and procedures to enforce intellectual property rights do not themselves become barriers to trade." A further goal of the agreement as identified in the preamble is to ensure that disputes on TRIPS matters are settled through multilateral procedures. This statement recognizes that international law is needed in this area of commercial

relations.⁶ A point worth noting is the Preamble's separate reference that "intellectual property rights are private rights."⁷ However, Article 7 indicates that the main objective of the Agreement is "the promotion of technological innovation and the transfer and dissemination of technology⁸". The conflicting pressures between cooperation and protectionism, in the context of the TRIPS Agreement, are well represented by the divergence between the provisions to protect individual rights, as narrowly interpreted by industrialized countries, and the provisions to facilitate technology transfer, broadly interpreted as dealing with natural consequences of implementing TRIPS.

In firmly linking the notion of private property to the concept of intellectual property, the TRIPS Agreement borrows from the western tradition of property rights and contract law first elaborated in John Locke's "Second Treatise of Government". This foundational work offers a great deal of insight into the contemporary understanding of the specifically western tendency to link together concepts of property, rights, and law. In establishing an argument for liberalism, Locke begins with the assertion that the only way to overcome the condition of unpredictability and unreliability existing in the State of Nature was the creation of political society. The political society was realized through the inception of a sovereign government, which would have to promote the common good responsibility of protecting property through abiding by the Rule of Law, which

⁶ *The Legal Texts, Annex IC – The Agreement of Trade-Related Aspects of Intellectual Property Rights – TRIPS.*

Preamble: *Emphasizing* the importance of reducing tensions by reaching strengthened commitments to resolve disputes on trade-related intellectual property issues through multilateral procedures.

⁷ *The Legal Texts, Annex IC – The Agreement of Trade-Related Aspects of Intellectual Property Rights – TRIPS. Preamble.*

⁸ *The Legal Texts, Annex IC – The Agreement of Trade-Related Aspects of Intellectual Property Rights – TRIPS.*

Article 7 - Objectives

The protection and enforcement of intellectual property rights should contribute to the promotion of technological innovation and to the transfer and dissemination of technology, to the mutual advantage of producers and users of technological knowledge and in a manner conducive to social and economic welfare, and to a balance of rights and obligations.

was to be applied equally to all individuals. Locke's main assumptions for the proper functioning of the political society are as follows: first, that humans operate on the basis of reason and enlightened self-interest; second, there is a belief that the protection of private property is the main reason for the existence of government; third, there is the notion of Contract; fourth, there is an idea of individualism and the supporting role of the minimalist state.⁹ Of these four, the most relevant for the present context is the idea of contract and Rule of Law.

In his recent book, in which he contemplates the influence of ideas on economic development, Francis Fukuyama recalls the assertion made by economic historians that the creation of a stable system of property rights in the West was the crucial development that permitted the process of industrialization to begin. In countries like the United States, a system of property rights was established early on, such that even family businesses were usually also incorporated as legal entities. This, however, was not the case elsewhere. In China, for example, there has never been a tradition of property rights; instead, businesses remained contained within large families where transactions were based on trust and did not require legal protection¹⁰. The Chinese culture traditionally placed a higher value on the community than the individual. Accordingly, imitation was the greatest recognition an artist could receive. In ancient Indonesia, exclusive patent laws were not even permitted because new discoveries had to be shared with all the members of the community.

Intellectual property concepts are thus essentially North American and European legal concepts. One might be tempted to speculate that other societies, having been

⁹ John Locke (1986) *Two Treatises of Government*, London: Dent.

¹⁰ Francis Fukuyama (1996) *Trust – The Social Virtues and the Creation of Prosperity*, New York: Penguin Books, pp. 63-64.

brought by a different path to their point of institutional development¹¹, should be drawn by a combination of economic and political factors into attempts at achieving greater institutional coherence with the West in their treatment of intellectual property rights.

However, despite being situated within the western tradition of property rights, the TRIPS agreement curiously sets aside the historical understanding of intellectual property rights. Contrary to the present understanding embedded within the TRIPS agreement, which declares that IPR are private rights, the first IPR were designed to ensure a diffusion of knowledge and create a public domain for new inventions and knowledge. The first copyright law originated in England in 1710 when the British Parliament enacted the Statute of Anne. The law contained legal protection for consumers of copyrighted works by curtailing the term of a copyright, thus preventing a monopoly on the part of the booksellers. It also created a “public domain” for literature by limiting the length of term of a copyright, and by limiting the rights granted to the copyright owner (print, publish, sell) so the publishers were not able to maintain the perpetual monopoly for the publishing of literary work. The Statute dramatically changed the allocation of entitlements among authors, publishers and readers. It also removed literary works from the censorship of the booksellers and in effect unleashed a free market for literature¹².

Patents began as instruments used by European nobility during the Renaissance to induce the transfer and disclosure of technologies. Systematic protection of intellectual property by governments is usually traced back to 1474 when the senate of the Venice Republic passed the first patent law. And its purpose was to stimulate invention and

¹¹ Richard Gerster (1998) “Patents and Development” in *Journal of World Intellectual Property*, Vol.1, No.4, pp. 605-619.

¹² Paul Goldstein (1994) *Copyright's Highway-From Gutenberg to the Celestial Jukebox*, New York: Hill and Wang Publishers, pp. 42-43.

innovation¹³. Patent, the Latin adjective, means ‘open’, and the noun form abbreviates the term ‘letters = patent’ which refers simply to open letters. The first patents were the official documents by which certain privileges, rights, and ranks were conferred and publicly announced. Patent letters often served as recognition of the natural rights of the inventors and authors to the fruits of their creative efforts and were meant to facilitate a marketplace of ideas by awarding prestige and fame to the creators.

US patent institutions were derived from those of Britain. In 1641 the General Court of Massachusetts Bay adopted a number of provisions that created a statutory basis on which to grant future patents¹⁴. However, as David observes: “the importation of inventions from the ‘Old World’ was a natural enough proposition for the ‘New World’ settlers, so it is not surprising that even while British courts during the eighteen century increasingly construed the purpose of patents to be the encouragement of indigenous invention, Americans continued to consider the potential utility of providing incentives for technology transfers.”¹⁵ Up to 1974 it was very easy to obtain a patent in the US¹⁶. In other words, the dissemination of technology, and not so much its protection, remained the principal rationale behind the early patent legislation in the continental Europe and in the US.

The TRIPS Agreement is the most comprehensive legal regime ever concluded at the multilateral level in the area of intellectual property rights. TRIPS lays the foundation

¹³ Paul. A. David (1997) “The Evolution of Intellectual Property Institutions” in Paul A. David (ed) *System Transformation in Historical Perspective*, Oxford: Oxford University Press, p. 136.

¹⁴ Pamela Long (1991) “Invention, Authorship, “Intellectual Property” and the Origins of Patents” in *Technology and Culture*, No. 4, pp. 846-84.

¹⁵ Paul. A. David (1997) “The Evolution of Intellectual Property Institutions” in op. cit., p. 138. Also, Paul A. David (1996) *Real Income and economic welfare growth in the early republic, or, Another try at getting the American story straight*, Oxford: University of Oxford Press.

¹⁶ According to the above analysis 99% patent applications in the US (up to 1976) were successfully concluded. Ibid.

for convergence toward higher standards of protection around the world as it supplements and modifies the previous conventions governing intellectual property rights. The most important of these include¹⁷: the Paris Convention for the Protection of Industrial Property (1967); the Berne Convention for the Protection of Literary and Artistic Works (1971); the Rome Convention – the International Convention for the Protection of Performers, Producers of Phonograms and Broadcasting (1961) and the Washington Treaty – the Treaty on Intellectual Property in Respect of Integrated Circuits, sometimes labeled the ICIP Treaty (1989). The TRIPS agreement also obligates Members to provide for the protection of plant varieties, either by patent or by an effective *sui generis* system such as the plant breeder's rights established in the International Union for the Protection of New Varieties of Plants (UPOV) convention. This intergovernmental organization is based on the International Convention for the Protection of New Varieties of Plants signed in Paris in 1961. Both the Paris and Berne conventions have been revised several times and since 1967 they have been administered by the WIPO¹⁸.

The TRIPS agreement calls for the standardization of intellectual property rights among the signatories. It also establishes minimum standards of protection and guidelines for enforcement, in contrast with the previous WIPO conventions that only focused on ensuring implementation of domestic legislation. As a result TRIPS significantly modifies domestic intellectual property laws. The TRIPS Agreement requires each WTO member to adhere to the provisions of the previous international IPR conventions, whether or not the Member is party to those conventions. This, of itself, is a major extension for many countries. For example, the coverage of integrated circuits is a

¹⁷ Table 9 at the end of this chapter lists all the IPR Conventions that have become incorporated within the TRIPS/WTO legal framework.

¹⁸ World Intellectual Property Organization (WIPO) at (<http://www.wipo.org>).

novelty for many countries, including industrial countries. Under TRIPS, WTO members must consider unlawful – if not authorized by the right-holder – the import, sale, or other commercial distribution of the integrated circuit design, of integrated circuits containing that design, and of articles that contain such integrated circuits¹⁹.

As another example, the Rome Convention that establishes rights of performers, producers of sound recordings, and broadcasters has few signatories, particularly among developing countries. The TRIPS agreement creates obligations for governments that allow recording companies from one country to attack the unauthorized reproduction and sale of its products within another country. In addition, the TRIPS agreement in some areas has broader coverage than the relevant international convention. It goes beyond, for example, the Berne Convention to obligate copyright protection for certain computer programs and computerized databases, and it provides the first multilateral obligations on industrial designs (e.g., textile designs)²⁰.

The oldest of the international conventions is the International Convention for the Protection of Industrial Property, also known as the Paris Convention, first initiated in the

¹⁹ *The Legal Texts, Annex IC – The Agreement of Trade-Related Aspects of Intellectual Property Rights – TRIPS*, op. cit.

Article 1.3. Members shall accord the treatment provided for in this Agreement to the nationals of other Members. In respect of the relevant intellectual property right, the nationals of other Members shall be understood as those natural or legal persons that would meet the criteria for eligibility for protection provided for in the Paris Convention (1967), the Berne Convention (1971), the Rome Convention and the Treaty on Intellectual Property in Respect of Integrated Circuits, were all Members of the WTO members of those conventions.

²⁰ *The Legal Texts, Annex IC – The Agreement of Trade-Related Aspects of Intellectual Property Rights – TRIPS*

Article 10 *Computer Programs and Compilations of Data*

1. Computer programs, whether in source or object code, shall be protected as literary works under the Berne Convention (1971).

2. Compilations of data or other material, whether in machine readable or other form, which by reason of the selection or arrangement of their contents constitute intellectual creations shall be protected as such. Such protection, which shall not extend to the data or material itself, shall be without prejudice to any copyright subsisting in the data or material itself.

19th century. This convention covers patents, industrial designs, trademarks, and unfair competition. It requires *national treatment* of the intellectual property of foreign nationals, and it prescribes a period for filing for protection in any Convention country after the first filing in any Convention country. The protection relates back to the filing date in the first application. In very broad terms, this treaty offers to parties filing patent applications in a member country a grace period within which patent applications can be filed in other member countries. In the case of a design patent (and a trademark, for that matter), the grace period is six months. In the case of a utility patent (also known as a patent of invention), the grace period is one year.²¹

The Berne Convention was initially concluded in 1886 and finally amended in 1979²². If the foreign country was a signatory to the Convention for the Protection of Literary and Artistic Works, also known as the Berne Convention, then a domestic author had the same copyrights in a foreign country which is signatory to Berne that the foreign country grants its own citizens. The three basic principles of the Berne Convention are the following: (a) Works originating in one of the contracting States (that is, works the author of which is a national of such a State or works which were first published in such a State) must be given the same protection in each of the other contracting States as the latter grants to the works of its own nationals (principle of "national treatment"). (b) Such protection must not be conditional upon compliance with any formality (principle of "automatic" protection)²³. (c) Such protection is independent of the existence of

²¹ *Paris Convention for the Protection of Industrial Property*, 20 March 1883 - Article 1(2), Article 2(1) and Article 4 A (2).

²² In the meantime the Berne Convention was revised at Paris in 1896 and at Berlin in 1908, completed at Berne in 1914, revised at Rome in 1928, at Brussels in 1948, at Stockholm in 1967 and at Paris in 1971.

²³ It means that no additional paper work should be required. The "copyright" sign is sufficient.

protection in the country of origin of the work (principle of the "independence" of protection). If, however, a contracting State provides for a longer term than the minimum prescribed by the Convention and the work ceases to be protected in the country of origin, protection may be denied once protection in the country of origin ceases²⁴.

Under the TRIPS agreement, the principles of national treatment, automatic protection and independence of protection now bind all WTO Members, most importantly even those Members which have never become parties to the Berne Convention²⁵. In addition, the TRIPS agreement imposes an obligation of "most-favored-nation treatment," under which advantages accorded by a WTO Member to the nationals of any other country must also be accorded to the nationals of all WTO Members²⁶. However, the TRIPS agreement does not require that Article 6bis of the Berne Convention be observed. This Article deals with the issue of *moral rights*, or an author's right to protect the integrity of her work and object to changes that would be prejudicial to her reputation²⁷.

The Berne Convention traditionally sanctified the *moral rights* of the author widely recognized under the European copyrights laws. The concept of *moral rights* allowed authors to maintain control over what they create, and to keep anyone, even their own publishers, from making any changes to their works. The US legislative tradition,

²⁴ *Berne Convention for the Protection of Literary and Artistic Works*, 1971, Articles 5-8. See the relevant documents at <http://www.berne-convention.com>.

