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**An Analysis of the relationship between the International Economic-
Legal Regime and the achievement of balanced and stable growth
through the International Economic Cycle**

By

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A thesis submitted in fulfilment of the requirements for the degree of
Doctor of Philosophy in Law

University of Warwick
Department of Law

September 2011

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ABBREVIATIONS

AML/CFT Anti-Money Laundering and Combating the Financing of Terrorism

BCP Basel Core Principles for Effective Banking Supervision

BIS Bank for International Settlements

BOP Balance of Payments

CPSIPS Core Principles for Systematically Important Payment Systems

CTS Council for Trade in Services

DSS Dispute Settlement System

DSU Dispute Settlement Understanding

DTIS Diagnostic Trade Integration Studies

EBOPS Extended Balance of Payments Services

ECB European Central Bank

ECJ European Court of Justice

ECOSOC Economic and Social Council

EUROSTAT Statistical Office of the European Communities

FATF Financial Action Task Force

FSA Financial Services Authority

FSAP Financial Sector Assessment Program

FSC Committee on Trade in Financial Services

FSF Financial Stability Forum

FSI Financial Soundness Indicators

GATS General Agreement on Trade in Services

GATT General Agreement on Tariffs and Trade

GDSS General Data Dissemination System

GNP Gross National Product

IAIS International Association of Insurance Supervisors

ICJ International Court of Justice

ICP Insurance Core Principles

ICSID International Centre for the Settlement of Investment Disputes

IDA International Development Association

IEI International Economic Institutions

IELR International Economic Legal Regime

IF Integration framework

IFC International Finance Corporation

IL International Law

IMF International Monetary Fund

IO International Organisation

IOSCO International Organisation of Securities Commissions

IP Intellectual Property

IPR Intellectual Property Rights

IR International Relations

ITO International Trade Organisation

LDC Least Developed Countries

MFA Multi-Fiber Arrangement

MFN Most Favoured Nation

MIGA Multilateral Guarantee Agency

NGO Non-Governmental Organisations

NTB Non-Tariff Barriers

OECD Organization for Economic Cooperation and Development

PTA Preferential Trade Agreement

R&D Research and Development

ROSC Report on the Observance of Standards and Codes

RTA Regional Trade Agreement

SDDS Special Data Dissemination Standard

TA Technical Assistance

TIM Trade Integration Mechanism

TPRB Trade Policy Review Body

TPRM Trade Policy Review Mechanism

TRIPS Trade Related Intellectual Property

UK United Kingdom

UNDP United Nations Development Programme

US United States

USA United States of America

WIPO World Intellectual Property Organization

WTO World Trade Organisation

ACKNOWLEDGEMENT

Many people helped me through the research process and contributed to make this thesis possible. First and foremost, I am especially grateful to my supervisors, Rodrigo Olivares Caminal (former supervisor) with whom I started my PhD and Tony Cole who helped me extensively in concluding my research. Both of them extended their unconditional support and guidance throughout this process. Their invaluable observations and commitment were most helpful in completing this thesis. Second, I would like to express my gratitude to my sponsor: Higher Education Commission of Pakistan (HEC) for its generous financial support in pursuing this research. Third, I would also like to extend my special thanks to staff in the department of law, fellow postgraduate students and friends who contribution to my work. Fourth, I am grateful to all my teachers who have ever taught me. Fifth, I am thankful to my examiners Kern Alexander and Dwijen Rangnekar for their valued suggestions and feedback. Last but not least, I am grateful to my family, specially my siblings (Sadia, Shella and Taimoor) and their spouses; my parents Nusrat Hashim and Rao Naeem Hashim; and my wife Sana and my daughter Dina, for their unconditional extensive understanding, help and support without which I could never have accomplished my endeavor.

DECLARATION

I declare that the thesis does not include work-forming part of a thesis presented successfully for another degree. I declare that the thesis represents my own work except where referenced to others.

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September 2011

ABSTRACT

The global economy is controlled by an ‘international economic–legal regime’ (hereinafter “IELR”), in which international economic institutions (hereinafter “IEIs”) are the major non-state actors. They provide the rules of the game for the interaction of the States in an international economic scenario. These IEIs, through their institutional capacity, enhance certainty and predictability within the IELR, thereby passively supporting stable and a balanced growth of global economy.

This thesis argues that opportunities to achieve stable and balanced growth, in which both the financial and the real side of the economy grow, can be improved if the IEIs increase their focus on the relationship between the Economic Cycle and the IEIs’ institutional role. This argument is developed by analysing the relationship between the IEIs’ institutional role and the Economic Cycle, first describing the Economic Cycle, and then clarifying the functioning of the IEIs in their institutional role. To narrow the scope of this research, this thesis takes two IEIs as case studies; namely, the IMF and the WTO.

I. Introduction

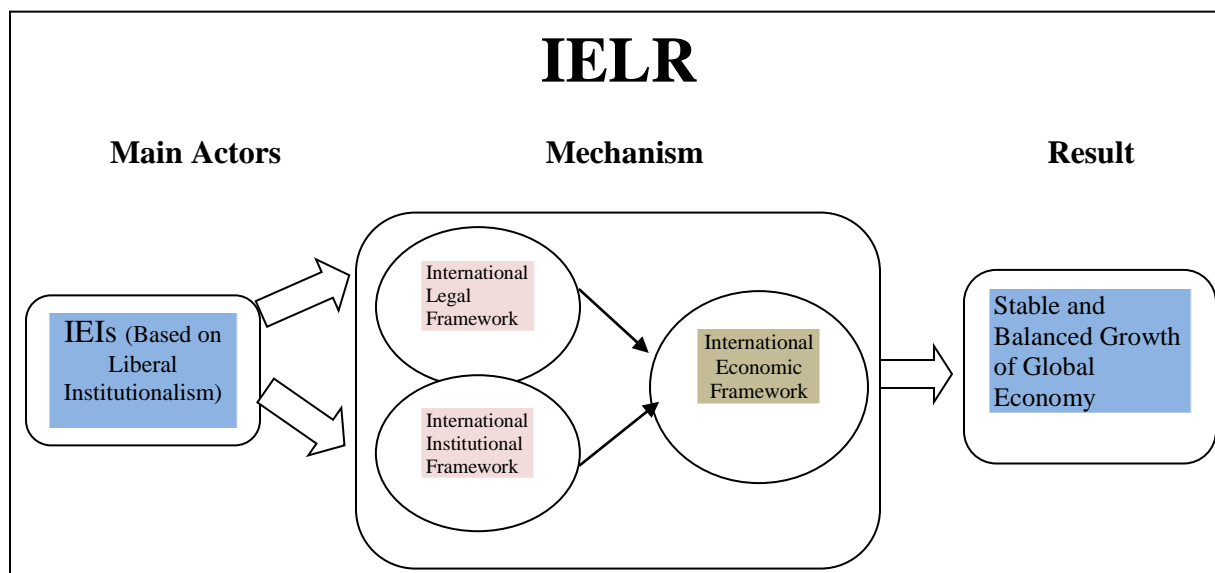
This thesis answers the question: can the institutional role of the IEs increase the chances of achieving more stable and balanced growth of the global economy? The answer is provided in the form of an analysis of the relationship between the IELR and the achievement of balanced and stable growth through the International Economic Cycle. The principal contribution of this thesis is to systematically analyse the current regime (IELR) through a liberal institutionalist lens and its effect on the Economic Cycle.

Over the last couple of decades, the global economy has expanded significantly. This expansion is accompanied by the substantial interdependence of national economies, resulting in it difficulty for the states to control cross-border economic activities. These cross-border economic engagements fall within the sphere of global governance¹ and call for the regulation of international economic relations in order to tackle this issue. These issues are dealt by means of a wide variety of principles, rules, standards and norms, mostly created by the different IEs and, over a period of time, these global regulations have evolved into a regime (IELR) based on politics, economics and law.

The concept of the IELR is based on liberally institutionalised rational cooperation among the sovereign states for collective gain in the form of IEs. These IEs, being the most important non-State actors, operate within the international economic framework through an international legal framework or international institutional framework or both (referred to as ‘mechanism’ in the

¹ For an interesting discussion of interdependence and globalization theories (and a useful bibliography), see Zürn, M. (2002) ‘From Interdependence to Globalization’, Handbook of International Relations, Editors: Carlsnaes, W., Risse, T., Simmons, Beth A. London: Sage, p. 235-254.

figure below) to achieve an end result; that is, the more stable and balanced growth of the global economy. See the figure below, which explains the concept in graphic form.



To explain and analyse the above-mentioned concept, this thesis takes two IEIs as a case study; namely, the IMF and the WTO. The reason for choosing these IEIs is very simple; in the current regime (IELR), these IEIs contribute the most in the context of the Economic Cycle. The IMF has a leading role in the process of setting the rules of the game for the global financial sector whilst the WTO is the most prominent in dealing with international trade issues.

The thesis is divided into three sections. The first section establishes the theoretical foundations of the dissertation and the evolution of the IELR. The second section discusses the institutional role of the IMF in achieving stable and balanced growth within the global economy. The third section explores the WTO's institutional role in producing a more stable and balanced growth in the global economy. In sections two and three, the emphasis is on the way in which these institutions operate and enhance the certainty and predictability of the rules of the game.

Section one: Conceptual Framework and Evolution of the IELR

This section of the thesis takes a Liberal Institutional view to analyse the IELs as a forum for organised, rational cooperation between states for collective gain. It discusses the institutional role of the IELs in terms of their legislative and normative capacity, executive and administrative authority, and judicial and quasi-judicial functioning.

The international economic framework is also addressed, through the model of the Economic Cycle. According to the Economic Cycle, economic growth is achieved through development of global financial sector (Patrick's supply lead hypothesis)², which in turn stimulates international trade, which then reinforces economic growth and leads to the development of the financial sector (Patrick's demand followed hypothesis)³. The Economic Cycle is then used to analyse the IELs' institutional framework and the way IELs generate the stable and balanced growth of the global economy by stimulating the components of the Economic Cycle to create certainty and predictability.

In addition, for a better understanding of the IELR, this section also documents the historical background to the current regime and the way in which it evolved to its current stage. Its historical background and evolution allows us to analyse the current regime in the context of its evolving nature, which provides room for criticism and adaptability within the IELR. For this purpose, Chapter Three takes into account events starting with World War I, the Bretton Woods system, the creation of the WTO which evolved from the International Trade Organisation (hereinafter ITO), then to GATT and then the WTO. As the IMF and the World Bank have not undergone any significant structural changes, they are not discussed in depth.

² Patrick, H.T., (1966) 'Financial Development and Economic Growth in Underdeveloped Countries', *Economic Development and Cultural Change*, Vol. 14, No. 1, p.174–89

³ Ibid

Section Two: The IMF

Section two of the thesis analyses the IMF's institutional role in stimulating the Economic Cycle through the promotion of certainty and predictability in the global economic scenario. It provides in-depth analysis of the legal framework and institutional role of the IMF, focusing on its legislative and normative, and executive and administrative authority.

As a result, section two shows that the IMF currently plays an important institutional role even though it does not explicitly acknowledge this. It is highly involved in devising the rules of the game for the international economic scenario, thereby structuring the IELR. The argument put forward here is that the effectiveness of the IMF is limited by its refusal to openly acknowledge this institutional role, whereas an acknowledgement that it performs this institutional role would allow it to fulfil its objectives more effectively.

The main reason for the IMF not explicitly acknowledging its institutional role is that it does not want to reveal its realist aspect within the liberally institutionalised IELR. It makes and promotes global regulations; however, its focus is on achieving the end result without highlighting its rule-making role. In spite of an absence of democratic values within the IMF's framework,⁴ its membership effectively follows the IMF; this is due to the non-existence of any substitute organisation to help in times of desperate monetary need.

⁴ In the current discussion this thesis supposes, indeed contends, that the most significant democratic values are the following: first, equivalent respect for the essential benefits of all persons; second, decision-making regarding public order via principles, mutual consideration; and third, common respect for people as those who are guided by reason. Keohane, Robert O. and Buchanan, Allen (2006). *The Legitimacy of Global Governance Institutions*. *Ethics and International Affairs*, 20(4): 405-437. Kern Alexander and other have put forward a slightly different view for more or less the same issue that is the global governance. They might see IELR as subject of global governance. According to them, global governance of financial system should have three main principles; i) efficiency in creating effective regulatory rules and standards, ii) accountability in the decision making structure and chain of command, iii) and legitimacy, meaning that these subjects to international regulatory standards have participated in some meaningful way in their development. See, Chapter I: *Managing Systemic Risk, The rationale for International financial regulations*, in Alexander, Kern, Dhumale, Rahul, and, Eatwell, John, (2005). 'Global Governance of

However, even if this institutional role was fully acknowledged, the IMF would remain handicapped by its institutional structure, which gives excessive control to wealthier States (specially the US). As a result, the IMF is not well-designed to properly fulfil its institutional role.

This section is divided into two chapters, namely; the IMF and its Legal Framework (Chapter IV) and the institutional role of the IMF in achieving stable and balanced growth of the global economy through the International Economic Framework (Chapter V). The purpose of this section is to show that the IMF has an institutional role and it actively participates in the global regulation-making and implementation process. However, the IMF does not explicitly express its institutional role and thus it loses the opportunity to improve upon it and squanders any chance of enhancing its contribution towards achieving a more stable and balanced growth of the global economy.

Section Three: The WTO

Section three of the thesis carries out a similar analysis of the WTO's institutional role in stimulating the Economic Cycle by promoting certainty and predictability in the global economic scenario, thereby leading to the more stable and balanced growth of the global economy. It comprehensively analyses the WTO's legal framework and its institutional role in the form of its legislative/normative, executive/administrative authority and quasi-judicial functioning.

This section emphasises the fact that the WTO is currently the most effective IEI in the IELR, and does not suffer from the structural problems faced by the IMF. It therefore calls for the enhancement of the WTO role, especially in financial sector development, to allow it to play an

Financial Systems, The International Regulation of Systemic Risk.' Published to Oxford Scholarship Online: September 2007.

even larger part in enhancing the certainty and predictability of the rules of the game in the international economic framework.

The unidentified institutional role of the IMF has evolved over a period of time,⁵ thus it has some key structural deficiencies which are significant hurdles to its operating optimally in the context of the IELR. These structural deficiencies are decision-making with realistic insight; focusing more on legal transplant than on legal harmonisation; and the lack of an effective adjudicating system. Section two argues that if changes were made to address these key institutional structural deficiencies, then idealistically, the IMF could contribute much more effectively towards the IELR and the Economic Cycle. However, realistically, such extensive institutional modifications to the IMF are unlikely because the dominant powers (mainly the US) would not relinquish their influence in the formation of global financial regulations easily or readily.

As discussed above, there are practical implications in making modifications to the institutional structure of the IMF. Thus, section three argues, on the basis of practicality, that the WTO, by far the most effective IEI in the IELR to affect the international Economic Cycle, could practically enhance its role in financial sector development, and in doing so, the WTO could become the optimal IEI in the IELR. It could, in fact, lead the IELR.

For this purpose, this section demonstrates the comprehensive institutional role of the WTO as part of the IELR. As the international economic cycle takes into account both the financial sector and international trade, so this section highlights the WTO's institutional role in the development of both. However, greater emphasis is placed on the contribution of the WTO in the development of the financial sector. Popular opinion regarding the WTO is that it only deals with trade issues

⁵ The IMF has evolved as an important IEI in context of financial global regulation. This evolution of the IMF's role took place because there was and still is a vacuum or need for global financial regulations and there is no other IEI to do this job. Thus even with a realist approach and lacking democratic values, it is followed (possibly due to legal transplant) widely in the liberally institutionalized global economy because there is no viable alternative.

and has nothing to do with the development of the financial sector. This viewpoint is totally refuted by underlining the WTO's contribution in the development of the global financial sector. The WTO's contribution to financial sector development is less significant in comparison with the IMF; nevertheless, any contribution made by the WTO does not face problems of legitimacy, accountability and respect for democratic values.

An obvious question arises here; why can the WTO be reformed yet the IMF cannot? Given that the US has a vested interest in not allowing the WTO to be used as a way of circumventing its hegemony of the IMF, the answer to this question is easy. The US is the most dominant country in the organisational structure of the IMF and has a power to veto anything. Therefore, any move to address US dominance can be vetoed by the US itself. On the other hand, the WTO is a liberal institution which respects democratic values and so the collective free will of the WTO membership could push for the enlargement of the WTO's role in financial sector development. The US has no veto in the WTO so if the member countries so wish, they can call for the increased role of the WTO.

A slight modification of the role of the WTO in the context of financial sector development would only involve a more realistic and practical approach, as compared to the major structural changes necessary within the IMF. If this were to happen, then the soft laws (global regulations)⁶ would not lack democratic values and would also be subject to the WTO adjudication process.

The WTO's Committee on Trade in Financial Services contributes towards global financial regulation in the form of soft laws, but on a very small scale. It simply needs to contribute more to the financial sector and this does not require big structural changes. Therefore, this section calls for the enhancement of the WTO's institutional role in the context of financial sector

⁶ The expansion of the role of the FSC of the WTO in the creation of soft laws in the short term and could also be made part of the hard binding commitment in the longer term.

development as a more viable, practical and realistic solution to the current dilemma within the IELR, i.e. regarding legitimacy and the effectiveness of the rules of the game.⁷

For this purpose, section three is divided into three chapters; Chapters VI, VII and VIII. Chapter VI examines the legal framework of the WTO, whilst Chapter VII deals with the institutional role of the WTO in the promotion of international trade, albeit briefly, since the institutional role of the WTO and overall promotion of the international trade are uncontested and require no substantial change. Chapter VIII focuses on the institutional role of the WTO in the development of the global financial sector and calls for the expansion of its institutional role in this area.

⁷ A very good proposal for a structure of global financial system is put forwards by well-known scholars who take into account both, legitimacy and accountability. However, it is too good to be adopted because it calls of enormous cooperation and collaboration of all the participants of IELR. See generally, Chapter 5: Strengthening the global financial system through institutional and legal reforms, in Alexander, Kern, Dhumale, Rahul, and, Eatwell, John, (2005). 'Global Governance of Financial Systems, The International Regulation of Systemic Risk.' Published to Oxford Scholarship Online: September 2007.

II. THEORETICAL FRAMEWORK

The increasing pace of international economic activities and the mounting interdependence of national economies have made it difficult for governments to implement policies in relation to the growing number of cross-border economic activities. These economic activities sometimes lie outside the territorial control of the national government and sit within the domain of global governance.⁸

These trends, which may have resulted from globalization⁹ (or vice versa) necessitated the need for regulating international economic relations. In reality, these regulations, rules, norms etc, do exist but in the form of an amalgamation of politics, economics and law at international level. The complex interaction of these disciplines has created an ‘international economic-legal regime’ (hereinafter “IELR”) at international level.

To develop a theoretical understanding of this new dimension of IELR, we need to take a multidimensional approach in order to best explain this trend. That is, it should take into account all the constituents of IELR (such as International Relations¹⁰, International Law¹¹ and International Economics).

⁸ For an interesting discussion of interdependence and globalization theories (and a useful bibliography), see Zürn, M. (2002) ‘From Interdependence to Globalization’, Handbook of International Relations, Editors: Carlsnaes, W., Risse, T., Simmons, Beth A. London: Sage, p. 235-254.

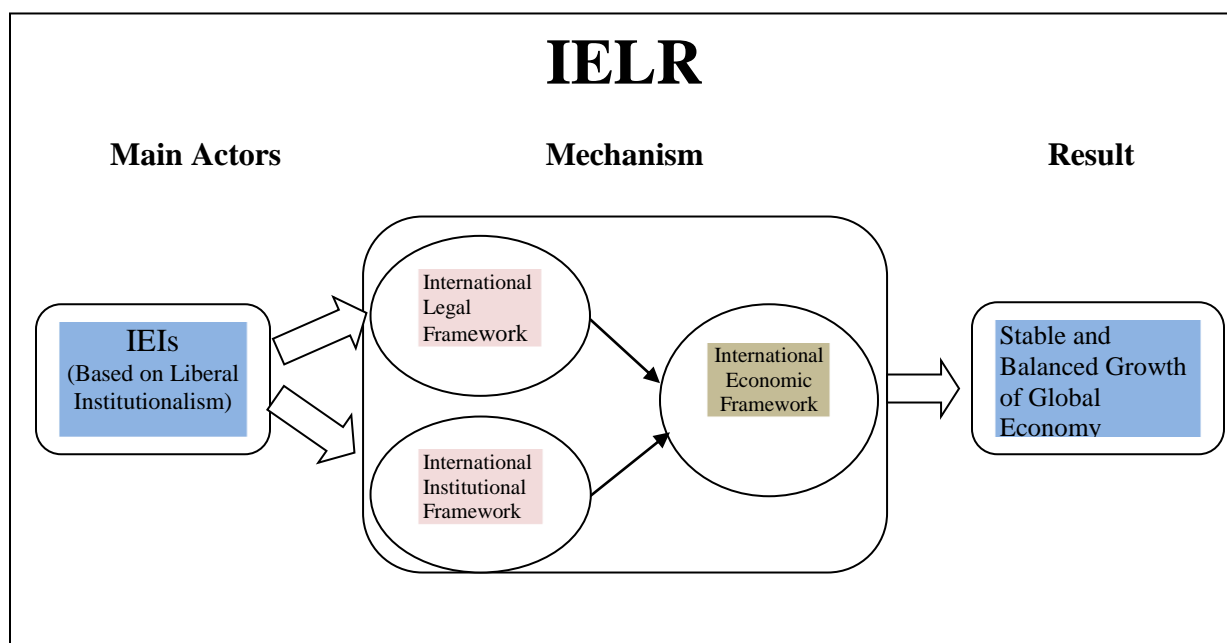
⁹ Globalization definition by Holm and Sorensen: the ‘intensification of economic, political, social and cultural relations across borders’. [Holm, H. and Sorensen, G., (1995) ‘Introduction: What has Changed’, Whose World Order: Uneven Globalization and the End of the Cold War, Editors: Holm, H. and Sorensen, G., Boulder: Westview, p. 1; and also see, Braithwaite, J. and Drahos, P., (2000) ‘Global Business Regulation’, Cambridge University Press, p. 8] Globalization result from the interdependence of national economies or it is the other way around that the globalization causes interdependence of national economies.

¹⁰ Hereinafter “IR”.

¹¹ Hereinafter “IL”.

The concept of IELR can be better understood using the example of a cooking recipe. Just suppose International Economic Institutions (hereinafter “IEIs”) have the main ingredients to bake a cake of global, balanced and stable economic growth. There are two ways to bake this cake; one is using the international institutional framework (based on IR) process and the other one uses the international legal framework process (based on IL). Both of these techniques if applied (together or separately) to the international economic framework, result in a delicious cake of stable and balanced growth of the global economy. See the figure below, explaining the concept in graphic form.

Figure 1



The above figure tries to explain the concept presented in this thesis. This thesis takes IEIs as an organised, rational cooperation between states for collective gain and these IEIs are viewed through the Liberal Institutionalists’ lens. The thesis then takes IEIs as the main non-state actors in the IELR. These IEIs then act within the international economic framework through an

international legal framework or international institutional framework or both (referred to as ‘mechanism’ in the above figure) to achieve an end result, that is, a more stable and balanced growth of the global economy.

This thesis, for a better theoretical understanding, will discuss in detail the main constituents of the IELR. In order to do that, this chapter will look into theories based on IR, IL and international economic aspects. For this purpose, this chapter is divided into three main parts; A, B and C. Part A of this chapter talks about the main actors in the IELR and their institutional role through which they create certainty and predictability. Part B is dedicated to the mechanism/process through which these IEIs operate in the international economic framework. Thus this part will discuss the international institutional framework (based on IR), international legal framework (based on IL) and the international economic framework. Finally, part C is the conclusion.

The concept of the international institution used in this thesis needs to be clarified and discussed. Therefore, the following part of this subheading is dedicated to the term ‘international institution/IEIs’ and then their institutional role.

A. Main Actors in the IELR

As mentioned earlier, this thesis takes IEIs as the main non-state actor in the IELR. Before moving on to discuss the mechanism through which these IEIs use the international economic framework to result in a more stable and balanced growth of the global economy, we need to clarify the term ‘international institutions’ and their role in creating the certainty and predictability of the rules of the game in the economic scenario that is the IELR. Therefore this subheading will discuss the international institutions, their institutional role and the relationship of certainty and predictability of the rules of the game within the economy.

1. International Institutions/Organisations

The theories which are to be discussed in this chapter are all about the reasoning behind and need for the cooperation of states within the global system which forms the IELR. There are many approaches but most of them arrive at more or less the same conclusion: the states cooperate with each other to develop an understanding of their interaction with each other. The most common method of this co-operation between the states is through the international institutions/organisations.¹²

As mentioned earlier that this thesis looks into the global economic scenario and at the cooperation of states for a more organised and better interaction of states within it. This interaction (based on interdependence) relies considerably on IELs, which have evolved into a regime governing the interaction of independent states within the global economic system.

There is slight confusion about the term ‘institutions’ in economic literature that are the institutions itself the rules of the game or they set the rules of the game for the interaction of states in the global economic system.¹³ North, a prominent scholar in the area of institutions and

¹² The term international institutions and international organisations are used as interchangeable words. According to Simmons and Martin, the distinction between institutions and organisations is secondary if the research, does not involve informal organisations. Simmons, B. and Martin, L., (2002) ‘International Organizations and Institutions’, Handbook of International Relations, Editors: Carlsnaes, W., Simmons, Beth A., Risse, T.

¹³ John Mearsheimer defines institutions as ‘sets of rules that stipulate the ways in which states should cooperate and compete with each others’ [Mearsheimer, John J., (1994/95) ‘The False Promise of International Institutions’, International Security, Vol. 19, No. 3, p. 5-49.]. Bromley, “institutions are the means whereby the collective control of individual action is given effect.” [Bromley, Daniel W., (2006) ‘Sufficient Reason: Volitional Pragmatism and the Meaning of Economic Institutions’, Woodstock, Princeton: Princeton University Press, p. 31]. “[I]nstitutions are the rule of the game in a society or, more formally, are the humanly devised constraints that shape the human interaction. In consequence they structure incentives in human exchange, whether political, social, or economic.” [North, Douglass C., (1990) ‘Institutions, Institutional Change, and Economic Performance’, Cambridge University Press.]. Williamson refers to institutions as “[G]overning structures” [As quoted in, Nelson, R.R. and Sampat, B.N., (2001) ‘Strands of Institutional Analysis’, Journal of Economic Behavior & Org., Vol. 44, p. 31–54]. “[W]idely common and predictable patterns of behavior in a society, including generally shared habits of thought as well as of action.” [Veblen, T., (1915) ‘Imperial Germany and the Industrial Revolution’, Macmillan, New York. As quoted in, Nelson, R.R. and Sampat, B.N., (2001) ‘Strands of Institutional Analysis’, Journal of Economic Behavior & Org., Vol. 44, p. 31–54] John R. Commons, a prominent economist defined an institution as something which tell individuals what they “must or must not do, ... what they may do without interference from other individuals, ... what they can do with the aid of collective power, ... and what they cannot expect the collective power to do in their behalf.” [Commons, John R., (1957) ‘Legal Foundations of Capitalism’, Madison : University of Wisconsin Press.]

economic growth, considers institutions as the rules of the game itself (which includes both formal and informal rules) and distinguishes it from the organisations which he asserts are a group of people compelled by some mutual drive to attain common goals, and which could be political bodies,¹⁴ economic bodies,¹⁵ social bodies¹⁶, and educational bodies^{17 18}.

However, this thesis takes institutions and organisations as interchangeable terms. The reason for not distinguishing between these two terms is that it is secondary to the purpose of my thesis, as I am only looking into formal international organisations.¹⁹

In the context of international organisations, scholars have, in general, agreed that for any entity to qualify as an international organisation, it must have certain characteristics and these characteristics are as follows;²⁰

- Its membership must be composed of states and/or other international organisations;
- It must be established by treaty;
- It must have an autonomous will distinct from that of its members and be vested with legal personality; and
- It must be capable of adopting norms applicable to its members.

¹⁴ Parliament, political parties, a city council, a regulatory body, etc.

¹⁵ Firms, trade unions, family farms, cooperatives, etc.

¹⁶ Churches, clubs, athletic associations, etc

¹⁷ Schools, universities, vocational training centers, etc

¹⁸ North, Douglass C., (1990) 'Institutions, Institutional Change, and Economic Performance', Cambridge University Press.

