Occasional Paper

Australian Farm Institute

October 2000

The WTO, or Law of the Jungle

Over the past twelve months, few international organisations seem to have attracted as much vitriol and bad press as the World Trade Organisation. Ignited by the November 1999 "Battle of Seattle", critics ranging from President Bill Clinton to organised labour, economic commentators and environment groups have been attacking aspects of the organisation and what it stands for. Many in the rural sector, both within Australia and internationally, have been especially critical of the WTO.

A close examination of the organisation, its history and its activities leads to the conclusion that, while it may not be perfect, no-one seems to have come up with a better alternative!

Since mankind first recognised that specialisation and trade were key components of greater community prosperity, the establishment of fair rules to facilitate trade between individuals, corporations and nations has been a never-ending quest. In less civilised times, trade disputes were resolved utilising the simple rule that might is right! Quite frequently, asserting 'might' in a trade disagreement led to international conflict resulting in significant human and economic damage. Trade, or disputes over valuable tradable resources were the basis of most of the major international conflicts prior to the twentieth century.

The more recent history of world trade is somewhat checkered. At the end of the nineteenth Century, world economies were relatively well integrated, and trade between nations was largely unhindered. Goods and people moved freely across international borders, underwritten by British pounds and the gold standard. The period is often considered to be the height of free-market capitalism. It unravelled in the early decades of the twentieth century, and ultimately resulted in World War 1. What followed after that era of massive destruction was a period where nations struggled to rebuild industries and employment, resorting increasingly to trade barriers to encourage the development of domestic industries, and hence self-sufficiency and security. During the 1920's, nations such as the USA dramatically increased tariffs (for example the Fordney-McCumber Tariff of 1922). This developed into a spiral of ever-increasing tariffs and reduced trade that many consider exacerbated the Great Depression. For example, between 1929 and 1933, the total volume of world trade is estimated to have declined by two thirds. Whether trade barriers were a cause or effect of the Great Depression is disputed.[1] However there is no doubt that the misery of that time and the subsequent rise of extremist political movements coincided with a period when international trade was dramatically reduced.

Attempts were made during the post-depression years to establish an internationally agreed framework for world trade, however the onset of World War 2 in 1939 largely derailed these. Even as that conflict escalated, work was underway to establish a post-war international economic architecture where trade and the subsequent prosperity and economic integration it generated would assist in ensuring that such destructive global conflicts did not recur. The conference between the USA and the UK at Bretton Woods in 1944 finalised proposals for this framework, including the establishment of the United Nations, the International Monetary Fund, the World Bank, and the proposed International Trade Organisation.

In 1947 during the gestation phase of these structures, the General Agreement on Tariffs and Trade (GATT) was agreed by nine countries. Between them, they accounted for about 80% of world trade, and included the US, the UK, Australia, Canada, France and the Netherlands. A key feature of this agreement was that all signatories became eligible to enjoy the most-favourable trading arrangements offered by each other signatory (most-favoured nation status). This agreement established a new set of rules governing how nations would regulate their trade, and it also incorporated a commitment to specific reductions in tariffs. The GATT agreements came into force on January 1, 1948, and were a conclusive step in developing international trade rules. Initially, it was proposed the GATT would be administered by the International Trade Organisation (ITO).

This body was to have trade rule enforcement powers.[2] The proposal was derailed by business interests in the US, which feared that the proposed one nation - one vote structure would be dominated by developing nation interests.

1 Lovett et. al., (1999) US Trade Policy. History, Theory and the WTO. M E Sharpe, Publishers.

2 Noland, M (2000). Understanding the World Trade Organisation. Paper published by the Institute for International Economics.

There were also concerns about the extent to which the proposal amounted to "world government" and threatened national sovereignty.[3]

Despite the lack of a formal organisational structure, the GATT survived remarkably well. This is partly attributed to pragmatic leadership, but also to the exclusion of contentious issues such as agriculture and textiles from the agreements that made it up. Some also attribute its survival to the decision of the US Congress to cede its power over international trade to the President, thus neutralising traditional US domestic pressures for special-interest tariff protection. GATT's survival is also probably attributable to regular changes to the agreements that were negotiated via a series of multi-lateral trade rounds held approximately each decade.