²⁵ Among the 123 countries that were GATT contracting parties by April 1994, thirty-three were not party to the Berne Convention. Carlos A. Primo Braga, (1996) "Trade-related intellectual property issues" in *The Uruguay Round and the Developing Countries*. Edited by Will Martin and Alan Winters. Cambridge: Cambridge University Press, pp.367- 370, Appendix A.

²⁶ *The Legal Texts - The Results of the Uruguay Round of Multilateral Trade Negotiations - Annex 1C - Agreement of Trade-Related Aspects of Intellectual Property Rights - TRIPS*, Articles 3 and 4.

²⁷ In accordance with Article 9 of the TRIPS agreement, WTO Members are not obliged to enforce *moral rights*, which were guaranteed under the Berne Convention. For more details, read: Carlos M. Correa (1994) "TRIPS Agreement: Copyrights and Related Rights" in *International Review of Industrial Property and Copyright Law*, No. 4, pp. 543-550. According to Correa this is a "Berne-minus" solution.

however, had long been resisting efforts to import the doctrine of *moral rights* into American copyright law. In 1987 Congressman Richard Gephardt introduced a bill to prohibit the unauthorized alteration of motion pictures²⁸. This was the last failed attempt of trying to bring the concept of *moral rights* to the US. The practitioners in the field routinely use the example of an author's moral right, and its rejection in the US, as evidence of a profound division separating the European and the American cultures of copyright²⁹. The European culture of copyright places authors at its center giving them a right to control every use of their creations. By contrast, the American culture of copyright centers on a utilitarian calculus that favors the needs of copyrights consumers over the rights of authors³⁰.

During the Uruguay Round of negotiations, the US negotiators insisted on removing the concept of *moral rights* from the provisions covered by the TRIPS Agreement³¹. The American argument of doing away with *moral rights* in order to obtain a greater commercial flexibility on the global markets had prevailed. The TRIPS Agreement consolidates the idea of a globalizing economy in which the intangible goods protected by intellectual property rights are classified jointly with tangible goods and services. Thus, intangible goods are considered in the TRIPS Agreement as any other good in international economic transactions. This understanding stresses the economic

²⁸ The framers of the US Constitution made copyright law purely federal (Article I, Section 8(43)). Congress subsequently enacted the Copyright Act of 1790 and major revisions to it in 1831, 1870, 1909, and 1976.

²⁹ Indeed, many European countries call their statutes protecting literary and artistic works, not "copyright" laws at all, but "author's rights" laws. For example, *droit d'auteur* in France, *diritto d'autore* in Italy, *prawa autorskie* in Poland, *Urheberrecht* in Germany.

³⁰ Paul Goldstein (1994) *Copyright's Highway-From Gutenberg to the Celestial Jukebox*, op. cit., pp. 165-196.

³¹ Interview with a WTO official, Geneva 2000.

aspects of copyright. In consequence, the authors' moral rights are rendered secondary, while the rights of the industry acquire a central role.

With the entry into force of the TRIPS Agreement, many countries found themselves in a curious situation. Some WTO Members (mostly industrialized countries) were already signatories to the IPR Conventions. On the other hand, most developing countries have never relied on IPR protection as a mechanism to foster innovation. However, after the establishment of the WTO, these countries had to accept TRIPS as an integral part of WTO Agreements. As a result all the present and future WTO Members will have to comply with the obligations established in the previous IPR Conventions (except for Article 6bis of the Berne Convention), and they will have to apply the additional provisions provided in the TRIPS Agreement.

Questioning the arguments behind TRIPS

Debate on Trade-Related Intellectual Property Rights in GATT can be traced back to the Tokyo Round of multilateral trade negotiations (1973-1979)³². At that time, the discussion focused narrowly on counterfeit trading³³. In the Uruguay Round, however, intellectual property rights became a major topic for negotiation³⁴. With the increased significance of technological innovations and revolution in communications, many forces have converged to thrust intellectual property rights into a position of international

³² Abdulqawi A. Yusuf (1998) "TRIPs: Background, Principles and General Provisions" in Carlos M. Correa and Abdulqawi A. Yusuf (eds.) *Intellectual Property and International Trade: The TRIPs Agreement*, Kluwer Law International: London, p. 6. See also GATT Document (1979) 'Agreement on Measures to Discourage the Importation of Counterfeit Goods'. (L/4817) 31 July.

³³ "Counterfeit" usually refers to goods to which a trademark has been applied without authorization.

³⁴ GATT Document (1986) *Ministerial Declaration on the Uruguay Round- Punta del Este*, reprinted in Basic Instruments and Selected Documents (BISD) Thirty-third Supplement. John Croome (1995) *Reshaping the World Trading System – A history of the Uruguay Round*, op. cit. pp. 130-138.

prominence. The growing demand for multilateral disciplines in these areas has been triggered by the desire to protect the increasingly important knowledge-based innovations³⁵. As more countries have been seeking to construct open market economies, the creation, use and dissemination of intellectual property has become a key determinant of international competitiveness.

The inclusion of an agreement on IPR within the WTO was particularly crucial to developed economies. Most developing countries, in turn, initially opposed it³⁶. In fact, from its beginning the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) was perceived to be one of the most controversial components of the final package of the Uruguay Round agreements and became a symbol of the north-south split³⁷. The agreement was conceived as a way of bringing the intellectual property rights under a harmonized system of international rules³⁸. TRIPS was an attempt to establish a comprehensive set of intellectual property rights standards, legally enforceable around the world by the reformed dispute settlement mechanism that the WTO Agreements had otherwise established. Its declared goal was to ensure global technological progress by securing the inventors' rights to benefit from their research and development efforts³⁹.

³⁵ Frederick M. Abbott (1998) "The Enduring Enigma of TRIPS: A Challenge for the World Economic System," *Journal of International Economic Law*, Vol.1, No.4, p. 498.

³⁶ John Croome (1995) *Reshaping the World Trading System – A history of the Uruguay Round*, op. cit pp. 120-121.

³⁷ "The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) was obtained by the threat and reality of trade sanctions and the withdrawal of aid. The TRIPS agreement is now being enforced by similar methods" says Lord Sydney Templeman (1998) "Intellectual Property" *Journal of International Economic Law*, Vol. 1, No. 4, p. 604.

³⁸ Frederick M. Abbott "The Enduring Enigma of TRIPS: A Challenge for the World Economic System," op. cit. p. 499.

³⁹ Carlos A. Primo Braga (1996) "Trade-related intellectual property issues: the Uruguay Round agreement and its economic implications," in *The Uruguay Round and the developing countries*, Will Martin and L. Allan Winters (eds.) Cambridge: Cambridge University Press, pp. 341-344; Jerome H. Reichman (1998) "Securing Compliance with the TRIPS Agreement after *US v India*," in *Journal of International Economic Law*, Vol. 1, No. 4, pp. 585-601.

With the implementation of the TRIPS agreement, intellectual property rights became for WTO Members, international obligations of commercial policy that cannot be escaped. Intellectual property rights are thus enforceable rules governing the establishment and treatment of the rights and terms of competition. The adoption and enforcement of at least the minimum standards required will procure considerably stronger global protection of intellectual assets. Developed countries were required to comply with all TRIPS commitments by 1996, developing countries and some transition economies were given five years to comply⁴⁰, while the least developing countries have eleven years to do so. Some developing nations, however, have complained about this deadline, arguing that they are not able to implement TRIPS commitments in time.

Some observers often write about TRIPS as though the rules it contains are comparable to disciplines against trade restrictions with respect to goods⁴¹. While there are certainly parallels, these two policy regimes differ fundamentally. First, goods trade restrictions are border measures that inherently discriminate between home and foreign interests. The same cannot necessarily be said about the partial harmonization of IPR standards put forward by TRIPS⁴². These standards apply without discrimination to domestic and foreign interests, meaning that the TRIPS agreement extends the reach of WTO rules into domestic commercial regulation.

Second, according to many economists border restrictions amount to inefficient taxes on particular forms of economic activity⁴³. Their reduction or removal via trade

⁴⁰ Until January 2000. This transitory period had already expired.

⁴¹ Robert Pechman (1998) "Seeking Multilateral Protection for Intellectual Property: The United States 'TRIPS' over Special 301" in *Minnesota Journal of Global Trade*, No.7, pp. 202-206.

⁴² Keith E. Maskus and Mohan Penubarti (1995), "How Trade-Related Are Intellectual Property Rights?" *Journal of International Economics*, No. 39, pp. 227-248.

⁴³ Bernard M. Hoekman and Michel M. Kostecki (1995) *The Political Economy of the World Trading System: from GATT to WTO*. Oxford: Oxford University Press.

liberalization is widely viewed by economists as a movement toward national and global welfare maximization. Put another way, free trade in goods and services generates the maximum gains from efficient global resource specialization, with each country benefiting. Protection of IPR, in contrast, tilts the balance toward incentives for innovation while raising the costs of gaining access to the fruits of innovation⁴⁴. This outcome could raise global efficiency in a dynamic sense but cannot be expected to increase welfare in all countries⁴⁵.

The TRIPS Agreement makes protection of intellectual property rights a foundation block of the World Trade Organization. Many of the standards that must be observed in TRIPS, however, are explicitly intangible production processes. This is clearly the case with respect to patents, industrial designs, the use of integrated circuits, and plant varieties. It holds also for trade secrets and infringement of software copyrights. Weak protection for these processes produces goods that are not necessarily inferior or dangerous for consumption relative to goods produced under strong protection⁴⁶. In effect, TRIPS ushers into the system of global trading rules an extensive mechanism for disciplining standards in addition to services and products. Consequently, critics of TRIPS wonder why, if IPR are included in the WTO to protect capital, labor standards are not also needed to protect workers, environmental regulations to protect natural resources, and competition policy to protect consumers⁴⁷.

⁴⁴ Keith E. Maskus (2000) "Intellectual Property Rights and Foreign Direct Investment" *Policy Discussion Paper No.0022*, Australia, CIES: University of Adelaide, pp. 13-15.

⁴⁵ Paul Krugman (1991) "Increasing Returns and Economic Geography," in *Journal of Political Economy*, No. 4, pp. 483-499.

⁴⁶ Jagdish Bhagwati (1998) *A Stream of Windows: Unsettling Reflections on Trade, Immigration, and Democracy*. Cambridge, MA: The MIT Press, pp. 80-82.

⁴⁷ Keith E. Maskus (1997) "The Role of Intellectual Property Rights in Encouraging Foreign Direct Investment and Technology Transfer," Paper presented at the Conference "Public-Private Initiatives

Thus, a question should be asked why IPR attained this status, while other major forms of business regulation - competition policy, environmental regulations, and labor rights - did not. To a considerable extent, the answer relies on considerations from political economy. Three powerful and easily organized industries (pharmaceuticals, entertainment industries, and high-tech/software) presciently recognized the opportunity afforded by the Uruguay Round to protect their intellectual property in the future and made IPR a core issue for the United States Trade Representative (USTR)⁴⁸. This approach complemented their efforts to publicize the damages they faced from weak international IPR and to push for aggressive unilateral trade actions by the United States under Section 301⁴⁹. As intellectual property became better recognized as a trade policy issue, more American export-oriented industries signed on to the effort, making TRIPS a required condition for success in the negotiations.

Moreover, some critics believe that the TRIPS Agreement was inserted into the WTO because it was backed by developed country power, especially as reflected in Special 301 retaliations by the United States. At the same time the arguments against the Agreement expressed by economists from developing countries, as well as the negotiating objections of some of their governments, were simply brushed aside.⁵⁰ Raghavan contends that “in TRIPS a high moralistic tone was adopted in order to present US/EC demands as a measure to prevent some kind of ‘criminal activity’ – piracy, theft

After TRIPS: Designing a Global Agenda” Brussels, July 16-19, later reprinted in *Duke Journal of Comparative and International Law*, 1998, pp. 7-11.

⁴⁸ Michael P. Ryan (1998) *Knowledge Diplomacy: Global Competition and the Politics of Intellectual Property*. Washington, DC: Brookings Institution Press.

⁴⁹ Edwin Mansfield (1993) “Unauthorized Use of Intellectual Property: Effects on Investment, Technology Transfer, and Innovation,” in M. B. Wallerstein, M. E. Moguee, and R. A. Schoen, (eds.) *Global Dimensions of Intellectual Property Rights in Science and Technology*, Washington, DC: National Academy Press, pp. 107-145.

⁵⁰ Jagdish Bhagwati (2000) *The Wind of the Hundred Days – How Washington Mismanaged Globalization*, Cambridge, MA: The MIT Press, p. 279.

and counterfeiting – rather than its reality, namely, to ensure *rentier* incomes for the TNCs through global monopoly rights – the antithesis of liberalization.”⁵¹

This is not a new anxiety. As the Uruguay Round was ending, most developing countries continued to view the inclusion of the IPR agreement in the final package not only as an instrument to combat counterfeiting and piracy, but also as a component of a policy of *technological protectionism*⁵² aimed at consolidating an uneven division of labor where industrialized nations generate innovations and developing countries constitute the market for the resulting products and services. Yet, under the principle of *single undertaking*, all WTO Members are now obliged to make a commitment to implement TRIPS. The transitory periods given to developing countries have already expired and no new ones are allowed for the acceding countries⁵³. The immediate implementation of the TRIPS agreement is unconditionally demanded upon accession. Thus, for any acceding government, establishment of a satisfactory IPR system becomes the most challenging aspect of the whole WTO accession process.