¹⁹ According to Simmons and Martin, the distinction between institutions and organisations is secondary if the research, does not involve informal organisations. Simmons, B. and Martin, L., (2002) 'International Organizations and Institutions', Handbook of International Relations, Editors: Carlsnaes, W., Simmons, Beth A., Risse, T.

²⁰ This definition of international institutions/organisations is taken from Amerasinghe, C. F., (2005), 'Principles of the Institutional Law of International Organizations', Cambridge Studies in International and Comparative Law. Cambridge University Press, p 10 and also used by Philippe Sands, P., Klein, P. (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, p. 16; see also Morgenstern, F., (1986), 'Legal Problems of International Organizations', p19; see also, Schermers, Henry G. and Blokker, Niels M. (1995) 'International Institutional Law: Unity within Diversity', 3rd ed, Martinus Nijhoff Publishers, The Hague, p. 45-46; see also, Seidl-Hohenveldern, I., (1965) 'Legal Personality of International and Supranational Organizations', Egyptian Review of International Law, Vol. 21, p. 66.

The international institutions/organisations which this thesis analyses as the main constituents of the IELR (other than states) are based on the criteria mentioned above. This international regime analysis gained momentum in the early 1970s. The main focus was on the principles, procedures, rules, and norms that govern the expected behaviour of states in an international context.²¹ The current IELR which evolved during the past couple of decades focuses on the rules of the game regarding the behaviour of states between each other in the context of economic relations. The IELRs lay down the legal foundations of the international economic system.²²

This economic regime provides legal certainty and predictability and guides its constituents according to its rules. At international level, it permits states to plan their economic activities with less uncertainty.²³ This regime concept is materialised through a global legal structure²⁴ based on international institutions and multilateral treaties which reduces uncertainty and increases predictability. This legal certainty aspect is covered by the IELRs as they provide a legal structure, through their organisational framework, to the global economy. In this context, there are three ways in which IELRs provide a legal structure²⁵ to the global economy through their institutional capacity: firstly, in their legislative and normative capacity; secondly, through their

²¹ Krasner, Stephen D. (ed.) (1983) 'International Regimes', Ithaca, N.Y.: Cornell University Press. Also see, Haggard, S. and Simmons, Beth A., (1987) 'Theories of International Regimes', *International Organization*, Vol. 41, No. 3, p. 491-518.

²² Economic institutions comprise and define the legal foundations of any economic system. [Bromley, Daniel W., (2006) 'Sufficient Reason: Volitional Pragmatism and the Meaning of Economic Institutions', Woodstock, Princeton: Princeton University Press, p. 31]. However, the author takes economic institutions as rules of the game and also setter of these rules. This thesis only looks institutions as the setter of the rule of the game.

²³ See Maxeiner, James R., (2006) 'Legal Indeterminacy Made in America: U.S. Legal Methods and the Rule of Law', *VAL. U. L. REV.*, Vol. 41, p. 517, 522. [hereinafter Maxeiner, *Legal Indeterminacy Made in America*].

²⁴ Gessner asserts that along with the legal structures social structures also contribute to legal certainty. By legal structures he means state law and international law which includes multilateral agreements. [Gessner, V., (1998) 'Globalization and Legal Certainty', *Emerging Legal Certainty: Empirical Studies on the Globalization of Law*, Editors: Gessner, V., Budak, Ali C. Aldershot: Dartmouth.]

²⁵ As a general principle of European legal systems, structure is where: "(1) laws and decisions must be made public; (2) laws and decisions must be definite and clear; (3) decisions of courts must be binding; (4) limitations on retroactivity of laws and decisions must be imposed; and (5) legitimate expectations must be protected." See Maxeiner, James R., (2007) 'Legal Certainty: A European Alternative to American Legal Indeterminacy?' 15 *Tulane J. Int'l & Comp. L.* p. 541, 545-46.

executive and administrative authority; and thirdly, through judicial and quasi-judicial functions.²⁶ This above-mentioned institutional role or contribution towards global economic certainty is discussed in the latter part of this chapter. However, at this stage it becomes inevitable to discuss the relationship between certainty and predictability within the economy. Thus the following subheading sheds some light on this aspect.

2. Certainty and Predictability of the Rules of the Game and the Economy

The certainty and predictability of the rules of the game result from an effective functioning of a regime; however, at this point it becomes important to look into the relationship of the certainty and predictability of the rules of the game within economic development. This aspect of economics and certainty and predictability of laws is discussed below.

There are four different approaches adopted by the scholars in discussion of the certainty of law and economics:²⁷ (1) classical sociology of law²⁸; (2) law and development²⁹; (3) economic sociology³⁰; and (4) institutional economics³¹. All of these approaches, one way or another,

²⁶Gessner asserts that the legal structures contribute to legal certainty. By legal structures he means state law and international law which include international organisations. Gessner, V., (1998) 'Globalization and Legal Certainty', *Emerging Legal Certainty: Empirical Studies on the Globalization of Law*, Editors: Gessner, V., Budak, Ali C. Aldershot: Dartmouth.

²⁷Gessner, V., (2009) 'Towards the Theoretical Framework of Contractual Certainty', *Contractual Certainty in International Trade: Empirical Studies and Theoretical Debates on Institutional Support for Global Economic Exchanges*. Editors: Gessner, V. Hart Publishing: Oxford; Portland, p. 7.

²⁸In the classical sociology approach of law the most significant scholar is Max Weber. He asserts that the legal certainty ensure calculability of economic activities. Dorbeck-Jung, B., (2009) 'Global Trade: Changes in the Conceptualization of Legal Certainty', *Contractual Certainty in International Trade: Empirical Studies and Theoretical Debates on Institutional Support for Global Economic Exchanges*. Editors: Gessner, V., Hart Publishing: Oxford; Portland.

²⁹ See generally for law and development, Trubek, David M., and Galanter, M. (1974) 'Scholars in Self-Estrangement: Some Reflections on the Crisis in Law and Development Studies in the United States', *Wis. L. Rev.*, p. 1062-102; Gardner, James A., (1980) 'Legal Imperialism: American Lawyers and Foreign Aid in Latin America', University of Wisconsin Press; Larson-Rabin, L., (2007) 'Happenstance and Memory: A Legacy of Law and Development Scholarship and Policy in Legal Education', *Wisconsin International Law Journal*, Vol. 25, No. 2, p. 209-234.

³⁰ For legal elements in the economic structure in economic sociology see generally work of Karl Marx and Karl Polanyi.

assert that the rule of law and legal certainty is essential for the economy. These above-mentioned approaches are briefly discussed below.

First approach explaining the relationship between law and the economy is the **classical sociology of law**. The most significant scholar of this approach is Max Weber³². He propagates that legal certainty in any system ensures the calculability of economic activities within that system.³³ According to Weber, law is a system with rules which are general, uniform, stable, clear, predictable and publicly announced. These rules are backed by the state's monopolised, organised violence.³⁴

Weber's view of sanctions based on a state's monopoly of organised violence is highly challenged in the global economic scenario³⁵ because the current regimes are mainly based on cooperation and understanding between sovereign states. Moreover, international institutions are based on the notion that independent sovereign states have the ability to reach cooperative solutions to problems without the intervention of coercive action.³⁶ The logic behind cooperation is that all (the majority) of the participants will benefit from cooperation in the long run.

³¹ See North, Douglass C. (1990) 'Institutions, Institutional Change, and Economic Performance', Cambridge University Press.

³² For an English translation of the entire three-volume text, see Weber, M., (1956) 'Economy and Society: An Outline of Interpretive Sociology', Editors: Roth, G., Wittich, C. Trans. by Fischhoff, E. et al. New York: Bedminster Press, 1968.

³³ Weber, M., (1956) 'Economy and Society: An Outline of Interpretive Sociology', Editors: Roth, G., Wittich, C. Trans. by Fischhoff, E. et al. New York: Bedminster Press, 1968. Also see Dorbeck-Jung, B., (2009) 'Global Trade: Changes in the Conceptualization of Legal Certainty', Contractual Certainty in International Trade: Empirical Studies and Theoretical Debates on Institutional Support for Global Economic Exchanges. Editors: Gessner, V., Hart Publishing: Oxford; Portland.

³⁴ Scheuerman, William E., (1999) 'Globalization and the Fate of Law', Recrafting the Rule of Law, Editor: Dyzenhaus, D. Oxford: Hart. Dorbeck-Jung, B., (2009) 'Global Trade: Changes in the Conceptualization of Legal Certainty', Contractual Certainty in International Trade: Empirical Studies and Theoretical Debates on Institutional Support for Global Economic Exchanges. Editors: Gessner, V., Hart Publishing: Oxford; Portland.

³⁵ Such as R. Axelrod.

³⁶ This concept is derived on the optimistic approach adopted by Axelrod towards the ability of humans to solve their problems by cooperation. Axelrod, R., (2006) 'The Evolution of Cooperation' (Revised ed.), Perseus Books Group.

However, Weber's basic idea of the law leading to the certainty of rules for the calculability of other participant's economic activities is highly relevant to this thesis. The predictability of economic activities within a system is based on the certainty of the rules of the game of that system. In the global economic aspect, the IEIs define the rules of the game for all the actors in the global economic system, which reduces uncertainty and increases the calculability of economic activities of the other participants (i.e. member states).

A second approach relevant to this thesis was originated by Trubek and Galanter who applied Weber's concepts³⁷ to modernization theory in the context of **law and development**. The notion of modern law is that the law that comprises rules "to achieve social purposes"³⁸ and "to advance in a rational way toward some knowable goal."³⁹ The main purpose of law in the modernization theory was to utilise law as a tool to shape the social order in which "the state exercises its control over the individual through law," "rules are consciously designed to achieve social purposes or effectuate basic social principles" and are "enforced equally for all citizens, in a fashion that achieves the purposes for which they were consciously designed," and in which "the courts have the principal responsibility for defining the effect of legal rules."⁴⁰ In other words,

³⁷ Modernization theorists made the claim that modern law (clearly articulated legal standards that provide a predictable framework for the resolution of disputes) is an essential prerequisite for the progression towards and growth of a modern market, however, Weber had studied this very connection in *Economy and Society*. See, Weber, M., (1956) 'Economy and Society: An Outline of Interpretive Sociology', Editors: Roth, G., Wittich, C. Trans. by Fischeff, E. et al. New York: Bedminster Press, 1968. See also, Cao, L., (1992) 'Law and Economic Development: A New Beginning?' *Law and Development*, Editor: Carty, A. New York, N.Y.: New York University Press, *Texas International Law Journal* Summer 1997.

³⁸Trubek, David M., and Galanter, M., (1974) 'Scholars in Self-Estrangement: Some Reflections on the Crisis in Law and Development Studies in the United States', *Wis. L. Rev.* 1071.

³⁹Friedman, Lawrence M., (1969) 'On Legal Development', *Rutgers L. Rev.* Vol. 24, p. 11, 30. In modern, dynamic systems, "[t]he role of organized society, of government and law, is to insure that change is channeled in the right direction. In the modern world, governments do more than maintain order; presumably, they also solve problems. ... Law itself is not scared and timeless, but moves with the times. ... It is plainly manipulated by living people and by organized groups to secure their rights and advance their interests. People believe that law has a purpose." Id.

⁴⁰Trubek, David M., and Galanter, M. (1974) 'Scholars in Self-Estrangement: Some Reflections on the Crisis in Law and Development Studies in the United States', *Wis. L. Rev.* 1071-72. For a discussion of the seven commonly shared assumptions regarding the relationship between law and development, which the authors refer to as the

Modernization theory links modern law with predictability, rationality, and purposefulness. It conceives of law as a body of legal rules shaped by rational and conscious design⁴¹ and “valued for their instrumental utility in producing consciously chosen ends.”^{42 43}

If the current economic legal regime is viewed in same way in which Weber took economy and society, and the way in which modernization theorists implanted Weber’s concept into the relationship of law and economic development, then it can be better understood. The rules set by the IELR are highly purpose-oriented and are planned with high rationality so that the subjects can calculate the possible results of their actions.

Economic Sociology: The term institution in its sociological form is a broad one since it contains the set of rules and regulations that these organizations follow and which help them to function properly. An example would be the standard which governs property rights and labor relations. Hence, institutions and organizations should be treated as separate from one another with organizations being defined as the cooperative setup that bring together human and physical resources to fulfill their objective, including International Economic Organizations such as IMF, World Bank and WTO.). Whereas organizations may be actors, institutions cannot.⁴⁴

The economic sociology does not examine the economy broadly; in its place studies particular economic systems, such as, feudal economies, the economies of primitive societies, capitalist economies, etc.⁴⁵

“paradigm” of “liberal legalism” or “the original paradigm of law and development studies in the United States,” see id. at 1070-72.

⁴¹See Galanter, M. (1966) ‘The Modernization of Law’, Modernization: The Dynamics of Growth. Editor: Weiner, M.

⁴²See Galanter, M. (1966) ‘The Modernization of Law’, Modernization: The Dynamics of Growth. Editor: Weiner, M. p.155.

⁴³ See, Cao, L. (1992) ‘Law and Economic Development: A New Beginning?’ Law and Development. Editor: Carty, A., New York, N.Y.: New York University Press, Texas International Law Journal Summer 1997, p. 506.

⁴⁴ Trigilia, C. Economic sociology : state, market, and society in modern capitalism. Blackwell Publishers, p17-36.

⁴⁵ Trigilia, C. Economic sociology : state, market, and society in modern capitalism. Blackwell Publishers, p17-36.

Karl Polanyi was one of the prominent researchers in the field of economic sociology. In his analysis, he used the studies involving economies based on archaic principles where the economic exchange used to take place in the presence of non-economic principles. For instance, the goods produced and traded via agriculture, breeding, fishing and handicrafts was done so on the concept of 'reciprocity' or 'redistribution', unlike it is done in the modern economy on the basis of market trade.⁴⁶

The principle of reciprocity implied that the basis of the production and distribution of goods and services was a unified obligation towards other members of the family or tribe. This led to different kinds of goods being traded as well as an uninterrupted cycle of goods being exchanged. Whereas in the modern economy, individual actions are triggered by personal gain and the amount of goods produced is determined by the market equilibrium, in these societies this is not the case. Instead the commitments that the members of the society have towards each other based on the premise of reciprocity social obligations were the main driving force of the economic activities.⁴⁷

Another common attribute of these societies was the principle of redistribution, which played along with reciprocity. For instance, in such a society, the societal rules would require a certain amount of produce to be given to the leader of the tribe. In this event, the produce would be stored and relocated when need be based on the amount that is prescribed to each social group. In this type of economic organization, it was seen that a specific division of labor was possible and was characteristic of large empires like ancient Mesopotamia, Egypt? Hence, when the political structures became more distinguished, the practice of redistribution on a large scale was directly linked to it. There was a 'center' that defined what the obligations of the people were towards the

⁴⁶ Polanyi, K. (1968) *Primitive, Archaic and Modern Economies*. New York: Doubleday.

⁴⁷ Trigilia, C. *Economic sociology : state, market, and society in modern capitalism*. Blackwell Publishers, p17-36.

economy. As time went by, economic activity boosted and money was brought in, the economic behavior of people was not determined by their social obligations – it was done so by rules that the political powers defined which gained their significance through the religious forces. Thus, it is clear the any analysis of economy is very deeply interlinked with that of political structures where economic activity is entrenched.⁴⁸

Polanyi concluded that a very essential part of European feudalism was reciprocity and redistribution as a means to control economic activity which constituted of a set of connections between the monarch, the liege-lord and the inhabitants of the estate. In spite of this, it was noted that the medieval period, even in Europe, led to an increase in the market being seen as a tool to manage economic activity, as the principles of reciprocity and redistribution became outdated.⁴⁹

Not all types of exchange are those that fall under ‘market trade’. There are three types of exchange depending on the kind of relationship that is present between the concerned actors. The first one is ‘gift trade’ which is characterized by the principle of reciprocity that is hinged on social norms.⁵⁰ The second type of exchange was ‘administered trade’ – this included transactions that were heavily influenced by the prevailing political powers as was the case in the large empires of primitive economies.⁵¹

What is significant about these types of transactions is that instead of being determined by the interplay of demand and supply, they are controlled by the social and political norms. Market trade has a specific characteristic; that it is based strictly on the demand and supply relationship. As time went by, market exchange gained significance. It was in the 1800s that markets where price is set through the interaction of demand and supply i.e. ‘self-regulating’ markets were

⁴⁸ Trigilia, C. *Economic sociology : state, market, and society in modern capitalism*. Blackwell Publishers, p17-36.

⁴⁹ Trigilia, C. *Economic sociology : state, market, and society in modern capitalism*. Blackwell Publishers, p17-36.

⁵⁰ Polanyi, K. (1977) *The Livelihood of Man*, edited by Harry W. Pearson. New York: Academic Press, p 94.

⁵¹ Polanyi, K. (1977) *The Livelihood of Man*, edited by Harry W. Pearson. New York: Academic Press, p 94-95.

primarily used to control the (production and distribution of goods and services in the developed world). Consequently, social and political forces ceased to control the exchange of goods and services, and it was profit seeking that became the driving force. In this new setup, the political system became an external force that affected property rights and bargaining, whereas individuals carried out transactions in the economic market. Therefore, economics progressed to become a science once it began to be separated from social and political limitations and economic research was conducted based on the market rules and regulations.⁵²

The connection between sociology and economic is primary due to uneasy interactions between modern rational choice theory and economic sociology. The reason being that the rational choice theory stresses on economics and on the other hand economic sociology focuses on social.⁵³

Economic sociologists stress on the point that social structures, cultural patterns and close-knit relationships are the roots of economic behaviour.⁵⁴ Since the inception of this current regime the market forces based on rational choice has dominated the global economic scenario. This thesis relies on a rational choice concept and does not rely on the economic behaviours based on social structures, cultural patterns and their relationship in formation of IELR. Moreover, IELR originates since the inter World War period and this thesis does not go beyond that period. Therefore the economic sociological approach is not widely utilised in this thesis.

Institutional Economic lead by North lays stress equally on both informal and formal institutions' efficacy for economic performance.⁵⁵ Institutional economics explores the role of

⁵² Trigilia, C. *Economic sociology : state, market, and society in modern capitalism*. Blackwell Publishers, p17-36.

⁵³ Zafirovski, Milan (2001) *Reexamining economic sociology: Beyond rational choice reductionism*. The American Sociologist. Springer New York.

⁵⁴ Gessner, V. (2009), 'Towards the Theoretical Framework of Contractual Certainty', *Contractual Certainty in International Trade: Empirical Studies and Theoretical Debates on Institutional Support for Global Economic Exchanges*. Editors: Gessner, V. Hart Publishing: Oxford; Portland.

⁵⁵ North, Douglass C. (1990) 'Institutions, Institutional Change, and Economic Performance', Cambridge University Press.

institutions in determining economic behaviour. It highlights a comprehensive research of institutions and perceives markets as a consequence of the multifaceted relationships of different institutions (e.g. social norms, individuals, firms, states). According to institutional economics, individuals don't have perfect information and due of this they encounter uncertainty related to unanticipated circumstances and consequences and thus suffer transaction costs to obtain information. Therefore, humans create institutions in order to decrease risk and transaction costs. In institutional economics, institutions are taken as written (formal) and unwritten (informal) rules, norms and constraints that humans formulate to increase their control and lower uncertainty within their surroundings.⁵⁶ Moreover, institutional economist substantially focuses on human understanding towards reality, which in turn outlines the institutional environment they build.⁵⁷

The concept of institutions is very broad under institutional economics and there is no consensus among institutionalist scholars for a definition of institutions. It includes both formal and informal institutions. There is no consensus on the term 'institution' by the institutionalist scholars. Moreover, it's not even clear if organizations and institutions are the same thing or there is a substantial difference between these two terms.

There is slight confusion about the term 'institutions' in economic literature that are the institutions itself the rules of the game or they set the rules of the game for the interaction of states in the global economic system.⁵⁸ North considers institutions as the rules of the game itself

⁵⁶ These include (i) written rules and agreements that govern contractual relations and corporate governance, (ii) constitutions, laws and rules that govern politics, government, finance, and society more broadly, and (iii) unwritten codes of conduct, norms of behavior, and beliefs. [C. M'énard and M. M. Shirley (eds.) (2005), *Handbook of New Institutional Economics*, 1–18. Springer. Printed in the Netherlands].

⁵⁷ C. M'énard and M. M. Shirley (eds.) (2005), *Handbook of New Institutional Economics*, 1–18. Springer. Printed in the Netherlands. See also, North, Douglass C. (1990) 'Institutions, Institutional Change, and Economic Performance', Cambridge University Press, p3-6.

⁵⁸ John Mearsheimer defines institutions as 'sets of rules that stipulate the ways in which states should cooperate and compete with each other's' [Mearsheimer, John J., (1994/95) 'The False Promise of International Institutions',

(which includes both formal and informal rules) and distinguishes it from the organisations which he asserts are a group of people compelled by some mutual drive to attain common goals, and which could be political bodies,⁵⁹ economic bodies,⁶⁰ social bodies⁶¹, and educational bodies⁶² .⁶³

There are some scholars⁶⁴ who consider organizations as special institutions that encompass (a) *criteria to establish their boundaries and to distinguish their members from nonmembers*, (b) *principles of sovereignty concerning who is in charge*, and (c) *chains of command delineating responsibilities within the organization*.⁶⁵ Moreover, the interaction between institutions and organizations that shapes the institutional evolution of an economy.⁶⁶ If institutions are the rules of the game (which include both formal and informal constraints) then organizations (which are special type of institutions) are the players who are capable to set the rules of the game.

International Security, Vol. 19, No. 3, p. 5-49.]. Bromley, “institutions are the means whereby the collective control of individual action is given effect.” [Bromley, Daniel W., (2006) ‘Sufficient Reason: Volitional Pragmatism and the Meaning of Economic Institutions’, Woodstock, Princeton: Princeton University Press, p. 31]. “[I]nstitutions are the rule of the game in a society or, more formally, are the humanly devised constraints that shape the human interaction. In consequence they structure incentives in human exchange, whether political, social, or economic.” [North, Douglass C., (1990) ‘Institutions, Institutional Change, and Economic Performance’, Cambridge University Press.]. Williamson refers to institutions as “[G]overning structures” [As quoted in, Nelson, R.R. and Sampat, B.N., (2001) ‘Strands of Institutional Analysis’, Journal of Economic Behavior & Org., Vol. 44, p. 31–54]. “[W]idely common and predictable patterns of behavior in a society, including generally shared habits of thought as well as of action.” [Veblen, T., (1915) ‘Imperial Germany and the Industrial Revolution’, Macmillan, New York. As quoted in, Nelson, R.R. and Sampat, B.N., (2001) ‘Strands of Institutional Analysis’, Journal of Economic Behavior & Org., Vol. 44, p. 31–54] John R. Commons, a prominent economist defined an institution as something which tell individuals what they “must or must not do, ... what they may do without interference from other individuals, ... what they can do with the aid of collective power, ... and what they cannot expect the collective power to do in their behalf.” [Commons, John R., (1957) ‘Legal Foundations of Capitalism’, Madison : University of Wisconsin Press.]

⁵⁹ Parliament, political parties, a city council, a regulatory body, etc.

⁶⁰ Firms, trade unions, family farms, cooperatives, etc.

⁶¹ Churches, clubs, athletic associations, etc

⁶² Schools, universities, vocational training centers, etc

⁶³ North, Douglass C., (1990) ‘Institutions, Institutional Change, and Economic Performance’, Cambridge University Press.

⁶⁴ Geoffrey M.Hodgson (2006), 'What Are Institutions?', Journal of Economic Issues, JOURNAL OF ECONOMIC ISSUES. Vol. XL no. 1.

⁶⁵ Geoffrey M.Hodgson (2006), 'What Are Institutions?', Journal of Economic Issues, JOURNAL OF ECONOMIC ISSUES. Vol. XL no. 1.

⁶⁶ North, D., (1994) Institutional Change: A Framework Of Analysis. Economic History, Econ WPA, revised.

Organizations are made up of groups of individuals bound together by some common purpose to achieve certain objectives.⁶⁷

This concept of the organizations under the institutional economics and the concept of institutions in the international relations is quite similar and also relevant to this thesis. This thesis takes the term international institution as used in international relations and not as used in economics. International relations use international institutions for formal international organizations such as UN and its related bodies.⁶⁸

Whether institutions are rules of the game or they set rules of the game. This is the confusing part of the Institutional Economics. According to institutionalists institutions are rules of the game and they can also set the rule of the game. My thesis takes institutions as actor in the international economic scenario which set rules of the game for the international economic scenario.

Moreover, the formal and informal constraints can be used for the purposes of exploring the role of IOs. Formal constraints take form binding commitments under treaties. On the other hand, soft laws could be understood in light of informal constraints. Moreover, informal constraints are also observed in the decision making process within the international economic institutions (IEI). Such as, the 'Green Room' meetings within WTO. Furthermore, the "Gentleman's Agreement" between US and EU for the appointment of IMF and World Bank heads could also be analyzed in light of informal commitments.

So far this chapter has discussed the term 'international institution' and the relationship between law (certainty and predictability of the rules of the game) and the economy in order to achieve a

⁶⁷ Geoffrey M. Hodgson (2006), 'What Are Institutions?', *Journal of Economic Issues*, JOURNAL OF ECONOMIC ISSUES. Vol. XL no. 1

⁶⁸ Beth A. Simmons (2001), *International Organizations and Institutions*, in *Handbook of International Relations*. Edited by

better understanding of the IELR. The certainty and predictability of the rules of the game are mainly achieved through the international institutions (within the global economy through IEs) through their institutional capacity. Therefore, it becomes imperative at this stage to explain the term ‘institutional role’ of the international institutions in the promotion of certainty and predictability in the global legal and economic scenario.

The next part of the theoretical framework will discuss the institutional role of IEs which is based on their normative capacity, their executive and administrative authority, and also includes quasi-judicial functions.

3. International Institutional/Organisational Role

The international institutional role has some significance in this thesis as it is the main mechanism through which the IEs promote the certainty and predictability of the rules of the game in the IELR. This institutional role of the IEs becomes even more significant when it is viewed as part of the international economic framework leading to the stable and balanced growth of the global economy. The following part discusses the international institutional role of the IEs and is inspired by discussions in Bowett’s *Law of International Institutions*⁶⁹ and *International Institutional Law: Unity Within Diversity*⁷⁰ regarding the functions of an effective international organisation.

By ‘*international organisational role*’ I mean that the role played by these institutions in their normative capacity, executive and administrative authority, and quasi-judicial functioning, in order to promote predictability and certainty in international economic affairs of states. This part

⁶⁹Sands, P. and Klein, P. (eds), (2001) ‘Bowett’s Law of International Institutions’, London: Sweet & Maxwell, 5th ed.

⁷⁰Schermers, Henry G. and Blokker, Niels M. (1995) ‘International Institutional Law: Unity Within Diversity’, 3rd ed, Martinus Nijhoff Publishers, The Hague.

of the theoretical chapter discusses in detail the terminology ‘*international institutional/organisational role*’ as used in my thesis. The following part discusses the legislative and normative capacity of an international organisation (hereinafter “IO”) and will then discuss in the same manner the executive and administrative authority, and judicial and quasi-judicial functioning as the institutional role of IOs.

a) ***Legislative and Normative capacity***

One of the constitutive elements⁷¹ of an IO is its capability of adopting norms (which include laws, rules, regulations, standards, best practices)⁷² for its constituent members.⁷³ The majority of scholars place emphasis on the fact that the IOs are formed mainly to adopt norms in their areas of speciality.⁷⁴ In the context of norms formation, IOs mostly become a forum for the elaboration, negotiation, and finally, acceptance of international conventions by the member states of that IO.

In this thesis, the term legislative and normative are used as interchangeable terms. However, a reasonable amount of vigilance is required when dealing with the term “legislative” in this thesis. This is due to two reasons; the first is that there are only a few IOs which have the capacity to carry out complete authoritative decision-making or in broader terms, institutional acts⁷⁵.

⁷¹ Scholars have in generally agreed that there are four constituent elements of and IO and they are as follows; “(1) Its membership must be composed of states and/or other international organisations; (2) It must be established by treaty; (3) It must have an autonomous will distinct from that of its members and be vested with legal personality; and (4) It must be capable of adopting norms addressed to its members.” [Sands, P., Klein, P. (eds), (2001) ‘Bowett’s law of International Institutions’, London: Sweet & Maxwell, 5th ed. p.16]

⁷² These norms can be either mandatory or not mandatory.

