TRADE POLICY FLEXIBILITY AND ENFORCEMENT IN THE WTO

The World Trade Organization (WTO) is an incomplete contract among sovereign countries. Trade policy flexibility mechanisms are designed to deal with contractual gaps, which are the inevitable consequence of this contractual incompleteness. Trade policy flexibility mechanisms are backed up by enforcement instruments which allow for punishment of extra-contractual conduct.

This book offers a legal and economic analysis of contractual escape and punishment in the WTO. It assesses the interrelation between contractual incompleteness, trade policy flexibility mechanisms, contract enforcement, and WTO Members' willingness to cooperate and to commit to trade liberalization. It contributes to the body of WTO scholarship by providing a systematic assessment of the weaknesses of the current regime of escape and punishment in the WTO, and the implications that these weaknesses have for the international trading system, before offering a reform agenda that is concrete, politically realistic, and systemically viable.

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TRADE POLICY FLEXIBILITY AND ENFORCEMENT IN THE WORLD TRADE ORGANIZATION

A Law and Economics Analysis

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To my parents, for their love and unquestioning support, and to my sister Lena, for being her

CONTENTS

FIGURES

ABBREVIATIONS

AoA	Agreement on Agriculture
AB	Appellate Body
ABM	Agreement on Anti-Ballistic Missiles
AD	antidumping
ADA	Antidumping Agreement
Art./Arts.	article(s)
BoP	balance of payments
CCC	Pareto-efficient complete contingent contract
CvD	countervailing duty
DDA	Doha Development Agenda
DG	Directorate General
DR	default rule(s)
DS	dispute settlement
DSB	Dispute Settlement Body
DSM	Dispute Settlement Mechanism
DSU	Dispute Settlement Understanding
EBC	efficient "breach" contract
EC	European Communities
EEC	European Economic Communities
EU	European Union
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GPA	Agreement on Government Procurement
GSP	Generalized System of Preferences
ILC	International Law Commission
ILO	International Labour Office
ILP	Agreement on Import Licensing Procedures
IMF	International Monetary Fund
IO	industrial organization
IP	intellectual property
IR	international relations
IT	information technology

ITO	International Trade Organization
L&E	law and economics
LDC	least developed country/countries
LR	liability rule(s)
MFN	most-favored nation
NGO	non-governmental organization
NVC	non-violation complaint(s)
OMA	orderly marketing agreements
PD	prisoners' dilemma
PR	property rule(s)
PROF	politically realistic objective function(s)
R&D	research and development
ROO	Agreement on Rules of Origin
RPT	reasonable period of time
SALT	Strategic Arms Limitations Treaty
SCM	Agreement on Safeguards and Countervailing Measures
SG	safeguard
SGA	Agreement on Safeguards
SIG	special interest group
SPS	Agreement on Sanitary and Phytosanitary Measures
TBT	Agreement on Technical Barriers to Trade
TC	transaction costs
TOT	terms of trade
TPRM	Trade Policy Review Mechanism
TRIMs	Agreement on Trade-Related Investment Measures
TRIPS	Agreement on Trade-Related Intellectual Property Rights
UCC	United States Uniform Commercial Code
UR	Uruguay Round
USTR	United States Trade Representative
VCLT	Vienna Convention on the Law of Treaties
VER	voluntary export restraint(s)
WTO	World Trade Organization

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"Build a house, beget a son, plant a tree, write a book." It is said that these are four essential things every man should accomplish during his lifetime. Writing a book certainly can be a solitary, frustrating, and self-deprecating process at times. Yet it does not have to be this way, especially if one receives as generous a support as I did during the completion of this book. It is thanks to the following outstanding individuals that I now could – in theory – turn my full and undivided attention to more tangible projects, such as planting trees or constructing houses.

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Simon Arnd Benedikt Schropp
Geneva

FOREWORD

The study of WTO dispute settlement has been attracting increasing interest in law and economics scholarship: in part, as a reaction to the largely impressionistic early legal literature, which had decided on the effectiveness of the new regime on scarce evidence; in part, because of the characteristics of the new regime – compulsory third party adjudication is not the paradigmatic adjudication process in international relations. There is already an impressive body of literature that addresses a series of questions relating to the participation of various WTO Members in proceedings; the impact of third parties on the outcome; the legal capacity of the various participants as an explanatory variable for success in proceedings; the propensity of complainants to prevail; the decision to litigate, and the connected decision to move from one stage of the proceedings to the next. The predictive power of the various models employed varies, and some would argue that it is probably too early to have robust empirical evidence for many of them.

The study of remedies occupies a prominent place within this body of literature. The original contributions, which saw nothing wrong with the WTO system, gave way to more skeptical views over time. There are few empirical papers and lack of transparency often makes this study difficult. Simon Schropp is on top of the literature, and this volume displays it in excellent manner. However, this is not all that the author does. Borrowing from contract theory, he places enforcement in a wider context where a player deviates from the contract (ab)using its safeguards clauses and/or without invoking them.

There should be little doubt that, in light of the de facto prospective nature of remedies in the WTO, WTO Members have an incentive, for political economy reasons, to abuse recourse to, say, safeguards, and thus to provide their domestic industry with the necessary "breathing space." Indeed, bad-faith behaviour is probably exacerbated by the fact that WTO adjudicating bodies have interpreted the safeguard clause in a

very restrictive manner, de facto depriving potential users of an important instrument.

More generally, we are still far away from developing a comprehensive theory of disputes – there are no models predicting when disputes will occur in a setting like the WTO. Contract incompleteness is probably a contributing factor, but in and of itself no reason for a dispute: for one, the trading partners can always go back to the table and negotiate further; unless one takes the view that some of the GATT provisions are obligationally incomplete, it should be that heavy negotiating costs dictate adjudication over renegotiation.

Schropp's work is one of the first that tries to shed light on these questions. The author provides both a framework for analysis for all these questions, as well as his own proposals to help trading partners deal with the various problems identified in this volume. The outcome is a very welcome input to an ongoing discussion regarding the shaping of the multilateral trading system. Having set himself high standards with his first work, his subsequent steps in this area will be eagerly anticipated.

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