The weakness of the economic arguments behind TRIPS

The primary rationale behind the move towards globalization of intellectual property rights was an attempt to have a strong, harmonized and legally enforceable system of protection. The argument stressed the need to regulate the creative efforts of authors and inventors through the usage of various policy instruments (like patents and

⁵¹ Chakravarthi Raghavan (1997) “A New Trade Order in a World of Disorder” in *World Trade-Toward Fair and Free Trade in the Twenty-first Century*, Jo Marie Griesgraber and Bernhard G.Gunter (eds.) London: Pluto Press, p.24.

⁵² Carlos M. Correa (2000) *Intellectual Property Rights, the WTO and Developing Countries*, op. cit., p. 5.

⁵³ WTO document (2000) *Technical Note on the Accession Process*, (WT/ACC/7/Rev. 2) op. cit., p. 3.

copyrights) designed to enhance the economic welfare by stimulating technological progress.⁵⁴ Furthermore, including TRIPS in the world trading body was presented as bringing under multilateral rules and disciplines an important segment of global economic activity to prevent the theft and unauthorized use of inventions or illegal diffusion of knowledge.⁵⁵

Trade specialists justify international policy regimes on the basis of overcoming failures of countries to advance their long-term interests through collective action. Indeed, the essential purposes of GATT were to prevent countries from unilaterally raising tariff rates on behalf of domestic political interests and to establish a multilateral forum for reducing tariffs to the joint benefit of members. In IPR, it is argued that countries may choose standards that are weaker than optimal in an effort to promote local production through copying more rapidly than neighbor countries.⁵⁶ If a collection of developing nations did this, each country might be caught in a low-level equilibrium set of standards that discourage growth and technological progress. This would result in a net free ride by developing countries on developed countries. In other words, this argument says that whenever developing countries choose lower standards than those prevailing in the developed world, they are free riding the system.

⁵⁴ Jeong-Yeon Lee and Edwin Mansfield (1996) "Intellectual Property Protection and U.S. Foreign Direct Investment," *Review of Economics and Statistics*, Vol. 78, pp. 181- 186.

⁵⁵ Mansfield, Edwin (1993), "Unauthorized Use of Intellectual Property: Effects on Investment, Technology Transfer, and Innovation," in M. B. Wallerstein, M. E. Moguee, and R. A. Schoen, eds., *Global Dimensions of Intellectual Property Rights in Science and Technology*, (Washington, DC: National Academy Press, (1993), pp. 107-145.

⁵⁶ The theory supporting this claim is weakly established at best in the IPRs area and there is little evidence that countries compete on these grounds. Keith E. Maskus (2000) *Intellectual Property Rights in the Global Economy*, Washington DC: Institute for International Economics, pp. 28-35 and 44.

Another concern is that weak IPR generate inadequate global investment in R&D⁵⁷. In addition, the argument was put forward that weak and variable international IPR protection promotes uncompensated international technology diffusion and product copying, which could slow down invention and innovation.⁵⁸ A subtler variant is that weak IPR in developing countries result in too little R&D aimed at meeting particular needs of consumers in those countries, such as tropical medicines and some theoretical research points in this direction⁵⁹.

However, the evidence on this point is mixed and hardly conclusive. In fact, a contrary scenario is plausible. In some instances, technology is transferred through imitation by firms in developing countries. When the global IPR system is strengthened by the adoption of minimum standards, imitation becomes harder as foreign patents are enforced. The rate of imitation declines and, contrary to what might be expected, this can slow down the global rate of innovation also. This is because if innovative firms expect slower loss of their technological advantages they can earn higher profits per innovation, reducing the need to engage in R&D⁶⁰.

Furthermore, it is observed that a strong regime for protection of IPR constitutes a form of monopoly. Consider, for example, a patent. By preventing an unauthorized usage of a patented invention, the patent establishes legal barriers to production and importation. In principle, then, a patent is incompatible with the idea of free trade as it

⁵⁷ David Coe and Elhanan Helpman, (1995) "International R&D Spillovers," *European Economic Review*, Vol. 39, pp. 859-887.

⁵⁸ Jonathan Eaton and Samuel J. Kortum, (1996) "Trade In Ideas: Patenting and Productivity in the OECD," *Journal of International Economics*, Vol. 40, pp. 251- 278.

⁵⁹ Ishak Diwan and Dani Rodrik. (1991) "Patents, Appropriate Technology, and North-South Trade." In *Journal of International Economics* Vol. 35, pp. 79-90.

⁶⁰ Elhanan Helpman (1993) "Innovation, Imitation, and Intellectual Property Rights," *Econometrica*, Vol. 61, No.5, pp. 1250-1280.

contradicts contemporary ideas about competition and promotion of knowledge⁶¹. With the TRIPS Agreement, the tradeoff between protecting individual rights and promoting technological progress has led to the view that strong protection of intellectual property rights should be advocated to serve the former goal, at the expense of the latter.

The conventional economic rationale for the protection of intellectual property rights indicates a compromise “between the incentives they create for innovation and the inefficiencies that arise from granting a monopoly over the use of the patented good/technique.”⁶² The argument is based on microeconomic analysis that identifies the so-called ‘appropriability of knowledge problem’⁶³ caused by the ‘public-goods-like’ attributes of scientific knowledge⁶⁴. To the extent that intellectual property rights enhance appropriability they are expected to foster investment into activities that stimulate creation of new knowledge (inventions and innovations) by “enhancing the market power of titleholders”⁶⁵. In other words, since knowledge itself is not-competitive in nature, and it helps to enhance the human progress through new inventions, it should be freely available. If this were the case, however, the market would not invest in the production of

⁶¹ This explains why many liberal supporters of free trade opposed the introduction of patents during political debates on the issue that took place in the nineteenth century. For more details read: Fritz Machlup and Edith Penrose (1950) “The Patent Controversy in the Nineteenth Century,” *Journal of Economic History*, Vol. 10, pp. 1-29.

⁶² Will Martin and L. Alan Winters (1996) “The Uruguay Round: a milestone for developing countries” in *The Uruguay Round and the Developing Countries*, edited by Martin, Will and Alan Winters Cambridge: Cambridge University Press, p. 25.

⁶³ ‘Appropriability of scientific knowledge’ relates to the fact that certain tangible goods gain public utility because of the scientific knowledge that has been invested in their creation. In other words, as certain products become publicly desirable, or even essential, the inventors feel compelled to improve them to further enhance the quality of life. But the inventors will only do that if their inventions are protected by the strong IPR regime.

⁶⁴ Kenneth J Arrow (1962) “Economic Welfare and the Allocation of Resources for Invention” in *The Rate and Direction of Inventive Activity: Economic and Social Factors*. A Conference of the Universities – National Bureau Committee for Economic Research and the Committee on Economic Growth of the Social Science Research Council, Princeton, NJ: Princeton University Press, pp. 609-25.

⁶⁵ Braga, Carlos A. Primo (1996) “Trade-related intellectual property issues” in *The Uruguay Round and the Developing Countries*. Martin, Will and Alan Winters (eds.) Cambridge: Cambridge University Press, p. 37

new discoveries, because inventors would not be able to recover their costs. By granting inventors the exclusive rights to commercialize their intellectual creations, the IPR laws offer an incentive for the production of knowledge.

The above argument is easily explained in theoretical terms, though in fact it is not clear whether effective diffusion of knowledge happens more readily under weak or strong IPR. Moreover, the impact on global welfare is not easily determined. Evidence exists that diffusion transpires through a variety of international channels⁶⁶, including the legitimate use of patented technologies⁶⁷.

Inclusion of IPR in the WTO has also been justified by their relationship to trade in goods and foreign direct investment (FDI) flows⁶⁸. The essential point of this argument is that a weak IPR regime can operate as a non-tariff barrier to trade by reducing domestic demand for goods imported under patent or trademark protection. However, a strengthening of IPR does not necessarily increase trade volumes because it enhances market power at the same time that it shifts demand toward imports. Net impacts depend on a variety of factors in each country and product⁶⁹. The relation to FDI is even more uncertain.

A recent policy research project to examine the relation between strong IPR protection and direct foreign investment has demonstrated the apparent weakness of such

⁶⁶ David Coe and Elhanan Helpman, and Alexander W. Hoffmaister (1997) "North-South R&D Spillovers" in *The Economic Journal* No. 87, pp. 134-149.

⁶⁷ Eaton, Jonathan and Samuel Kortum. (1996) "Trade in Ideas: Patenting and Productivity in the OECD" in *Journal of International Economics* Vol. 40, pp. 251-278.

⁶⁸ Lael S. Brainard (1997), "An Empirical Assessment of the Proximity-Concentration Tradeoff Between Multinational Sales and Trade," *American Economic Review*, Vol. 87, pp. 520-544.

⁶⁹ Keith E. Maskus (2000) *Intellectual Property Rights in the Global Economy*, Washington, DC: Institute for International Economics, pp. 20-26.

connection.⁷⁰ In order to compare different national FDI experiences the study quantifies the strength of patent protection, taking into consideration the duration of protection, exclusionary provisions and scope provisions. After translating these criteria into numerical indicators, various empirical tests are performed to test the relationship between patents laws and FDI.

Multinational enterprises make multifaceted decisions regarding means by which they can access foreign markets. Firms may choose simply to export at arm's-length to a particular country or region. Alternatively, they may decide to undertake FDI, which requires selecting where to invest, in what kind of facilities, whether to purchase existing operations or construct new plants, which production techniques to pursue, and how large an equity position to take with potential local partners. Firms may prefer a joint venture with some defined share of input costs, technology provision, and profits or losses. Finally, firms may opt to license a technology, product, or service, leading to complicated issues of bargaining over license fees and royalty payments⁷¹.

The project on establishing relations between patents and FDI has involved probing various hypotheses. One assumes that firms engage in FDI because they can enjoy three types of advantages, against domestic competitors: ownership advantages; internalization of advantages, and locational advantages. Patent protection can be classified as a locational advantage if it affects the firm's choice for the best location⁷². Investing in a country with weak patents means more risks and less protection for the

⁷⁰ Edson K. Kondo (1995) "The Effect of Patent Protection on Foreign Direct Investment" *Journal of World Trade*, Vol. 29, No. 6, pp. 97-122.

⁷¹ Marcus Noland (1998) *Competition Policy and FDI: A Solution in Search of a Problem?* Washington DC: Institute for International Economics.

⁷² Claudy G. Culem (1988), "The Locational Determinants of Direct Investments among Industrialized Countries," *European Economic Review*, Vol. 32, pp. 885-904.

multinational corporations (MNCs). As a result, a hypothesis suggests stronger patent protection should be associated with more FDI. This effect, however, may be dampened by the implications of the product-cycle hypothesis. This hypothesis suggests that innovative products go to the developing countries later in their life-cycle, which means that relatively little patent life is left when products reach developing countries. Thus, depending on how fast new products reach these countries, patent protection may or may not affect FDI decisions⁷³.

Operating in the opposite direction is risk-avoidance driven FDI. According to this hypothesis, MNCs engage in FDI as one response to counter the risk of lagging behind their competitors. If the patent protection is weak, the firm decides to engage in FDI because of the fear that its rival may legally produce copies of its patented products and sell them overseas.

However, a contrary thing can happen when the patent protection is strong and the firm feels secure in the belief that the rival cannot challenge the patented product's market. According to this working hypothesis explored in the study, the firm can be expected to continue exporting instead of engaging in FDI⁷⁴. This is an informational imperfection in the market for technology that actually implies, other things being equal, that firms would be more likely to engage in FDI in countries with weaker IPR and contract-enforcement procedures. Another implication is that, as IPR in a particular nation become stronger, firms would tend to choose more technology licensing and joint ventures and less FDI. This is the one identifiable theoretical case in which the strength

⁷³ Edson K. Kondo "The Effect of Patent Protection on Foreign Direct Investment" in *Journal of World Trade*, 1995 (29) No. 6, pp. 97-122.

⁷⁴ Carlos M. Correa (1999) "Review of the TRIPS Agreement – Fostering the Transfer of Technology to Developing Countries" *Journal of World Intellectual Property*, Vol. 2, No.6, pp. 951-953.

of IPR would be negatively associated with FDI flows⁷⁵. It applies most readily to firms that have proprietary technologies that have been expensive to develop but are easily copied, such as pharmaceuticals, agricultural chemicals, and computerized processes.

After formulating hypotheses to examine the relationship between the strength of patent protection and FDI, the project performed several multiple regression analyses, concentrating on the 1979-1987 period. In short, the results showed that patent variable coefficients consistently fell well below the 5-per cent significant level indicating that even if there is a connection it is, at best, weak. In their final report, the researchers concluded that there is no evidence of a relationship between patent-law strength and FDI flows. In fact, the risk-avoidance driven FDI actually signals the possibility of a negative relationship as formulated in the last hypothesis.⁷⁶ On the basis of the results of the above research project, in short, it could be inferred that countries featuring weak patent protection have no clear advantage in adopting more stringent protection standards.

In fact, China offers a classical example supporting the hypothesis of low response of FDI to IPR protection. Despite that fact that China has been one of the most consistent violators of foreign IPR, the flows of FDI into that country have grown significantly in recent years. Yet, the TRIPS issue has played a major role in WTO accession negotiations that stalled for a number of years because WTO Members have considered the Chinese IPR regime to be unsatisfactory⁷⁷. On the whole, it seems that strong IPR alone are insufficient for generating strong incentives for firms to invest in a country.