⁷³ Schermers, Henry G. and Blokker, Niels M. (1995) ‘International Institutional Law: Unity within Diversity’, 3rd ed, Martinus Nijhoff Publishers, The Hague, p.22.

⁷⁴ Such as, Virally, M. (1968) ‘The Sources of International Law’, Manual of Public International Law, Editor: Sorensen, M.; Sands, P., Klein, P. (eds), (2001) ‘Bowett’s law of International Institutions’, London: Sweet & Maxwell, 5th ed. p. 261.

⁷⁵ Sands, P., Klein, P. (eds), (2001) ‘Bowett’s law of International Institutions’, London: Sweet & Maxwell, 5th ed. p. 261.

The second explanation for having reservations in the usage of the terminology "legislative" at the current stage of my thesis is that it can easily be confused by the legislative processes of sovereign national governments. The legislative process of the sovereign national governments is the main source of the binding laws for its constituents. Whilst the norm-making process adopted by the IOs results in non-binding norms for its members, if the member voluntarily commits to the IO, then the non-binding norms become binding for that specific member. So it would be misleading to take the legislative process of national governments and IOs as the same.⁷⁶

In the realm of IOs, norms are created (both types, binding and non-binding) through different forms of bodies, be they plenary (and composed of representatives of member states or of private individuals) or of limited composition, which gives the vague effect of a legislative process at global level. To explore the way in which the IOs perform their normative functions, the following part of the chapter will focus on the procedural aspect of the legislative or the normative process, the types of normative acts along with their legal effect and lastly, the requisite legality of such acts.⁷⁷

(1) Procedural Aspects:⁷⁸

In all IOs, the approval of normative acts is dealt with through explicit procedural rules. Conformity with such procedural rules is a vital requirement for the legality of these acts.⁷⁹ The

⁷⁶ Sands, P., Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed. p.262.

⁷⁷ Sands, P., Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed.

⁷⁸ Sands, P., Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed.

⁷⁹ Validity also depends on the satisfaction of requirements relating to substance. For example, Article 18(3) of UN Charter for the General Assembly [Article 18 allows one vote to each state the UN General Assembly. Section 2 "Decisions of the General Assembly on important questions shall be made by a two-thirds majority of the members present and voting. These questions shall include: recommendations with respect to the maintenance of international peace and security, the election of the non-permanent members of the Security Council, the election of the members of the Economic and Social Council, the election of members of the Trusteeship Council in accordance with paragraph 1 (c) of Article 86, the admission of new Members to the United Nations, the suspension of the rights and

procedure to adopt norms generally differs between IOs; however, in most cases, the norms have to be accepted either by the consensus of the members⁸⁰ or a majority vote, or via a weighted voting system⁸¹. The base line in the procedural aspect of norm-making is that it should take into consideration the consent of its constituents.⁸²

(2) *Types of Acts and Legal Effects*⁸³

A vast range of institutional acts are adopted by or within IOs which may be achieved as the consequence of exercising the IOs' legislative or normative function. In this context, the basic difference should be clarified at this stage between the roles of the IO; as a forum for the taking up of multilateral conventions on the one hand, and, on the other hand, the role whereby it makes norms for itself.

privileges of membership, the expulsion of Members, questions relating to the operation of the trusteeship system, and budgetary questions.” And section 3 “Decisions on other questions, including the determination of additional categories of questions to be decided by a two-thirds majority, shall be made by a majority of the members present and voting.”

⁸⁰ The UN defines consensus as the “adoption of a decision without formal objections and vote; this being possible only when no delegation formally objects to a consensus being recorded, though some delegations may have reservations to the substantive issue at issue or a part of it” (definition proposed by the UN Office of Legal Affairs, UNJY 1987, 174).

⁸¹ Weighted voting, Majority requirement. It also reflects the political situation at the time of creation of the organisation. See, Virally, M. (1968) 'The Sources of International Law', Manual of Public International Law, Editor: Sorensen, M.

⁸² The decisions made in the International organisations are based mostly on consensus amongst all parties as opposed to one that is forced through a vote. A direct result of this is that all the options are discussed and debates are conducted and the result is reached with everyone's consent. As a consequence, it is common to come across one or more of the Member States to disagree with the results, but the decision is not opposed for their own motives. However, many a time, most principal agreements of International Organisations are made through majority vote in the event the member states fail to agree to one outcome. See for example, WTO Agreement, Art. IX.1. The latter provision states that, “[e]xcept as otherwise provided, where a decision cannot be arrived at by consensus, the matter at issue shall be decided by voting.” However, the practice in the WTO is that a vote is never taken: see Wouters, J. and De Meester, B. (2007) 'The World Trade Organization: A Legal and Institutional Analysis', International Law, Vol. I, Antwerp, Intersentia. See also, for the difference between 'passive consensus' and 'active consensus' in the WTO, Footer, M. (2005) 'An Institutional and Normative Analysis of the World Trade Organization', The Hague, Nijhoff, p. 138–139. Also see, Wouters, J. and De Man, P. (March 2009) 'International Organizations As Law-Makers', Working Paper No. 21, Leuven Centre for Global Governance Studies.

⁸³ Sands, P., Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed. p 275.

(a) IOs as a forum for the adoption of multilateral conventions

It has been noted that IOs often act as a forum for the adoption of multilateral conventions.⁸⁴ IOs arrange a number of conferences in order to tackle specific issues or for the resolution of problems under discussion within those IOs' areas of speciality. Many of these conferences organised by IOs result in the taking up of multilateral treaties in the context of those specific issues discussed in conferences.⁸⁵

Though international relations have mostly now been institutionalised⁸⁶, the practice of adopting treaties from the conferences has not ended. On the contrary, many constituent instruments of the IOs have been formed as a result of a multilateral convention on a specific issue. For example, Article 62(3) of the UN Charter states that the Economic and Social Council [hereinafter ECOSOC] “*may prepare draft conventions for submission to the General Assembly, with respect to matters falling within its competence.*” Relying on the above-mentioned Article of the UN Charter, the ECOSOC prepared drafts for conventions such as the Covenants on Economic, Social and Cultural Rights, Covenant on Civil and Political Rights and the Convention against Torture which were passed by the UN General Assembly in 1966, 1966 and 1984 respectively.⁸⁷ Similar provision can be found in the constituent instruments of some regional organisations, such as the Council of Europe⁸⁸. Article 1 (a and b respectively) of the Statute of the Council of

⁸⁴ Sands, P., Klein, P. (eds), (2001) ‘Bowett's law of International Institutions’, London: Sweet & Maxwell, 5th ed. p 275.

⁸⁵ See, for example, the Final Act of The Hague Peace Conference, (1899) Available at [<http://www.icrc.org/ihl.nsf/INTRO/145?OpenDocument>].

⁸⁶ By institutionalization of international relations I mean that in current international relation scenario a number of international institutions exist in most of the concerned area of international relations.

⁸⁷ Sands, P., Klein, P. (eds), (2001) ‘Bowett's law of International Institutions’, London: Sweet & Maxwell, 5th ed. p 276.

⁸⁸ The Council of Europe is an IO working towards European integration, having been founded in 1949. It has a particular emphasis on legal standards, human rights, democratic development, the rule of law and cultural co-

Europe states “*The aim of the Council of Europe is to achieve a greater unity between its members*” and “*This aim shall be pursued through the organs of the Council by discussion of questions of common concern and by agreements and common action in economic, social, cultural, scientific, legal and administrative matters*”⁸⁹ Since its creation, it has concluded more than 200 conventions including some well know conventions such as the European Convention on Human Rights (1950)⁹⁰. In short, it is considered that the multilateral conventions held by IOs are a significant platform for states to legislate on an international level.⁹¹

According to the Vienna Convention (1969), conventions enjoy the status of being ordinary multilateral treaties,⁹² and these conventions are of a binding nature for those states which agree to be part of these treaties.⁹³ However, this whole process of making multilateral treaties based on conventions held by the IOs is most commonly referred to by some scholars as “*not real law-making by IOs but rather the preparation of inter-state law-making within an IO.*”⁹⁴

(b) Institutional Acts Adopted by IOs

These are the institutional, normative acts through which the IOs operate in their specialised fields to accomplish the purpose of their creation. These norms may endeavour to standardise the action of its constituent members in accordance with the prevailing international legal order, or in some cases, within national legal orders where the IO is a specialised institution in a specific

operation. It has 47 member states with some 800 million citizens. It is distinct from the European Union (EU). <http://www.coe.int/>

⁸⁹ Available at [<http://conventions.coe.int/Treaty/en/Treaties/html/001.htm>]

⁹⁰ Available at [<http://conventions.coe.int/treaty/Commun/QueVoulezVous.asp?NT=005&CL=ENG>]

⁹¹ Here I am talking about intergovernmental organisations. Sands, P., and Klein, P. (eds), (2001) ‘Bowett's law of International Institutions’, London: Sweet & Maxwell, 5th ed. p 277.

⁹² Article 5 of Vienna Convention, (1969), Available at [http://untreaty.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf]

⁹³ Sands, P., Klein, P. (eds), (2001) ‘Bowett's law of International Institutions’, London: Sweet & Maxwell, 5th ed. p 277.

⁹⁴ Sommer, J. (1996) ‘Environmental Law-Making by International Organisations’, Max-Planck-Institut für ausländisches öffentliches Recht und Völkerrecht, p. 638. See also Sands, P., and Klein, P. (eds), (2001) ‘Bowett's law of International Institutions’, London: Sweet & Maxwell, 5th ed. p 277.

area. In any case, the main aim of the majority of institutional or normative acts is to ensure the working of the organisation itself, as it not always the main treaty or convention which created the IO which contains all the detailed rules for the operation of the IO.⁹⁵

However, in the case of institutional acts affecting others outside the IO's legal domain, the scope to do so is quite limited. Large numbers of scholars agree that any act of an IO affecting those outside its legal order requires to be embodied explicitly in the constituent treaty instrument which formed the IO and cannot be implied.⁹⁶

It has been noted that although the normative acts of the IOs are mostly consultative in nature in the context of acts affecting others beyond its internal matters, sometimes IOs make these acts practically binding on its members. For example, the IMF attaches conditions when funding a member who is in financial distress. Theoretically, these conditionalities are not binding on members and are merely suggestions but practically, they turn out to be binding. As the member country is financially distressed and vulnerable, it accepts the IMF's conditions in order to obtain funding, which is vital for that member at that stage.

Moreover, in the past, the IMF has bound its members with institutional acts which were not binding on the IMF itself; for example, in 1971, when the system of exchange rate stability was destroyed and a new system of floating exchange rate system was introduced. To make it binding on its members, the IMF needed to revise its Article of Agreement (however, it was thought that

⁹⁵ See generally, Skubiszewski, K. (1985) 'The Elaboration of General Multilateral Conventions and of Non-Contractual Instruments having a Normative Function or Objective', Resolutions of the General Assembly of the United Nations, 61 A.I.D.I. 30. And also, Sands, P., and Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed. p 279.

⁹⁶ Schermers, Henry G. and Blokker, Niels M. (1995) 'International Institutional Law: Unity within Diversity', 3rd ed, Martinus Nijhoff Publishers, The Hague, para. 1320.

it was too premature to revise the Article) but nevertheless, the Executive Directors of the IMF adopted the guidelines for a new exchange rate regime.⁹⁷

In theory these guidelines were not binding; however, practically they served as regulations until the amendment of Article IV of the Agreement in 1976.⁹⁸ Even after the formal amendment, the Executive Directors were given powers to take up "principles"⁹⁹ with binding effect in order to achieve the purpose of its creation.

Furthermore, sometimes the normative institutional acts adopted by the IOs in the form of suggestions could have a binding effect on its constituents if the act concerned is part of customary international law.¹⁰⁰ The acts are generally well-accepted customary international law¹⁰¹ and are simply a reaffirmation of existing customary norms of international law.¹⁰² These institutional acts remain binding, though enunciated in a non-mandatory instrument.

(3) *Legality of Institutional Acts*

IOs may put into effect the powers which have been authorised to them by their members. However, there are limitations to the usage of those powers, i.e. IOs can only use their authority within the parameters defined by its members, and it only relates to the performance of the

⁹⁷ Sands, P., and Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed. p 288.

⁹⁸ Sands, P., and Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed. p 288.

⁹⁹ IMF Executive Directors decision on 'Surveillance over Exchange Rate Policies', (1977), 6 IMF Survey p. 131.

¹⁰⁰ See generally, Virally, M. (1968) 'The Sources of International Law', Manual of Public International Law, Editor: Sorensen, M. p. 259 and Schermers, Henry G. and Blokker, Niels M. (1995) 'International Institutional Law: Unity within Diversity', 3rd ed, Martinus Nijhoff Publishers, The Hague, para. 1339; also see, Alexandrovicz, Charles H., (1973) 'The Law-making Functions of the Specialized Agencies of the United Nations', Angus and Robertson, Sydney, p. 8-9.

¹⁰¹ Such as, a rule of customary law in IO is that "abstentions do not affect the concurring votes of the permanent members of the UN Security Council." For detail see, Schermers, Henry G. and Blokker, Niels M. (1995) 'International Institutional Law: Unity within Diversity', 3rd ed, Martinus Nijhoff Publishers, The Hague, para. 821 and 1399.

¹⁰² Sapiro, M. (1995) 'Changing the CSCE into the OSCE: Legal Aspects of a Political Transformation', American Journal of International Law, Vol. 89, p. 631-2.

functions which are assigned to them.¹⁰³ This means the IOs can only perform legislative or normative functions within the parameters laid down by its members. In other words, all the institutional acts performed by the IO will only be valid and have a legal effect if they are in accordance with the organisational rules set by the members.¹⁰⁴ This concept of the legality of institutional acts is applicable to all acts within the IO and in the international or domestic legal order.¹⁰⁵

In addition, all institutional acts should comply substantively with the objectives of the organisation and those acts which do not act in accordance with the substance of the creation of the IO are substantively illegal.¹⁰⁶ However, some authors think that before terming an act 'illegal', it should also be assessed in view of the subsequent practice.¹⁰⁷ Furthermore, the International Court of Justice (ICJ) and European Court of Justice (ECJ) assert that institutional acts should be in accordance with the rules of the procedure. This assertion aims to bring stability to international relations by giving a greater level of certainty to the acts of intergovernmental organisations.¹⁰⁸

b) ***Executive and administrative authority***

The efficacy of an IO would remain limited if its powers were curtailed to the production of norm. The real effectiveness of an IO lies in the execution and implementation of institutional

¹⁰³ Franck, Thomas M. (1992) 'The Powers of Appreciation: Who Is the Ultimate Guardian of UN Legality?' American Journal of International Law, p. 520.

¹⁰⁴ M Virally 'The Sources of International Law' in Max Sorensen (ed) Manual of Public International Law (1968), p246

¹⁰⁵ Sands, P., and Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed. p 292.

¹⁰⁶ Sands, P., and Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed. p 295.

¹⁰⁷ See generally, Morgenstern, F., (1966-77) 'Legality in International Organization', 48 British Year Book of International Law. (EXAMPLE)

¹⁰⁸ Thierry, H., (1980) "Les resolutions des organes internationaux dans la jurisprudence de la Cour internationale de Justice," Recueil des Cours de l'Academie de Droit International de La Haye Vol. 167, p 423, as cited in Sands, P., and Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed. p 296.

acts.¹⁰⁹ For instance, if the implementation and the execution of institutional acts are left only to the members, and the members do not implement the required measures, then that IO effectively becomes useless. Thus, to make the implementation and execution of institutional acts effective, IOs need to be empowered with executive and administrative authority.

The executive and administrative authorities of the IOs are again bound by the concept of legality. It aims to empower them to be able to provide assistance and supervision to members for the implementation of institutional acts and, in some cases, also empowers the IOs to exercise sanctions.¹¹⁰ These powers are vital for the implementation of the decisions of IOs so that they can function smoothly and achieve their goals. This aspect of the IOs' function is quite important and thus all IOs have a proper institutional structure with an administrative organ, or Secretariat, which has the central position in the management of the organisation and its activities.¹¹¹ Through this institutional structure, the IOs perform their executive or administrative functions so that they can manage the realisation of institutional acts and the supervision of compliance with those acts by the members.¹¹²

IOs are nowadays engaged in much wider activities at both regional and global levels. Their constituent treaties and normative acts focus more on creating technical standards (such as postal standards), promoting peace (for example, through the framework of the UN), encouraging the

¹⁰⁹ Sands, P., and Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed. p 314; and also see, Schermers, Henry G. and Blokker, Niels M. (1995) 'International Institutional Law: Unity within Diversity', 3rd ed, Ch. 10, Martinus Nijhoff Publishers, The Hague.

¹¹⁰ For sanction as means of enforcement see generally; Downs, George W., (1998) 'Enforcement and the Evolution of Cooperation', Michigan Journal of International Law, Vol. 19, p. 319; Doxey, Margaret P. (1996) 'International Sanctions in Contemporary Perspective', 2nd ed, Basingstoke: Macmillan; Chayes, Abram and Antonia H., (1998) 'The New Sovereignty: Compliance with International Regulatory Agreements', Harvard University Press; and also see, Sands, P., and Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed. p 324.

¹¹¹ These secretariats are considered to be highly essential organ of IOs. For instance, the GATT secretariat was the only organ of the GATT which became part of the WTO. For detail see Article XVI (2).

¹¹² Sands, P., and Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed. p 297.

setting of minimum standards of behaviour (such as human rights and environment protection), endorsing the environment for economic development (for example, through supporting trade, competition and intellectual property rights), and also extending financial support (such as through the multilateral development banks and the IMF).¹¹³

The development and promotion of global standards and rules in specific fields is mainly dominated by the IOs. Even though, in almost every field, standards and codes are formed by IOs, these standards and codes would be useless if there did not exist a system for their execution. Thus, an extremely important executive function of the IOs is that which is mostly focused on the execution, through compliance, of the standards set by IOs. Overseeing the compliance of standards and codes is taken into account as one of the most important functions of an IO.¹¹⁴

There are no hard and fast rules regarding the overseeing authority of IOs. The way an IO oversees compliance with its created standard and codes depends upon the authority awarded to it by the treaty which created it, and by the subsequent practices adopted for this purpose. Generally, the overseeing authority of IOs is observed in the following forms: (i) formation and supervision of reporting obligation; (ii) information collection in the context of compliance; (iii) examination of activities; and (iv), in the case of non-compliance, implementation via different methods, such as, suspension of membership, sanctions, and judicial means.

(1) REPORTING

Generally, most of the IOs require their members to report them regarding the status of its compliance with standards and codes created by that IO. For example, the Trade Policy Review

¹¹³ Sands, P., and Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed. p 315

¹¹⁴ G. Schermers and Niels M. Blokker (1995), International Institutional Law: Unity Within Diversity. 3rd edn, The Hague, M. Nijhoff, para. 1390.

Mechanism (TPRM) of the WTO obligates its members to submit a report to the Trade Policy Review Body (TPRB) for review. This report relates to all the trade practices and policies of the member country which are subject to the WTO Agreement.¹¹⁵

The IMF is also a good example of an IEI in the context of surveillance. It obligates its membership, under Article VIII (5), to immediately inform it of any changes in exchange arrangements under Article IV (1).¹¹⁶

(2) Fact finding, information collection and surveillance¹¹⁷

Besides a self-initiated compliance report tendered by the members of the IO with regard to its commitments to the IO, IOs may gather information relating to members' compliance through different means. This authority to collect information can either be expressed or implied in the constituent instrument of the IO.

IOs which are expressly empowered by their constituent treaty to collect information can obtain information straight from its membership. A good example of this is the UN Security Council. Under Article 34 of the UN Charter, the UN can obtain information in the case of a dispute or circumstances leading to dispute.¹¹⁸ However, Article 34 is invoked very infrequently;¹¹⁹ this is

¹¹⁵ WTO Agreement, (1994), Annex 3. See Mavroidis, P., (1992) 'Surveillance Schemes: The GATT's New Trade Policy Review Mechanism', Michigan Journal of International Law, Vol.13 No. 2, pp. 374-414; Qureshi, A., (1996) 'The Trade Policy Review Mechanism', The World Trade Organization: Implementing International Trade Norms, Ch. 5, Manchester University Press.

¹¹⁶ Sands, P., and Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed. p 318.

¹¹⁷ Sands, P., and Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed. p 319.

¹¹⁸ Kerley, Ernst L., (1961) 'The Powers of Investigation of the United Nations Security council', American Journal of International Law, Vol. 55, p. 902.

¹¹⁹ Examples include matters concerning Greek frontier incidents (Security Council Resolution, (1946), No. 15 and the India-Pakistan question (Security Council Resolution (1948), No. 39).

because the UN requires all permanent members of the Security Council to give their approval for investigation. On the other hand, under implied powers, the UN General Assembly and the Secretary-General can ask for information from any member.¹²⁰

This practice of collecting information can also be found in IEOs, such as the *WTO* and the *IMF*. Both of these IOs are expressly empowered to monitor their members' activities in areas of concern. The *WTO*, for example, can monitor its members' trade policies under Article 21.5 and 21.6 of the *DSU*.¹²¹ On the other hand, the *IMF* under Article IV(3) of its Articles of Agreement needs to conduct firm surveillance of its members' activities: "*firm surveillances over its members exchange rate policies, and to adopt specific principles for the guidance of all members with respect to those policies. To that end each member is required to provide the IMF with the information necessary for such surveillance, and, when requested by the IMF, to consult with it on the members' exchange rate policies.*"¹²²

(3) *Examination / inspection*

Inspection is one step ahead of information collection as it involves relatively more interference with the member countries' jurisdiction. In this process, the IO itself obtains facts directly. As inspection is intrusive in nature, its usage is quite limited and mostly leads to controversial debate. One common example of an IEO inspecting its members' territory directly is that of the World Bank. However, the inspecting panel might obtain the consent of the member

Simma, B., (ed), (1994) 'A Charter of the United Nations: A Commentary', New York: Oxford University Press, p. 515. See also, Sands, P., and Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed. p 320.

¹²¹ "The DSB, shall keep under surveillance the implementation of adopted recommendations or rulings." Available at: http://www.wto.org/english/docs_e/legal_e/28-dsu_e.htm#21_6

¹²² 'Articles of Agreement of the IMF', Article IV(3). Available at: <http://www.imf.org/external/pubs/ft/aa/aa04.htm>

concerned. World Bank-led inspections are mostly related to investigations into the performance of the member country concerned in the context of projects it has financed.¹²³

(4) Enforcement powers

No doubt the supervisory role of IOs is most frequently in operation and is of significant importance. However, if a member is still not complying with the commitment which it made with the IO, then in some cases, IOs are empowered with the authority to force the member to comply.¹²⁴ IOs can enforce their members' compliance by opting for coercive action, in order to guarantee the realisation of commitments owed to it by its members.¹²⁵ Such action may be comprised of judicial (or quasi-judicial) measures, cultural and communication restraints, diplomatic and political pressure, economic and trade restrictions, and lastly, military measures.¹²⁶

c) Judicial and quasi-judicial functioning

There are a number of ways available to resolve international disputes involving states and other actors within the international community. In this context, the UN has made an effort to put forward some peaceful means of settling disputes. Article 33 of the UN charter states some of these dispute settlement methods, which include negotiation, inquiry, mediation, conciliation,

¹²³ 'The World Bank Inspection Panel', September 22, 1993, Resolution No.IBRD 93-10 and Resolution No.IDA 93-6, International Bank for Reconstruction and Development and International Development Association, para 21. See also, Sands, P., and Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed. p 320.

¹²⁴ See 'Reparations for Injuries Case', (1949), I.C.J. Reps, 174, where the I.C.J. determined that the UN had an 'undeniable right' to 'demand that its Members fulfill the obligations entered into by them in the interest of the good working of the organization'.

¹²⁵ See, G. Abi-Saab, (1996) 'De la sanction en droit international, essai de clarification', Theory of International Law at the Threshold of the 21st Century: Essays in Honour of Krzysztof Skubiszewski, The Hague: Kluwer, p. 61 and 70-7.

¹²⁶ This typology is drawn from Doxey, M. (1996) 'International Sanctions in Contemporary Perspective', 2nd ed, New York: St. Martin's Press, p. 11 and 14-15.

arbitration, judicial settlement, resort to regional agencies or arrangements or any other nonviolent channels from which the members concerned may choose.

All of the peaceful methods available can be split into two main types: diplomatic and legal. Means of diplomatically-solving disputes can most commonly be subdivided into negotiation, consultation, mediation, conciliation, and inquiry. One important point to be considered with regards to using diplomatic means is that the parties to the dispute have the control to enable them to solve the dispute themselves, as compared to legal means in which dispute-solving authority is given to a third party whose decision is binding on both parties. Arbitration and judicial settlement are the most common ways to legally solve disputes.¹²⁷

Dispute settlement will be discussed in detail later in this thesis.¹²⁸ However, this thesis will focus more on international disputes settlement relating to the global economy.

B. Mechanism/process through which IEIs strive to achieve more stable and balanced growth within IELR

As shown in the figure at the beginning of this chapter, the IEIs act on the economic framework to achieve stable and balanced economic growth in the global economy. The mechanism through which these IEIs achieve the outcomes of the IELR can be explained via two pathways. These are the international institutional framework and the international legal framework based on IR and IL respectively. This part of the chapter will shed light on these pathways and the international economic framework on which these two operate.

¹²⁷ Sands, P., and Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed.

¹²⁸ The WTO's dispute settlement is discussed in the section three of this thesis.

1. International Institutional Framework

The IELR has evolved into an effective de facto international regime¹²⁹ which significantly affects and controls the international economic activities of sovereign states. Interestingly, the main non-state constituents of this regime, such as IEs, have a de jure standing with a small regime effect on its constituents. The cumulative effect of these de jure IEs, due to cooperation and coordination with each other (including their constituents), has resulted in a de facto regime at international level.

This synthesis of the small regimes of IEs resulting in a bigger de facto regime can be understood through the international institutional framework of the IELR. This subheading of the theoretical framework discusses this institutional framework of the IELR and its main non-state constituents. For this purpose, this subheading will look into the meaning of the term 'IEI's in this thesis and the theoretical approaches towards the IELR based on the theories of IR.¹³⁰

The two theories which best explain these phenomena of the IELR are Institutionalism and the regime theory. Institutionalism provides an explanation for the existence of IEs which is the justification of the IELR at micro level. On the other hand, regime theory explains the existence of the IELR at macro level.

¹²⁹ The reason to refer IELR as a de facto regime is that it evolved in result of formation of other smaller regimes which were created with the intension to regulate specific area.

¹³⁰ See, Chapter I: Managing Systemic Risk, The rational for International financial regulations, in Alexander, Kern, Dhumale, Rahul, and, Eatwell, John, (2005). 'Global Governance of Financial Systems, The International Regulation of Systemic Risk.' Published to Oxford Scholarship Online: September 2007, p14. It argues that institutional framework is essential for standard setting and rule-making which comply with principles of global governance.

a) ***Institutionalism***

The first approach to the IELR is based on the theory of Institutionalism, based on international relations¹³¹, which endeavours to solve the problems of state behaviour in the context of the IELR. Institutionalism is based on the concept that norms, rules, principles and an adjudicating process at international level can reduce the effect of anarchy at global level and it further encourages states to cooperate with each other in order to achieve common goals. According to this theory, international institutions form an international regime through cooperation, in the pursuit of common ends.¹³²

The basic assumptions of Institutionalism are as follows¹³³:

- 1) States are the key actors in the international system.
- 2) States tend to strive for power in the absence of institutions.
- 3) Anarchy at international level can be modified through the institutions as they encourage states to cooperate in the long term in pursuit of the common interest.

Institutionalism is based on the concept of cooperation which explains how states cooperate to achieve common ends. The cooperative behaviour of states can be better explained if we understand the three pathways through which states achieve cooperation amongst themselves.

¹³¹ There are other theories of international relations in global cooperation context, such as realism, liberalism and Social Constructivism. Every scholar has its own view point and in my thesis, my focus will be on institutionalism (based on rational functionalism) as theory to answer the cooperation at international level.

¹³² Slaughter, A., (2004) 'International Law and International Relations Theory: A Prospectus', The Impact of International Law on International Cooperation, Editors: Benevisti, E. and Hirsch, M.

