Legal and Economic Principles of World Trade Law

The World Trade Organization (WTO) Agreement covers the vast majority of international commerce in goods and services. The Agreement covers not only measures that directly affect trade, such as import tariffs and import quotas, but potentially almost any type of internal measure with an impact on trade. Thus WTO legal texts are by necessity expressed in vague terms, and in need of continuous interpretation.

The overarching aim of the project *Legal and Economic Principles of World Trade Law*, led by the American Law Institute, is to contribute to the analysis of WTO law in not only law but also economics. This volume reports work done thus far to identify improvements to the interpretation of the Agreement. It starts with two background studies, the first of which summarizes the study *The Genesis of the GATT*, published by Cambridge University Press in 2008, which highlights the negotiating history of what became the GATT 1947–1948; the second study, coauthored by Gene M. Grossman and Henrik Horn, is an introduction to the economics of trade agreements. These are followed by two main studies. The first, authored by Kyle Bagwell, Robert W. Staiger, and Alan O. Sykes, discusses legal and economic aspects of the GATT regulation of border policy instruments, such as import tariffs and import quotas. The second, written by Gene M. Grossman, Henrik Horn, and Petros C. Mavroidis, focuses on the core provision for the regulation of domestic policy instruments – the National Treatment principles in Art. III GATT.

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Legal and Economic Principles of World Trade Law

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In 2001, the American Law Institute (ALI) began work on the law of world trade. The project was different from all prior Institute work in two ways. First, the goal was to have every aspect of the work accomplished by economists and lawyers working together. Second, the Chief Reporters, Professors Henrik Horn of Stockholm and Petros C. Mavroidis of Columbia University and lately the European University Institute, were both Europeans. Principles of trade law require both legal and economic analysis, and the subject could not be satisfactorily understood without input from many continents.

We did not accomplish the drafting of principles appropriate for ALI debate and then Council and Annual Meeting approval. For that, this area of law requires more development, more evolution through decisions by the Appellate Body of the World Trade Organization (WTO), and more academic agreement. But we have accomplished a great deal in two directions. First, we have authored and Cambridge University Press has published volumes analyzing the important WTO decisions of the past decade. In each instance, the papers were written by economist–lawyer teams and then subjected to rigorous discussion and criticism from experts. Most of the discussion meetings were held in the WTO building in Geneva, allowing participation from top WTO officials. Second, our distinguished scholars have now completed a major volume that contains analysis of the most important issues in the law of world trade and makes policy recommendations for improving current law. This volume begins with a short summary of the origins of trade law in the General Agreement on Tariffs and Trade. (The full story of the post–World War II history is in The Genesis of the GATT, a product of the ALI’s work that was published by Cambridge University Press in 2008.) Next in the new volume comes the economics of trade agreements: what the GATT framers had in mind, how today’s economists think about trade liberalization, and how “non-discrimination” should be framed and applied as a legal obligation. Finally, the book asks whether law as interpreted in decided cases makes sense. Does the world now need new treaty language, or can the existing agreements be interpreted in the dispute-resolution process to achieve economically
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The authors propose a series of legal principles that would bring case-law interpretation back to what they believe were the original intentions of the legal pioneers who created the current structure. The tremendous accomplishments in this new book are the work of Professors Kyle Bagwell, Gene Grossman, Bob Staiger, and Alan Sykes, as well as the Chief Reporters, Professors Horn and Mavroidis. Professor Doug Irwin played a major role as a coauthor of the earlier *The Genesis of the GATT* volume.

In addition to the authors mentioned above, we have had essential input from a substantial number of other academics, practicing lawyers, WTO Appellate Body members, and WTO leaders. Of course, our major debt is to Henrik Horn and Petros Mavroidis, who have recruited colleagues, made sure deadlines were achieved, and throughout maintained the highest standard for economic and legal thinking and collaboration and for policy recommendations based on economic validity, understanding of international politics, and awareness of the challenges facing the WTO dispute-resolution process, a new institutional setting for peaceful application of what are often immensely difficult international disputes.

The ALI also thanks The Jan Wallander and Tom Hedelius Research Foundation in Stockholm, the Milton and Miriam Handler Foundation, and all who have participated in the many meetings necessary to advance the publications already published and soon to be published.

Lance Liebman
Director
*The American Law Institute*
January 15, 2013
The World Trade Organization (WTO) Agreement covers the vast majority of international commerce in goods and services, and also contains an agreement on the protection of intellectual property. The Agreement covers not only measures that directly affect trade, such as import tariffs and import quotas, but potentially almost any type of internal measure with an impact on trade.

The WTO legal texts are by necessity expressed in vague terms, and in need of continuous interpretation. To this end, the WTO contains a rarity in international relations, a compulsory third-party adjudication system. While there is an expressed preference for bilateral resolutions of trade conflicts, the system embodies the idea that trade conflicts that cannot be resolved bilaterally should be resolved through multilateral adjudication rather than through unilateral actions. This two-level system of legal adjudication – the Dispute Settlement (DS) system – plays a core role in the WTO by determining the practical ambit of the legal obligations in the various agreements comprising the WTO Agreement.