⁷⁵ Ignatius Horstmann and James R. Markusen (1987), "Licensing Versus Direct Investment: A Model of Internalization by the Multinational Enterprise," *Canadian Journal of Economics*, Vol. 20, pp. 464-481.

⁷⁶ Edson K. Kondo "The Effect of Patent Protection on Foreign Direct Investment" op. cit. pp. 97-122.

⁷⁷ WTO Document (2000) *Communication from China – The Chinese Laws* (WT/ACC/CHN/40), 9 November.

Seen in the proper policy context, IPR are an important component of the general regulatory system, including taxes, investment regulations, production incentives, trade policies, and competition rules, and as such, it is the creation of a generally competitive business environment that matters overall.

Standards of IPR protection under TRIPS

The TRIPS Agreement sets international standards for the protection of intellectual property rights. Every country has a relative freedom to design its IPR laws except that they have to guarantee the protection of seven IP areas and they have to grant a minimum length of protection for patents and copyrights. Patents, trademarks, copyrights (and neighboring rights), industrial designs, geographical indicators, integrated circuits and trade secrets are the major classifications of intellectual property under TRIPS⁷⁸. *Patents* are legal titles granting the owner the exclusive right to make commercial use of inventions⁷⁹. *Trademarks* are words, signs, or symbols that identify a certain product or company. *Copyrights (and neighboring rights)* protect original works of authorship⁸⁰. *Industrial designs* protect the ornamental features of consumer goods such as shoes or cars. Similar to trademarks, *geographical indications* identify a product (Champagne, Burgundy Wine) with a certain city or region⁸¹. *Layout designs for integrated circuits* protect producers of semiconductors. *Trade-secret* protection does not

⁷⁸ Keith E. Maskus (2000) *Intellectual Property Rights in the Global Economy*, Washington, DC: Institute for International Economics, pp. 15-26.

⁷⁹ To qualify for patent protection, inventions must be new, non-obvious, and commercially applicable. The minimum term of patent protection under TRIPS is 20 years from the date of application.

⁸⁰ Copyright protection differs from patent protection in that copyright solely protects the expression of an intellectual creation. Copyright protection under TRIPS must be afforded for the life of the author plus 50 years.

⁸¹ So far this only concerns spirits and wines as negotiated by France. For example only France has a right to 'Champagne', every other country is now forced to use a name 'Sparkling Wine.'

grant an explicit title to the creator of an original work. Instead it protects business from the unauthorized disclosure or use of confidential information.

Although TRIPS does not create a universal IPR regime, it nevertheless presents a list of minimum standards describing the protection that each domestic legislature must provide. These so-called minimum standards mean the incorporation of the past IPR Conventions under TRIPS legal framework.⁸² In other words, WTO Members are now signatories of all the IPR Conventions. The standards are similar for each of the seven areas. In the instance of patents these standards must cover: a) what is patentable; b) what rights flow to the owner of a patent – government is obligated to prevent unauthorized persons from using, selling or importing the patent, the patented process, the patented product or the product or products directly made from the patented process; c) what exceptions to those rights are permissible – e.g., compulsory licensing may be required, but details guard the right of the patent owner and require that compulsory licensing not discriminate on the basis of technology nor between domestic production and imports⁸³; c) how long the protection lasts. Some critics continue to argue that “these [are] not ‘minimum’ standards of intellectual property protection in the classical sense of the term; rather, they collectively expressed most of the standards of protection on which the developed countries could agree among themselves”⁸⁴.

The most difficult IPR standards that are now universalized under TRIPS concern the establishment of the IPR enforcement mechanism. The acceding countries in

⁸² See Table 9 at the end of this chapter.

⁸³ A compulsory license “is a license generally granted by a government (with or without the consent of the right owner) which permits a party other than the original owner of the rights to use a patent” in Michael R. Gadbow and Timothy J. Richards (eds.) (1988) *Intellectual Property Rights: Global Consensus, Global Conflict?* Boulder, CO: Westview Press, p. 408.

⁸⁴ Jerome H. Reichman (1998) “Securing Compliance with the TRIPS Agreement After *US v India*” *Journal of International Economic Law*, Vol. 1, No. 4, December, p. 586.

particular experience great difficulties with implementing these standards. They require each WTO Member to make available enforcement measures and sanctions capable of deterring further infringing activity. The TRIPS Agreement makes a distinction between infringing activity in general, in respect of which civil judicial procedures and remedies must be available, and counterfeiting and piracy -- the more blatant forms of infringing activity -- in respect of which additional procedures and remedies must also be provided, namely border measures and criminal procedures⁸⁵.

While establishing such a comprehensive regulatory regime for the protection and enforcement of IPR, the candidates face tremendous administrative and legal challenges because of their limited financial resources and inadequate expertise in the field. As countries expand the number of intellectual property rights receiving protection, they will also need to expand their administrative apparatus for granting patents, copyrights and the like. Many acceding countries will need to expand and modernize to accommodate increased volume of applications for IPR as their economies industrialize. Computerization is necessary (but often unavailable) to speed up the process of granting IPR (e.g., conducting trademark searches). The process of implementing TRIPS is thus very expensive. In consequence, the acceding countries inevitably resist introducing so quickly the WTO style IPR regime and they continue to fear the agreement will ultimately lessen their access to new technologies⁸⁶.

⁸⁵ *The Legal Texts – The Results of the Uruguay Round of Multilateral Trade Negotiations – Annex 1C The Agreement of Trade-Related Aspects of Intellectual Property Rights (TRIPS) - Articles 41-62.*

⁸⁶ Jayashree Watal (1998) "The TRIPS Agreement and Developing Countries – Strong, Weak or Balanced Protection?" *Journal Of World Intellectual Property*, Vol. 1, No. 2, pp. 290-294; Carlos M. Correa (2000) *Intellectual Property Rights, the WTO and Developing Countries – The TRIPS Agreement and Policy Options*, op. cit, pp. 167-198.

The task is enormous for developing and the acceding countries alike. In a bid to join the organization, the candidate countries are asked to commit themselves to implement the TRIPS agreement immediately upon accession, with no transitory period allowed⁸⁷. Although the enforcement of intellectual property rights remains sporadic after the accession process is completed, the commitment to abide by the TRIPS agreement is expected to strengthen the protection of intellectual property rights.

The TRIPS Agreement contains provisions linking it with the WTO dispute settlement system to ensure that all WTO Members fully implement it or risk engaging in a trade dispute, which can end up in retaliatory measures. The enforcement provisions under TRIPS are particularly demanding on the acceding countries. Not only do they have to create a completely new administrative and regulatory framework for protection of IPR, they have to satisfy WTO Members that all the new IPR laws and regulations will be enforced and that the violators will be punished. Given the extensive requirements for establishing a sufficient level of enforcement under TRIPS, WTO Members place a variety of demands on the candidate states. These demands are often impossible to satisfy. Once the acceding country introduces the appropriate laws and enforcement procedures, private rights holders in the Member states can decide that the level of enforcement is still unsatisfactory. These rights holders can then petition their governments to intervene at the WTO.

In the case of the acceding countries such complaints over the implementation of TRIPS from private rights holders can prolong the WTO accession process indefinitely. However, a more delicate problem emerges when complaints and petitions are submitted against developing countries already in the WTO but they are having problems with

⁸⁷ WTO document: (WT/ACC/7/Rev. 2) *Technical Note on the Accession Process*, op. cit.

implementing the Agreement⁸⁸. The subsequent trade disputes will pose difficult questions concerning the ability of countries (WTO Members) to sit in judgment on the legal practices of other WTO Member states whose administrative capabilities, financial resources, bureaucratic and judiciary expertise, and even cultural heritage may differ radically from that of the complainants. These disputes are likely to happen soon given, on the one hand, absence of legal clarity for setting the interpretative limits of the TRIPS Agreement, and the scope of the Agreement itself, on the other. The following section illustrates the astonishing scope of the minimum standards for IPR enforcement procedures that must be established as a condition for WTO membership.

IPR enforcement provisions to be implemented by all WTO Members

General obligations

The general obligations relating to enforcement are contained in Article 41⁸⁹. Paragraph 1 requires that enforcement procedures must be such as to permit effective action against any act of infringement of intellectual property rights, and that the

⁸⁸ *The Legal Texts – The Results of the Uruguay Round of Multilateral Trade Negotiations – Annex 1C - The Agreement of Trade-Related Aspects of Intellectual Property Rights (TRIPS) - Article 64*

3. During the time period referred to in paragraph 2, the Council for TRIPS shall examine the scope and modalities for complaints of the type provided for under subparagraphs 1(b) and 1(c) of Article XXIII of GATT 1994 made pursuant to this Agreement, and submit its recommendations to the Ministerial Conference for approval. Any decision of the Ministerial Conference to approve such recommendations or to extend the period in paragraph 2 shall be made only by consensus, and approved recommendations shall be effective for all Members without further formal acceptance process.

⁸⁹ *The Legal Texts – The Results of the Uruguay Round of Multilateral Trade Negotiations – Annex 1C The Agreement of Trade-Related Aspects of Intellectual Property Rights (TRIPS) - Article 41*

1. Members shall ensure that enforcement procedures as specified in this Part are available under their law so as to permit effective action against any act of infringement of intellectual property rights covered by this Agreement, including expeditious remedies to prevent infringements and remedies which constitute a deterrent to further infringements. These procedures shall be applied in such a manner as to avoid the creation of barriers to legitimate trade and to provide for safeguards against their abuse.

remedies available must be expeditious in order to prevent infringements and they must constitute a deterrent to further infringements. Paragraph 2 deals with enforcement procedures. Such procedures must be fair and equitable, and they may not be unnecessarily complicated or costly, or entail unwarranted delays. Paragraph 3 concerns decisions on the merits of a case. Paragraph 4 requires that parties to a proceeding shall have an opportunity for review by a judicial authority of final administrative decisions and, subject to jurisdictional provisions in a Member's law concerning the importance of a case, of at least the legal aspects of initial judicial decisions on the merits of a case.

Civil and administrative procedures and remedies

The TRIPS Agreement requires that civil judicial procedures must be available in respect of any activity infringing intellectual property rights covered by the Agreement. Article 42 contains certain principles aiming at ensuring due process. Article 43 deals with how the rules on evidence should be applied in certain situations. Article 44 requires that the courts be empowered to order injunctions. Article 45 provides that the courts must be empowered to order an infringer, at least if he or she acted in bad faith, to pay the right holder adequate damages. Article 46 requires that the judicial authorities must have the authority to order infringing goods to be disposed of outside the channels of commerce, or, where constitutionally possible, destroyed.

The judicial authorities may be authorized to order the infringer to inform the right holder of the identity of third persons involved in the production and distribution of the infringing goods or services and of their channels of distribution (Article 47). Article 48 provides that the judicial authorities must have the authority to order the applicant who has abused enforcement procedures to pay an adequate compensation to the defendant

who has been wrongfully enjoined or restrained to cover both the injury suffered and expenses.

Provisional measures

Article 41 requires that enforcement procedures must permit effective action against infringements and must include expeditious remedies. As these judicial procedures may take a fair amount of time, it is necessary for the judicial authorities to be empowered to provide provisional relief for the right holder in order to stop an alleged infringement immediately. The provisions on provisional measures are contained in Article 50⁹⁰. It requires each country to ensure that its judicial authorities have the authority to order prompt and effective provisional measures.

Effective use of provisional measures may require that action be taken without giving prior notice to the other side. Therefore, the judicial authorities must have the authority to adopt provisional measures without prior hearing of the other side, where appropriate, in particular where any delay is likely to cause irreparable harm to the right holder, or where there is a demonstrable risk of evidence being destroyed (paragraph 2)⁹¹.

Special requirements related to border measures

The emphasis in the enforcement part of the TRIPS Agreement is on internal enforcement mechanisms, which, if effective, would enable infringing activity to be stopped at source, the point of production. Where possible, this is both a more efficient way of enforcing intellectual property rights and less liable to give rise to risks of discrimination against imports than special border measures. However, the Agreement

⁹⁰ *The Legal Texts – The Results of the Uruguay Round of Multilateral Trade Negotiations –Annex IC The Agreement of Trade-Related Aspects of intellectual Property Rights (TRIPS)*

⁹¹ *The Legal Texts – The Results of the Uruguay Round of Multilateral Trade Negotiations –Annex IC The Agreement of Trade-Related Aspects of intellectual Property Rights (TRIPS) - Article 50.*

recognizes that such enforcement at source will not always be possible and that in any event not all countries are Members of the TRIPS Agreement. The Agreement therefore also recognizes the importance of border enforcement procedures that will enable right holders to obtain the cooperation of customs administrations so as to prevent the release of infringing imports into free circulation.

According to Article 51 of the Agreement, the goods, which must be subject to border enforcement procedures, must include at least counterfeit trademark and pirated copyright goods that are being presented for importation. The Article leaves flexibility to Member governments on whether to include imports of goods, which involve other infringements of intellectual property rights.

The basic mechanism required by the Agreement is that each Member must designate a “competent authority”, which could be administrative or judicial in nature, to which applications by right holders for customs action shall be lodged (Article 51). The right holder lodging an application to the competent authority shall be required to provide adequate evidence of a *prima facie* infringement of his intellectual property right and to supply a sufficiently detailed description of the goods to make them readily recognizable by the customs authorities. The provisions on border measures require the taking of what are essentially provisional measures against imports of infringing goods.