¹³³ Ibid

The pathways or dimensions for cooperation are: substantive content; participation; and legalization.¹³⁴

The stance in this theory is that states understand that if they cooperate, they benefit.¹³⁵ However, the major hurdle in their cooperation is a lack of information which leads to uncertainty regarding the issue(s) on which cooperation is needed.¹³⁶ To overcome this hurdle in cooperation, scholars have identified three cooperative pathways to achieve effective cooperation.¹³⁷ The success in achieving effective cooperation is attributed to two of the **basic features** of the cooperative pathways/dimensions (framework conventions, plurilateral, and soft law). Firstly, states have full freedom to limit their commitment level of cooperation; in other words, cooperation theory allows states to commit only to those things of which they are certain.

¹³⁴ Abbott, Kenneth W. and Snidal, D., (2004) 'Pathways to International Cooperation', *The Impact of International Law on International Cooperation*, Editors: Benevisti, E. and Hirsch, M. Cambridge University Press.

¹³⁵ Cooperation is also studied through the game theory models. The most common and the basic model representing basic human nature is the prisoner's dilemma. The payoff to the Prisoner's Dilemma game is as illustrated in Figure 1 where two agents have to decide whether to cooperate or to defect. Let us call the agents player 1 and player 2 respectively. If both cooperate they both get a payoff of 4. However, both player 1 and player 2 could be better off by playing Defect if the other player continues to play Cooperate. If player 1 chooses to cooperate and player 2 chooses to defect then player 2 gains with a payoff of 6 while player 1 loses with a payoff of only 0.5 and vice versa if player 2 cooperates but player 1 defects. Therefore, both players would reason that they are better off defecting and as a result end up obtaining a payoff of 1 each. This is clearly less than the Pareto optimum of obtaining a payoff of 4 each by both cooperating. [Velu, C. and Iyer, S. (2008) 'Returns-Based Beliefs and The Prisoner's Dilemma', Cambridge Working Papers in Economics 0854, Faculty of Economics, University of Cambridge.]

Prisoner's Dilemma game		Player 2	
		Cooperate	Defect
Player 1	Cooperate	(4,4)	(0.5, 6)
	Defect	(6, 0.5)	(1, 1)

However, the in international cooperation it is not always as we encounter prisoner's dilemma and that there are many other factors involved. Thus this thesis doesn't take Prisoner's dilemma as primary bases for cooperation. For further discussion about the prisoner's dilemma in the international institutional analysis see, Snidal, D. (Dec. 1985) 'Coordination versus Prisoners' Dilemma: Implications for International Cooperation and Regimes', *The American Political Science Review*, Vol. 79, No. 4, p. 923-942.

¹³⁶ Abbott, Kenneth W. and Snidal, D. (August 2002) 'Filling in the Folks Theorem: The Role of Gradualism and Legalization in International Cooperation'. Paper presented at the annual meeting of the American Political Science Association, Boston Marriott Copley Place, Sheraton Boston & Hynes Convention Center, Boston, Massachusetts.

¹³⁷ Abbott, Kenneth W. and Snidal, D., (2004) 'Pathways to International Cooperation', *The Impact of International Law on International Cooperation*, Editors: Benevisti, E. and Hirsch, M. Cambridge University Press.

Secondly, it allows states to commit further once they are comfortable with their previous commitment level (i.e. a progressive commitment process is followed in this approach).¹³⁸

Characteristics of dimensions for cooperation

The first of the three characteristics of state cooperation is *substantive content*. According to this characteristic, the reason for cooperation and the level of commitment (i.e. what states actually agree to commit to in relation to the issue under discussion) is very important. The substance matter for cooperation should be of mutual interest, and cooperation the most rational solution to that issue. This is because cooperation is only possible if all parties involved in the process benefit from it. Moreover, a legally binding agreement is not required for cooperation if the subject under discussion is of high importance (such as the Universal Declaration of Human Rights, the Rio Declaration on Environment and Development, etc.).¹³⁹

The second characteristic is *broad participation*. Some issues require an adequate number of states to take part in the cooperation process so as to reap the benefits from it. Thus, in order to solve the issue, all the affected parties need to cooperate. For instance, issues relating to global environmental problems need broad participation from the states.

The third characteristic is international *legalization*.¹⁴⁰ In this pathway for cooperation, the states try to legalize their cooperation process by tying themselves to cooperate. This international legalization process has three important characteristics which significantly lead to effective cooperation. These characteristics are: obligation, precision, and delegation. *Obligation*, here, denotes that states have agreed to bind themselves by certain rule(s) or commitment(s). These

¹³⁸ Ibid

¹³⁹ Downs, G., Roche, D. and Barsoom, Peter N., (1996) 'Is the Good News about Compliance Good News about Cooperation?' International Organization, Vol. 50, No. 03, Cambridge University Press.

¹⁴⁰ Abbott, Kenneth W. and Snidal, D., (2004) 'Pathways to International Cooperation', The Impact of International Law on International Cooperation, Editors: Benevisti, E. and Hirsch, M. Cambridge University Press.

rule(s) or commitment(s) have a legal effect on the states, that is, their acts are subject to scrutiny and can be questioned under the general rules, procedures, and discourse of both international and national law. *Precision*, here, means that rules or commitments must be clear cut and they should precisely elaborate the behaviour these rules or commitments entail, allow, or recommend. *Delegation* means that the states have agreed and bound themselves to empower third parties to implement, interpret, and apply the rules, to adjudicate their disputes and in addition, create new rules in this *delegation* process.¹⁴¹

Three types of pathway towards cooperation¹⁴²

The first pathway is the *Framework Convention*. According to this approach, cooperation starts with an agreement which is moderately legalized and is adequately participated in, one which involves shallow substantive commitments which deepen in the long run. This type of cooperation is needed in which broad participation is key to reaping the benefits from the cooperation process. An example of an area in which such cooperation is required is the international environment-related laws.¹⁴³

The next pathway towards cooperation is *Plurilateral* which involves highly-legalized deep, substantive commitments with limited participation but where participation increases over the long term. The best example is of the EU, which started with limited membership and now has a huge membership.¹⁴⁴

¹⁴¹ Abbott, Kenneth W., Keohane, Robert O., Moravcsik, A., Slaughter, A. and Snidal, D., (2000) 'The Concept of Legalization', *International Organization*, Vol. 54, p. 401.

¹⁴² Abbott, Kenneth W. and Snidal, D., (2004) 'Pathways to International Cooperation', *The Impact of International Law on International Cooperation*, Editors: Benevisti, E. and Hirsch, M. Cambridge University Press.

¹⁴³ Brunnee, J. and Toope, Stephen J. (Jan. 1997) 'Environmental Security and Freshwater Resources: Ecosystem Regime Building', *The American Journal of International Law*, Vol. 91, No. 1, p. 26-59

¹⁴⁴ Abbott, Kenneth W. and Snidal, D., (2004) 'Pathways to International Cooperation', *The Impact of International Law on International Cooperation*, Editors: Benevisti, E. and Hirsch, M. Cambridge University Press.

The last pathway used by states for cooperation is through *Soft law*. According to this pathway, cooperation starts with broad participation and high substantive commitments but is weakly legalized. However, in the longer term, the legalization aspect increases.¹⁴⁵

The table below illustrates the ideal types of pathways for international cooperation.¹⁴⁶

Table 1

Pathways	Substantive Content	Participation	legalization	Long Run
Framework Convention	Shallow	Broad	Moderated	Substantive Content deepens
Plurilateral	Deep	Limited	Strong	Participation expands
Soft Law	Deep	Broad	Weak	Legalization strengthens

The base line in the cooperative pathways is that they all lead to international cooperation. However, deciding which pathway to start with depends on the type of issues involved for which cooperation is needed.

b) *Regime theory*

The last theory to explain the phenomena of the IELR is the Regime theory in IR. This theory gained momentum in the 1970s with the purpose to analyse the ability of the US to sustain the economic regime formed after WWII. There are many approaches towards regime analysis; however, the regime theories can be divided into three broad schools of thought. They are liberalism, realism and constructivism. This subheading will discuss these different approaches

¹⁴⁵ Ibid

¹⁴⁶ Ibid

and then conclude which of these approaches best explains the IELR. However, before moving on to the above-mentioned discussion, this subheading will first explain regime terminology and its essential features.

There is no straightforward explanation of what make up a regime and there are numerous different definitions by many scholars identifying those elements essential for a regime. However, the definition formulated by Krasner has been significantly accepted by many regime theorists.¹⁴⁷ Krasner defines international regimes as *“principles, norms, rules, and decision-making procedures¹⁴⁸ around which actor expectations converge¹⁴⁹ in a given issue-area.”*¹⁵⁰

This definition by Krasner comes quite close to explaining the regime concept used in this thesis. The *“principles, norms, rules, and decision-making procedures”* of the global economy (*“issue-area”*) result mostly from the institutional role played by the IELRs. Furthermore, the expectations of its constituents converge around this institutional role. In other words, by employing Krasner’s definition and the concept of IELR in this thesis, it could be said that the principles, norms, rules, and decision-making procedures (in result of the institutional role of the IELRs) around which actors (subjects of IELR) expectations converge (due to certainty and predictability of the rules of the game) in a given issue-area (global economy).

This definition is a great help, but to understand the concept and the correct approach towards regimes used in this thesis, we need to discuss the different approaches to regime analysis, and as such the following highlights different approaches towards regimes.

¹⁴⁷ Such as, John G. Ruggie, 'International Responses to Technology: Concepts and Trends,' International Organization (V. 29, N. 3, Summer 1975), p. 570. And, Marc A. Levy, Young and Michael Zürn, 'The Study of International Regimes,' IIASA Working Paper WP-94-113 (November 1994), p. 6.

¹⁴⁸“Principles, norms, rules, and decision-making” points to the certainty of the rules of the game.

¹⁴⁹“[A]ctor expectations converge” point out the predictability of the rules of the game aspect of a regime.

¹⁵⁰ Krasner, Stephen D. (1982) 'Foundation Structural Causes and Regime Consequences: Regimes as Intervening Variables', International Organization, Vol. 36, No. 2, p.185-205

(1) *Realist Approach*

The first approach to discuss is the realist approach. The realist stance towards international regimes is along these lines: the hegemon or dominant power forms a hegemonic system of itself and controls the essential principles, norms, rules and decision-making processes of the system; the strength of the hegemon or dominant power is an essential condition for other countries to acknowledge the formation of an international regime; the hegemon or dominant power retains its hegemonic system and makes the best of its dominant position by extracting maximum benefit from regimes; the weakening or decay of the hegemon or dominant power will result in changes to the international regimes of the hegemonic system.¹⁵¹

This thesis does not approach the concept of regimes from the realist viewpoint. The reasons are discussed below in the form of critiques on the realist insight into regime.¹⁵²

Firstly, the realist thinks that the existence of a hegemon¹⁵³ is an essential pre-requisite for an international regime. In the view of realists, the hegemon or the dominant power is the creator and sustainer of international regimes. Most of the current international regimes were formed shortly after World War II. In these regimes, the US was the hegemon and it has done a lot to sustain the existing international regimes. However, it cannot be correct to assume that international regimes can neither be formed nor sustained without a hegemon. Robert Keohane offers the best analysis in this respect. One of his books entitled *After Hegemony: Cooperation*

¹⁵¹ See generally Baylis, J. and Smith, S. (edited), (2001) 'The Globalization of World Politics: An Introduction to International Relations', Ch. 7, Oxford University Press, p. 162. Also see, Wohlforth, William C. (2008) 'Realism', The Oxford Handbook of International Relations, Editors: Christian, R. and Snidal, D., Ch. 7, Oxford: Oxford University Press. Also Donnelly, J. (2008) 'The Ethics of Realism', The Oxford Handbook of International Relations, Editors: Christian, R. and Snidal, D., Ch. 8, Oxford: Oxford University Press.

¹⁵² Honghua, M. 'Critiques of the Theory of International Regimes: The Viewpoints of Main Western Schools of Thought', Institute of International Strategic Studies, China's Central Party School.

¹⁵³ "Hegemon" is defined as one that "is powerful enough to maintain the essential rules governing interstate relations, and willing to do so". Keohane, R., (1989) 'International Institutions and State Power: Essays in International Relations Theory', Boulder: Westview Press, p.234.

and Discord in the World Political Economy is based on the critique of Hegemonic Stability Theory (realist approach).¹⁵⁴ Keohane admits the hegemon's role in regime creation, but contends that a regime can be made even without a hegemon. In fact, hegemony can assist some kind of cooperation, but hegemony is not at all an essential requirement for cooperation. Cooperation does not essentially need the presence of a hegemon once international regimes have been created; furthermore, post-hegemonic cooperation is also possible (discussed below).¹⁵⁵

The reason for cooperation without a hegemonic power is that international regimes provide important information and reduce transaction cost.¹⁵⁶

Secondly, the realist does not take the international regime as an independent variable. The realist considers power channels as the only, and vital variable in the international system. However, international regimes are considered a superseding variable based on state power.¹⁵⁷ Therefore, the regime itself is not an independent variable. There are two flaws in this realist argument. Firstly, as stated above, regimes are not always dependent on hegemonic power and can survive without it, which means that the international regime can contain a power structure within it or perhaps become a central part of an independent power structure. Keohane's study of the link between American dominance and international regimes since the 1970s can confirm this argument. Secondly, the international regime can be regarded as an information-providing

¹⁵⁴ Keohane, Robert O. (1984) 'After Hegemony: Cooperation and Discord in the World Political Economy', Princeton, N.J.: Princeton University Press, p.100.

¹⁵⁵ Ibid p.31. Also see, Honghua, M. 'Critiques of the Theory of International Regimes: The Viewpoints of Main Western Schools of Thought', Institute of International Strategic Studies, China's Central Party School.

¹⁵⁶ Keohane, Robert O. (1984) 'After Hegemony: Cooperation and Discord in the World Political Economy', Princeton, N.J.: Princeton University Press, p.124-125

¹⁵⁷ Crawford, Robert M. (1996) 'Regime Theory in the Post-Cold War World: Rethinking Neoliberal Approaches to International Relations', p.57.

and transaction cost-reducing body with a life of its own.¹⁵⁸ Therefore, in reality, international regimes should be considered as an independent variable in the global economic scenario.

The realist approach does not explain the future of international cooperation without hegemony.

The reason why the realist approach cannot clearly explain the change of international economic regimes is because it did not consider the international institutions' role in cooperation realisation and improvement. Keohane contends that hegemonic cooperation is not the only thinkable method of cooperation and in reality, post-hegemonic cooperation does exist.¹⁵⁹

The latest example of cooperation in the global economy, in the context of financial crisis, resulted in the creation of the Financial Stability Board. The reason for post-hegemonic cooperation is that it decreases the cost of transaction and uncertainty, and provides principles. Both hegemony and international regimes can contribute to cooperation, but neither one is a necessary or sufficient condition.¹⁶⁰

(2) *Liberal Approach*

Liberalism or liberal institutionalism is the approach adopted in this thesis to understand the IELR concept. This approach shares some common assumptions with the realist approach towards the international regime; for example, states operate in an anarchic international system, states create regimes, regimes are established on the bases of cooperation and they promote international order.¹⁶¹ See the table below for a better understanding.

¹⁵⁸ Hasenclever, A., Mayer, P. and Rittberger, V. (1997) 'Theories of International Regimes', Cambridge: Cambridge University Press, p.87.

¹⁵⁹ Keohane, Robert O. (1984) 'After hegemony: Cooperation and discord in the world political economy', Princeton, N.J.: Princeton University Press, p.183.

¹⁶⁰ Ibid

¹⁶¹ Baylis, J. and Smith, S. (edited), (2001) 'The Globalization of World Politics: An Introduction to International Relations', Ch. 7, Oxford University Press, p. 371.

The regime theory of liberalism (or liberal institutionalism) represents the widely-held approach to examining international regimes. It is based on rationalism. Its basic statements are as follows: states are selfish, goal-seeking participants whose actions are aimed to maximise their own utility; it acknowledges power's role in international regimes, but regards international regimes as an independent variable in international relations; states can realise common interests in certain issue-areas only by cooperation; regimes are developed because participants of the global political scenario are convinced that with such setup they can get into mutually advantageous agreements that would else be hard or impractical to reach.¹⁶²

Table 2

Liberal Institutionalists vs. Realist approach to the analysis of regime¹⁶³	
Common Assumptions	
<ol style="list-style-type: none"> 1) States operate in anarchic international system 2) States creates regimes. 3) Regimes are based on rationalist approach. 4) Regimes are established on the bases of cooperation. 5) Regimes promote international order. 	
Competing Assessment	
<i>Liberal Institutionalists</i>	<i>Realist</i>
<ol style="list-style-type: none"> 1) Regimes promote common good. 2) Regimes flourish best when promoted and maintained by a benign hegemon. 3) Regimes promote globalizations and liberal world order. 	<ol style="list-style-type: none"> 1) Regimes generate differential benefits for states 2) Power is the central feature of regime formation and survival. 3) The nature of world order depends on the underlying principles and norms of regimes.

¹⁶² Keohane, R., (1989) 'International Institutions and State Power: Essays in International Relations Theory', Boulder: Westview Press, p.108. See also, Honghua, M. 'Critiques of the Theory of International Regimes: The Viewpoints of Main Western Schools of Thought', Institute of International Strategic Studies, China's Central Party School.

¹⁶³ This table is modified according to the regime approach used in this thesis. Baylis, J. and Smith, S. (edited), (2001) 'The Globalization of World Politics: An Introduction to International Relations', Ch. 7, Oxford University Press, p. 371

According to this approach, the international regime as an arrangement of international orderliness is a significant factor of self-interest. That is, a rational state will always calculate its own interest or benefit in any of its international dealings. Thus, when a rational state commits itself to cooperate with other states, even though the cooperative arrangement is not the most optimal decision, it does so because the states are not in isolation and are highly interdependent in this globalised world and can benefit most if they cooperate. In other words, in some situations, the self-interested calculations of states result in a collective decisive process rather than an independent one.¹⁶⁴ These collective decision-making processes lead to the formation of regimes in which sovereign nations, for the sake of their own interest, logically relinquish independent decision-making and opt to form regimes.¹⁶⁵

Robert O. Keohane uses the rational choice theory¹⁶⁶ (based on rational functionalism)¹⁶⁷ to explain and develop a theoretical framework which raises the basic questions of why, and under

¹⁶⁴ The conditions in which misperception matters, and the ways in which it matters, are delineated in Stein, Arthur A. (July 1982) 'When Misperception Matters', *World Politics*, Vol. 34, No. 4, p. 505-526.

¹⁶⁵ Stein, Arthur A. (1982) 'Foundation Coordination and Collaboration: Regimes in an Anarchic World', *International Organization*, Vol. 36, No. 2, *International Regimes*, p.299-324.

¹⁶⁶ See Snidal, D., (2002) 'Rational Choice and International Relations', *The Handbook of International Relations*, Editor: Walter Carlsnaes et al., 73, 77, London: Sage (observing that "[n]on-cooperative game-theoretic models are the predominant approach" to modeling rational choice). For a discussion on rational choice theory, see generally id. There is a rich literature on the application of game theory to international cooperation. See *infra* note 59 (listing sources). Game theory encompasses both cooperative games, in which promises are assumed to be binding, and non-cooperative games, in which promises are not necessarily binding. Given the absence of a supranational governance regime, international games are analyzed as non-cooperative games. See, e.g., Rasmusen, E., (1994) 'Games and Information: An Introduction to Game Theory', 2nd ed, p. 16-19; Hirsch, M., (1998) 'Game Theory, International Law and Future Environmental Cooperation in the Middle East', *Denv. J. Int'l L. & Pol'y*, Vol. 27, p. 75, 80.

The Rational Choice Theory is based upon the assumption that the driving force behind people's actions is money and the desire to make a profit and it therefore manages to construct a proper model that depicts the actions of people based upon forecasting. It states that an intricate set of collective actions can be determined by the basic acts of single entities that comprises them. This is called 'methodological individualism', and it states that: 'The elementary unit of social life is the individual human action. To explain social institutions and social change is to show how they arise as the result of the action and interaction of individuals' (Elster, J. Ed. (1986). 'Rational Choice', Oxford: Basil Blackwell.)

what conditions international regimes should be formed and then gain strength. He examines international regime creation within a constraint-choice framework and highlights two factors: the deficiency of authoritative governmental institutions in world politics and uncertainty. Therefore, in order to prevent things leading to a "war of all against all" due to the condition of anarchy, the main rationale of international regimes is to assist the states in forming mutually advantageous agreements.¹⁶⁸

Moreover, Keohane tries to answer the question: is it beneficial to form regimes? Why is it not more efficient simply to avoid the regime stage and make agreements on an ad hoc basis? This is answered by the theories of "market failure" in economics¹⁶⁹. However, Keohane explains the need for international regimes is due to the existence of two main factors: transactions cost and informational imperfections.

Rational choice theorists claim that just as economic theories aim to study the system of production, consumption and distribution of goods and services using money and markets as instruments, it is also possible to use similar tools to analyze situations where time, information, approval and prestige are entailed.

The actions of individuals are determined by their wants based on their 'preferences', according to rational choice theory. There is a certain set of particular restrictions and given information that influences their acts. In a way, preferences and constraints have a correlation like that of 'a means to an end' – since individuals cannot fulfill all their desires, it becomes significant to study as to how they manage to balance the need to fulfill their needs as well as how to do it. Rational choice theory states that an individual would predict the results of various actions and decide which one would be most beneficial to it; the opportunity that brings the highest level of fulfillment would be a rational individual's selection (Carling, A., (1992) 'Social Divisions', London: Verso, 27; Heath, A., (1976) 'Rational Choice and Social Exchange', Cambridge: Cambridge University Press, 3). See also Scott, J. (2000) 'Rational Choice Theory', Understanding Contemporary Society: Theories of The Present, Editor: Browning, G., Halcli, A. and Webster, F., Sage Publications.

¹⁶⁷ This rational/functionalist discourse started with Keohane's *After Hegemony* and Krasner's edited volume on international regimes. See, Keohane, Robert O. (1984) 'After hegemony: Cooperation and discord in the world political economy', Princeton, N.J.: Princeton University Press.

¹⁶⁸ Keohane, Robert O. (1982) 'Foundation The Demand for International Regimes', *International Organisation*, Vol. 36, No. 2, International Regimes, p.325-355

¹⁶⁹ A scenario where the end result, determined by a market's conditions, is not the most favorable one with the individuals' utility functions and resources as given, is referred to as Market failure. This is a situation in which the outcome does not benefit all participants equally. Under such circumstances, these ineffective outcomes come about when inept powerful groups affect economic activities as opposed to conditions that would have prevailed under perfect competition. These deficiencies are not in the actions of the individuals, who choose to make their decisions based on maximization of their utility – rather it is the mechanism with which the system or institutions function. For detailed understanding about market failure see, Arrow, Kenneth J., (1974) 'Essays in the Theory of Risk-Bearing', New York: North Holland/American Elsevier.

He used Ronald Coase's theorem to explain the need for the international regimes, i.e., by reversing the Coase theorem. In other words, reversed Coase provides a list of circumstances¹⁷⁰ in which regimes can assist states to take advantage from cooperation. This list is:¹⁷¹ *(a) lack of a clear legal framework establishing liability for actions; (b) information imperfections (information is costly); (c) positive transactions costs.*¹⁷²

Regime analysis from the Liberal Institutionalists' viewpoint is the lens through which this thesis perceives the IELR. However, the IELR is a super-regime; its constituents are not only the sovereign states. The IEs (with regime effect) and other transnational actors (such as MNC and NGOs) are also part of it. The specific emphasis of this thesis is on the IEs as the main non-state contributors of the IELR.

Therefore, through the Liberal Institutionalists' lens towards the IELR, the rational states cooperate with each other to form IEs which have the effect of regimes, and collectively these IEs form a super-regime at global level with no dominant power. The IELR, through the institutional framework of the IEs, sets out the rules of the game for the global economy which results in certainty and the predictability of the actions of its constituents.

¹⁷⁰ Ronald Coase suggested in his theory that it is possible to achieve an economically efficient outcome in the presence of externalities – just because externalities exist does not automatically imply that the result would be suboptimal. The pareto-optimal solution can be attained through negotiations carried out between the actors. However, there are a few conditions presented by Coase: '(a) a legal framework establishing liability for actions, presumably supported by governmental authority; (b) perfect information; and (c) zero transactions costs (including organization costs and costs of making side-payments)'. [Coase, R. (October 1960) 'The Problem of Social Cost', *Journal of Law and Economics*, Vol. 3.] Keohane, Robert O. (1982) 'Foundation The Demand for International Regimes', *International Organization*, Vol. 36, No. 2, *International Regimes*, p.325-355.

¹⁷¹ The system can prove to be beneficial in that, abandoning the assumption that all individuals are interested in maximizing utility and working in their own interest, such rules be made that automatically makes it possible for actors to integrate these in their utility functions. This would be of immense significance in political as well as economic scenarios in the real-world, as Schumpeter, Polanyi, and Hirsch on show in their works based on the moral objectives behind the functioning of the market. Not only that, it would prove to be extremely important in international situations as well. See Schumpeter, J., (1942) 'Capitalism, Socialism, and Democracy', New York: Harper & Row, especially Part II, 'Can Capitalism Survive?'; Polanyi, K. (1942) 'The Great Transformation: The Political and Economic Origins of Our Time', Boston: Beacon Press, reprinted in 1957); and Hirsch, F. (1976) 'Social Limits to Growth', Cambridge: Harvard University Press.

¹⁷² Keohane, Robert O. (1982) 'Foundation The Demand for International Regimes', *International Organisation*, Vol. 36, No. 2, *International Regimes*, p.325-355

However, the liberal institutionalist approach has been criticised by the Constructivists¹⁷³. Constructivism argues that rationalism is the common nature of realism and liberalism, and this approach towards the international regimes is wrong.¹⁷⁴ The approach put forward by the Constructivists better explains the moral values within the IELR¹⁷⁵, since this aspect has been ignored by the both realism and liberalism.¹⁷⁶

The next part is dedicated to the international legal framework within the IELR. This is the second approach which acts within the international economic framework to better achieve stable and balanced growth of the global economy.

2. International Legal Framework

By international legal framework, this thesis means the legal framework which exists in the world. This legal framework is mostly attributed to the IL and regulates the actions of its constituents and creates certainty and predictability within an international system. This thesis takes the international legal framework as a result of the IELR. The IEIs, through the international legal framework, create certainty and predictability in the international economic framework and achieve a more stable and balanced growth of the global economy.

¹⁷³ Constructivism puts forward ideas different to traditional theories on international regimes. Firstly, it values the roles of subjective factors (such as culture, norms) in the creation and changes of international regimes. Secondly, it stresses the significance of process, thinks that process values equally as structure and even “structure depends on process”. [Wendt, A., (1995) ‘Constructing International Politics’, *International Security*, Vol.20, p.71-81.] Thirdly, it emphasizes the analysis on identity of state and national interest.

In general, Constructivism (Cognitivism) criticizes fiercely the traditional rationalism theories, and puts forward its own views on international regimes. Yet, it develops in the criticizing process of traditional rationalism, pays most attention to criticize rather than to construct its own theoretical system. So the regime theory of Constructivism has its own defects. [Honghua, M. ‘Critiques of the Theory of International Regimes: The Viewpoints of Main Western Schools of Thought’, Institute of International Strategic Studies, China’s Central Party School.]

¹⁷⁴ Hasenclever, A., Mayer, P. and Rittberger, V. (1997) ‘Theories of International Regimes’, Cambridge: Cambridge University Press, p.23-26.

¹⁷⁵ By moral values in IELR I mean, the concept of welfare gains and development for every participant. That is the rational self-interested states assist lesser developed nations to develop through IEIs so they can benefit from the globalization process.

¹⁷⁶ Honghua, M. ‘Critiques of the Theory of International Regimes: The Viewpoints of Main Western Schools of Thought’, Institute of International Strategic Studies, China’s Central Party School.

The international legal framework can be explained with the help of two theories: legal pluralist theory and the theory of legal transplant. This thesis will not go into the detail of these theories as the main approach adopted in this thesis is based on the international institutional framework. However, the following part will briefly discuss the international legal framework and its relevance to this thesis.

When rules are created by IEs in their institutional capacities, initially they could be better understood with the pluralistic approach. However, once these rules, laws, standards, etc. are transplanted into the domestic systems of the sovereign states, then this pluralistic approach fades away. This transplantation of rules is sometimes quite controversial since it might be backed by forceful *conditionalities* of the IEs. Nevertheless, the outcome of this legal transplant is mostly harmonised rules, standards, principles, law, etc. in the global economy.