Despite GATT rules, international economic pressures during the 1980's resulted in a resurgence in trade restrictions as nations attempted to grapple with rising fears of debt-default amongst developing countries, and the US faced a growing trade deficit.

To head off protectionist pressures, Europe and the USA agreed to a new round of trade negotiations (the Uruguay Round) in September 1986. Two key objectives of this round were to be effective dispute settlement procedures, and the inclusion of agriculture under GATT rules, although the latter was strongly opposed by Europe.

Due to the contentiousness of these issues, and the fact that the GATT now involved over one hundred nations, this trade round took more than eight years to conclude. The resulting agreements were signed in Marrakech in April 1994 by one hundred and eleven nations.

For Australian agriculture there were three important outcomes. The first was some significant commitments by Europe and the US to dismantling agricultural export subsidies and domestic support measures, and freeing-up market access for agricultural products via a cut of 36% in import tariffs. Whilst far short of bringing agriculture under standard GATT rules, these measures did at least represent a start.

The second significant outcome was the establishment of a "built-in" agenda for future negotiations on agriculture, through agreement on a number of deadlines, and the establishment of a GATT Committee on Agriculture.[4]

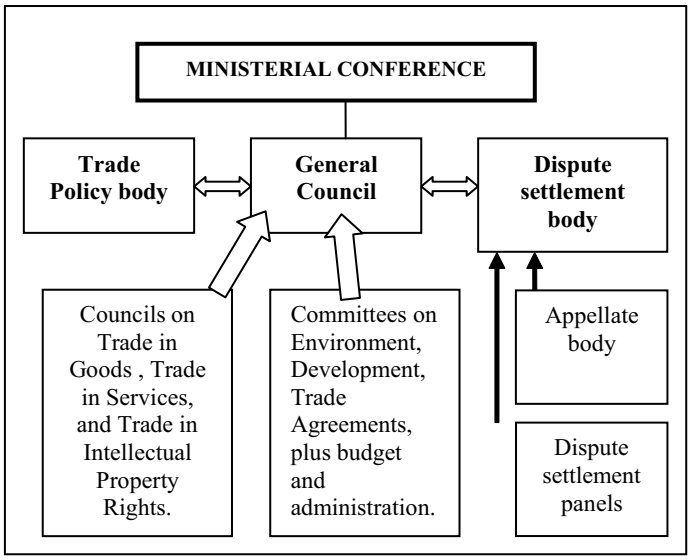
The third key outcome was the establishment of the World Trade Organisation (WTO). Its role was to administer the trade agreements negotiated as part of GATT, to act as a forum for further trade negotiations, and most significantly to operate a dispute resolution mechanism for member nations.

[3] Lovett et. al (1999) op. cit.

[4] Snape et. al (1998). Australian Trade Policy 1965-1997. Allen & Unwin.

The Structure and Operations of the WTO

The following figure provides a summary of the structure of the WTO.



The Ministerial Conference consists of a representative from each Member, and is the chief policy-making body that meets every two years. The General Council is responsible for overseeing WTO operations between Ministerial Conferences, and has authority in relation to a broad range of matters, but cannot alter the WTO constitution. It meets every few months, and consists of a representative of each member – usually an Ambassador or equivalent. For both the Ministerial Conferences and Council, decisions are usually by consensus. Where this is not possible they can be based on a majority vote with each country having one vote. So far, such a vote has never been required.

The General Council also sits as the Dispute Settlement Body, and it is this role that is the crucial one in terms of the operation of the WTO. The basic operation of the dispute settlement process is as follows:

1. To initiate the process, a WTO Member notifies the WTO of a request to enter into consultation with another member over a disputed trade measure.

2. If there is no agreement to consult, or no settlement within 60 days, a complainant can request the establishment of a Dispute Settlement Panel (DSP) consisting of independent experts (usually three) whose role it is to determine whether WTO rules have been broken.

3. A Panel normally completes its work within six months, or three months in special urgent cases.

4. A Panel report is considered by the Dispute Settlement Body (General Council) 20 days after it is issued. It is automatically adopted by the Council within 60 days, unless there is a consensus decision not to accept it, or one of the parties appeals.

5. If the Panel Report is appealed, the matter is heard before an Appellate Body which consists of 3 Members selected from a panel of seven. Appeal deliberations

must be concluded within 60 days, and the Appellate Report must be unconditionally accepted by the parties within 30 days, unless the General Council has rejected it.