Criminal procedures

The fifth and final section in the enforcement chapter of the TRIPS Agreement deals with criminal procedures⁹². According to Article 61, provision must be made for these to be applied at least in cases of willful trademark counterfeiting or copyright piracy

⁹² *The Legal Texts – The Results of the Uruguay Round of Multilateral Trade Negotiations –Annex 1C - The Agreement of Trade-Related Aspects of Intellectual Property Rights (TRIPS) Articles 61 and 62.*

on a commercial scale. The Agreement leaves it to Members to decide whether to provide for criminal procedures and penalties to be applied in other cases of infringement of intellectual property rights, in particular where they are committed willfully and on a commercial scale. Sanctions must include imprisonment and/or monetary fines sufficient to provide a deterrent, consistent with the level of penalties applied for crimes of a corresponding gravity. Criminal remedies in appropriate cases must also include seizure, forfeiture and destruction of the infringing goods and of materials and instruments used to produce them.

To summarize: the enforcement provisions of TRIPS require that every WTO Member provide civil as well as criminal remedies for infringement of intellectual property rights. Judicial systems and enforcement procedures must be developed or modernized in many countries to comply with this aspect of TRIPS. The technical complexity of many IPR issues means that judges, customs officials and others involved in enforcing IPR may require additional technical training.⁹³ The enforcement provisions also obligate Members to provide means by which right-holders can obtain the cooperation of customs authorities to prevent imports of infringing goods. While it is impossible to predict how the process of application and interpretation through the WTO dispute settlement mechanism will play out, it is difficult to see sufficient flexibility in the TRIPS agreement so that developing and newly acceded countries could strike a balance between the interests of underdeveloped late-comers, the need to promote innovation and investment in innovation that favors second comers, and the overwhelming costs and excessive requirements that have to be met to implement TRIPS.

⁹³ UNCTAD Document (1996) *The TRIPS Agreement and Developing Countries* (UNCTAD/ITE/I) United Nations: New York and Geneva.

The case of Ecuador – a lesson for future acceding countries

Ecuador was the first country to accede to the WTO following its transition from the GATT in 1995. As the accession process commenced, Ecuador began to construct its new IPR regime to ensure the level of protection and enforcement required under TRIPS. During the accession negotiations, WTO Members of the Working Party conducted repeated inquiries about the status of intellectual property protection in Ecuador, for example, the extent to which pharmaceutical products, microorganisms, and plant species were protected under the existing legislation⁹⁴. WTO Members were monitoring closely whether Ecuadorian legislation gave adequate protection to software, and whether piracy in this area was effectively prevented and prosecuted⁹⁵. The government of Ecuador was asked to prove that its enacted laws and regulations concerning the protection and enforcement of intellectual property were consistent with the provisions of the TRIPS Agreement⁹⁶.

When Ecuador started its accession process in September 1992, its government was hoping to join the world trading body before the conclusion of the Uruguay Round. When in the spring of 1993 it became clear that the outcome of the Uruguay Round would certainly be a new comprehensive package of multilateral agreements, Ecuador was asked to submit an additional set of documentation to the Members of the Working Party. This demand was placed on the government of Ecuador to address the enlarged scope of the new organization, which was to replace the GATT. The new Memorandum on its foreign trade

⁹⁴ Interview with an Ecuadorian official, Geneva 2000.

⁹⁵ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador* (WT/L/77), 14 July, Paragraph 77.

⁹⁶ GATT Document (1994): *Information Concerning the Uruguay Round of Multilateral Negotiations* (L/7523), 5 August.

regime was submitted by Ecuador in May 1993. For the first time it included specific paragraphs on the current regime for trade in services and measures relating to intellectual property and investment⁹⁷. Soon after, a meeting of the Working Party took place in July 1993. During this meeting the discussion about the scope and transparency of the Ecuadorian intellectual property regime played a prominent role⁹⁸.

As step one of the accession negotiations on intellectual property, it was expected that Ecuador would present WTO Members with a detailed list of IPR legislations that were already in place⁹⁹. Before the accession process began, Ecuador had only very limited IPR regulation. It consisted primarily of the Copyright Law, enacted by Supreme Decree No. 610 and published in the Official Journal on 13 August 1976. Supreme Decree No. 2821, published in Official Journal No. 0735 of 20 December 1978, had amended this Law, including in it protection against piracy in the reproduction, distribution or sale of illegal copies of phonograms¹⁰⁰.

On 17 December 1993, Ecuador and the Andean Group member countries had adopted Decision 351 establishing a common regime on copyright and neighboring rights. With regard to the rights that were protected, the Andean Group Decision recognized authorship of the work, integrity and other rights of a moral nature that could be exercised by the author, his heirs or the state in their absence. It also recognized ownership rights consisting in the exclusive right of the author to authorize or prohibit the reproduction, marketing, translation, arrangement or transformation of his works. The duration of the

⁹⁷ GATT Document (1993) *Memorandum on Foreign Trade Regime of Ecuador* (L/7202), 17 May. See also: WTO Document (1995) *Communication from Ecuador* (WT/L/54), 20 March.

⁹⁸ Interview with an Ecuadorian official, and with a WTO official, Geneva 2000.

⁹⁹ GATT Document (1994) *Communication from Ecuador* (L/7488), 22 June.

¹⁰⁰ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador*, (WT/L/77) Paragraph 77.

rights recognized in Decision 351 was to be no less than the life of the author and 50 years after his death, which was modeled on the provisions of the future TRIPS agreement. The protection granted by this Decision covered literary, artistic and scientific works that could be reproduced or divulged by any means known. Decision 351 also granted protection of neighboring rights, which are the rights of persons who participate in their dissemination of the relevant works. The protection referred to performers, producers of phonograms and broadcasting organizations. In January 1994 the new regime for industrial property was enacted in Ecuador. The new law was adopted by the Commission of the Cartagena Agreement following the Decision 344 from January 1994¹⁰¹. This new regime contained rules governing the grant of trademarks and patents, and also protecting for the first time industrial secrets and appellations of origin. The legislation also contained a long list of new procedures and principles for creating a new administrative system in Ecuador to ensure enforcement of IPR.

Despite the introduction of new legislation in Ecuador, the industrialized Members of the WTO Working Party continued to express their concerns with respect to the inadequate level of intellectual property rights protection. During the series of multilateral accession meetings of the Working Party in May 1995, Ecuador complained that it was simply not possible to establish what was in effect a completely new system of IPR protection within such a short period of time. As the overall accession process was coming to its end, WTO Members agreed to grant Ecuador a very limited transitory period until 31 July 1996 to bring its intellectual property rights regime in full compliance with the TRIPS Agreement. Ecuador further agreed that this extended implementation process would be

¹⁰¹ GATT Document (1994) *Communication from Ecuador* (L/7523) 5 August. Also, WTO Document (1995) *Report of the Working Party on the Accession of Ecuador*, op. cit., Paragraph. 77.

supervised by the existing Members under the commitment about notifying WTO Members on a periodic basis¹⁰².

Since 1996 Ecuador has had a new intellectual property law to complement the provisions of Andean Pact legislation, mainly Decision 344 of the Cartagena. Agreement. This was a result of monitoring the IPR regime in Ecuador by WTO Members. Since Ecuador acceded to the WTO there were numerous complains filed asking for more substantial revision of the existing legislation. The new law is a combination of the European and the American legal tradition. Like the European Patent Convention, the Andean Pact legislation contains a prohibition on the grant of patents for inventions whose exploitation would be contrary to morality. The new law in Ecuador sets out certain types of inventions that are to fall within this prohibition. They include inventions that could cause damage to the environment or ecosystem, the cloning of human beings or parts, the use of human embryos for industrial or commercial purposes and processes that change the genetic identity of animals if this causes pain and does not provide any substantial medical benefit for human beings or animals.

Among the most important new provisions modeled on the American legislation, the Ecuadorian law stipulates that integrated circuits and lay-out designs are to be protected for ten years from creation without the need for registration¹⁰³. Furthermore, new plant varieties will be protected on the basis of showing that the new variety has been deposited with the Plant Variety Office of a country that is a member of the International Convention for Protection of New Varieties of Plants. Software is to be

¹⁰² WTO Document (1995) *Report of the Working Party on the Accession of Ecuador*, op. cit., Paragraphs 77 and 80.

¹⁰³ WTO Document (1995) *Report of the Working Party on the Accession of Ecuador*, op. cit., Paragraph 76.

protected as a literary work. Licenses to use copyrighted works must be in writing for a fixed term, although they may be renewed indefinitely by agreement of the parties. The sale of blank audio or video tapes or recording equipment will require the collection of a fee to compensate copyright owners for the use likely to be made of such items in copying works that are the subject of copyright protection. The law further enhanced the administrative procedures for enforcement of IPR by establishing a separate judiciary body to deal exclusively with IPR cases.

Article 8.2 of TRIPS addresses the relationship between IPR and legislation intended to prevent distortions in competition. The strengthening of IPR in developed countries has run parallel to the development of competition law. In contrast, most developing countries have been forced to expand and reinforce the former in the absence of appropriate legal mechanisms to prevent and remedy anti-competitive practices. This is probably one of the major imbalances in the economic law regimes in developing countries and one of the important issues to be dealt with in association with the implementation of the TRIPS Agreement. Measures to prevent or remedy abuses of intellectual property rights should be adopted either as part of the intellectual property legislation or under competition law¹⁰⁴. Ecuador had to enact the relevant law and did so in cooperation with other member-states of the Andean Group. Article 46 of Decision 344 of the Andean Group uses the IPR approach favored by industrialized nations. In accordance with it:

"The competent national office may, either *ex officio* or at the request of a party, and after having obtained the consent of the national authority on free competition, grant compulsory licences where practices are noted that are not in keeping with the proper

¹⁰⁴ Edward M. Graham and J. David Richardson. (1997) *Competition Policies for the Global Economy*. Policy Analyses in International Economics - Paper 51. Washington DC: Institute for International Economics.

exercise of industrial property rights and adversely affect free competition, especially when they constitute an abuse by the owner of the patent of his dominant position on the market".

The example of Ecuador is a good representation of the reforms necessary to implement the TRIPS agreement by a country acceding to the WTO. Ecuador once again set a standard for implementation of TRIPS for the future WTO candidates. After Ecuador, all the successful applicants have undertaken unprecedented obligations to implement significant reforms to establish the intellectual property regime. Implementing such reforms is difficult and is closely monitored by the Working Party Members¹⁰⁵. WTO Members routinely argue that as the IPR institutions in the candidate countries are weak, they will benefit from strengthening and reform. Thus the acceding governments must continue to strengthen the institutions and processes that produce and implement legal instruments to ensure a satisfactory IPR protection. The ultimate goal is to ensure predictability and lawfulness of the acceding countries' trade regime.

Clearly, this goal is a fundamental requirement for the development of public institutions that can sustain market economies and provide a base for democratic pluralist systems. No government can function well without developing at all levels of the administration a strong capital stock of human resources, with language skills and specialized knowledge in fields such as economics, law and public administration. These efforts must be accompanied by measures to provide senior civil servants with career continuity, as well as opportunities to gain international exposure and to use their accumulated experience.

¹⁰⁵ Sylvia Ostry (1998), "China and the WTO: The Transparency Issue," in *UCLA Journal of International Law and Foreign Affairs*, Vol. 3, Summer.

However, our analysis indicates that WTO obligations reflect little awareness of development problems and little appreciation for the capacities of the acceding countries to carry out the functions that intellectual property regulations demand. The content of these obligations is unrealistically excessive. During the accession process the advanced countries place unbalanced demands on much weaker countries. These demands have been imposed in an imperial way, with little concern for what they will cost, how they will be met, or whether they will support the country's development efforts¹⁰⁶.

For example, inadequate protection of foreign intellectual property rights in the former Soviet-republics is one of the issues that causes the most complaints from the present WTO Members and often constitutes one of the biggest obstacles to their accession to the WTO¹⁰⁷. This is also a major stumbling block in the Chinese accession¹⁰⁸. The policies and institutions governing these matters under central planning were either radically different or completely lacking¹⁰⁹. Under the centrally planned economy, new knowledge was perceived as belonging to the whole society. Therefore, all legislation on intellectual property rights in Latvia, Estonia, Mongolia, Georgia, the Kyrgyz Republic, Albania, and Croatia, was created during these countries' WTO accession negotiations. The problem is that these countries had to draft intellectual property laws and then construct the elaborate infrastructure to implement TRIPS in a

¹⁰⁶ David M. Blumental (1999) "Applying GATT to Marketizing Economies: The Dilemma of WTO Accession and Reform of China's State-Owned Enterprises (SOEs)" *Journal of International Economic Law*, Vol. 2, No. 1, pp 113-153. Roman Grynberg and Roy Mickey Joy (2000) "The Accession of Vanuatu to the WTO – Lessons for the Multilateral Trading System" *Journal of World Trade*, op. cit. Wenguo Cai and Michael M. Hart (1996) *Vietnam's Accession to the World Trade Organization: Background and Issues*. Paper No. 42, Ottawa: Centre for Trade Policy and Law at Carleton University.

¹⁰⁷ WTO Document (2000) *Communication from H.E. Mr. William Rossier, Chairperson of the Working Party accession of the Russian Federation* (WT/ACC/SPEC/RUS/15) 12 July.

¹⁰⁸ Hiddo Houben (1999) "China's Economic Reforms and Integration into the World Trading System," in *Journal of World Trade*, Vol. 33, No.3.

¹⁰⁹ Patrick Heenan and Monique Lamontagne (1999) *The CIS Handbook*, London: Fitzroy Dearborn Publishers, pp. 28-32.

record time and under the scrutiny of WTO Members. Consequently, the TRIPS agreement underlines the transparency issue. The agreement establishes a separate Council for TRIPS to monitor compliance. Countries must provide notification of all regulations and administrative arrangements to the Council¹¹⁰.