The next paragraphs are dedicated to the pluralistic approach to rules, laws etc. which resulted from the institutional role of IEs. Then, in the same way, legal transplantation and legal harmonization will also be discussed.

Legal Pluralist approach: In plain words, legal pluralism is the subsistence of more than one legal system within a particular territory. Plural legal systems existed mainly in former colonial systems, where the law of a former colonial authority subsisted in conjunction with the traditional legal system of that colony. During the development of this pluralist legal approach within the colonial system, it was common practice for certain types of matters to be dealt with by colonial law (such as commercial transactions) and the remaining matters were left to be dealt with by the local or traditional laws.¹⁷⁷

¹⁷⁷ Michaels, R., (June 29, 2009) 'Global Legal Pluralism', Annual Review of Law & Social Science, Vol. 5, Duke Law School Public Law & Legal Theory Research Paper No. 259.

The growing complexity of norms within the international legal scenario makes it inevitable for these norms to come into contact with one another and, at times, with national legal orders.¹⁷⁸

The interaction of these independent legal orders has become an important factor in defining how the global legal system grows.¹⁷⁹

Many legal pluralistic scholars compare the international norms as supranational constitutions and strive to prove that these norms and rules are getting stronger with rapid interdependence.¹⁸⁰ They assert that the significance of a judicial system is of high importance in the effective functioning of global pluralistic constitutions. However, effective regimes can exist even without a judicial organ such as the IMF and the World Bank.¹⁸¹

An example of a pluralistic approach in the IELR is the WTO's legal framework. The WTO's dispute settlement system decides cases according to the WTO legal framework and not on the basis of the domestic laws of sovereign states. Therefore, in this case, the WTO legal framework acts as superior legal system over the domestic legal systems of its members. However, both systems coexist at the same time.

¹⁷⁸ Walker, N., (2008) 'Beyond Boundary Disputes and Basic Grids: Mapping the Global Disorder of Normative Orders', *Int'l J. Const. L.*, Vol. 6, p. 373, 382.

¹⁷⁹ For a survey of the mechanisms and processes for upgrading the common interest under conditions of legal pluralism, see Berman, Paul S., (2007) 'Global Legal Pluralism', *Southern California Law Review*, Vol. 80, p. 1155, 1196-1234.

¹⁸⁰ See generally, Stone, A., (2009) 'Constitutionalism, Legal Pluralism, and International Regimes', *Indiana Journal of Global Legal Studies*, Vol. 16, No.2, p. 621-645; Stone, A., (Summer 1984), 'What Is a Supranational Constitution? An Essay in International Relations Theory', *The Review of Politics*, Vol. 56, No. 3, Special Issue on Public Law, p. 441-474; Hongju Koh, H., (2007) 'Bringing International Law Home,' *Houston Law Review*, Vol. 35, p. 623, 641-42; Berman, Paul S. (2007) 'A Pluralist Approach to International Law', *Yale J. Int'l L.*, Vol. 32, p. 301, 322-23.

¹⁸¹ Regimes facilitate on-going collective action by performing three important functions. First, regimes enable states to collectively establish legal rights and obligations, and in doing so, establish "legitimate standards of behaviour." Second, regimes lower bargaining costs: institutionalization iterates the game, lowering the cost of interaction over time and enhancing the capacities of players to link issues and make side payments. Third, regimes reduce uncertainty (information costs), by providing a forum and vocabulary for the signalling of preferences and intentions.[Keohane, Robert O. (1984) 'After hegemony: Cooperation and discord in the world political economy', chapter 6, Princeton, N.J.: Princeton University Press; Snidal, D., (1989) 'The Limits of Hegemonic Stability Theory', *International Organization*, Vol. 39, p. 581; see also, Stone, A., (Summer 1984), 'What is a Supranational Constitution? An Essay in International Relations Theory', *The Review of Politics*, Vol. 56, No. 3, Special Issue on Public Law, Alec Stone, p. 441-474.]

Legal Harmonization and Legal Transplant: The main difference between legal transplant and legal harmonization is that one involves non-cooperative and the other cooperative adaptation processes.¹⁸² Legal transplant is the unilateral amendment of domestic rules and the adoption of rules in the domestic legal system and is more commonly followed by a different legal system (in this case, the international system). Legal transplantation reduces or tries to reduce the differences between legal systems through the unilateral non-cooperative effort of one system (domestic system).¹⁸³ An example of legal transplantation is the soft laws (standards & codes and best practices) backed by IMF conditionalities.

On the other hand, legal harmonization is a bilateral or a multilateral coordination effort by states to harmonize their legal systems with each other. In it, states agree on a set of objectives and targets and let each state align their domestic laws to achieve the set objectives.¹⁸⁴ The best examples of legal harmonization are the EU and WTO framework of agreements.

Looking at the IELR from the point of view of the legal pluralistic approach, we make an interesting observation: the major challenge caused by the IELR can be understood from a legal pluralistic viewpoint, such as the coexistence of a domestic legal system with an international legal system.¹⁸⁵ In other words, the IELR as a result of the interaction of its constituents (main non-state constituents such as IEIs, in their institutional capacities) produces international economic norms, rules, and laws. This cumulative institutional effect of the IEIs (i.e. IELR) has produced a global legal system based on global legal pluralism. This global legal constitution which is, to a large extent, incorporated in the domestic legal systems through legal transplant

¹⁸² Carbonara, E. and Parisi, F., (2007) 'The Paradox of Legal Harmonization', Public Choice, Vol. 132, p. 367–400

¹⁸³ Carbonara, E. and Parisi, F., (2007) 'The Paradox of Legal Harmonization', Public Choice, Vol. 132, p. 367–400

¹⁸⁴ Ibid

¹⁸⁵ Michaels, R., (June 29, 2009) 'Global Legal Pluralism', Annual Review of Law & Social Science, Vol. 5, Duke Law School Public Law & Legal Theory Research Paper No. 259.

and harmonization brings predictability and certainty of the rules of the game to the global economy which then acts as a stimulus for the Economic Cycle.

3. International Economic Framework

A well-developed financial sector with an open international trade is an essential element of flourishing economies. Finance and trade are connected in a number of ways; however, the causality is not always clear.¹⁸⁶ This part of the chapter endeavours to explain that trade expansion relies heavily on the development of a financial system and on the other hand, financial sector development can be considerably stimulated with international trade. Moreover, it is a known fact that international trade is one of the essential elements of a global economy and it has a substantial role in stabilising the economic wellbeing of a country (as growing exports can actually help crisis-effected countries to recover from a distressing economic situation).¹⁸⁷

¹⁸⁶ There are three views in this context. The first view argues that financial development, which results from financial liberalization leads to economic growth [McKinnon, R.I., (1973) 'Money and Capital in Economic Development,' Washington DC: The Brookings Institution; Patrick, H.T., (1966) 'Financial Development and Economic Growth in Underdeveloped Countries', *Economic Development and Cultural Change*, Vol. 14, No. 1, p.174–89; Fry, M.J. (1973), 'Manipulating Demand for Money', *Essays in Modern Economics*, Editor: Parkin, M., Longman, London; De Gregorio, J. and Guidotti, Pablo E., (March 1995) 'Financial Development and Economic Growth,' *World Development*, Elsevier, Vol. 23, No. 3, p. 433-448; Choe, C and Moosa, Imad A., (June 1999) 'Financial System and Economic Growth: The Korean Experience,' *World Development*, Elsevier, Vol. 27, No. 6, p. 1069-1082; Habibullah, M.S. and Eng, Y., (2006) 'Does Financial Development Cause Economic Growth? A Panel Data Dynamic Analysis for the Asian Developing Countries', *Journal of the Asia Pacific Economy*, Vol. 11, No. 4, p. 377–93]. The second view maintains that it is economic growth that leads to financial development [The demand for financial development hypothesis in Patrick, H.T., (1966) 'Financial Development and Economic Growth in Underdeveloped Countries', *Economic Development and Cultural Change*, Vol. 14, No. 1, p. 174–89. And also see Robinson, J., (1952) 'The Generalization of the General Theory', *The Rate of Interest and Other Essays*, London: Macmillan; and Romer, P.M., (1990) 'Endogenous Technological Change', *Journal of Political Economy*, Vol. 98, No. 5, S71-S102 in the context of effect of economic growth on financial development.] The third view, however, contends that both financial development and economic growth cause one another [Granger, C. W. J., (1969) 'Investigating Causal Relations by Econometric Methods and Cross-Spectral Methods', *Econometrica*, Vol. 37, p. 424-438; Granger, C. W. J., (1980) 'Testing for Causality: A Personal Viewpoint', *Journal of Economic Dynamics and Control*, Vol. 2, p. 329-352. And also see Lyons, S.E. and Murinde, V., (1994) 'Cointegration And Granger-Causality Testing Of Hypotheses On Supply-Leading And Demand-Following Finance', *Economic Notes*, Vol. 23, No. 2, p. 308- 316].

¹⁸⁷ The topic of export led growth has been enormously discussed by international trade economists and policy makers. Many researches have been made to study the effects of exports on the economic growth leading to economic stability. [Bahmani-Oskooee, M and Alse, J., (1993) 'Export Growth and Economic Growth: An Application of Cointegrating and Error-Correction Modelling,' *The Journal of Developing Areas*, Vol. 27, p. 35-42; Ahmad J. and Harnhirun S., (1995) 'Unit-Root and Cointegration in Estimating Causality between Exports and

This section will try to establish the relationship conceivable in the form of a cycle (“Economic Cycle”) involving financial sector development,¹⁸⁸ economic growth, and international trade. In addition to forming a relationship, I shall (place heavy emphasis) focus on the possible direction of the causality. To that purpose, first of all, this part of the chapter will establish the causality between financial sector development and economic growth; second, the causality between economic growth and international trade; third, the causality between international trade and economic growth. Finally, I shall develop the causality between economic growth and financial sector development.

This thesis then takes the Economic Cycle as a conceivable causal relationship between its constituents and analyses the way in which IEs in their institutional capacity can use this causal

Economic Growth: Empirical Evidence from the ASEAN Countries’, *Economics Letters*, Vol. 49, p. 329-334; Biswal B. and Dhawan U., (1998) ‘Export-led Growth Hypothesis: Cointegration and Causality Analysis for Taiwan’, *Applied Economic Letters*, Vol. 5, p. 699-701; Giles, J. A. and Williams, C. L., (2000a) ‘Export-led Growth: a Survey of the Empirical Literature and Some Non-Causality Results’, *Journal of International Trade and Economic Development*, Vol. 9, Part 1, p. 261-337.

Giles, J. A. and Williams, C. L., (2000b) ‘Export-led Growth: a Survey of the Empirical Literature and Some Non-Causality Results,’ *Journal of International Trade and Economic Development*, Vol. 9, Part 2, p. 445-470; Hossain, M. A. and Karunaratne, N. D., (2004) ‘Export and Economic Growth in Bangladesh: Has Manufacturing Exports become a New Engine of Export-Led Growth?’ *International Trade Journal*, XVIII, p. 303-334; Tang, T.C., (2006) ‘Export Led Growth in Hong Kong: Empirical Evidence from the Components of Exports’, *International Journal of Business and Society*, Vol. 7, p. 30-52, among others]. The impact of export on growth originates from the Keynesian growth theory in which economic growth rate is affected by the rate of growth in demand. According to it, growth in exports signifies growth in demand, and thus enhancing economic growth. Generally scholars affirms that the export-led growth policy support high economic functioning.

Liwan and Lau, documents that there is notable a direct correlation between export and GDP of all the countries (included in their research i.e. Indonesia, Thailand and Malaysia). They argue to expand exports in order to increase the economic growth rate. As the domestic economy expands it will increase job prospects which raise countries per capital earnings and living standard. [Liwan, A. and Lau, E., (2007) ‘Managing Growth: The Role of Export, Inflation and Investment in three ASEAN Neighboring Countries’, MPRA, Paper No. 3952. Available at <http://mpa.ub.uni-muenchen.de/3952/>]

¹⁸⁸ Measures of Financial Development. The term financial development is referred as the factors, policies, and institutions that lead to effective financial intermediation and markets, and deep and broad access to capital and financial services. See ‘The Financial Development Report’, (2008) World Economic Forum, USA; see also, Calderon, C. and Liu, L., (2003) ‘The Direction of Causality Between Financial Development and Economic Growth’, *Journal of Development Economics*, Elsevier, Vol. 72, No. 1, p. 321-334] Financial development is one of the key elements of financial liberalization. It plays a vital role in the process of financial liberalization. It is a necessary condition for financial liberalization [Mavrotas, G. and Kelly, R., (2001) ‘Savings Mobilization and Financial Sector Development: The Nexus’, *Savings and Development*, Vol. 25, No. 1, p. 33–66]. And for this chapter often uses synonymously the terms financial development and financial liberalization.

relationship to achieve stable and balanced growth. The collective action of these IEIs in their institutional capacities produces the regime effect which results in the certainty and predictability of the rules of the game within the global economy. The certainty and predictability of the rules of the game act as a stimulus in the Economic Cycle. Once the Economic Cycle is stimulated at any stage, it will continue its cycle and result in a more stable and balanced growth of the global economy.

In order to establish the above-mentioned linkages, I shall rely on the different literatures which support these causalities. The following section looks into the relationship between financial sector development and economic growth.

a) ***Financial Development (through liberalization process)
leading to Economic Growth***

There are three views in this context. The first view maintains that financial sector development leads to economic growth.¹⁸⁹ The second view claims that it is economic growth that leads to financial sector development.¹⁹⁰ The third view, however, argues that both financial sector development and economic growth cause one another.¹⁹¹

¹⁸⁹ McKinnon, R.I., (1973) 'Money and Capital in Economic Development,' Washington DC: The Brookings Institution; Patrick, H.T., (1966) 'Financial Development and Economic Growth in Underdeveloped Countries', Economic Development and Cultural Change, Vol. 14, No. 1, p. 174–89; Fry, M.J. (1973), 'Manipulating Demand for Money', Essays in Modern Economics, Editor: Parkin, M., Longman, London.

¹⁹⁰ The demand for financial development hypothesis in Patrick, H.T., (1966) 'Financial Development and Economic Growth in Underdeveloped Countries', Economic Development and Cultural Change, Vol. 14, No. 1, p. 174–89. And also see Robinson and Romer [Robinson, J., (1952) 'The Generalization of the General Theory', The Rate of Interest and Other Essays, London: Macmillan]; Romer, P.M., (1990) 'Endogenous Technological Change', Journal of Political Economy, Vol. 98, S71-S102] in the context of impact of economic growth on financial development.

¹⁹¹ Granger, C. W. J., (1969) 'Investigating Causal Relations by Econometric Methods and Cross-Spectral Methods', Econometrica, Vol. 37, p. 424-438; Granger, C. W. J., (1980) 'Testing for Causality: A Personal Viewpoint', Journal of Economic Dynamics and Control, Vol. 2, p. 329-352. Granger, C. W. J., (1988) 'Granger Causality, Cointegration and Control', Journal of Economic Dynamics and Control, Vol. 12, p. 551-59. Lyons, S.E. and Murinde, V., (1994) 'Cointegration And Granger-Causality Testing Of Hypotheses On Supply-Leading And Demand-Following Finance', Economic Notes, Vol. 23, No. 2, p. 308- 316.

The expansion of different types of financial intermediation and an increase in the variety of channels (which might be due to the liberalization process) to make best use of savings is a basic component of economic growth enhancement. Financial institutions have a direct effect on the economy; they collect and direct savings into investment (in other words they collect and inject funds into productive activities). The better the financial sector, the more the efficient and resourceful allocation of funds as investment, based mostly on savings, acts as a stimulus for economic growth.¹⁹² The availability of all types of financial intermediaries (such as capital market institutions, merchant banks and finance houses or commercial and savings banks) increases the competition level in the financial sector which enhances the options for investors (who give up their liquid assets for the purpose of investment). A deficiency of these financial intermediaries (even a lack in numbers), might slow down investment or in some cases, might even cause it not to take place, which would directly affect the technological progress (which, as we know, is a very important factor for economic growth) which, in return, would slow down the growth rate. Thus, it can be deduced that there is an interaction between the development of a financial sector and economic growth.¹⁹³

¹⁹² Newlyn W. T. and Rowan, D. C., (1954) 'Money and Banking in British Colonial Africa: A Study of the Monetary and Banking Systems of Eight British African Territories', Oxford University Press: Oxford. And also Levine R., (1997) 'Financial Development and Economic Growth: Views and Agenda', *Journal of Economic Literature*, Vol. 35, No. 2, p. 688–726.

¹⁹³ Gurley, J. and Shaw, E. (September 1955) 'Financial Aspects of Economic Development', *American Economic Review*, Vol. 45, p. 515-38; Patrick, H., (January 1966) 'Financial Development and Economic Growth in Underdeveloped Countries', *Economic Development and Cultural Change*, Vol. 14, p. 174-89; Porter, R., (July 1966) 'The Promotion of the 'Banking Habit' and Economic Development', *Journal of Development Studies*, Vol. 2, p. 346-66; Goldsmith, R., (1969) 'Financial Structure and Development', New Haven, Conn.: Yale University Press; Morley, S., (January 1971) 'Inflation and Stagnation in Brazil', *Economic Development and Cultural Change*, Vol. 19, p. 184-203; and McKinnon, R.I., (1973) 'Money and Capital in Economic Development,' Washington DC: The Brookings Institution.

A reasonable proportion of the literature supports the notion that financial sector development is quite important for escalating economic growth.¹⁹⁴ The most common, and also the core justification given by scholars for the above-mentioned notion, is that economic growth is primarily contingent on investment. Investment is financed by borrowing from the deposits made by individuals (which include artificial persons and as well sovereign governments) with banks and non-bank financial institutions.¹⁹⁵

A sound financial system improves the possibilities for innovation by providing relatively better opportunities for R&D into the economy, and in doing so, speeds up economic growth.¹⁹⁶ Likewise, a poorly functioning financial sector decreases the opportunities for investment in R&D which further pushes the rate of innovation down and ultimately adversely affects the rate of economic growth. Therefore, a financial system is a highly significant factor in determining productivity, growth, and economic development¹⁹⁷.

¹⁹⁴ See also Shaw, E., (1973) 'Financial Deepening in Economic Development', Oxford: Oxford University Press; and Bhatia, R. and Khatkhate, D., (March 1975) 'Financial Intermediation, Savings Mobilization and Entrepreneurial Development: The African Experience', IMF Staff Papers, Vol. 22, p. 132-58.

¹⁹⁵ Dobson, W. and Jacquet, P., (1998) 'Financial Service Liberalization in the WTO', Peterson Institute.

¹⁹⁶ King and Levine used an endogenous growth model to study the relationship of financial systems and economic growth. "An endogenous growth macro model is one in which the long-run growth rate of output per worker is determined by variables within the model, not an exogenous rate of technological progress as in a neoclassical growth model" see Ramsey [Ramsey F.P., (1928) 'A Mathematical Theory of Saving', Economic Journal, Vol. 38, No. 152, p. 543-59], Solow [Solow, Robert M., (1956) 'A Contribution to the Theory of Economic Growth', Quarterly Journal of Economics, Vol. 70, p. 65-94], Swan [Swan, Trevor W., (1956) 'Economic Growth and Capital Accumulation', Economic Record, Vol. 32, p. 334-61], Koopmans [Koopmans, Tjalling C., (1963) 'On the Concept of Optimal Economic Growth', Cowles Foundation Discussion Papers, Vol. 163, Cowles Foundation, Yale University]. Influential early endogenous growth models are Romer [Romer, Paul M., (1986) 'Increasing Returns and Long-run Growth', Journal of Political Economy, University of Chicago Press, Vol. 94, No. 5, p. 1002-37], Lucas [Lucas Jr. R.E., (1988) 'On the Mechanics of Economic Development', Journal of Monetary Economics, Vol. 22, No. 1, p. 3-42], and Rebelo [Rebelo, S., (1991) 'Long-Run Policy Analysis and Long-Run Growth', Journal of Political Economy, University of Chicago Press, Vol. 99, No. 3, p. 500-521]. According to Hulten, an endogenous growth model is a model with an the assumption that the marginal product of (generalized) capital is constant, rather than diminishing as in classical theories. Where generalized capital includes the result of investments in R&D [Hulten, Charles R., (January 2000) 'Total Factor Productivity: A Short Biography', NBER Working Paper No. W7471. Available at SSRN: <http://ssrn.com/abstract=213430>].

¹⁹⁷ King, R.G. and Levine, R., (1993) 'Finance and Growth: Schumpeter Might Be Right', Quarterly Journal of Economics, Vol. 108, No. 3, p. 713-37.

According to an empirical study on the relationship between financial sector development and economic growth, development in the financial sector positively contributes to the rate of economic growth. However, the effect of the relationship between financial sector development and economic growth differs for different countries over time.¹⁹⁸ Moreover, the financial intermediaries play a relatively more significant role in the growth process than the capital markets.¹⁹⁹

Numerous research conducted by different scholars which supports the view that financial sector development has a positive effect on the economic growth process. In other words, the majority of research reaffirms the Schumpeterian hypothesis (i.e. financial development leads to real economic growth) and Patrick's supply-leading hypothesis (i.e. by increasing the supply of financial opportunities in the economy, there are relatively more opportunities for investors to invest money in the real economy, thus escalating the growth process).²⁰⁰

¹⁹⁸ De Gregorio and Guidotti conducted an empirical study on the relationship between financial sector development and economic growth. See for details, De Gregorio, J. and Guidotti, Pablo E., (March 1995) 'Financial Development and Economic Growth,' *World Development*, Elsevier, Vol. 23, No. 3, p. 433–48.

¹⁹⁹ This point was identified by Choe and Moosa in their study to examine the contribution of a financial system in the economic growth process with a specific reference to Korea. They came to the conclusion that the development in the financial sector generally leads to economic growth, moreover, they also found out that the financial intermediaries play relatively more significant role in the growth process than the capital markets. Choe, C and Moosa, Imad A., (June 1999) 'Financial System and Economic Growth: The Korean Experience,' *World Development*, Elsevier, Vol. 27, No. 6, p. 1069-82.

²⁰⁰ Habibullah and Eng conducted a research to study the causal relationship between financial sector development and economic growth process with reference to Asian countries. Their study supports the belief that there is a strong link between the financial sector and economic growth as found by King & Levine [King, R.G. and Levine, R., (1993) 'Finance and Growth: Schumpeter Might Be Right', *Quarterly Journal of Economics*, Vol. 108, No. 3, p. 713–37.] Their study supports that 'financial depth contributes more to the causal relationships in developing countries.' Their result suggests that the supply-leading growth hypothesis indicates that financial intermediation promotes economic growth in the nine Asian developing nations for the period 1990–1998. It implies that the policy of liberalization and financial reforms adapted by these Asian countries has shown to improve economic growth. Their research is in conformity with other empirical research in causality by [Calderon, C. and Liu, L., (2003) 'The Direction of Causality Between Financial Development and Economic Growth', *Journal of Development Economics*, Elsevier, Vol. 72, No. 1, p. 321-334], [Fase, M. M. G. and Abma, R. C. N., (2003) 'Financial Environment and Economic Growth in Selected Asian countries', *Journal of Asian Economics*, Vol. 14, p. 11–21.], and [Christopoulos, D. K. and Tsionas, E.G., (2004) 'Financial Development and Economic Growth: Evidence from Panel Unit Root and Cointegration Tests', *Journal of Development Economics*, Vol. 73, p. 55–74.] that financial development promotes growth, thus, supporting the old Schumpeterian hypothesis and Patrick's supply-leading hypothesis. Habibullah, M.S. and Eng, Y., (2006) 'Does Financial Development Cause Economic Growth? A Panel

As documented above, there is sufficient evidence from the economic literature which supports the idea that financial sector development leads to economic growth. As this is an important part of the economic cycle (showing the causal relationship between two of its components), it has high relevance to this concept in analysing the role played by the IEs in their institutional capacity for achieving stable and balanced growth. In the same context, the next subheading will look into the role of economic growth in the promotion of international trade.

b) ***Economic Growth promotes International Trade***

There is substantial evidence that financial sector development enhances opportunities for investment to take place, as investment becomes cheaper due to competitive pressure in the financial market. In a competitive market, where all companies have equal opportunity to access funds (through financial intermediaries and institutions), the general competition level in the economy increases. High competition pressure in the economy forces or drives the market players to come up with something innovative, in order to be successful or survive (survival of the fittest), thus as the competition level in the economy rises, market players increase their investment budget for R&D²⁰¹ which allows more innovation. Again, innovation is an extremely significant stimulus for international trade;²⁰² therefore we can deduce that higher economic growth would lead to an increase in international trade.

Continuous advancement in technological knowledge through R&D is essential in order to sustain a positive growth rate in output per capita. This concept was shown in the Solow-Swan

Data Dynamic Analysis for the Asian Developing Countries', Journal of the Asia Pacific Economy, Vol. 11, No. 4, p. 377–93.

²⁰¹ Availability of funds due to liberalization process and higher growth level the competition among the firms increases so they invest more in R&D in order to introduce in methods, products etc to establish an edge on the rival firm. [Beiji, P., (1998) 'Technological Change in the Modern Economy', Edward Elgar Publishing Limited, p. 122]

²⁰² Standard international trade theory supports that difference of technologies encourages or gives reason to market players to trade. [Dixit, A. and Norman, V., (1980) 'Theory of International Trade: A Dual, General Equilibrium Approach', William Clowes Limited.]

model (also known as the exogenous growth model and Neo-classical growth model) of economic growth. Solow and Swan maintain that a persistent positive rate of growth in per capita output can only occur due to exogenous advancement in technology.²⁰³

The “New growth theory”²⁰⁴ which is heavily based on the Schumpeterian concept that gives relatively more weight to technological innovation in the growth process (rather than to other factors²⁰⁵ involved in the growth process) also emphasises the significance of the impact of R&D in the growth of the economy.²⁰⁶

Further empirical evidence shows that the higher the level of competition in the economy, the more resources will be invested in R&D, leading to higher technological enhancement.²⁰⁷

Furthermore, other empirical research shows that firms are keen to increase their investment in R&D as a tool to overcome competition pressure. The intensely competitive economy forces firms to innovate more, therefore they invest more in R&D in order to overcome competition.²⁰⁸

In this way, creating technological differences in the international trading scenario will act as a significant stimulus for trade growth.

Now, if we look at standard international trade theory, which talks about comparative advantage, (i.e. differences in relative opportunity costs, and then tries to explain comparative advantage in

²⁰³ See: Solow, Robert M., (1956) ‘A Contribution to the Theory of Economic Growth’, *Quarterly Journal of Economics*, Vol. 70, p. 65-94 and also see: Swan, Trevor W., (1956), ‘Economic Growth and Capital Accumulation’, *Economic Record*, Vol. 32, p. 334–61.

²⁰⁴ New Growth Theory or the Endogenous Growth Theory. See Cortright, J., (2001) ‘New Growth Theory, Technology and Learning: A Practitioners Guide’, *Reviews of Economic Development Literature and Practice*: No. 4 [http://www.eda.gov/PDF/1G3LR_7_cortright.pdf]

²⁰⁵ Such as land, labour etc.

²⁰⁶ Fagerberg, J., Hansson, P., Lundberg, L and Melchior, A., (1997) ‘Technology and International Trade’, Edward Elgar Publishing, p. 39 and also see Grossman, G.M. and Helpman, E., (1991) ‘Innovation and Growth in the Global Economy’, Cambridge, MA: MIT Press. And also Grossman, G.M. and Helpman, E., (February 1991) ‘Technology and Trade’, Discussion Paper Series, No.1134, London: CEPR.