The WTO Agreement, and its interpretation by WTO adjudicating bodies, is subject to intensive policy debate, conducted largely by politicians and non-governmental organizations. There is also an ongoing debate among mainly trade-law practitioners and legal scholars, concerning the appropriate interpretation of the law.

The overarching aim of the project *Legal and Economic Principles of World Trade Law* is to contribute to the analysis of WTO law. The distinguishing feature of the project is the aim to base the analysis not only in Law but also in Economics. Such an interdisciplinary approach is, in our view, necessitated by the fact that the WTO Agreement has inherently economic objectives. For instance, its Preamble states that the objectives of the Agreement are to contribute in:

…raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing
for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development.…

A fundamental methodological problem facing a joint economic and legal analysis of the WTO contract is that there is yet no field “The Economics of Trade Law” that could be leaned against for such analysis. Instead, the relevant specialized fields, such as International Trade Law and International Economics, differ widely, in terms of both aims and methods. Lawyers and economists are also typically too specialized in their respective fields to be able to undertake legal-cum-economic analyses of the law alone. It is therefore necessary that an analysis of the agreement is conducted jointly by economists and lawyers.

The project Legal and Economic Principles of World Trade Law proceeds along two complementary paths. The first part analyzes regularly the emerging case law from the adjudicating bodies of the WTO. Each dispute is evaluated jointly by an economist and a lawyer. To date, almost 70 reports have been written, covering all disputes that came to an end during the years 2001–2011. The disputes have concerned all three major WTO agreements – the GATT and the other Annexes forming the multilateral regulation of trade in goods, the services agreement, the General Agreement on Trade in Services, as well as the Agreement on Trade-Related Aspects of Intellectual Property Rights. But reflecting the use of the Dispute Settlement system, most analyzed cases have involved trade in goods.

The second part of the project aims to identify improvements to the interpretation of the agreement. This volume reports work done thus far in this leg of the project. It starts with two background studies. The first briefly summarizes the study The Genesis of the GATT, which highlights the negotiating history of what became the GATT 1947–1948. This study was undertaken by Douglas A. Irwin (Dartmouth College), Petros C. Mavroidis, and Alan O. Sykes, and has been published by Cambridge University Press. The study argues that the GATT was essentially an agreement about border barriers to trade, where the two superpowers at the time (the UK and the United States) aimed at constraining each other's behavior. But in order to prevent members from circumventing the commitments on border instruments by use of domestic policy measures, two lines of defense were put in place: first, whatever policy was (unilaterally) devised at home would be applied in even-handed manner (nondiscriminatory) to domestic and imported goods – the National Treatment principle; second, if concessions were eroded even though nondiscrimination had been observed, trading nations could always invoke the so-called non-violation complaints, an
instrument meant to provide the ultimate defense for those whose expectations have been defied.

The second preparatory study – *Why the WTO? An Introduction to the Economics of Trade Agreements*, authored by Gene M. Grossman and Henrik Horn – lays out the perceptions by which most economists approach trade agreements, to readers with little or no training in economics. It follows most of the economic literature by viewing trade agreements as means for countries to address the negative international externalities that would result if governments were to set their trade policies unilaterally and without regard to their effects on actors in other countries. The study discusses economic aspects of a number of general features of trade agreements, such as their reciprocal nature, the need for agreements to be self-enforcing, the inevitable contractual incompleteness of trade agreements, and the fact that trade agreements are manifestly textual documents.

The volume contains two main studies. The first, *Legal and Economic Principles of World Trade Law: Border Instruments*, authored by Kyle Bagwell, Robert W. Staiger, and Alan O. Sykes, discusses legal and economic aspects of the GATT regulation of border policy instruments, such as import tariffs and import quotas. The goals of the study are both positive and normative. From a positive perspective, it draws on the economic theory of international trade and relevant aspects of economic history to explain the legal treatment of border instruments in the WTO/GATT system as it has evolved over time. From a normative perspective, the study builds on an economic understanding of the function of the various legal disciplines to critique elements of the treaty text and the case law. The study focuses on the core provisions regulating border instruments, such as tariff bindings, quantitative restrictions, and the "most-favored-nation" (MFN) obligation.

The final study, *Legal and Economic Principles of World Trade Law: National Treatment*, written by Gene M. Grossman, Henrik Horn, and Petros C. Mavroidis, focuses on the core provision for the regulation of domestic policy instruments – the National Treatment principles in Art. III GATT. The study first examines the negotiating record relevant to the rationale for the enactment of the National Treatment provision, the manner in which case law has understood it, and the economic rationale for the provision. The study also discusses the manner in which the provision has been implemented in case law. In light of the dissatisfaction with the case-law interpretations of some key terms, the study presents two possible interpretations of the National Treatment provision, one of which is argued to be preferable.

Finally, we would like to sincerely thank the ALI and its Director, Lance Liebman, for the support the project has received over the years, *sine qua non* the project would not have existed. We also want to express our sincere
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gratitude to The Jan Wallander and Tom Hedelius Research Foundation in Stockholm, and the Milton and Miriam Handler Foundation in New York, for financial support.

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