With regard to bringing developing countries' IPR regulations up to the standards of the WTO Agreement, the UNCTAD case studies in support of IPR reform in developing countries likewise provide us with little insight into how to calibrate the appropriate balance. The studies only demonstrate a considerable range of needed reforms. The UNCTAD has concluded that the direct and administrative costs of complying with the TRIPS Agreement depends on the country's level of economic development and state of existing IPR institutions. In general, developing and the acceding countries need to introduce reforms in legislation, administration and enforcement. With respect to legislation, the immediate task in complying with the

¹¹⁰ *The Legal Texts – The Results of the Uruguay Round of Multilateral Trade Negotiations – Annex 1C: The Agreement of Trade-Related Aspects of Intellectual Property Rights (TRIPS)*

Article 63 Transparency

1. Laws and regulations, and final judicial decisions and administrative rulings of general application, made effective by a Member pertaining to the subject matter of this Agreement (the availability, scope, acquisition, enforcement and prevention of the abuse of intellectual property rights) shall be published, or where such publication is not practicable made publicly available, in a national language, in such a manner as to enable governments and right holders to become acquainted with them. Agreements concerning the subject matter of this Agreement which are in force between the government or a governmental agency of a Member and the government or a governmental agency of another Member shall also be published.

2. Members shall notify the laws and regulations referred to in paragraph 1 to the Council for TRIPS in order to assist that Council in its review of the operation of this Agreement. The Council shall attempt to minimize the burden on Members in carrying out this obligation and may decide to waive the obligation to notify such laws and regulations directly to the Council if consultations with WIPO on the establishment of a common register containing these laws and regulations are successful. The Council shall also consider in this connection any action required regarding notifications pursuant to the obligations under this Agreement stemming from the provisions of Article 6ter of the Paris Convention (1967).

3. Each Member shall be prepared to supply, in response to a written request from another Member, information of the sort referred to in paragraph 1. A Member, having reason to believe that a specific judicial decision or administrative ruling or bilateral agreement in the area of intellectual property rights affects its rights under this Agreement, may also request in writing to be given access to or be informed in sufficient detail of such specific judicial decisions or administrative rulings or bilateral agreements.

TRIPS Agreement is to introduce or rewrite laws guaranteeing protection of patents, copyrights, trademarks, trade secrets, etc., so that these laws comply with the TRIPS Agreement. In some countries this will require writing new laws that extend protection to new IPR (e.g., plant varieties, computer software). In other cases this will require re-writing existing laws to specify the length of patent or copyright protection.

Paying attention to the development needs of the weaker WTO Members, would likely require a considerable departure from the balance that has been institutionalized in the industrial countries' intellectual property rights law and has now become entrenched in the TRIPS Agreement. That balance, some economists argue, is tipped toward the interests of commercialized producers of knowledge – tipped past the point of optimality even for the community of interests that make up industrial country societies¹¹¹. Even for an individual country, it would be almost impossible to provide objective guidelines for striking the optimal balance between legal incentives to create, and the costs that are thereby incurred by users and potential second-comers. It would be even more difficult to scale this balance to different levels of economic development.

A number of authors further argue that the balance currently institutionalized in industrial countries is not the socially optimal one even for these countries. Reichman for example urges that “the logical course of action for the developing countries in implementing their obligations under the TRIPS agreement is to shoulder the pro-competitive mantle that the developed countries have increasingly abandoned”¹¹² while

¹¹¹ Joseph E. Stiglitz (1999) “Two Principles for the Next Round or, How to Bring Developing Countries in from the Cold,” paper presented at the conference organized by the UNCTAD and the World Bank in Geneva 21 September. Richard Gerster “Patents and Development” in *Journal of World Intellectual Property*, Vol.1, No.4, July 1998, pp. 605-619. Arvind Panagariya “TRIPS and the WTO: An Uneasy Marriage,” Conference Paper, Geneva, 2000.

¹¹² Jerome H. Reichman “*Securing Compliance with the TRIPS Agreement after US v India*,” op. cit., p. 589.

Templeman argues that there is no public justification for the level of intellectual property rights defined by industrial countries' laws¹¹³. Crudely interpreted, the implication of the TRIPS Agreement is that the global economy not only needs the rules and standards to be harmonized but needs to harmonize them up to the levels prevailing in developed countries.

WTO accession candidates, developing countries and growing problems with TRIPS

The first six years of implementation of the TRIPS agreement have been marked by attempts by industrialized nations to focus attention exclusively on securing the IPR for their corporations and paying no attention to their obligations to transfer and disseminate technological knowledge to address the issue of developmental objectives¹¹⁴. It is to be noted that under TRIPS the protection of intellectual property should contribute to "technological innovation" as well as to the "transfer and dissemination of technology" -- both of which are matters of major concern to developing countries. However, reference to the concepts of "mutual advantage", "social and economic welfare" and "balance of rights and obligations" indicates that the recognition and enforcement of intellectual property rights are subject to higher social values. In particular, a balance needs to be found between the interests of the various users of technological knowledge.

¹¹³ Lord Sydney Templeman (1998) "Intellectual Property" in *Journal of International Economic Law*, Vol. 1, No. 4, pp. 603-606.

¹¹⁴ *The Legal Texts – The Results of the Uruguay Round of Multilateral Trade Negotiations – Annex 1C The Agreement of Trade-Related Aspects of Intellectual Property Rights (TRIPS) - Article 7: Objectives*

The protection and enforcement of intellectual property rights should contribute to the promotion of technological innovation and to the transfer and dissemination of technology, to the mutual advantage of producers and users of technological knowledge and in a manner conducive to social and economic welfare, and to a balance of rights and obligations.

The imbalances with TRIPS implementation need to be addressed. Unfortunately, the transitional provisions of the TRIPS Agreement, under which developing countries were given until January 2000 to implement it, have been used by the industrialized WTO Members to demand the establishment of comprehensive IP regimes in all developing countries. In a similar fashion the accession process has been exploited by the developed countries to set high standards of IP protection, which have become the WTO norm¹¹⁵. All the acceded countries made a commitment to fully comply with the TRIPS Agreement without any time extension allowed¹¹⁶. This can have major consequences for those countries because their commitments are legally enforceable with recourse to the proceeding of the WTO Dispute Settlement Mechanism.

The excessive focus on patent protection of IPR by the industrialized WTO Members has shifted attention away from the protection of products of direct relevance to many acceding countries. For example, Vanuatu, a small least-developed country, is having problems with its WTO accession process. Vanuatu is resisting the excessive demands of WTO Members because these demands concern the immediate establishment of an IPR regime. And while its costs are obvious and difficult to meet, the benefits are hard to envision. Vanuatu is the biological home of the root crop 'kava'. Kava is a traditional beverage in Vanuatu and has been consumed by the people of Vanuatu long before the arrival of Europeans. However, large pharmaceutical companies in the United States and the EU now produce, and have patented, Kava Pills¹¹⁷. Apart from export of the unprocessed root, Vanuatu gains nothing from this increasingly popular natural

¹¹⁵ United Nations (2000) *The Future WTO Agenda and Developing Countries*, UN: New York, pp. 67-70.

¹¹⁶ WTO Document (2000) *Technical Note on the Accession Process* (WT/ACC/7/Rev. 2), op. cit.

¹¹⁷ Roman Grynberg and Roy Mickey Joy (2000) "The Accession of Vanuatu to the WTO – Lessons for the Multilateral Trading System," op. cit., p. 166.

sedative. The implementation of the TRIPS Agreement does nothing to protect the indigenous IPR Vanuatu claims to have to kava. The Agreement does not provide international standards for the protection of such indigenous IPR.

Article 27 of the TRIPS agreement guarantees "The protection of plant varieties either by patents or by an effective *sui generis* system or by any combination thereof."¹¹⁸ TRIPS, however, does not establish any criteria for international standards to protect indigenous plant varieties, allowing for the exploitation of biological resources in developing countries by the powerful pharmaceutical corporations. By stipulating compulsory patenting of micro-organisms (natural living things) and microbiological processes (natural processes) Article 27 contravenes the basic tenets on which patent laws are based. This is that substances and processes that exist in nature are a discovery and not an invention and thus cannot be patented. TRIPS allows WTO Members the option to exclude from the patentability of plants and animals, and this exclusion should be extended to micro-organisms as there is no scientific basis for the distinction. In fact, the recognition of the provisions and measures proposed under the Convention on Biodiversity and the International Undertaking that countries exercise sovereign rights over their biological resources should be reflected in TRIPS. However, all genetically modified seeds and organisms are fully protected under TRIPS and so are the formulas that use indigenous plant varieties.

¹¹⁸ *The Legal Texts – The Results of the Uruguay Round of Multilateral Trade Negotiations –Annex 1C: The Agreement of Trade-Related Aspects of Intellectual Property Rights (TRIPS) - Article 27. 3. Members may also exclude from patentability:*

(b) plants and animals other than micro-organisms, and essentially biological processes for the production of plants or animals other than non-biological and microbiological processes. However, Members shall provide for the protection of plant varieties either by patents or by an effective *sui generis* system or by any combination thereof. The provisions of this subparagraph shall be reviewed four years after the date of entry into force of the WTO Agreement.

The Convention on Biological Diversity, which opened for signature at the "Earth Summit," came into force legally in 1993. Under the terms of the Convention, access to these resources is granted by the "country of origin" on the basis of mutually agreed terms. Article 2 states that the country of origin of genetic resources "means the country which possesses those genetic resources in in-situ conditions." And in-situ conditions "means conditions where genetic resources exist within ecosystems and natural habitats, and, in the case of domesticated or cultivated species, in the surroundings where they have developed their distinctive properties." The protection of the rights and knowledge of indigenous communities are fully taken into account in the Convention and International Undertaking¹¹⁹.

Much to the dismay of developing countries, the framers of the TRIPS Agreement refused to take into account the principles of the Biodiversity Convention. Currently, TRIPS does not afford any exclusive rights to holders of traditional knowledge. On the other hand, it is permissible to patent the biological raw material found anywhere in the world, without the prior informed consent of the country of origin. Many developing countries express their concerns in the WTO over growing "biopiracy," where unscrupulous firms engage in patenting natural resources and traditional knowledge (ancient recipes, folk patterns, etc.) without compensating or even informing the providing community.

Furthermore, protection of products bearing geographical indications other than wines and spirits - such as Darjeeling tea, Basmati rice, Bulgarian yogurt, Ecuadorian native crafts – have been kept out of the WTO review of the TRIPS Agreement currently

¹¹⁹ UN Document (1992) *The Convention on Biodiversity and the International Undertaking*

taking place¹²⁰. The same degree of protection of the geographical indications as granted exclusively to wines and spirits under the TRIPS Agreement needs to be extended to cover other products traditionally produced in developing countries. During the accession of the Kyrgyz Republic, its government complained at the high costs of changing the labels on the domestic 'Champagne' bottles to replace them with a 'Sparkling wine' label. Later, when the Kyrgyz Republic proposed to identify its domestic goat cheese under geographical indications, the request was flatly denied¹²¹.

Clearly, while developing and the acceding countries were forced to establish domestic regulatory frameworks to protect and enforce IPR, the concerted approach of the industrialized WTO Members in not allowing developing and reforming countries to resist comprehensive implementation of the TRIPS agreement has created a confrontational approach to the TRIPS in the WTO¹²².

Of particular concern are those aspects of a strong regime for protecting intellectual property which relate to matters of the public's health by limiting consumers' access to new healthcare inventions. The fundamental issues are both ethical and economic. Historically, public policy encouraged investment in healthcare R&D. It becomes more difficult when the TRIPS Agreement emphasizes a property rights approach meaning that private "owners" of the inventions can restrict access on the basis of commercial considerations. The ethical issues are obvious. Higher prices for pharmaceuticals and other healthcare technologies prevent lower income consumers from

¹²⁰ WTO Document (2000) *Annual Report of the Council for TRIPS (IP/C/22)* 6 December.

¹²¹ Interview with a Kyrgyz official, Geneva 2000.

¹²² WTO Document (2000) *General Council-Implementation-Related Issues and Concerns (WT/L/384)* 19 December.

obtaining important therapies, including life-saving therapies¹²³. This is not just a problem for the poorest countries. Pharmaceutical and biotechnology companies are very aggressive about pricing new healthcare technologies, causing enormous problems for consumers in the developed nations¹²⁴.

The regulatory treatment of health registration data varies from country to country. Many OECD countries now provide similar or even greater periods of exclusivity for health registration data. Some countries do not. The U.S. is currently in a dispute with Argentina on this topic¹²⁵. Argentina protects health registration data by making it confidential. The United States does not object to the Argentine confidentiality policies, but it does object to the fact that Argentina permits firms to "rely upon" decisions by the U.S. FDA or similar agencies to demonstrate that a drug is safe and effective. The U.S. claims the Argentine policy violates Article 39.3 of the TRIPS, which requires nations to protect such data from "unfair commercial use." The U.S. trade officials say it is "unfair" for foreign regulators to make permissions to market drugs on public information regarding decisions by the U.S. FDA or other regulators.¹²⁶ Specifically, during the first 5 years or more of a drug's introduction into its market, the United States wants a firm to produce its own clinical trials and research data before it can obtain marketing approval. This creates a large entry barrier, because a new entrant will have to duplicate scientific research that has already been done -- a very wasteful and costly burden. Yet, the United

¹²³ Candace Redden (forthcoming) *Social Rights and the Challenge of Difference: Health Care, Entitlement and Citizenship*, University of Toronto Press, pp. 22-31.