²⁰⁷ Fagerberg conducted an empirical research on competition and R&D. Fagerberg, J., Hansson, P., Lundberg, L and Melchior, A., (1997) ‘Technology and International Trade’, Edward Elgar Publishing, p. 51

²⁰⁸ Aghion has built a model in which firms are keen to increase their investment in R&D as a tool to overcome competition pressure. Aghion, Philippe, Diego Comin and Peter Howitt. (2006) "When Does Domestic Saving Matter for Economic Growth?" NBER Working Paper No. 12275.

terms of differences in technologies, factory supplies, etc.), we can see that, as the economy grows, R&D will be improved and innovation will take place, which creates differentiation in technologies between countries and making room for international trade to grow.²⁰⁹ In other words, the greater the technological innovation (as a result of economic growth), the more room there will be for international trade.²¹⁰

So far this chapter has strived to develop a causality link between the development of the financial sector and economic growth and, then consider economic growth's role as a stimulus for the growth of international trade. On the same line of developing causalities, the next subheading will endeavour to determine the role of international trade in the economic growth process.

c) ***International Trade promotes Economic Growth***

To explain how international trade promotes economic growth, I shall refer to the literature which talks about the economic gains from international trade. According to the gains from the trade theorem that states that a country will be better off if it can trade at any price ratio other than its home prices, than it would be in autarky.²¹¹ A number of scholars have the same opinion about the common gains from trade concept. They are as follows: firstly, there are more welfare gains in an open economy, with absolutely no trade restrictions, than in autarky (closed

²⁰⁹ David Ricardo is normally considered to be the founder of the classical theory of international trade. The theories of gains from trade and the comparative advantage are commonly affiliated with him. In this theory the most significant factor employed to explain international trade scenario is technology. According to the theory the difference in comparative costs of production is a prerequisite for the occurrence of international trade. Moreover, this theory asserts that the technological differences (which includes difference in techniques of production) between countries determine international division of labour and consumption and trade patterns. [Zhang, W., (2008) 'International Trade Theory: Capital, Knowledge, Economic Structure, Money, and Prices Over Time', Published by Springer.]

²¹⁰ Dixit, A. and Norman, V., (1980) 'Theory of International Trade: A Dual, General Equilibrium Approach', William Clowes Limited.

²¹¹ An autarky is an economy that is self-sufficient and does not take part in international trade, or severely limits trade with the outside world. In the economic meaning, it is also referred to as a closed economy.

economy, i.e. without any trade); secondly, a partially open economy, with trade restrictions (such as trade tariffs, subsidies, etc.) still has higher welfare gains than autarky; and, finally, an open economy as compared with a partially open economy has more welfare gains provided the concerned economy is a small economy which cannot affect the global economy itself.²¹²

This part of the chapter will discuss in detail (1) traditional economic gains from trade, (2) gain from trade under new trade theory, and (3) the dynamic gains from trade. The analysis follows below.

(1) The Traditional Approach: Gains from Specialisation

Under this subheading, I shall be discussing the traditional approach towards gains from trade, which takes into account the laws of absolute advantage²¹³ and comparative advantage²¹⁴. I shall start with Adam Smith's theory of absolute advantage and David Ricardo's comparative advantage theory, for a better understanding of the traditional gains from trade.

²¹² Samuelson, P. A., (1939) 'The Gains from International Trade', *Canadian Journal of Economics and Political Science*, Vol. 5, No. 2, p. 195-205; Kemp, M. C., (1962) 'The Gain from International Trade', *The Economic Journal*, Vol. 72, No. 288, p. 803-819; Deardorff, A. V., (May 1979) 'Weak Links in the Chain of Comparative Advantage', *Journal of International Economics*, Vol. 9, p. 197-209 and also Deardorff, A. V., (2005a) 'Gains from Trade and Fragmentation', *Research Seminar in International Economics Discussion Paper N 543*, Ann Arbor: University of Michigan; Corden, W. M., (1984) 'The Normative Theory of International Trade', *Handbook of International Economics*, vol. I, Editor: Jones, R. W. and Kenen, P.B., Amsterdam: North Holland, p. 63-130; Markusen, J. R., Melvin, J. R., Kaempfer, W. H., and Maskus, K. E., (1995) 'International Trade Theory and Evidence', New York: McGraw-Hill; Wong, K., (1995) 'International Trade in Goods and Factor Mobility', Cambridge, MA: The MIT Press.

²¹³ Henderson, W., (2006) 'Evaluating Adam Smith: Creating the Wealth of Nations', London: Routledge. See also, Smith, A., (1986) 'The Wealth of Nations', Books I-III, with an introduction by Andrew Skinner, London: Penguin Group, New York: Viking Penguin.

²¹⁴ Comparative advantage can be defined as the "low relative cost of a good compared to other countries in autarky". [Deardorff, A.V., (1998) 'Benefits and Costs of Following Comparative Advantage', *The Sweetland Inaugural Lecture*, presented at the 45th Annual Conference on the Economic Outlook, Ann Arbor Michigan, November 20, 1997.]

This can be explained with the help of an example of a doctor and a domestic cleaner. Suppose that the doctor is a better cleaner than the domestic worker. The doctor, however, earns GBP 250 / hour in her professional capacity while the domestic cleaner charges GBP 10 an hour. It makes economic sense for the doctor to pay the domestic cleaner to clean her house. (WTO (2008), *World Trade Report*. Available at: www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report08_e.pdf)

(a) Adam Smith and Absolute Advantage²¹⁵

Adam Smith, in 1776, came up with the theory of absolute advantage as a rationale for international trade (i.e. countries participating in trade should gain mutually from this activity otherwise there is no motivation for the countries to participate). The concept of absolute advantage can be better understood with an example. Let's assume that there are two states in the world with two commodities; each state has absolute advantage (higher in efficiency) in producing one of those commodities. In this scenario both the countries can put all their resources into producing the commodity in which they have an absolute advantage and import the other product in which they lack efficiency (absolute disadvantage).

A numerical example of this would further elaborate the absolute advantage concept. Let's assume that there are two countries, Pakistan and the UK, with two commodities - cloth and shoes. Technologies and the cost of production of each commodity for both the countries are fixed. Let us suppose that the unit costs of production of cloth and shoes are correspondingly 2 and 8 in Pakistan; while they are correspondingly 6 and 4 in UK. It can be observed that the cost of producing one unit of cloth (in terms of shoes) in Pakistan is 0.25 ($2/8=0.25$) and in the UK is 1.5 ($6/4=1.5$). So, Pakistan has absolute advantage in the manufacturing of cloth (as the cost to produce one unit of cloth is lower in Pakistan i.e. $0.25 < 1.5$). On the other hand, the cost of producing one shoe (in terms of cloth) in Pakistan is 4 ($8/2=4$) and in UK is 0.66 ($4/6=0.66$). So, the UK has absolute advantage in the manufacturing of shoes (as the cost to produce one shoe is lower in the UK i.e. $0.66 < 4$).

²¹⁵ Zhang, W., (2008) 'International Trade Theory: Capital, Knowledge, Economic Structure, Money, and Prices Over Time', Published by Springer. See also, Henderson, W., (2006) 'Evaluating Adam Smith: Creating the Wealth of Nations', London: Routledge. See also, Smith, A., (1986) 'The Wealth of Nations', Books I-III, with an introduction by Andrew Skinner, London: Penguin Group, New York: Viking Penguin.

Without trade (in autarky), Pakistan, with 10 units of production, could only produce 1 unit of cloth and 1 units of shoes and the UK, with 10 units, could only produce 1 unit of cloth and 1 unit of shoes (I am assuming that preference for both products in each country is equal). Thus, the total world production in autarky would be 2 cloths and 2 shoes. Now, if both the countries specialise in the commodity in which they have absolute advantage, then the world output could increase. That is, if Pakistan specialises in cloth, then with 10 units of production, it could produce 5 ($10/2$) units of cloth and zero units of shoes. On the other hand, if the UK specialises in shoes, then with 10 units of production it could produce 2.5 ($10/4$) units of shoes. The total world output with specialisation could be 5 and 2.5 units of cloth and shoes respectively which is significantly higher than in autarky. Thus both the countries could easily export the abundant product and import the deficient product, and by doing this, both countries could easily gain from specialisation and trade.

(b) The Ricardian Trade Theory²¹⁶

There is no doubt that Smith's concept of absolute advantage served as a basis for the early development of international trade; however, David Ricardo is mostly commonly recognised as the founder of traditional theory of international trade. He asserted that it is possible to reap far more gains from international trade than Smith thought of in his absolute advantage theory. In this context, he introduced the concept of comparative advantage as an advance in and practical concept of international trade in comparison with Smith's absolute advantage theory.

Ricardo, in his theory of comparative advantage, asserts that the countries participating in international trade, without having absolute advantage in the production of any commodity, can

²¹⁶ Zhang, W., (2008) 'International Trade Theory: Capital, Knowledge, Economic Structure, Money, and Prices Over Time', Published by Springer.

still gain from trade if there is a difference in the cost of production between the home country and abroad. According to him, the rationale for international trade is the difference in the comparative cost of production due to technological difference (technological difference stands for the difference in production technique) between the nations.

The Ricardian theory can be better explained with the help of a numerical example. Let's suppose that (1) the world consists of two countries (e.g., Pakistan and the US), (2) there are only two commodities (cloth and shoes); (3) with one factor of production i.e. labour, and (4) the production techniques (i.e. technology) of both countries are fixed.

Suppose that the cost of production of one unit of cloth and shoes in terms of labour are 2 and 4 in US, while they are 3 and 5 in Pakistan, respectively. As is quite clear, the US can produce both the products more cheaply than Pakistan and, from the absolute advantage viewpoint, there could be no scope for international trade. However, Ricardian theory asserts that there is still scope for international trade as there is possibly room for both countries to gain from trade. According to Ricardo, the necessary pre-condition for trade to take place is the difference in the comparative cost of production at home and abroad.

The comparative cost of production is the ratio between the cost of production of one unit of the two products in the same country. Thus, according to the above illustration, the comparative costs are respectively $2/4 = 0.5$ and $3/5 = 0.6$ in the US and Pakistan. The ratio of production costs of cloth and shoes between US and Pakistan is respectively $2/3$ and $4/5$. It can be observed that the US has a comparative advantage in the production of cloth than shoes (because the US can produce 33% cheaper cloth and 25% cheaper shoes as compared to Pakistan). In other words, Pakistan has a comparatively smaller disadvantage in the production of shoes. The Ricardian model of comparative advantage for international trade states that if the terms of trade

are greater than 0.5 and smaller than 0.6, then both countries can benefit from trade. For example, if the terms of trade are fixed at 0.55, which means that 0.55 units of shoes are exchanged for one unit of cloth, then in an open trading scenario, in the US one unit of cloth exchanges for 0.55 units of shoes (rather than 0.5 as in autarky) and in Pakistan 0.55 (rather than 0.6) units of shoes is exchanged for one unit of cloth. Therefore, both countries can take advantage from trade provided that the terms of trade are fixed between the two comparative costs (i.e. between 0.5 and 0.6 in the above illustration). However, if the comparative cost is equal, then there would be no motive to trade whilst, on the other hand, if the terms of trade lie outside the comparative costs, then one of the countries will lose out if trade occurs.²¹⁷

(2) “New” Trade Theory

This sub-section discusses the “new” trade theory, which focuses on the significance of intra-industry trade and of trade between countries with same capacity and level of technology. This theory asserts that even countries with equal capability and technologies can increase welfare gain from trade by supplying a broader variety of products and services to economies at lower prices. This can be achieved by taking advantage of economies of scale when firms have access to a larger market (i.e. the combined market of both countries).

The “New” trade theory is generally attributed to Krugman²¹⁸. He used a simple model of two countries and illustrated that countries of equal capabilities can also benefit from international trade by providing their consumers with more variety at lower prices. In his model, there are two countries (A and B). Both countries’ consumers prefer to have more variety, however, variety

²¹⁷Zhang, W., (2008) ‘International Trade Theory: Capital, Knowledge, Economic Structure, Money, and Prices Over Time’, Published by Springer.

²¹⁸Krugman, P., (1979) ‘Increasing Returns, Monopolistic Competition, and International Trade’, *Journal of International Economics*, Vol. 9, p. 469–479.

comes with increased cost (as firms are operating on economies of scale, so more variety means working below the economies of scale equilibrium, thereby creating higher prices). A high demand for variety would not enable firms to operate on economies of scale. So let us assume that both countries A and B are alike in every aspect and so there are no traditional comparative advantage reasons for trade; in the absence of trade, country A produces red, blue and pink cars and country B produces green, orange and black cars.

If trade is allowed, then the countries involved in it can still reap welfare gains. This is because with trade, firms will produce on economies of scale which would increase production and push the cost down, but interestingly the consumers will be presented with more variety than in a situation without trade. If country A only produces red and blue cars and country B only produces green and black cars and trade takes place, then actually the degree of variety available to individual customers in each country will increase to red, blue, green and black, even though the world variety declines.

In short, the “New” trade theory provides three welfare gains. First, production will take place on a large scale so it will enable the firms to reap profit from economies of scale. Secondly, buyers in both countries will benefit from a greater diversity of products and services on the market. Thirdly, through market integration, competition levels will rise which will push prices down. The net effect of the “New” trade theory is quite logical as it enables similar countries to trade with each other and yet everyone (consumers and efficient producers) gain from the trading scenario.

(3) *Dynamic Gains*

This subhead mainly focuses on the impact of trade on GDP growth and will review both practical and theoretical studies. The traditional theory of economic growth assumes that the

economy is isolated and external factors (such as import, export and technological differences) are not taken into consideration.²¹⁹ In other words, its basic idea is that countries make and utilize in isolation and no trade exists between them. On the contrary, practical world growth experience is totally different; it reveals that all the countries are closely connected and it is difficult to study countries in isolation.²²⁰ These three facts have been underlined in the 2008 World Trade Report.²²¹ First, the global economy has grown extensively since WW II. Secondly, facts also reveal that the volume of global trade since WW II has grown but at an even higher rate than the global economy. Thirdly, the empirical data documents a strong positive relationship between GDP growth and trade volume growth.²²²

Long term economic growth relies heavily on technological improvement and this can be better explained with the help of endogenous growth models. These growth models place heavy emphasis on the key factors which determine technological enhancement, which in turn lead to increased productivity and growth. This subsection will highlight the factors which result from trade (such as increased competition, learning by doing and innovation) and how they directly affect economic growth.²²³

In many ways, trade can encourage and reinforce innovation, which directly affects economic growth. The ways in which trade affects economic growth are various: first, trade liberalization

²¹⁹Adam Smith viewed the growth process as strictly endogenous. Lowe, A., (1954) 'The Classical Theory of Economic Growth', Social Research, Vol. 21, p.127–158, reprinted in A. Lowe (1987), Essays in Political Economics: Public Control in a Democratic Society, Editor: Oakley, A., Brighton: Wheatsheaf Books. See also: Kurz, H. and Salvadori, N., (2003) 'Theories of Economic Growth: Old and New', The Theory of Economic Growth: A Classical Perspective, Editors: Salvadori, N., Edward Elgar Limited, UK.

²²⁰ Ventura, J., (2005) 'A Global View of Economic Growth', Handbook of Economic Growth - Edition 1, Editors: Aghion, P. and Durlauf, S., Amsterdam, North Holland: Elsevier, p. 1419-1497.

²²¹(WTO (2008), World Trade Report. Available at: www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report08_e.pdf)

²²²WTO (2008), World Trade Report p.64. Available at: www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report08_e.pdf

²²³ Baldwin, Richard E., (1992) 'Measurable Dynamic Gains from Trade', The Journal of Political Economy, Vol. 100, No. 1, p. 162-174, The University of Chicago Press. See also, Salvadori, N., (2003) 'The Theory of Economic Growth: A Classical Perspective', Edward Elgar, UK.

expands the market size (from domestic to global), and thus companies can enjoy economies of scale; second, from the knowledge spillover effect of international trade; third, by increasing general competition levels in the economy, the market is pushed to provide better quality products at cheaper prices; fourth, the distribution of global product manufacturing changes as trade restrictions are reduced. This is because firms would prefer to manufacture a product in a country where factors of production are cheaper. Finally, the trade liberalization process encourages governments and firms to race for innovation in order to reap the benefits of trade. In all of these above-mentioned ways, trade affects economic growth positively through technological improvement.²²⁴

d) ***Economic Growth leads to Financial Development***

Patrick identified two patterns in the causality relationship between the development of the financial sector and economic growth. The first pattern states that economic growth exerts pressure on the financial system to expand in order to cater for the needs of the economy.²²⁵ This view is referred to as "demand-following" expansion of the financial system. It further maintains that where a financial system is not growing, this means that in that economy, the demand for financial services is still low. Therefore, when the real side of the economy grows, it creates a

²²⁴WTO (2008), World Trade Report p.64. Available at: www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report08_e.pdf; Barro R. J. and Sala-i-Martin, X., (1995) 'Economic growth', McGraw-Hill, Inc, New York; Grossman, G.M. and Helpman, E., (1991) 'Innovation and Growth in the Global Economy', Cambridge, MA: MIT Press. Grossman, G. M., and Helpman, E., (1991) 'Quality Ladders in the Theory of Growth', Review of Economic Studies, Vol. 58, p. 43-61. Grossman, G. M. and Helpman, E., (1991) 'Endogenous Product Cycles', The Economic Journal, Vol. 101, p. 1229-1241; Aghion P. and Howitt, P., (1992) 'A Model of Growth Through Creative Destruction', Econometric, Vol. 60, p. 323-51.

²²⁵Patrick, H.T., (1966) 'Financial Development and Economic Growth in Underdeveloped Countries', Economic Development and Cultural Change, Vol. 14, No. 1, p.174–89

demand for financial services, and in order to match these demands, the financial sector also expands.²²⁶

The second pattern in the causal relationship of financial development and economic growth is known as the “supply-leading” expansion of the financial sector. According to this view, the expansion of the financial sector takes place before the demand for those services is created. This happens when the financial system channels individuals’ savings to the investors in order to provide them with better investment opportunities and in doing so, the financial sector stimulates economic growth. The supply-leading causality relationship trend is mostly documented in less developed economies rather than the developed economy.

One point which emerges in this causality scenario between financial sector development and economic growth is that of determining the possible direction of the causality. Patrick gives an explanation for the bidirectional causality wherein the direction of causality changes over the course of the economic development of an economy. He asserts that financial sector development is able to stimulate real economic growth through innovative types of investment before the economy has achieved prolonged modern economic growth. In other words, supply-led financial development is effective until a certain level of economic growth is achieved and after that, supply-led financial developmental impetus slowly becomes less effective. At this stage, demand-led financial development impetus becomes dominant.²²⁷

²²⁶ Murinde, V. and Eng, Fern S. H., (December 1994) ‘Financial Development and Economic Growth in Singapore: Demand-following or Supply-leading?’ *Applied Financial Economics*, Vol. 4, Issue 6, p. 391 – 404.

²²⁷ Expand more the demand lead financial development. [Patrick, H.T., (1966) ‘Financial Development and Economic Growth in Underdeveloped Countries’, *Economic Development and Cultural Change*, Vol. 14, No. 1, p.174–89]. Besides the two countries discussed by Patrick, Japan and the United States, D. Stammer conducted a case study of Hong Kong (Stammer, D., (January 1972) ‘Financial Development and Economic Growth in Underdeveloped Countries: Comment,’ *Economic Development and Cultural Change*, Vol. 20, p. 318-29). Odhiambo, Nicholas M., (2007) ‘Supply-leading versus Demand-following Hypothesis: Empirical Evidence from Three SSA Countries’, *African Development Review*, Vol. 19, Issue 2, p. 257 – 280. Jung, Woo S., (1986) ‘Financial Development and Economic Growth: International Evidence’, *Economic Development and Cultural Change*, Vol. 34, p. 333–346.

There are a number of studies that contend that economic growth causes financial development e.g. Young, Boulila and Trabelsi²²⁸. They conducted empirical research to find out the causality relationship between economic growth and financial sector development. Their empirical findings supported the notion that, as the real side of the economy grows, it creates demand for financial services which expand to meet this growing demand.

Furthermore, as specialisation in the economy increases, the income of the economy also increases (by exploiting economies of scale) which in turn raises the stock of both real and financial wealth.²²⁹ This aspect of specialisation and financial wealth was studied by Gurley and Shaw who explain this relationship of economic growth and financial growth in terms of demand and supply in real and financial markets.

Keeping Gurley and Shaw's empirical findings in mind, then it could be said that the income elasticity of savings (percentage change in the savings divided by percentage change in income) is greater than one at low levels of income, and the savings elasticity of demand for financial assets (percentage change demand for financial assets divided by percentage change in savings) remains more than one as income rises.²³⁰ Therefore, as income increases due to growth in the real economy (as a result of technological changes, the economy exploiting economies of scale,

²²⁸Boulila, G. and Trabelsi, M., (2002), 'Financial Development and Long-run Growth: Granger Causality in a Bivariate VAR Structure—Evidence from Tunisia (1962–1997)', Working Paper, Faculté des Sciences Economiques et de Gestion de Tunis.

²²⁹Gurley and Shaw also support the demand followed hypothesis of Patrick. Gurley, J. and Shaw, E., (1967), 'Financial Structure and Economic Development', *Economic Development and Cultural Change*, Vol. 34, p. 333-46.

²³⁰ Income elasticity of savings means that as people at lower levels of income get more money, they will save more (as it is difficult for them to improve their standard of living suddenly, e.g. If a person was earning GBP 500 a week and suddenly he starts getting GBP 600 a week, so he would save most of that additional GBP 100), therefore, elasticity is greater than 1. Savings elasticity of demand for financial assets merely means that as people start to save more, they will demand more financial assets or products to save in, thus more savers in an economy higher will be the demand for financial assets. So in short, if people have more income they will save more, and hence they will demand more financial assets to save and invest their money in.

etc.), savings and the demand for financial assets also increases. In short, a rise in income is associated with real development which in turn stimulates financial development.

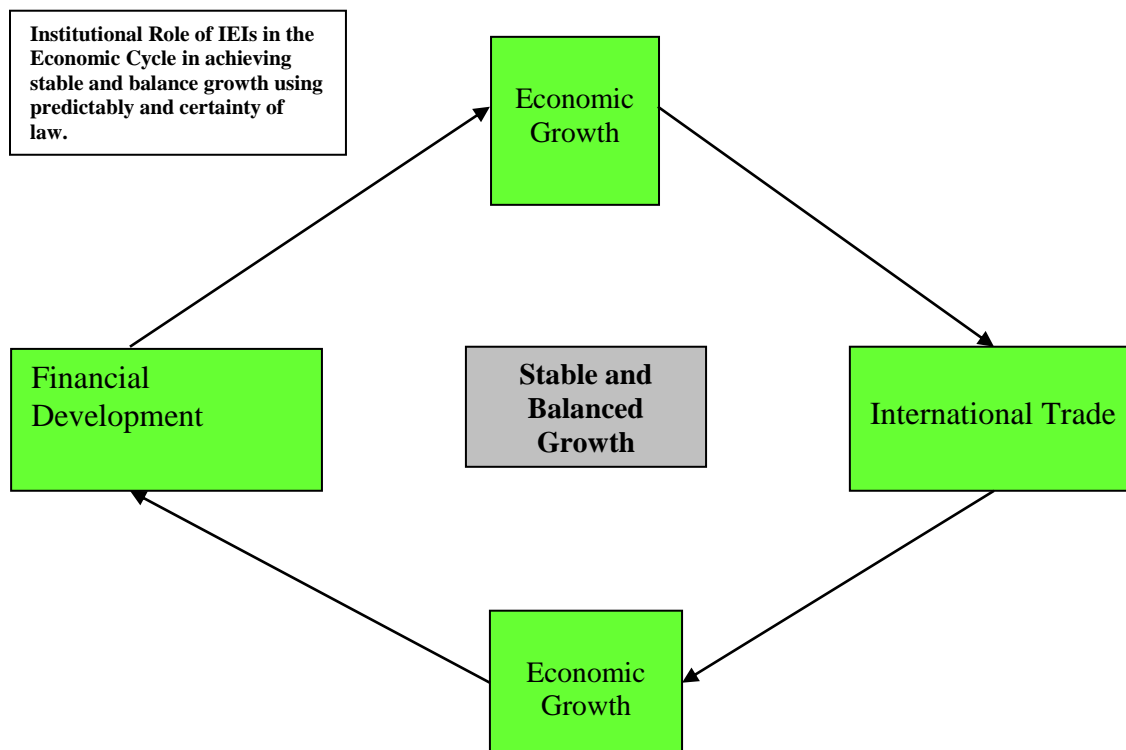
e) ***Formation of Economic Cycle***

As mentioned above, there are many scholars who support the idea that financial development through liberalization leads to economic growth and there is substantial literary and empirical evidence that economic growth enhances competition in the economy, which puts pressure on firms and organisations to come up with innovative ideas and technology. Innovation (or the technological difference between countries) is considered by many scholars as a stimulus for international trade, thus economic growth promotes international trade. On the other hand, international trade reinforces competition, innovation and economies of scale which automatically promotes economic growth. When the real side of the economy grows, then it creates demand for the financial side (Patrick's demand-followed financial development hypothesis).

By summarising the above discussion, we can form a financial sector development, international trade and economic growth cycle and name it an "Economic Cycle", according to which, financial development leads to economic growth, economic growth promotes international trade, international trade reinforces economic growth which again promotes financial development leading to a balanced and stable economy.

The only purpose for discussing the probable causality between the components of the Economic Cycle is to use this possible causal relationship as an economic fact and then analyse the IEIs' institutional framework using certainty and predictability in stimulating components of the Economic Cycle.

Figure 2



C. Conclusion

Looking into our recent history, membership of the IEIs has increased considerably and this could only have happened if these countries were convinced that being a member of these organisations they can reap more advantages than opting to staying out or not having any other options. If countries want to be part of globalization and want to reap the possible benefits of welfare gain, then they become part of the IEI network.

There could be many reasons for sovereign states becoming part of a global regime and compromising their independent decision-making. States join IEIs of their own free will. They

only do it because they think that the overall advantages of staying in an organisation are more than those of staying out.²³¹

Four of explanations are often theorised for the existence of these IEIs²³²: firstly, limiting the dominant powers. According to Ikenberry, they facilitate to control the behaviour of the most dominant countries.²³³ By making and then act in accordance with rules of the game laid by the IEIs, the dominant countries reassure weaker countries that they will not exploit of them.

Secondly, IEIs provide information and reduce transaction costs. International institutions promote agreements by increasing the expected costs of not following the agreements. IEIs are comparatively efficient institutions since their principles and rules form a connection between issues which gives states an incentive to reach mutually beneficial agreements.²³⁴ Or, in other words, IEIs constrain economic behaviour in ways that rule out actions that, if widely practised, would be economically costly.²³⁵

Thirdly, institutions promote reciprocity amongst members. The concept of reciprocity and mutuality is of significant importance in an institution. In other words, the IEIs promote the concept of cooperation for collective gain which gives each (or the majority) of its constituents a sense of contribution towards the collective good.

²³¹ As Gruber contends, if the most dominant country outline the options open to the developing countries and create multilateral institutions, all countries can relatively benefit by becoming part of these organisations, than in a situation in which no institution existed. Gruber, L., (2000) 'Ruling the World: Power Politics and the Rise of Supranational Institutions', Princeton: Princeton University Press.

²³² Milner mentioned four common reasons to join international institutions. Milner, Helen V. (2005). 'Globalization, Development, and International Institutions: Normative and Positive Perspectives', Perspectives on Politics, Vol. 3 , p 833-854.

²³³ Ikenberry, G. J., (2001) 'After Victory: Institutions, Strategic Restraint, and the Rebuilding of Order After Major Wars', Princeton: Princeton University Press.

²³⁴ Keohane, Robert O. (1984) 'After hegemony: Cooperation and discord in the world political economy', chapter 6, Princeton, N.J.: Princeton University Press.

²³⁵ Nelson, Richard R. and Sampat, Bhaven N., (2001) 'Making Sense of Institutions as a Factor Shaping Economic Performance', (Spanish Version), Revista de Economía Institucional, Vol. 3, No. 5, Second Semester, available at SSRN: <http://ssrn.com/abstract=923637>

Fourthly, it facilitates countries in reforming their domestic politics. By becoming a member of an IEI and overtly committing to follow its rules of the game has significant impact on the domestic politics. It can possibly assist local leaders to modify their rigid domestic policies which they otherwise would not be able to do and can support them lock in “good” policies. Thus it reduces the possibility of any state changing their economic policies arbitrarily.

Having said all of the above, regarding the rationale and benefits for the existence of IEIs, there is always the other side of the coin. Currently, the IEIs may not be the most optimal entities for creating the rules of the game for the global economy. They have deficiencies and this fact needs to be addressed by the IEIs or their constituents. For example, consensus rule-making in the WTO is good from some aspects, but practically it nearly standstills the rule-making process as the Contracting Parties fail to develop consensus (Doha Round is a clear example).

In the case of the IMF and the World Bank, developing countries have no say in their operation. These institutions lead the global monetary and financial regime. The voting system needs to be addressed in these institutions. Almost all the sovereign states approach these IEIs, even when they don't like them, simply because they have no other option.