6. Once either the Panel Report or the Appellate Report is adopted, the relevant Member has 45 days to notify its intentions in adopting the recommendations. If immediate implementation is impractical (eg. if legislation has to be changed) then the Member has to obtain agreement of the General Council (sitting as the DSB) on a timetable.

7. There are further processes enabling a Member to seek compensation or the suspension of trade concessions, with this process again having a defined timetable, and arbitration processes in the event of disputation. An important aspect is the requirement that a Member cannot simply impose penalties, but requires the agreement of the DSB on any penalties proposed or compensation sought.

The appropriateness of these procedures probably depends on which side of a dispute a Member sits on. For a Member with industries being harmed by a measure, the prospect of waiting several years before a remedy is obtained probably does not look overly attractive. On the other hand, a Member found to be breaching WTO rules would probably regard two years as the absolute minimum period necessary to rectify the situation.

What is significant about these processes is that the final decision rests with the General Council sitting as the Dispute Settlement Body. Ultimately a judgement on the legality or otherwise of a Member's trade measure is made by all other members of the WTO – in effect a judgement by peers.

The second significant aspect of these processes arises as a result of the general WTO/GATT framework. In effect, the entire membership of the WTO agrees to abide by any decisions reached, meaning that a trade dispute between two Members should not escalate into a global trade war involving many nations.

Offending Members that are tempted to ignore an adverse finding, and perhaps even walk away from the WTO, risk being outside the club and losing the automatic most favoured trade terms with all members. This would place a nation at a significant disadvantage, and is therefore not an attractive option.

In addition, in the past a trade war between two major nations often resulted in significant 'collateral damage' as the measures taken resulted in significant distortions in world markets. For example, the formerly routine trade wars between Europe and the USA in grain markets resulted in significant damage to nations such as Australia and Canada, who had no part in the dispute. Any retaliation a damaged member proposes to take under WTO rules must first be sanctioned by the WTO General Council, and this requires that all possible efforts are made to ensure that the retaliatory measures only impact on the offending member. The sanctions adopted by the USA and Ecuador in the EU banana dispute (see below) are a good example of this operating in practice.

A final point worthy of consideration is that, unlike the previous arrangements that existed under GATT, individual WTO Members are not able to block decisions that are made utilising the Dispute Settlement Processes.

The Dispute Procedures in Practice

Rules and procedures amount to little unless they also secure national commitment, so perhaps the best means of assessing the WTO is to examine how specific trade disputes have been dealt with through these processes, particularly disputes between the two biggest players in the game, the USA and Europe.

Amongst a number of contentious matters between these two trade protagonists, perhaps the longest-running dispute has, somewhat surprisingly, involved bananas.

The origins of the dispute date back to 1993, when the EU adopted a common banana import regime. This involved a tariff quota of around 2 million tonnes, with almost half of this restricted exclusively for traditional suppliers in former European colonies in Africa, the Caribbean and the Pacific (ACP). In addition, non-ACP suppliers faced a within-quota duty on their imports into Europe, from which ACP suppliers were exempt.

The US challenged this arrangement under GATT rules. The impetus for the challenge came reportedly from Chiquita Brands, a large US-owned corporation which exports bananas from Honduras and Guatemala, and which donated heavily to the Democrats during US elections in 1996.[5] The US complaint was joined by Ecuador, Guatemala, Honduras and Mexico. A WTO Dispute Settlement Panel was convened in mid-1996, and handed down a draft ruling in March, 1997. Subsequently, the WTO Dispute Settlement Body issued its final ruling in May 1997, and found that the EU banana import arrangements breached GATT rules, especially in respect of the preferences that exist for ACP nations.

In June 1997, the EU appealed against the WTO Panel decision, specifically the finding that all bananas imports must be treated under the same trade rules. The WTO Appellate body handed down its decision in September, 1997, rejecting the EU's appeal. In October, 1997, the EU advised the WTO it intended to comply with the WTO ruling, but would require a reasonable period of time

in which to implement the change. Subsequently, the US and other Latin American countries requested the appointment of an arbitrator to develop an agreed implementation timetable. The EU was given until January 1, 1999 to implement a WTO-compliant arrangement, which accords with the normal 15 month timeframe regarded as 'reasonable' under WTO rules.