¹²⁴ Simonetta Zarrilli and Colette Kinnon (1998) (eds.) *International Trade in Health Services: a Development Perspective*, Geneva: UNCTAD/WHO.

¹²⁵ WTO Document (2000) *Argentina – Certain Measures on the Protection of Patents and Test Data, complaint by the United States* (WT/DS196/1). This request, dated 30 May 2000, concerns Argentina's legal regimes governing patents in Law 24,481 (as amended by Law 24,572), Law 24,603, and Decree 260/96; and data protection in Law 24,766 and Regulation 440/98, and in other related measures.

¹²⁶ James Love (1997) *Comments for the Working Group On Intellectual Property Rights*. op. cit.

States considers that Argentina's legal regimes governing patents and data protection are therefore inconsistent with Argentina's obligations under the TRIPS Agreement and this is why it has initiated the proceedings under the WTO Dispute Settlement Understanding.

Many WTO disputes regarding intellectual property rights concern pharmaceuticals patents. The United States is pushing hard in several forums to ban or severely limit compulsory licensing of pharmaceuticals patents or related property rights¹²⁷. The TRIPS agreement addresses this in some detail. Compulsory licensing of patents are severely constrained by the TRIPS, but not flatly ruled out. In Article 31, the TRIPS sets out a long checklist of procedures a nation must follow. These are sufficiently ambiguous that future jurisprudence before the World Trade Organization (WTO) will be important in defining the limited rights retained by national governments. Compulsory licensing can create a strong domestic generic drug industry and is generally associated with greater competition and lower consumer prices. It can also lead to a necessary transfer of technology to less developed countries.

The resistance of developed countries to compulsory licensing continues to provoke forceful opposition from developing countries. In April 1999 the India decision to ignore the WTO deadline¹²⁸ for amending its patent law to allow for exclusive marketing rights to drugs and agro-chemicals had at its roots disagreements over demands to abolish a provision on compulsory licensing. Under the provision, India can widely license marketing rights on drugs and agro-chemicals in the interest of public health and safety. Several Indian officials believe that a proposed Patents (Amendment)

¹²⁷ WTO Document (1996) *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products- complaint by the United States (WT/DS50)*. This request, dated 2 July 1996, concerns the alleged absence of patent protection for pharmaceutical and agricultural chemical products in India.

¹²⁸ April 19, 1999.

Act, 1999 that was supposed to bring India patent law in compliance with WTO regulations is “totally against the public interest, public health, national interest and the Constitution.¹²⁹” The critics allege that under the amended Act, “importation will be equivalent to the working of a patent locally, thus discouraging local production, increasing foreign exchange outflows, reducing employment and increasing prices.”¹³⁰

In a related development, some Western governments, the WTO and pharmaceutical companies have come under heavy attack from developing countries and NGOs recently for their AIDS medication policies towards the world's poorest developing countries. Particularly harsh criticism came from the international aid group Oxfam, and the Nobel Prize winning Médecins sans Frontières (MSF), who accused drug companies of waging an undeclared war on the world's poor.

In a report released in February 2001, Oxfam said it would launch a new worldwide campaign to cut the cost of medicines for the poor, calling on the WTO to change patent rules, which it says result in restricted access to life-saving drugs¹³¹. In addition, the group seeks changes to WTO dispute settlement rules, under which disputes over TRIPS and other WTO Agreements are adjudicated. The group proposes broadening and clarifying the criteria under which compulsory licensing and parallel imports can be invoked, and shortening patent terms protected under the TRIPS Agreement. “Under WTO rules, patents on medicines produced by the drug industry are protected for 20 years. This is the shadowy side of globalization,” the report stated. “The WTO must

¹²⁹ *The Hindu – India* (1999) “Patents Act Changes Challenged,” New Delhi 21 April.

¹³⁰ Bernard D’Mello “Underdevelopment After the Uruguay Round: India” in *World Trade-Toward Fair and Free Trade in the Twenty-first Century*, op. cit., p. 65.

¹³¹ *UNITED PRESS INTERNATIONAL* (2001) “Oxfam accuses drug firms of war against poor,” 12 February.

change the rules that the drug industry is now using to cripple cheap, local competition, which in turn is inflating the cost of new and patented medicines.¹³²

In response, WTO spokesperson Keith Rockwell has said that "the TRIPS agreement strikes a reasonable balance between the interests of the private sector to ensure protection for their patented goods and the interest of governments to ensure their rights to protect public health." Rockwell also pointed out that the agreement allows WTO Members to write provisions in their intellectual property legislation allowing them to adopt measures necessary to protect public health and nutrition. Oxfam, however, argues that "these TRIPS provisions are hedged in by onerous conditions and, in practice, efforts to apply these measures have been fiercely contested by pharmaceutical companies, often with the backing of western governments."¹³³

During the first six years of the existence of the WTO, attempts by developing countries and the acceding countries to seek access to technology on realistic terms have been obstructed by the stance of the developed WTO Members. For example, proposals to examine the compulsory licensing provisions and the term of patent protection were rejected by industrialized countries¹³⁴. In a similar way, a comprehensive proposal for extending the implementation process of TRIPS by the group of the recently acceding countries headed by Latvia – one of the most recent WTO Members - was never considered during the Ministerial Session in Seattle¹³⁵.

¹³² *Inside US Trade* (2001) "Oxfam seeks major changes in TRIPS rules to lower drug prices," 16 February.

¹³³ *Bridges (Trade News Digest)* (2001) "TRIPS, AIDS Drugs and Developing Countries" Vol. 5, No. 6, 21 February.

¹³⁴ WTO Document (1996) *Report of the Committee on Trade and Environment* (WT/CTE/W/40) 7 November, pp. 31-32.

¹³⁵ WTO Document (1999) *Communication from CEFTA Countries and Latvia* (WT/GC/W/275) November.

Concluding remarks

The three main features of the TRIPS Agreement are: 1. *Standards*. The Agreement sets out the minimum standards of protection to be provided by each Member with relation to the previous international conventions on IPR. 2. *Enforcement*. The second main set of provisions lays down certain general principles applicable to all IPR enforcement procedures. In addition, it contains provisions on civil and administrative procedures and remedies, provisional measures, special requirements related to border measures and criminal procedures, which specify, in a certain amount of detail, the procedures and remedies that must be available so that right holders can effectively enforce their rights. 3. *Dispute settlement*. The Agreement makes disputes between WTO Members over TRIPS obligations subject to the WTO dispute settlement procedures.

In order to meet the demanding requirements of the WTO accession process, the acceding countries must ensure that their domestic regulations provide the so-called minimum standards of IPR protection. In order to do that the candidates are expected to fully implement the TRIPS Agreement. The TRIPS mandated minimum IPR standards correspond to a country being in compliance with the provisions of all the past international Conventions on IPR as well as in compliance with additional rules subsequently added into the TRIPS Agreement. These minimum IPR standards also correspond to the requirement for establishment of the specific domestic enforcement procedures that are specified in the Agreement.

Although TRIPS does not prescribe one single model of IPR protection for each country, the Agreement will certainly have a harmonizing global effect with respect to substantive and procedural rules concerning the enforcement of IPR. National legislation

of WTO Members must implement a significant number of rules enforceable under the WTO system. The implementation of the TRIPS Agreement, however, should not stem from retaliation threats by industrialized countries. For example, the acceding countries are routinely forced by the powerful WTO Members to establish the precise scope of the IPR regime under domestic law. Non-compliance with the TRIPS standards and obligations - as interpreted by the existing WTO Members - can lead to commercial retaliations under the WTO settlement mechanism.

The countries that are applying for WTO membership must implement the TRIPS Agreement under the scrutiny of WTO Members. Among the difficulties faced by the acceding (and developing countries alike) in the implementation of the TRIPS Agreement, the following merit particular consideration. Firstly, there is not sufficient time allowed for the implementation process in view of the complexity of establishing the domestic IPR regime. Secondly, the acceding countries lack technical and financial support to develop rules and necessary institutional infrastructure for IPR protection.

The accession process is only completed if the monitoring WTO Members are satisfied with the laws and the enforcement procedures introduced by the candidates in response to their non-optional demands. Reluctantly, acceding countries give in to these demands if they decide to proceed with WTO accession. The twelve countries that have acceded to the WTO since its establishment had to substantially modify their regulatory regimes. These acceding countries routinely meet the excessive demands of WTO Members because they are led to believe that the full implementation of the TRIPS Agreement is essential for revitalizing their economies by securing the position of foreign investors.

Although its impact varies across countries and over time, foreign direct investment bears considerable promise for improving efficiency and growth in developing countries, particularly those that are scarce in capital and have limited managerial talents. In fact, recent theoretical treatments of the impacts of IPR on FDI in economic models produce mixed results. However, during WTO accession negotiations the candidates are told that the full implementation of the TRIPS Agreement is a necessary condition for attracting foreign investors. The acceding countries are also told that successful adoption of competition-enhancing IPR laws and regulations should materially improve the knowledge base of the economy and move it toward the globally efficient production frontier.

Recent experiences in developing economies indicate that liberalization of trade policies and investment regimes can have significant positive growth impacts. There is little doubt that a major determinant of relatively rapid economic growth in East Asia and Central Europe has been access to foreign technologies through FDI. There are good reasons to expect these growth effects to be lasting because additional benefits include access to a wider variety of specialized products and technologies, and rising real wages.

However, the advantageous impacts of FDI do not come without costs. The investing firms can engage in abusive practices of their protected market positions in exploiting stronger IPR. Such abuses could emerge in setting restrictive licensing conditions, tying up technology fields through cross-licensing agreements, establishing vertical controls through distribution outlets that prevent product competition, price discrimination, and predation against local firms. Thus, despite rhetoric in support of TRIPS, it is also possible that the Agreement can cause monopolization of intellectual

property in the hands of a few powerful title-holders. This can have a whole range of negative consequences, for example: overly expensive race-like competitions to be the first to obtain a title to the most commercially lucrative projects, neglect of those areas in which little financial award is perceived, and over-concentration of R&D facilities in the technologically advanced centers, making it too expensive for developing countries to compete, to name just a few.

The countries currently acceding to the WTO consistently express the above concerns¹³⁶. When the accession process stalls, it is quite often that such arguments prevail. Some acceding countries fear that they will find certain sectors of their economies coming under increasing control of foreign firms through exploitation of their specific advantages, including brand names, patented technology, marketing skills, and economies of scale.

It is true of course that exploitive business practices are possible only to the extent that monopoly positions are protected and tolerated. Many acceding countries, however, have not yet developed appropriate competition rules to deal with these issues. The absence of such a policy and the reliance on a globally standardized system of protection can have quite contrary outcomes. Many firms would be induced to engage in patent races in the hope of securing the exclusive right for collecting the licensing royalties. Such races can distort competition due to over-investment in R&D, wasteful and duplicative research and industrial intelligence. And naturally, the cost of this kind of maneuvering is quite substantial. Weak and under-developed countries find the global regime for intellectual property rights too expensive both to race against and buy from.

¹³⁶ Interviews with the government officials from China, Saudi Arabia, Russia, Ukraine, Algeria, Vanuatu and Vietnam, Geneva, 1999 and 2000.

Thus, some candidate countries prefer to forego the anticipated benefits of WTO membership by claiming an unwillingness to risk potential dependency at the hands of foreign firms. This is why WTO accessions of Ukraine, Vietnam, Algeria and Vanuatu have remained inactive for some time now¹³⁷.

The demands placed on developing countries that are trying to accede to the WTO demonstrate that the TRIPS Agreement is a problematic attempt to globalize intellectual property rights for at least two reasons. First of all, the economic arguments behind the TRIPS Agreement, namely that a strong IPR protection invites foreign direct investment and facilitates economic growth, have been seriously miscalculated. Second, intellectual property rights, like other categories of rights or law, are historically situated. They are conceived, constructed and interpreted in particular socio-economic contexts. Their emergence – as applied to a particular type of innovative activity - is related to economic, technological, cultural and political domestic factors often reflecting a particular level of development – and cannot be seen simply as the product of an abstract legal logic. Thus, it is unrealistic to expect that those countries that previously did not have a tradition of protecting such rights would construct a whole new system of intellectual property rights protection within a few years time.

¹³⁷ As of April 2001.

Table 9: International IPR Agreements Incorporated under TRIPS

Type of IPR	Instruments of Protection	Subject Matter	Main Fields of Application	Major International Agreements
Industrial Property	Patents, utility models	New, non-obvious inventions capable of industrial application.	Manufacturing, Agriculture	Paris Convention, Patent Cooperation Treaty (PCT), Budapest Treaty, Strassbourg Agreement, TRIPS
	Industrial Designs	Ornamental designs	Manufacturing, clothing, automobiles, electronics, etc.	Hague Agreement, Locarno Agreement, TRIPS
	Trademarks	Signs or symbols to identify goods and services	All industries	Madrid Agreement, Nice Agreement, Vienna Agreement, TRIPS
	Geographical indications	Product names related to a specific region or country	Agricultural products, foodstuffs, etc.	Lisbon Agreement, TRIPS
	Integrated circuits	Original layout design of semiconductors	Microelectronics industry	Washington Treaty, TRIPS
Literary and artistic property	Copyrights and neighboring rights	Original works of authorship	Printing, entertainment (audio, video, motion pictures), software, broadcasting	Berne Convention, Rome Convention, Geneva Convention, Brussels Convention, WIPO Copyright Treaty 1996, WIPO Performances and Phonograms Treaty, Universal Copyrights Convention, TRIPS
	Trade secrets	Secret business information	All industries	TRIPS
Sui generis protection	Plant breeder's rights	New, stable homogenous, distinguishable plant varieties	Agriculture and food industries	Convention of new varieties of Plants (UPOV), TRIPS

Conclusion

The Uruguay Round of multilateral negotiations marked an important point in the history of international trade. It created a formal organization with its own unified dispute settlement mechanism and brought in new issues that traditionally were not covered by the international trade regime. The World Trade Organization aims to be universal, and the accession of new countries is therefore welcomed in principle by all WTO Members. However, the WTO accession process is not as simple as it was under the GATT. The candidates confront more comprehensive obligations covering both border measures and domestic regulatory policies. At the same time, special privileges and exemptions for developing countries have been scaled down.