III. Historical Background and Evolution of IELR

The IELR which represents and controls the rules of the game of the current global economy has evolved over a long period of time. As discussed in the preceding chapter, the IELR emerged as a result of cooperation between sovereign states with a view to tackling issues which could no longer be dealt with by domestic law. Moreover, it was not the first time the sovereign states had tried to cooperate for the collective interest, the most recent example in history being the League of Nations.

To understand the essence of the current IELR, it is important to understand the historical background of the current regime and the way in which it evolved to its current stage. The historical background and evolution allow us to analyse the current regime in the context of its evolving nature, which provides room for criticism and adaptability within the IELR. This chapter talks in depth about the historical background and evolution of the current regime that is the IELR. It starts from World War I and then looks at the creation of the Bretton Woods system which is now a major part of the IELR. The focus is on the formation of the WTO as part of an evolutionary process which started with the ITO, then to GATT and then the WTO. The IMF and World Bank are not addressed in particular detail in this chapter because they did not go through any major structural changes. However, the practices and the scope of these two IELRs has evolved (or rather, has expanded) since their creation. These changing roles are discussed in Section Two of this thesis (which talks in detail about the IMF).

A. Historical Background

To understand the origins of the IELR, this part of the chapter begins by looking at the period of time just before World War I, when, even with high tariffs and the desire of many countries to become self-sufficient²³⁶, the volume of international trade prior to 1913 increased considerably.²³⁷ This growth in international trade was mainly due to two factors. Firstly, prices were rising which made tariffs relatively less obstructive; secondly, tariffs were also moderated by a series of commercial treaties.²³⁸ Thereafter, in June 1914, World War I broke out which brought an abrupt end to this growth in commerce. Countries which were engaged in World War I concentrated on the war works and ignored their commercial trade. The non-participating countries of World War I were also affected as their trade came to a halt because they could not get the ships to carry their goods even if they could have found prospective buyers. Thus, World War I generated a condition of economic isolation for countries all over the world and this isolation can be easily explained by not having any IEL or firm rules of the game in the economic scenario. The reason for the current IELR locking its constituents into commitments originates from lessons learned from history.

²³⁶ The concept of economic nationalism, to become self-sufficient in military and economic aspect, was quite popular before World War II. For details see Berend, Ivan T., (Mar., 2000) 'The Failure of Economic Nationalism: Central and Eastern Europe before World War II', *Revue économique*, Vol. 51, No. 2. And also see Rappard, William E., (Oct., 1933) 'Nationalism and the League of Nations Today', *The American Political Science Review*, Vol. 27, No. 5, p. 721-737.

²³⁷ International trade increased by threefold since 1888-1913. See Layton, W. T., (Mar., 1927) 'The Forthcoming Economic Conference of the League of Nations and Its Possibilities', *Journal of the Royal Institute of International Affairs*, Vol. 6, No. 2, p.69-87.

²³⁸ Many commercial treaties were signed by leading trading countries for the reduction of trade related tariffs. Of those commercial treaties some were relatively important than others. Such as; the Reciprocity Treaty between Canada and United States in 1854. For detail see Ankli, R., (1971) 'The Reciprocity Treaty of 1854', *Canadian Journal of Economics*, Vol. 4, p.1-20. The Cobden-Chevalier Treaty between Britain and France in 1860 and Treaty of Commerce and Navigation between Japan and United Kingdom in 1884. See for details: Pahre, R., (2008) 'Politics and Trade Cooperation in the Nineteenth Century: The Agreeable Customs of 1815-1914', Cambridge University Press.

The Treaty of Versailles, which was signed on 28 June 1919, marked the end of World War I. Even after World War I, international trade showed a marked decline for some considerable period due to sentiments of economic nationalism²³⁹ which resulted in the imposition of a complete prohibition of trading and deliberate barriers to transportation. The League of Nations [hereinafter the “League”], which came into being on 10 January 1920 as an international organisation was, in fact, a result of the Treaty of Versailles. The League’s main task was to ensure world peace and stability both in a political and economic sense.

The League was an organised attempt at cooperation between the sovereign states for collective gain. In setting the rules of the game context, the League held a number of conferences which were of quite marked significance. Of those conferences, the Brussels Financial Conference in 1920, the Genoa Conference in 1922 and the Economic Conferences of 1927 and 1933 were of relatively greater importance. The Brussels Financial Conference in 1920 established the Financial and Economic Commission²⁴⁰ in order to reconstruct the international economic system and the Commission worked with official committees and distinguished experts who undertook several initiatives to bring about financial and economic stability. Moreover, the Financial and Economic Commission also played a remarkable role in the reconstruction of Austria and Hungary.²⁴¹

The Brussels Conference, on the other hand, established a code and set of standards in relation to currency and finance matters in the international context. The Brussels Conference played a

²³⁹ See footnote no 236 for economic nationalism.

²⁴⁰ The Financial and Economic Commission was founded at the Brussels Financial Conference of 1920. [http://www.unog.ch/80256EE60057D930/\(httpPages\)/03F1E1DD124D3276C1256F32002EE3AB?OpenDocument](http://www.unog.ch/80256EE60057D930/(httpPages)/03F1E1DD124D3276C1256F32002EE3AB?OpenDocument)

²⁴¹ See Layton, W. T., (Mar., 1927) ‘The Forthcoming Economic Conference of the League of Nations and Its Possibilities’, *Journal of the Royal Institute of International Affairs*, Vol. 6, No. 2, p.79-80. [http://www.unog.ch/80256EE60057D930/\(httpPages\)/03F1E1DD124D3276C1256F32002EE3AB?OpenDocument](http://www.unog.ch/80256EE60057D930/(httpPages)/03F1E1DD124D3276C1256F32002EE3AB?OpenDocument)

significant role in bringing together, for the first time, European bankers and financiers to develop a common viewpoint on the problems of European finance.²⁴²

The Brussels and Genoa Conferences, which were very important in the context of monetary stability, were convened in 1920 and 1922 respectively. The Genoa Conference was significant in the context of the reconstruction of the international monetary system²⁴³; it assembled all the major gold-standard²⁴⁴ countries, other than the United States America [hereinafter the “US”] who maintained the status of an observer in all the League’s conferences.

Unfortunately, all the initiatives of the League failed to bring about international economic stability. The failure of the League can be attributed to various factors, one of which was the self-imposed isolation of the US. Although the US emerged as the world’s leading industrial power after World War I, it resisted taking responsibility for the development of international economic relations.²⁴⁵ One of the key reasons for the non-participation of the US in the League can arguably be attributed to its fear that the existing members of the League would insist on the cancellation of their respective war debts in order to ensure economic stability.²⁴⁶

As discussed earlier in the theoretical framework, the regime is initiated by the hegemon. Moreover, the hegemon’s involvement in the initial running of the regime is essential. Thus, the lack of involvement by the US (a relatively dominant power) in the League ultimately resulted in the weakening of the international system established after World War I. All the major initiatives

²⁴² See generally for the details of the Brussels Conference. Siepmann, H.A., (Dec., 1920) ‘The International Financial Conference at Brussels’, *The Economic Journal*, Vol. 30, No. 120, p. 436-459.

²⁴³ For history of Genoa Conference, see Fink, C., (1984) ‘The Genoa Conference: European Diplomacy, 1921 – 1922’, Chapel Hill: University of North Carolina Press. Also see Harris, W., (Sep., 1922) ‘The Genoa Conference’, *Journal of the British Institute of International Affairs*, Vol. 1, No. 5, p 150-158.

²⁴⁴The gold-standard is a system in which paper notes are medium of exchange which can be easily exchanged for specific quantities of gold. [Bradford, DeLong, J., (1996) ‘Slouching towards Utopia?: The Economic History of Twentieth Century’, University of California at Berkeley and NBER]

²⁴⁵This is the theme of the author in Kindleberger, Charles P., (1973) ‘The World in Depression, 1929-39’, Berkeley, CA: University of California Press.

²⁴⁶ See Kenen, Peter B., (1994) ‘Managing the World Economy: Fifty Years After Bretton Woods’, Institute for International Economics, p. 9.

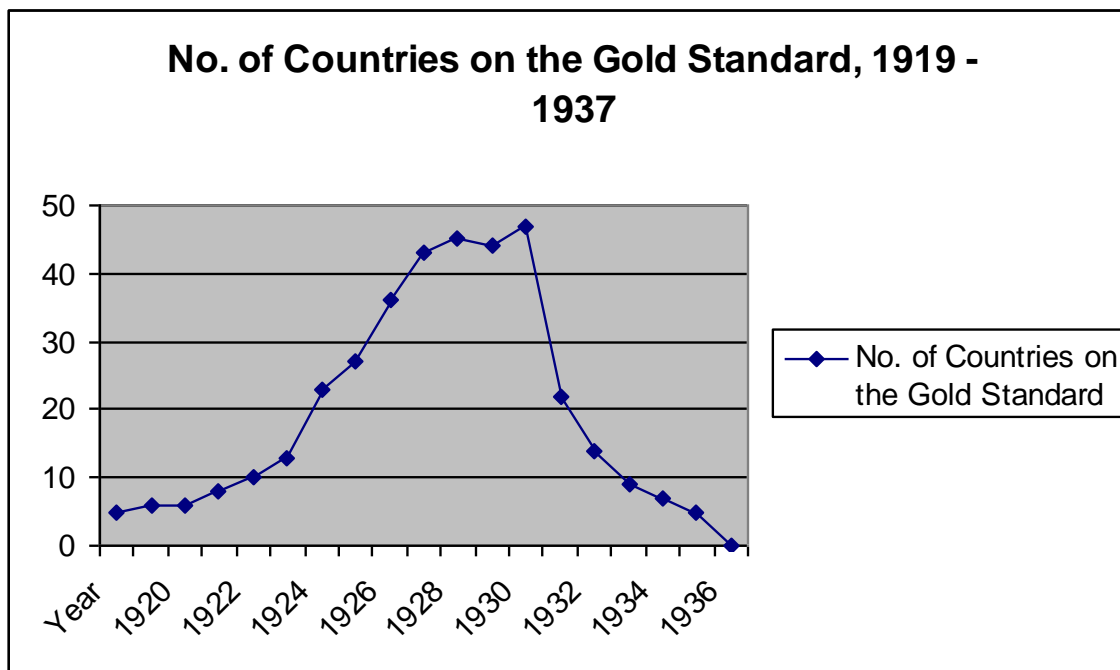
instigated by the League to bring stability in the international economic scenario were in the form of conferences to gather together all the major elements concerned (i.e. bankers, investors, government officials, etc.). Unfortunately, no definite rules were laid down, as an outcome of these conferences, to act as a guide for the international economic policies of the 1920s. Moreover, no institution was established to coordinate or cooperate in the process of the stabilisation of currencies. According to Flandreau²⁴⁷, the inadequate cooperation of the central banks was due to the absence of an institution during the 1920s, which, in turn, caused the breakdown of the inter-war gold standard and eventually contributed towards the Great Depression²⁴⁸. The international monetary system, during the inter-war period, moved towards the gold standard initially (i.e. until 1931) and then, there was a sharp transformation from gold to a gold-exchange²⁴⁹ standard.²⁵⁰ The absence of an international monetary institution resulted

²⁴⁷See Flandreau, M., (1997) 'Central Bank Cooperation in Historical Perspective: A Skeptical View', *Economic History Review*, Vol. 50, p. 735-63. In the same sense, see also Eichengreen, B., (2004) 'Understanding the Great Depression', *The Canadian Journal of Economics*, Vol. 37, No. 1, p. 12 and Moure, K., (2002) 'The Gold Standard Illusion: France, the Bank of France, and the International Gold Standard, 1914-1939. New York: Oxford University Press.

²⁴⁸ The Great Depression started in USA when the stock market collapsed on 24 October 1929 and all the investors lost faith in the American economy. Almost 25% of the US's total work force was left unemployed, moreover, those were able to keep their jobs had to work for 43% less pay between 1929 and 1933. It is considered as the worst economic and social calamity in the history of US. The US had considerable economic weight in the world economy at that time and that is why this great contraction of US economy affected the global economy so severely. [See Kenwood, A.G. and Lougheed, A.L., (2000) 'The Growth of the International Economy 1820-2000', p. 226] Economists and the economic historians are of the opinion that every feature of the international economy in the 1920s contributed to the Great Depression. The origins of the Great Depression must be sought in internal economic conditions, especially in the US; the reason it spread throughout the world and was so severe can be traced to three factors. First, relative overproduction in some branches of agriculture following World War I led to a relative fall in primary product prices and weakened the demand for the manufactured goods exported by the advanced countries. Second, the trend towards increased protection evident in the post-1918 period, particularly in the newly created countries in Europe, but also present in primary producing countries overseas and in the US. This reversed the trend towards increasing specialisation that had been present prior to 1914 and disrupted patterns of international trade. The third and most important factor was the disruption of the pre-war pattern of equilibrium in international payments as a result of war debts and reparations, the changed relative position of the US and the UK in international markets, and the restoration of the gold standard with undervalued and overvalued exchange rates which made it increasingly vulnerable to large flows of short-term capital. [See Barber, Clarence L., (Jan., 1978) 'On the Origins of the Great Depression', *Southern Economic Journal*, Vol. 44, No. 3, p. 432-456, p. 434.]

²⁴⁹A gold exchange standard is a mixed system of a reserve currency standard and a gold standard. In general it includes the following rules. First, a reserve currency is chosen. All non-reserve countries agree to fix their exchange rates to the reserve at some announced rate. Second, the reserve currency country agrees to fix its currency value to a weight in gold. Finally, the reserve country agrees to exchange gold for its own currency with other

in governments all over the world stabilising their currencies individually, thereby creating additional uncertainty in the international economic scenario.



Source: Palyi, Melchior. *The Twilight of Gold 1914-1936 Myths and Realities*. (1972). Table no. VI-1 at p. 116.

Figure 3

The League was not a successful institution both from a political and economic perspective, and, finally, it became practically ineffective when it could not prevent the invasions by Japan and Italy of Manchuria and Ethiopia, respectively, inaction which contributed to World War II. By this time, countries had lost all confidence in the League and were not willing to delegate authority regarding their commercial policy to any of its departments.

central banks within the system, upon demand. One key difference in this system from a gold standard is that the reserve country does not agree to exchange gold for currency with the general public, only with other central banks. (In a reserve currency system, another country's currency takes the role that gold played in a gold standard. In other words a country fixes its own currency value to a unit of another country's currency.)
<http://internationalecon.com/Finance/Fch80/F80-4.php>

²⁵⁰ See the figure below.

After the failure of the League, a vacuum was created for the emergence of a new regime and the dominant powers of that time took the lead and developed a new regime. These developments, which are discussed below, became the foundation for the evolution of the IELR.

B. Evolution of IELR

During World War II, the two leading economies and most dominant powers, the US and the United Kingdom [hereinafter the “UK”], started putting their efforts into building a new world trading order. Both countries, in August 1941 and February 1942, signed two very important agreements, the Atlantic Charter²⁵¹ and the Lend-Lease²⁵² respectively, in the context of international trade. In both these agreements, the governments agreed to include the principles of non-discrimination and free trade in their post-war commercial policies.

Following the end of World War II, the planners of the new international economic order (the US and the UK) primarily focused on establishing international institutions which would promote policies that would avert repetition of the inter-war economic scenario. As discussed earlier in this chapter, one of the main reasons for world political and economic instability during the inter-war time was the self-imposed isolation of the US. This instability resulted in World Wars I and II and the Great Depression. However, the US had learnt its lesson from the past and was now actively taking part in the international economic scenario. In this context, the US held a conference in July 1944 at Bretton Woods, New Hampshire, US [hereinafter the “Bretton Wood Conference”]²⁵³, the main objectives of which was to design a stable international

²⁵¹ For details see Brinkley, D. and Facey-Crowther, David R. (eds.), (1994) ‘The Atlantic Charter’, New York: St. Martin’s Press. And also visit: <http://www.un.org/aboutun/charter/history/atlantic.shtml>

²⁵² For details see Spencer, R. and Wood, Laurence I., (Jun., 1944) ‘The Lend-Lease Program and Post-War Patent Claims’, University of Pennsylvania Law Review and American Law Register, Vol. 92, No. 4, p. 372-390.

²⁵³ Matsushita, M., Schoenbaum, Thomas J. and Mavroidis, Petros C., (2006) ‘The World Trade Organisation : Law, Practice, and Policy’, Vol. 1, available at http://www.wto.org/english/thewto_e/whatis_e/tif_e/utw_chap1_e.pdf

monetary system, the reconstruction of World War II affected countries, the reduction of tariffs and the removal of quantitative controls on international trade.²⁵⁴

The Bretton Woods Conference was the origin of the current regime, i.e. the IELR, since it resulted in organised cooperation between sovereign states which later evolved into the IELR. The sovereign states signed agreements to set up the International Bank for Reconstruction and Development [hereinafter the “World Bank”] to enable the reconstruction and recovery of Europe after World War II so as to achieve full employment, and also to establish the International Monetary Fund [hereinafter the “IMF”] to attain a stable international monetary system. These two IEIs later proved to be significant in the global economic order.

The IMF and the World Bank are very significant contributors in the setting of the rules of the game within the present global economy. These institutions have not undergone any major organisational/institutional changes since their creation; however, these institutions did go through changes in their institutional roles. These institutional roles (as discussed in the theoretical framework) are the essence of the IELR. Whilst the institutional role of both these IEIs is discussed in detail in Section Two of this thesis, a brief historical summary of the evolutionary role of these IEIs is discussed below.

1. Main events in the history of the IMF²⁵⁵

As a result of the Bretton Woods Conference, the IMF was created in 1945, and in 1947 it started its work. Initially, 29 countries joined the IMF but over a short period of time, its membership increased substantially.

²⁵⁴ See O’Rourke, Kevin H. (ed.) ‘The International Trading System, Globalization and History’, Vol. 1, p. 130.

²⁵⁵ For further details about the IMF history visit: <http://www.imf.org/external/about/history.htm> and for detail IMF chronology visit: <http://www.imf.org/external/np/exr/chron/chron.asp>

The system introduced at this time by the IMF was the Par value system²⁵⁶ for exchange rates. Under this system, the USD was made the reserve currency. All the countries pegged their currencies with the USD and the US pegged its currency with gold. This system is also referred to as the Bretton Woods system. As already discussed, the US was the most dominant power after World War II and so everything revolved around the US.²⁵⁷ In 1971, the US temporarily suspended the USD's convertibility into gold and in 1973, the par value system collapsed and a floating exchange rate system was introduced. In this system, countries pegged their currencies with another currency or currencies.

The realist attitude of the US in terms of the functioning of the IMF has been quite evident ever since its inception. The IMF evolved according to the direction decided by the US treasury. This realist approach of the US is still present in the IMF; the global economy has evolved into a liberally institutionalised economy but the IMF is still constitutionally a realist IEI. One important question arises at this stage: how has the IMF remained realist in a liberal global economic scenario? The answer to this question can easily be found in the history of the global economy. Events (mainly the crisis) in economic history kept the IMF alive and needy sovereign states ignored its realist aspect.

The oil crisis in the 1970s²⁵⁸ resulted in an international debt crisis. Most of the oil-importing countries borrowed from commercial banks, and the interest rate surged in those industrial countries trying to control inflation which, in turn, led to a worldwide debt crisis. As the crisis

²⁵⁶ Katz, Samuel I. (1971). "The case for the par-value system, 1971," International Finance Discussion Papers 4, Board of Governors of the Federal Reserve System (U.S.).

²⁵⁷ See generally, Woods, Ngaire (2006), *The Globalizers: The IMF, the World Bank and Their Borrowers*, Cornell University Press, Ithaca.

²⁵⁸ For a good discussion about the oil crisis see generally, Barsky, R.; Kilian, L. (2004). "Oil and the Macroeconomy Since the 1970s". CEPR Discussion Paper No. 4496 1001: 48109–1220; also see, Hammes, David and Douglas Wills (2005). "Black Gold: The End of Bretton Woods and the Oil-Price Shocks of the 1970s," *The Independent Review*, v. IX, n. 4. pp. 501-511.

emerged, many countries approached the IMF for financial assistance which enormously increased the importance of IMF, and countries did not question its expansionary functioning based on implied powers. Furthermore, needy countries ignored the hegemonic influence of the US and its allies (mainly EU).

After the fall of the Soviet Union, the IMF's membership increased and the former Soviet bloc became clients of the IMF in terms of assistance (policy advice, technical assistance, and financial support) with regards to their transformation into market driven economies.²⁵⁹

Then came the Asian Financial Crisis²⁶⁰ which further enhanced the importance of the IMF in the global economic scenario. The IMF, with the passage of time, expanded its functioning through its implied power and filled the gaps in the global economic structure. During this time, the IMF remained very active in helping member countries and in doing so, developed a speciality in an area that was not matched by any other IEI. Thus, no country openly challenged the realist approach of the IMF. Moreover, it appears that the IMF has been used in support of US's foreign relations.²⁶¹ (Moreover, the IMF has been used as a US foreign policy tool.)

At the time of inception of the Bretten Woods institutions (IMF and World Bank) USA and Europeans developed an understanding on the bases of Gentleman's Agreement that Europe occupying the MD post of the IMF and the US having the lead in the World Bank. Although the

²⁵⁹ For a details discussion about the transition of Soviet Bloc see generally, Aslund, Anders (2002). *Building Capitalism: the transformation of the former Soviet bloc*. Cambridge, UK; New York: Cambridge University Press.

²⁶⁰ For Asian Financial Crisis see generally, Goldstein, Morris (1998), *The Asian Financial Crisis: Causes, Cures, and Systemic Implications Policy Analyses in International Economics* 55. Also see, Radelet, Steven, and Jeffrey D. Sachs, (1998) "The East Asian Financial Crisis: Diagnosis, Remedies, Prospects," *Brookings Papers on Economic Activity*, (1), 1-74.

²⁶¹ See generally, Thacker (1999), who presents statistical evidence that suggests that the IMF is more likely to lend to countries whose foreign policies shift towards U.S. foreign policy preferences. [Thacker, Strom C. (1999). "The High Politics of IMF Lending," *World Politics* 52, 38-75]; see also, Oatley, T., & Yackee, J. (2000). *Political determinants of IMF balance of payments lending: The curse of the carabosse?* IMF Working Paper 2000. IMF; see also, Momani, Bessma (2004). *The IMF, the U.S. War on Terrorism, and Pakistan Asian Affairs* Vol. 31, No. 1 (Spring, 2004), pp. 41-50

US was the most dominant power after the WWII, but in order to keep the interest of other important partners the US was not able to retain the top most post of both the Bretten Woods institutions. US opted for the World Bank because the majority of the World Bank funds were provided by the US private capital market. Therefore, in order to keep confidence of the US investors and it opted for the top post of the World Bank.

However, US dominance could be judged by the fact that the US kept its US dollar as reserve currency in the IMF. Moreover, the post of deputy MD of the IMF was created in 1949 and the nomination for this post was left with the US.

After the creation of EU the US is not the only one to have the veto power because collective votes of EU members are also more than 15% of the total votes of the IMF. Thus, in current international economic scenario, the Bretten Wood institutions are constitutionally dominated by the US and its allies (mainly EU).

The Gentlemen's Agreement is the longstanding convention between the US and Europe which divide the World Bank presidency and the IMF managing directorship between US and Europe. According to this convention Europe takes the top most post of the IMF and the US nominates the World Bank's president. The Europeans, specifically Germany, construes the convention as symmetric: the US is not questioned about its nominee for the World Bank presidency; Europe is entitled the same treatment for its candidate at the IMF.²⁶²

The only guidance for selection of the managing director in the Articles of Agreement of the IMF is given in Article XII, Section 4: "The Executive Board shall select a Managing Director who shall not be a Governor or an Executive Director. . . . The Managing Director shall cease to

²⁶² Diagnosis: Selection at the International Monetary Fund and World Bank, in *Leadership Selection in the Major Multilaterals*, p 19.

hold office when the Executive Board so decides.”²⁶³ The World Bank and the IMF are not administered by formal consensus decision making. In practice, informal weighted voting calculation, which is also referred as straw voting, is done to find out level of support.²⁶⁴ Once sufficient support of a candidate is evident then the other candidates withdraw and formal voting is circumvented.

US backing for the nomination of a European as MD did not preclude the US’s dominance at the IMF. The post of deputy managing director was created in 1949 and a new convention created that the post would be occupied by a US contender in order to make sure a keen eye on IMF functioning. Moreover, the US was notably active in the selection process of the early MDs. Although IMF’s MDs were Europeans, they should be Europeans approved by the US.²⁶⁵ Due to intra-European competition, in recent selections, the decisive choice rests with non-European members of the IMF. However, the result was quite uniform that is every MD was a European national.²⁶⁶

2. World Bank

The World Bank was created to finance the reconstruction of countries affected by World War II. However, over a period of time, it has evolved into a development institution, working in close cooperation with its other partners all of whom are part of the World Bank Group. These independent institutions, other than the World Bank, include the International Development

²⁶³ Gold, Joseph (1972), *Voting and Decision in the International Monetary Fund: An Essay on the Law and Practice of the Fund*, IMF, Washington DC, p14.

²⁶⁴ *Diagnosis: Selection at the International Monetary Fund and World Bank*, in *Leadership Selection in the Major Multilaterals*, p 23.

²⁶⁵ *Diagnosis: Selection at the International Monetary Fund and World Bank*, in *Leadership Selection in the Major Multilaterals*, Institute of International Economics, Washington, DC, p 25.

²⁶⁶ *Diagnosis: Selection at the International Monetary Fund and World Bank*, in *Leadership Selection in the Major Multilaterals*, Institute of International Economics, Washington, DC. p 24.

Association (IDA)²⁶⁷, the International Finance Corporation (IFC)²⁶⁸, the Multilateral Guarantee Agency (MIGA)²⁶⁹, and the International Centre for the Settlement of Investment Disputes (ICSID)²⁷⁰.

Historically, the World Bank did not undergo any structural changes. However, the tug of war between the US's influence in the running of the World Bank and that of the rest of the world required special attention.²⁷¹ This thesis only takes into account the World Bank (formally the IBRD)'s historical evolutionary role and the main approach involved in its running (realist or liberal). The other institutions under the World Bank Group are also important but are separate institutions in themselves, and therefore fall outside the scope of this thesis.

As mentioned in the preceding discussion on the evolving function of the IMF, the World Bank and the IMF were established mainly by the US and the UK. However, history speaks loudly that the World Bank was largely an American creation.²⁷² Moreover, the realist involvement of the US in the functioning of the World Bank is clearly evident from history.

Some scholars assert that the World Bank “was not created neutral.”²⁷³ The World Bank functioned to uphold the views of the US as to how the world economy should be organised, where to allocate resources, and in decisions about investment. Even though the earliest directors insisted upon moving the World Bank's head office from the US, they kept quiet once the US

²⁶⁷For further details about IDA visit: <http://www.worldbank.org/ida/>

²⁶⁸For further details about IFC visit: <http://www.ifc.org/>

²⁶⁹For further details about MIGA visit: <http://www.miga.org/>

²⁷⁰For further details about ICSID visit: <http://icsid.worldbank.org/ICSID/Index.jsp>

²⁷¹For a detailed discussion about the history of the World Bank, see generally, Kapur, Devish; Lewis, John. P.; and Webb, Richard (1997).*The World Bank: Its First Half Century, Volumes I & II*. Washington, DC: The Brookings Institution.

²⁷²The US role as the primary in the creation of the World Bank was acknowledged by the John Maynard Keynes in his speech at the Bretton Woods Conference. Mason, Edward, and Robert E. Asher (1973). *The World Bank Since Bretton Woods*. Washington, D.C., Brookings Institution, p13. And see also, Kapur, Devish; Lewis, John. P.; and Webb, Richard (1997).*The World Bank: Its First Half Century, Volume II*. Washington, DC: The Brookings Institution, p196.

²⁷³Bergsten, C. Fred (1980). Working paper of the Study on International Financial Institutions, Council on Foreign Relations. New York, p4.

made it clear that this would never happen.²⁷⁴ Moreover, all files regarding World Bank loans initially went to the Director from the US and then to the World Bank staff.²⁷⁵

In the late 1950s and early 1960s, there was a major shift from the reconstruction of countries affected by war to the development of less-developed countries. This shift was not an easy one but circumstances led the way to the formation of two affiliates of the World Bank, the IDA and IFC. The US used these as an instrument for its foreign policy and in the Cold War time, the US used these institutions to keep countries away from Soviet influence. After the fall of the Soviet Union, the World Bank invested considerably in the former Soviet Bloc. In short, the functioning of the World Bank has been heavily influenced by the hegemonic decision-making of the US. If any country wishes to benefit from the World Bank, it first needs to come into the orbit of the US's foreign policy.