[5] Time Magazine, March 31, 1997.

Several different proposals were progressively adopted by the EU in response to the WTO decision, and these were implemented in the second half of 1998. They involved some freeing up of access, but retained import preference for ACP nations, and tied the allocation of EU banana import licences to historical market shares. They also included a seven-year transition phase.

In December 1998, Ecuador requested that the original Dispute Panel be reconvened to examine whether the EU proposals were WTO compliant. Shortly afterwards, the US requested WTO authorisation of retaliatory measures worth $US 520 million annually, and Ecuador sought retaliatory measures valued at $US 202 million annually.

In response, the WTO found in May, 1999 that the new EU measures did not comply with WTO rules. At the same time, a WTO-appointed arbitrator assessed the appropriate value of US retaliatory measures to be $US191 million per annum, and authorised the US to take proposed retaliatory measures, which involved 100% tariffs on a range of imported European consumer goods, with the target goods to be changed annually. The US the imposed 100% tariffs on a range of European goods imported into the US.

The value of retaliatory measures appropriate for Ecuador was found to be $US 202 million per year. As a result, Ecuador proposed measures that would have impacted on fees paid to European companies for copyright on software and recorded music, and these were authorised by the WTO in May, 2000.

Seemingly as a result of these measures, the EU presented a proposal to the WTO in September 2000 which would see bananas imported on a 'first come, first served' basis to replace the current EU preferential market-access regime. It also proposed the possibility of a tariff-only regime after a transition phase. 6 This proposal will soon be considered by the WTO, but appears more likely to be accepted.

What is the Alternative to the WTO?

The banana dispute has taken four years to resolve in the WTO and critics would probably claim this is simply too slow, or alternatively, an example of a US multi-national using its muscle to capture a market that was previously reserved for small, developing nations.

While four years does is a long time to resolve a dispute such as this, it was made more complex by the fact that it involved 15 member nations of the EU, 70 African, Pacific and Caribbean nations, the USA, and at least four Latin American nations. Any expectation that it could be more quickly resolved is somewhat unrealistic.

This dispute was also in many ways a first-test of the WTO procedures.

The parties involved (especially the EU) were obviously intent on testing available WTO procedures to the fullest extent. Anecdotal evidence suggests that parties to subsequent disputes have moved more quickly to act on initial Panel findings.

This dispute seems to have been resolved in a way that limited the impact of measures taken to those parties directly involved. The two biggest trading entities in the world – the US and Europe – seem to have accepted the WTO umpires decision. Both these outcomes were not likely without the WTO dispute resolution mechanism.

It is true that the dispute process was apparently initiated by a large multi-national corporation, and that it stood to gain while small ACP banana-exporting nations stood to lose. However, the result also means that more efficient Latin American banana-producing nations such as Ecuador, Guatemala, Honduras and Mexico should now have access to the European markets they were previously excluded from.

The point was also made by the USA that there was nothing in WTO rules to stop the EU imposing a tariff on all banana imports. The EU could even impose a preferential (lower) tariff on bananas sourced from ACP countries. In addition, the EU could use money raised by the tariff to provide aid to those disadvantaged nations. In effect, this approach would separate aid from trade, whereas the previous EU arrangement attempted to combine the two.

This highlights an issue raised by many critics of the WTO, which is that the WTO rules disadvantage the poor and developing nations. What the banana dispute shows is that there are better and more direct ways to overcome these problems, without using trade-distorting measures that have much broader effects. These more direct ways are of course more transparent to taxpayers and require political accountability, which probably explains why the EU has been reluctant to adopt them.

The WTO model is not perfect, but while-ever communities increase their prosperity by international trade, the WTO model or something similar is needed to create order and certainty. Disbanding or neutralising the WTO would mean a return to the law of the jungle and the 'might is right' approach, which is likely to result in damage to those very nations WTO critics claim to be trying to protect.

COMMENTS CONTAINED IN THIS DOCUMENT ARE BASED ON INFORMATION AVAILABLE AT TIME OF PUBLICATION.

This paper originally appeared as an edition of the Primary Report published by NSW Farmers' Association. Re-published in 2004 by the Australian Farm Institute.

6 Bridges Weekly Trade News Digest, 4(38), October 10, 2000