In fact, the WTO accession process can be seen as a reflection of conflicting development ideologies as it epitomizes the pressures that the world economy puts on developing countries. WTO accession also demonstrates the changing role of the state since it mainly revolves around the internal reforms that the candidate state must undergo in order to behave in accordance with the legal principles that the WTO is based on. How developing countries adjust to all these new pressures is a central drama that is being played out on the international scene.

WTO accession mirrors some of the most compelling tensions taking place in the changing international order. It forces questions about globalization, the future of inter-state relations (particularly the political and economic relations between the industrialized economies and developing countries), and the domestic implications of progressive codification of international economic law. A code of WTO legal rules

effectively constraints the behavior of its Member states by way of monitoring and supervising the implementation of the commitments they made while joining the organization. Drawing upon the insights of the traditional interpretations of international relations, we have argued that the WTO is a particularly important step on the road to the progressive codification of international law because of its dispute settlement system capable of exercising retaliatory legal power against states that break their WTO commitments.

The world economy has been growing for generations. But never before have international economic transactions affected domestic politics so profoundly and so fast. No longer can these two domains be truly separated into distinct sets of priorities and activities. As David M. Blumental observes, “The premises of a global economy – interdependence and transparency – have permanently altered the notions of absolute sovereignty, escalating the natural tension between states’ sovereignty and domestic policy and adherence to international norms.¹” Indeed, it is one of the consequences of the new world economy that international law now intrudes far more directly into matters that were previously considered to be the certain domain of the state.

Traditionally, the practice of international law relied on principles of reciprocity and self-help, and could not ensure the rule of law in the absence of compulsory adjudication and because of the lack of effective retaliatory abilities. WTO legal rules for the first time in the history of international law introduce the practice of compulsory adjudication once a complaint by an injured party is accepted as valid. Furthermore, the WTO code includes provisions allowing for the authorization of sanctions, should they

¹ David M. Blumental (1999) “Applying GATT to Marketizing Economies: The Dilemma of WTO Accession and Reform of China’s State-Owned Enterprises (SOEs),” *Journal of International Economic Law*, Vol. 2, No. 1, p. 114.

become necessary to remedy the violation of agreed rules. Thus the WTO marks an important event in the tradition of international relations by attempting to move them away from inter-state bilateral crisis management towards rule-based mechanisms of global governance.

Accession to the WTO takes place pursuant to Article XII of the Marrakesh Agreement Establishing the WTO. Article XII makes clear that the applicant for accession must negotiate the precise terms of its accession with the current membership of the WTO. The negotiations are complex and require agreement on a difficult package of rights and obligations - many of which may present serious implementation problems for the acceding countries. From the entry into force of the WTO Agreements on 1 January 1995, until the end of April 2001, twelve countries have joined the WTO. They were, in chronological order, Ecuador, Mongolia, Bulgaria, Panama, Kyrgyz Republic, Latvia, Estonia, Jordan, Georgia, Albania, Croatia and Oman. More than 30 other countries have also applied for WTO membership and are now at various stages of negotiating the terms of their accessions.

The standards of WTO accession have evolved in such a way as to provide the existing WTO membership with assurances that a newly acceding country fundamentally is run on market principles. It can be reasonably expected that developing countries and transition economies will not secure WTO membership unless they can demonstrate that their trade regime is based on market transactions and the state does not have a monopoly over the economy. However, this is exactly what makes WTO accession a frustratingly slow process. To meet so much higher WTO

entry requirements, acceding countries routinely go through a thorny and unpredictable structural adjustment process under the supervision of incumbent WTO Members.

The most substantial problems that complicate and slow down accession negotiations arise from several crucial differences between the present situation and accessions to GATT 1947. In contrast, during the GATT era it was possible for a non-market economy to join the world trading body. Under the Protocol of Provisional Application a country could have become a GATT Contracting Party without undergoing any internal pro-market reforms. The influence of the GATT on the domestic politics of the state was minimal because the GATT system allowed countries to keep their domestic legislation intact, even if it was GATT-inconsistent. This is no longer possible under the WTO. After becoming a formal legal organization the WTO unavoidably did away with the provisional character of the GATT. In addition, the General Agreement dealt exclusively with goods, and thus it was mainly concerned with issues of tariffs and border measures. WTO rules are far more complex than those of the GATT, as they apply to a much wider variety of trade policies and sectors of the economy that were previously outside the multilateral disciplines, like services, intellectual property, agriculture, textiles, investment, and subsidies for industry and agriculture.

Supporters of the multilateral trade agreements emphasize the advantages of WTO accession. For example, WTO Members receive a legal right of access for their exports on non-discriminatory basis. This right is permanent and it is reinforced with recourse to the WTO dispute settlement mechanism in case of its being infringed. The new Members also will be able to participate in future multilateral negotiations to

improve the access conditions for their products and services. WTO membership can also facilitate the candidates' growth rates and trade volume as well as enhance the stability of their trading regimes. It is also expected that a successful accession process will result in the strengthening of domestic policies and institutions and create a competitive investment environment, provided that appropriate and not excessive or unrealistic commitments are negotiated. When applying for WTO membership, the successive acceding governments have stressed the fact that accession would encourage and consolidate their own internal reform process and allow them to play an active role in the new global economy.

Indeed, the WTO accession process becomes a vital part of the economic reforms taking place in the acceding country because of the interplay between the domestic and international politics of trade. Very serious non-market barriers to trade of a different kind exist in practically all countries acceding to the WTO. These relate to the general weaknesses of market supporting institutions, which appear to be pervasive but difficult to quantify systematically. Weaknesses exist both in general, for example, concerning enforcement of contracts and property rights, as well as in particular areas critical to international trade, such as the availability of trade finance and insurance, or the transparency of customs procedures. Most importantly, however, the ability of the acceding country to take full advantage of opportunities offered by WTO membership depends on shifting to a regulatory framework enhancing growth, competition, stability, and economic efficiency. Therefore a crucial lesson that emerges from WTO accession is that the scope of the WTO Agreements is actually

narrower than the scope of what must be done to make development sense out of their implementation.

The apparent needs of the acceding countries strongly confirm the impact of an effective regulatory framework even in countries where market systems are weak. We have developed a theoretical argument that stresses the importance of domestic institutional reforms. The argument further emphasizes the rule of law during the time of political and economic reforms. We have argued that the debate pondering the value of economic liberalization versus political democratization misses the main point. Reform credibility is essential, because of the apparent need for an instant improvement and the high cost of uncertainty. Consequently, it is the effective regulatory infrastructure that is needed in the first place to advance the economic and political reforms.

The framers of the WTO Agreements understood its significance and this is why the agreements contain the provisions stressing the importance of domestic regulations with respect to implementation and enforcement of WTO obligations by its Members. The regulatory reforms, however, are difficult and must be done in a thoughtful way to address the multiplicity of economic, social and political issues. It is mistaken, for example, to draft laws protecting intellectual property rights and then press for their immediate enforcement, and to neglect the issue of unemployment that can result from the introduction of these laws should they prohibit the state-run generic pharmaceutical industries. In order to be effective the new laws and regulations must be implemented and enforced in the context of the developmental strategy of the acceding country.

The WTO accession process was intended to help the candidate to reform its domestic institutions so it could fully benefit from the membership in the multilateral trading system. Sadly, this purpose has been lost during the first twelve WTO accessions. Instead of careful institution building while negotiating some moderate trade concessions, the acceding countries have been forced to make excessive liberalization commitments as a non-optional prerequisite to join the WTO. The depth and the multiplicity of the commitments undertaken in the course of the accession negotiations compel the acceding governments to question whether these commitments are realistic and beneficial to their economies. In other words, the main concern is whether the acceding governments will be able to overcome many formidable barriers of implementation – like absence of institutional infrastructure, insufficient legal expertise, limited financial resources, administrative paralysis, high unemployment, privatization of state-run enterprises, lack of organizational transparency - in order to benefit from WTO membership.

The WTO accession process clearly reveals that international institutions must be brought front and center to the analysis of the international political economy. Institutions are important because it is through them that historical agents have made and will continue to make their own history. In an attempt to understand the structural organization of the world economy, this dissertation has maintained a focus on practices of international trade in their institutional form. The WTO is the medium through which international trade flows are organized. But the WTO inevitably is also a global social entity created in response to a particular historical moment. We have examined how the organization is trying to account for the changes taking place in the

world economy. It is precisely through an organizational form like the WTO that a global market behavior emerges.

The legal rules of the WTO are well put into practice during the accession negotiations. By considering WTO accession to be the result of the institutional global behavior, we can strive for an understanding of the political economy of international trade in a way that complements the research about the interaction between the state and the market. This conceptualization also helps to understand how much the world economy has been changed by what we call legalization of world politics as symbolized by the politics of litigation and compliance.

Accession is a process that tests the boundaries of WTO membership. Unfortunately, this process has become a power-based game with no limits on the demands expressed by the major industrialized countries. The acceding countries are asked to implement the comprehensive package of WTO Agreement according to the formula decided by the powerful players with no consideration given to the countries' particular developmental needs and capabilities. Such high entry requirements are justified using the rhetoric of free trade, international cooperation and impartiality of legal rules. The problem is that the acceding countries are requested to make the liberalization commitments in the areas where the developed WTO Members have successfully maintained protectionist measures (industrial and agricultural subsidies and services) or in the areas where the developed countries have clear developmental advantage (intellectual property).

There is a certain element of hypocrisy in the way the industrialized countries are putting into practice the idea of legal fairness. The WTO accession process has no

precise legal rules, except precedent and power, as it permits the existing Members to decide when the candidate's trade regime is in conformity with WTO Agreements. Such a troubling approach is seriously undermining the credibility not only of the WTO, but also of all collective policy choices undertaken in the time of global market integration. It has become increasingly difficult to uncritically observe the behavior of world leaders during the high profile G8 summits or WTO Ministerial meetings in Seattle and Doha. The global policy makers appear to be arrogant in their adherence to the narrowly interpreted set of economic and legal prescriptions.

Most recently, one of the chief negotiators from Vanuatu has made an alarming observation about the WTO accession process. It happened after the US had arbitrarily blocked Vanuatu's accession negotiations. The US decided to be the only country to breach the consensus reached by the rest of the WTO membership in favor of concluding the process, because some of its demands remained unfulfilled. It did not matter that Vanuatu simply was not able to meet the US demands. The demands not only did not make any economic sense, but they actually meant breaking the existing agreements Vanuatu had with other countries. Subsequently the negotiator observed that although: "it remains one of the enduring convenient clichés of the multilateral trading system that the WTO is a "rules-based system", the actuality is that accession is inherently power based and hence the very antithesis of the WTO's credo²."

The fundamental problem in the accession negotiation stems from the institutional inequality between the candidate state and the incumbent WTO Members. The candidates have no bargaining power and no legal right to refuse the increasingly

² Roman Grynberg and Roy Mickey Joy (2000) "The Accession of Vanuatu to the WTO – Lessons for the Multilateral Trading System," *op. cit.*, p. 159.

intrusive accession demands by the major industrial countries. What's more, the institutional asymmetry of the WTO accession process tells a profound story about the application of international legal rules. Is it possible to talk about fairness and neutrality of the WTO rules-based system when its Members continue to be fundamentally unequal and the system itself appears to be acutely unbalanced?

WTO accession is an institutional consequence of collective global behavior in a time of increased global market integration. As an outcome of this collective global behavior, the establishment of the WTO was rationalized as a victory of the legal approach that would guarantee fairness of access for all, and would ensure due process when potential conflicts surface. However, the implementation problems experienced by the countries acceding to the WTO, as well as by developing WTO Members, make a mockery of these principles. The global policy makers have been badly misguided in separating the economic arguments and legal considerations from the countries' needs and traditions.

The recent tendency of international policy makers to rely on the legal precedent and on the abstract legal logic has dangerously removed the opportunity for a common sense compromise and understanding. The legal rules of the WTO are fast becoming the instruments of global policy in the hands of the powerful states. The underlying policy choices have already created some significant structural constraints that stand to impede global expansion of prosperity.

Accordingly, it should come at no surprise that the institutional behavior of the WTO has been generating a growing resistance in both the developed and in developing countries. The legal aloofness of the WTO has blurred the role of human agency.

Despite having a great potential to enhance international cooperation and prosperity around the world, the WTO instead has alienated itself from the very populations it is supposed to serve. By focusing on the global harmonization of their dominant institutional practices within the global trade system, the prominent WTO Member-states have lost sight of the contending interpretations of the legal rules. Indeed, it is difficult to defend the neutrality of the WTO legal code if its provisions are used to place the excessive and costly demands on the acceding countries behind closed doors in Geneva. The legal rules of the WTO Agreements can only be considered neutral in so far as they isolate themselves from actual human experience.

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