The IMF and the World Bank did not go through any major institutional structural evolution, thus they have been briefly discussed in their historical context. However, the next part of the chapter discusses the evolution of the WTO which underwent major institutional structural change.

3. Creation of the WTO

The idea was also put forward at the Bretton Woods Conference of forming an international trade organisation. In this context, the US performed a key role and in December 1945, its State Department drafted the multilateral accord on the rules for international trade. These rules were seconded by the UK and were later proposed to other countries.

²⁷⁴ Kapur, Devish; Lewis, John. P.; and Webb, Richard (1997). *The World Bank: Its First Half Century*, Volume II. Washington, DC: The Brookings Institution, p198.

²⁷⁵ Sommers, Davidson (1960). Address to Professional Staff Meeting on "The Early Days of the Bank." Washington, p5. Also see, Kapur, Devish; Lewis, John. P.; and Webb, Richard (1997). *The World Bank: Its First Half Century*, Volume II. Washington, DC: The Brookings Institution, p199.

On 1 January 1942, the US President, Franklin Delano Roosevelt, UK Prime Minister Sir Winston Leonard Spencer Churchill, Maxim Litvinov, of the USSR, and T. V. Soong, of China, signed a short document which came to be known as the United Nations Declaration [hereinafter the “Declaration”] and the very next day, representatives of twenty-two other nations added their signatures to this Declaration. The Declaration was formed in the light of the principles of the Atlantic Charter. According to the first clause of the Declaration, all the signatory nations had to subscribe to a common agenda of purpose and principles as stated in the Atlantic Charter.²⁷⁶

Three years later, the US President called a conference in San Francisco (US) and invited only selected countries²⁷⁷ i.e. those which had announced war on Germany and Japan by March 1945 and subscribed to the Declaration. The main purpose of this conference was the formation of an international organisation to facilitate cooperation in international law, international security, economic development, social progress and human rights. As a result of the San Francisco conference, on 24 October 1945, the United Nations [hereinafter the “UN”] came into existence. The existing and ongoing multilateral trade negotiations, to form an international trade organisation, were brought under the umbrella of the UN. The above-mentioned negotiations were dealt with within the framework of the UN’s Economic and Social Council [hereinafter “ECOSOC”]. ECOSOC, established under the UN Charter was the principal body for coordinating the economic, social, and related works of the 14 UN special agencies, functional commissions and five regional commissions.²⁷⁸ In 1946, ECOSOC adopted a resolution in favour

²⁷⁶ Available at: <http://www.un.org/aboutun/charter/history/>

²⁷⁷ The states which signed the Atlantic Charter were: Great Britain, Canada, Australia, New Zealand and the Union of South Africa and of the exiled governments of Belgium, Czechoslovakia, Greece, Luxembourg, the Netherlands, Norway, Poland, Yugoslavia, Mexico, Philippines, Ethiopia, Iraq, Brazil, Bolivia, Iran, Colombia, Liberia, France, Ecuador, Peru, Chile, Paraguay, Venezuela, Uruguay, Turkey, Egypt, Saudi Arabia, Syria, Lebanon

²⁷⁸ <http://www.un.org/ecosoc/about/>

of forming an International Trade Organisation [hereinafter “ITO”] for the development and coordination of world trade.²⁷⁹

In Geneva, in 1947, a meeting was held to discuss international trade. In this meeting, three main targets were set out: firstly, to draft a charter for the ITO; secondly, to prepare a schedule for the reduction of tariffs; and thirdly, to formulate a multilateral treaty related to the general principles of trade and tariffs [hereinafter “GATT”]. It was at the UN Conference on Trade and Employment held in March 1948 in Havana that the ITO charter was finalised as well as ratified. The scope of the ITO charter was wide; it included all matters relating to international trade and international economic activity, with rules covering not just commercial policy but also employment, commodity agreements, restrictive business practices, and international investment.²⁸⁰ The main features of the ITO included principles of non-discrimination, the promotion of free trade and the fact that decision-making power was with the majority of the members, each with one vote.²⁸¹

Unfortunately the ITO never entered into force as critical US support was not granted. The Republicans²⁸² won control of Congress in 1948 and they were not in favour of the ITO, as they thought that the ITO would involve itself in the internal economic issues of the US. Thus, the ITO charter was repeatedly submitted to the US Congress for its approval but still did not see the light of day.²⁸³ The Executive Committee of the US, the Council of the International Chamber of Commerce, also condemned the draft of the ITO charter, as quoted by Diebold²⁸⁴,

²⁷⁹ Van den Bossche, P. (2005) ‘The Law and Policy of the World Trade Organisation’, Vol. 80.

²⁸⁰ See O’Rourke, Kevin H. (ed.) ‘The International Trading System, Globalization and History’, Vol. 1, p. 131.

²⁸¹ Article 1 and 75 of ITO Charter. Available at <http://www.yale.edu/lawweb/avalon/decade/decad057.htm>

²⁸² A Political Party in United States.

²⁸³ Kenen, P.B. (2000) ‘The International Economy’, Vol. I, No. 376

²⁸⁴ Diebold, William Jr., (1952) ‘The End of the ITO’, Essay in International Finance, No. 16, International Finance Section, Department of Economics, Princeton University, p. 20-21

"[it is a] dangerous document because it accepts practically all of the policies of economic nationalism; because it jeopardizes the free enterprise system by giving priority to a centralized national governmental planning of foreign trade; because it leaves a wide scope to discrimination, accepts the principles of economic insulation, and in effect commits all members of the ITO to state planning for full employment."

During internal opposition to the ITO charter, the US was busy with other more important issues relating to its foreign affairs policy. Such as the Marshall Plan²⁸⁵ in 1948, the North Atlantic Treaty Organisation²⁸⁶ in 1949, and the Korean War in 1950. So finally, Harry S. Truman (the US President who succeeded President Franklin D. Roosevelt) gave up and announced on 6 December 1950 that the ITO would not be submitted for Congressional approval. The US officially abandoned the initiative on the ITO and the abandonment of the ITO by other countries was the natural corollary. As discussed earlier in this chapter,²⁸⁷ this was a result of the lack of US consent and backing which was necessary for the practical existence of any international institution which required its involvement.²⁸⁸

The US, being the hegemon in the World at that time, led every important matter. As discussed in the theoretical framework, involvement of the hegemon is essential for initiating a regime, therefore, when the US backed out of the creation of the ITO, then it was clearly evident that the formation of the ITO would be completely sabotaged.

²⁸⁵ Marshall Plan 1948 a US plan (named after US' Secretary of State George C. Marshall). It was a recovery plan for Europe by industrialisation and extensive investment into the region. It was also a stimulant to the U.S. economy by establishing markets for American goods. <http://www.state.gov/r/pa/ho/time/cwr/16328.htm>

²⁸⁶ Hereinafter "NATO." In April 1949, the US, Canada and ten West European countries, sign the Washington Treaty, which creates the NATO, formed an alliance which brings together free and sovereign countries in order to create a collective security system. The primary objective of the collaboration is mentioned in Article 5 which states that "an armed attack against one or more of them in Europe or North America shall be considered an attack against them all." For further details visit: <http://www.nato.int/docu/update/45-49/1949e.htm>

²⁸⁷ See Historical Background on page 95

²⁸⁸ The US had an extraordinary position in the global political system. In terms of GDP, the simplest measure of international power, US at the end of the World War II was three times larger than the Soviet Union and six times larger than the UK. The US was the world's largest producer of food, petroleum and electricity. Its technological capabilities were unparalleled and it also had the world's largest navy and monopoly of nuclear weapons until 1949. See Krasner, Stephen D., (Dec., 1979) 'The Tokyo Round: Particularistic Interests and Prospects for Stability in the Global Trading System', International Studies Quarterly, Vol. 23, No. 4, p. 491-531, p. 493.

Fortunately, the collapse of the ITO did not extinguish the only means of liberalising world trade policies. Work on GATT was completed before the preparation of the ITO charter. Thus, the negotiating countries (23 in total)²⁸⁹ adopted the protocol of a provisional application of GATT which became effective on 1 January 1948. According to this protocol, the negotiating countries agreed to reduce tariffs amongst themselves. The GATT was primarily about mutual and reciprocal advantage in trade, and did not require Congressional approval, as the agreement (GATT) was covered under the 1934 Reciprocal Trade Agreements Act.²⁹⁰

GATT was viewed as an intermediate measure towards implementing the ITO and accelerating the reduction of tariffs on world trade pending the finalisation of the ITO. GATT was never designed to exist as an institution by itself, but was only meant to serve as a temporary agreement until it could be absorbed into the ITO structure. The failure to establish the ITO meant the absence of the “third pillar”²⁹¹ of the Bretton Woods economic structure. Over the years, GATT gradually filled the gap for an international trade organisation. The signatory countries of GATT [hereinafter the “Contracting Parties”] held meetings regularly and new Contracting Parties joined GATT in successive years. Thus, GATT evolved into an ad-hoc international organisation, adopting its practices and agreements (which evolved over time) as its “charter”.²⁹²

²⁸⁹ Australia, Belgium, Brazil, Burma, Canada, Ceylon, Chile, China, Cuba, Czechoslovakia, France, India, Lebanon, Luxembourg, the Netherlands, New Zealand, Norway, Pakistan, South Africa, Southern Rhodesia, Syria, the UK, the US.

²⁹⁰ Reciprocal Trade Agreements Act of 1934 empowered the US President to enter into international treaties which were based on mutual and reciprocal advantage. Dam, Kenneth W., ‘Cordell Hull, the Reciprocal Trade Agreement Act, and the WTO’, The Chicago Working Paper Series Index. Available at: <http://www.law.uchicago.edu/Lawecon/index.html>

²⁹¹ First and second pillars of the Bretton Woods system were the IMF and the World Bank respectively.

²⁹² The GATT charter is composed of all the GATT practices (such as MFN and national treatment principles) and all the existing tariff reductions and the associated agreements. Matsushita, M., Schoenbaum, Thomas J. and Mavroidis, Petros C., (2006) ‘The World Trade Organisation: Law, Practice, and Policy’, Vol. 1, p. 3. Available at http://www.wto.org/english/thewto_e/whatis_e/tif_e/utw_chap1_e.pdf

The rationale and objective of GATT, as stated in the preamble, was to promote rising living standards and to realising full employment by signing mutual beneficial agreements which aim at notable reduction of tariffs and other barriers of trade, and removing discriminatory treatment in global economy. Part I of GATT contained two articles, the first mandating unconditional Most Favoured Nation [hereinafter the “MFN”] ²⁹³ treatment for all the Contracting Parties and the second, being the annexed schedules of all the tariff reductions that arose during negotiations. Part II of GATT included the main rules on commercial policy but was applied provisionally, and in so doing, the Contracting Parties were only required to comply with the GATT rules to the maximum extent if the rules were consistent with the then existing national legislations of the Contracting Parties. Article III of GATT dealt with the “National Treatment”²⁹⁴ Principle. Article XI contained a general prohibition on quantitative restrictions; however Article XII exempted the Contracting Parties from following this general prohibition in the context of balance of payment safeguards. Article XIX stated the circumstances under which a GATT obligation could be annulled or withdrawn; provided the effected Contracting Parties were compensated. The other Articles dealt with routine issues such as customs valuation, marks of origin, and other technical matters. Part III of the Agreement is about the functioning of GATT.

To achieve GATT’s objectives, GATT held many tariff reduction negotiation rounds. Most of these rounds were successful and proved quite fruitful in the furtherance of achieving GATT’s objectives. These negotiation rounds are very important and they illustrate the evolution of

²⁹³Under the GATT, Contracting Parties cannot discriminate (under normal circumstances) between other Contracting Parties. If on Contracting Party gives special treatment (such as a lower customs duty rate for one of their products) to one Contracting Party then they have to give the same treatment to all of the GATT membership. For details visit: (http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm#seebox)

²⁹⁴“National Treatment” is giving others the same treatment as one’s own nationals, i.e. imported and locally produced goods should be treated equally. For details visit: (http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm#seebox)

GATT into the current IELR. The summary of these tariff reduction rounds, held under the umbrella of GATT, is depicted below.

Table 3 Summary of the GATT trade rounds²⁹⁵ :

Year	Place/name	Weighted tariff reduction ²⁹⁶	Subjects covered	Countries
1947	Geneva	-26	Tariffs	23
1949	Annecy	-3	Tariffs	13
1951	Torquay	-4	Tariffs	38
1956	Geneva	-3	Tariffs	26
1960-1961	Geneva Dillon Round	-4	Tariffs	26
1964-1967	Geneva Kennedy Round	-38	Tariffs and anti-dumping measures	62
1973-1979	Geneva Tokyo Round	-33	Tariffs, non-tariff measures, "framework" agreements	102
1986-1994	Geneva Uruguay Round	-38	Tariffs, non-tariff measures, rules, services, intellectual property, dispute settlement, textiles, agriculture, creation of World Trade Organisation ²⁹⁷ , etc	123
2002- (currently going on)	Doha Round	--	All goods and services, tariffs, non-tariff measures, antidumping and subsidies, regional trade agreements, intellectual property, environment, dispute settlement, Singapore issues	144

²⁹⁵ Source: World Trade Organisation and updated by the author. http://www.wto.org/English/thewto_e/whatis_e/tif_e/fact4_e.htm

²⁹⁶ The calculation of average rates of reductions are weighted by MFN import values. (see World Trade Report, (2007), p. 207).

²⁹⁷ Hereinafter the "WTO"

The eighth round, under the umbrella of GATT, was the Uruguay Round, Geneva, 1986-94. This round was extremely important and is discussed below.²⁹⁸

In September 1986, the Uruguay Round was started by the ministers of the Contracting Parties. This round was by far the most grand and comprehensive of the multilateral trade negotiations held in the post-war era. It helped out both the developing and the developed countries to get out of recession.²⁹⁹ Previously, the developing countries did take sufficient interest in the multilateral trade negotiations. However, at the start and also during the Uruguay Round, the share of the developing countries increased notably in the world exports (trade in manufactured goods rose to 20% from 12.5% by 1992 which was nearly 75 % of their total trade). In global market the developing countries emerged as significant competitors.

Despite the many years of delay and negotiating impasses, the Uruguay Round achieved considerably more than half of its objectives. For example, and in order to illustrate the magnitude of its efforts, the Uruguay Round produced the Final Act which was signed in Marrakesh, Morocco on 15 April 1994, weighing 385 pounds and including over 22,000 pages. Just the reproduction of the basic text as part of the Final Act totalled approximately 424 pages.³⁰⁰

The most important objectives of the Uruguay Round were to extend the rule-based discipline of GATT treaties to three new subject areas: trade in services; trade in agricultural products; and the

²⁹⁸ See generally, Golt, Sidney (1988). *The GATT negotiations 1986-90, origins, issues & prospects*. Publisher (London): British-North American Committee; see also, Diane Publishing Company (Editor) (1995). *The Results of the Uruguay Round of Multilateral Trade Negotiations: Market Access for Goods and Services: Overview of the Results*; see also Schott, Jeffrey J. and Johanna W. Buurman (1994). *The Uruguay round: an assessment*. Volume 39 of *Policy analyses in international economics*. Institute for International Economics.

²⁹⁹ There was global recession during the Uruguay Round. And it is considered that Uruguay Round acted as a stimulus to the economy to come out of recession.

³⁰⁰ Kenen, Peter B., (1994) 'Managing the World Economy: Fifty Years After Bretton Woods', Institute for International Economics, p. 131.

protection of intellectual property. Moreover, the round gave priority to the negotiation of new rules governing subsidies, changes in dispute settlement procedures, attention to the problems of textile trade, and the further elaboration of the rules relating to product standards.

The most important result of the Uruguay Round was the establishment of the charter of the long-awaited WTO for the effective implementation of the trade rounds. The WTO was designed to be an international organisation to oversee and promote international trade liberalisation and on 1 January 1995, it succeeded GATT, which had been operating as a de facto international trade organisation since its formation in 1947. By creating the WTO as a formal international trade organisation, the Bretton Woods Economic structure which comprised of the IMF, the World Bank and ITO (as proposed at the Bretton Woods Conference in 1944) was accomplished. The ITO could not have survived as an international trade organisation for long as it was not supported by some major economic powers at that time, thus leaving a gap in the Bretton Woods System.

The other results of the Uruguay Round were remarkable and the original intentions of the ministerial conference which initiated the Uruguay Round were successfully achieved. There were twelve areas,³⁰¹ discussed below, in which the Uruguay Round made important achievements.

1. Services

GATT deals with tangible goods. A wide range of the services economy, ranging from hotels and restaurants to personal services and many more³⁰², were considered domestic activities and

³⁰¹ See, chapter IX "Topics for Negotiation," in Golt, Sidney (1988). The GATT negotiations 1986-90, origins, issues & prospects. Publisher (London): British-North American Committee.

³⁰² Rail transport, telecommunications, health, education and basic insurance services etc.

hence, were not covered by GATT. In the meantime, the global “services sector”³⁰³ has grown consistently since the 1970s, accounting for over 60% of global employment and production to date and representing nearly 24% of total trade (calculated on BOP basis³⁰⁴).³⁰⁵ However, many services, which were previously taken as domestic activities, have become gradually part of the international activities. This growth in the services sector has been fuelled by the invention of modern communication systems (such as tele-education services tele-health; electronic banking; etc.) and the opening up of old and strong monopolistic sectors (such as postal and telecommunication services) in many countries. This enhanced tradability of services created the need for a multilateral discipline for this sector. It was in the Uruguay Round that a decision was finally made to broaden talks to include trade in services. This was carried out under the umbrella of the WTO through the General Agreement on Trade in Services [hereinafter “GATS”]³⁰⁶, which was set up as the framework for negotiation on “trade in services”³⁰⁷. At present, 150 nations have signed up to participate in GATS.³⁰⁸

2. Intellectual Property

The agreement on Trade-Related Intellectual Property [hereinafter “TRIPS”] was a remarkable success of the Uruguay Round. It created significant new global regulations for the protection of intellectual property. Through this agreement, the Contracting Parties endeavoured to standardise the rules by narrowing the gaps between the ways in which these rights were protected around

³⁰³ A services sector is that part of the economy which is based on activities, rather than tangible goods, and which aims to satisfy a human need.

³⁰⁴ IMF definition: "The BOP or balance of payments is a statistical statement that summarizes transactions between residents and non-residents during a period." ('Overview of the Framework', IMF Balance of Payment Manual, Ch. 2, Paragraph 2.15) also available at <http://www.imf.org/external/pubs/ft/bop/2007/bopman6.htm>

³⁰⁵ For further details about the Services Sector and its liberalization visit : http://www.wto.org/english/tratop_e/serv_e/gatsqa_e.htm

³⁰⁶ Annex 1B of WTO agreement.

³⁰⁷ Article I of GATS.

³⁰⁸ For further details about GATS see generally , Understanding the WTO, available at www.wto.org

the globe. It created the minimum levels of protection which each contracting party is obliged to provide to the intellectual property of other Contracting Parties.

*The topics dealt under TRIPS are as follows*³⁰⁹:

- Copyright and related rights;
- Trademarks, including service marks;
- Geographical indications;
- Industrial designs;
- Patents;
- Layout-designs of integrated circuits;
- Undisclosed information.

The wider issues covered by the TRIPS are summarised as follows:³¹⁰

- The application of the basic principles of international intellectual property agreements;
- How to provide sufficient protection to intellectual property rights?
- Adequate implementation of intellectual property rights
- Dispute settlement and intellectual property rights;
- Special transitional measures for incorporation of TRIPS into domestic system.

3. Investments

The countries decided³¹¹ to disregard actions related to investment that restrain or influence particular kinds of investments i.e. to offer "national treatment" to investors from other Contracting Parties and to disregard quotas and other barriers.

³⁰⁹For the detail on the scope of TRIPS see: http://www.wto.org/english/tratop_e/trips_e/t_agm3_e.htm

³¹⁰See 'Understanding the WTO', 3rd ed, p. 39, previously published as "Trading into the Future", the WTO Information and Media Relations Division. Also available at http://www.wto.org/english/thewto_e/whatis_e/tif_e/understanding_e.pdf

4. Agriculture

The Uruguay Round created the first multilateral agreement devoted to the area of agriculture i.e. the Agriculture Agreement³¹². The object of this agreement is to improve trade in the field of agriculture and to formulate more market-based policies for this sector. In this respect, the Contracting Parties attempt to enhance predictability and certainty for the importation and exportation of agriculture-related products. It was considered to be a noteworthy first move in the direction to achieve a regulated, fair, competitive and a less distorted field. In 1995, the Agriculture Agreement, along with all its committed tariffs and tariff quotas, became operational. The Contracting Parties, present at the Uruguay Round, also agreed that developed countries over a period of six year would reduce uniformly the tariffs by an average of 36%. The developing countries would be expected to reduce tariffs uniformly over a period of ten year up to 24% and the least-developed countries were not required to reduce their tariffs.³¹³

5. Subsidies and Countervailing Duties

The Uruguay Round formed a new agreement namely, the Subsidies and Countervailing Measure³¹⁴. This agreement revolves around two main things: first of all, it regulates the exercise of subsidies, and secondly, it oversees the measures taken by Contracting Parties to offset the influence of subsidies (the countervailing measures).

6. Textiles

³¹¹ In Uruguay Round Trade-Related Investment Measures (hereinafter the “TRIMs”) Agreement was also signed.

³¹²http://www.wto.org/english/docs_e/legal_e/14-ag_01_e.htm. And for a summary Agreement on Agriculture see: http://www.wto.org/english/docs_e/legal_e/ursum_e.htm#aAgreement

³¹³ See ‘Understanding the WTO’, 3rd ed, p. 26-8, previously published as “Trading into the Future”, the WTO Information and Media Relations Division. Also available at: http://www.wto.org/english/thewto_e/whatis_e/tif_e/understanding_e.pdf

³¹⁴ A full copy of the agreement is available at : http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm8_e.htm#subsidies

Textiles, part of the special textile regime known as the Multi-Fiber Arrangement³¹⁵ [hereinafter the “MFA”] escaped the GATT provisions but was covered in the Uruguay Round in the form of an agreement to phase out the MFA’s effects, over a course of a decade. The phase-out took place in four stages and these phase-out stages are illustrated in the table below. According to this table, the phase-out was carried out in two directions; one to bring textile products under GATT and the second was the gradual decrease in the quotas (ultimately eliminating them).³¹⁶

Table 4

Four steps over 10 years to bring Textile under GATT obligations.	Percentage of products to be brought under GATT(including removal of any quotas)	How fast remaining quotas should open up, if 1994 rate was 6%
Step 1: 1 Jan 1995 (to 31 Dec 1997)	16% (minimum, taking 1990 imports as base)	6.96% per year
Step 2: 1 Jan 1998 (to 31 Dec 2001)	17%	8.7% per year
Step 3: 1 Jan 2002 (to 31 Dec 2004)	18%	11.05% per year
Step 4: 1 Jan 2005 Full integration into GATT (and final elimination of quotas). Agreement on Textiles and Clothing terminates.	49% (maximum)	No quotas left

7. Standards

In the Uruguay Round, the Contracting Parties expanded the rules for product standards following the achievement of the Tokyo Round. There were some major policy differences³¹⁷, such as the conflict between environmental concerns and trade policy objectives. Article 20 of

³¹⁵ MFA regulated the textile trade since 1974 until the creation of the WTO. It basically allowed quotas limiting imports into countries whose local industries were being negatively affected by sharply rising imports.

³¹⁶ For details on Textiles and its phase out plan, see ‘Understanding the WTO’, 3rd ed, p. 32, previously published as “Trading into the Future”, the WTO Information and Media Relations Division. Also available at: http://www.wto.org/english/thewto_e/whatis_e/tif_e/understanding_e.pdf

³¹⁷ The developed countries, as contrary to the developing countries, supported the idea of environmental protection over the trade goal.

GATT³¹⁸ permits governments to take action so as to protect human, animal or plant life or health, provided they do not discriminate or use this as hidden protectionism. Moreover, two specific WTO agreements³¹⁹ were negotiated in the Uruguay Round, which are directed at food safety and animal and plant health and safety, and with product standards in general. Both these agreements attempt to address the importance of product standards while stressing the importance of avoiding protectionism in disguise.

8. Safeguards

An inability to reach agreement on safeguards and the escape clause measures was the foremost shortcoming of the Tokyo Round. In this regard, the Uruguay Round resulted in an impressive and ambitious safeguard code (i.e. the Agreement on Safeguards)³²⁰. It provides the rules and criteria for regular usage of the escape clause and further, it set up rules against the intentional usage of the export restraints as a protectionist tool.

9. Market Access

Talks at the Uruguay Round focused considerable attention to progress on the question of market access. It was achieved through extensive cutbacks on tariff³²¹ and non-tariff barriers to trade and on the creation of an unambiguous, enforceable international trading system. The terms of the Uruguay Round agreement afforded additional period to the developing countries than the

³¹⁸ Article XX deals with General Exceptions.

³¹⁹ Sanitary and Phytosanitary Measures Agreement [hereinafter the “SPS”] it is a separate agreement which sets out basic rules on food safety and animal and plant health standards. The Technical Barriers to Trade Agreement [hereinafter the “TBT”] tries to ensure technical regulations, standards, testing and certification process do not cause needless hurdles in international trade.

³²⁰ The Agreement on Safeguards lays down the rules for usage of safeguard actions according to Article XIX of GATT 1994. Safeguard actions are classified as “emergency” measures in relation to rise in imports of specific commodities, provided that these imports are creating or endangering to cause severe harm to the local industry of the importing Contracting Party. Example of Safeguard measures is a quantitative import restriction or increase in agreed duty. For further details visit: http://www.wto.org/english/tratop_e/safeg_e/safeint.htm

³²¹ For example GATT Contracting Parties decided to reduce import tariffs by an average of 36%.

developed countries for conformity; the least-developed countries were afforded much extra period for compliance with market access commitments.

10. Developing Country Integration

As an outcome of the Uruguay Round, the developing countries, which previously did not take an active part, were fully incorporated into the GATT system. Excluding the Least Developed Countries [hereinafter the “LDC³²²”], this agreement contains an obligatory prerequisite that all countries, including developing countries, have to stick to their tariff and services commitments.

11. Dispute Settlement

GATT 1947 had a very limited approach towards dispute settlement, even though it did expressly provide, in Articles XXII and XXIII, for consultation and the submission of disputes to the Contracting Parties. However, over time, this practice (consultation and submission of disputes to the Contracting Parties) evolved as a rule-based system. For instance, in the late 1950s, the practice was to set up panels of individuals to identify the issues in the dispute and to recommend their findings to the Contracting Parties. Before the evolution of this practice, disputes were resolved by the representatives of governments in a broader context.³²³

As time passed, the Contracting Parties increasingly started to use the panel process. Gradually, more of the reports began to focus on the clear-cut and material questions of the violation of GATT obligations. At the closing stage of the Tokyo Round in 1979, the participants agreed on certain aspects related to dispute settlement³²⁴ which formalised the concepts and practices

³²² The United Nations in 1971 declared LDCs as a category of countries that are considered extremely deprived in their growth patterns (mostly due to geographical factors), and facing high threat to be unsuccessful in overcoming poverty. Available at: <http://www.unctad.org/Templates/Page.asp?intItemID=3618&lang=1> . And also see <http://www.un.org/special-rep/ohrlls/lcd/list.htm> for the complete list of LDCs.

³²³ Kenen, Peter B. (1994) ‘Managing the World Economy: Fifty Years After Bretton Woods’, Institute for International Economics, p. 140.

³²⁴ This understanding on the dispute settlement became the bases for the formation of a proper treaty text in this area in the Uruguay Round.

relating to dispute settlement procedures that had then developed. During the Uruguay Round a comprehensive adjudication system³²⁵ was established, which dealt with all segments of the Uruguay Round agreements. It also had proper legal text which served as the basis for carrying out the dispute settlement process.

The Uruguay Round agreement established a more organised method with more plainly- defined steps in the dispute settlement process. It established an efficient rules for the settlement of cases, with flexible time limits set at different stages of the procedure. The agreement also stressed the need for the quick settlement of disputes as part of the effective performance of the WTO. It sets out, in substantial detail, the processes and the schedule to be pursued in adjudicative process. It would normally take less than one year to 15 months from the first ruling to its appeal, if a case stretches to its full course.³²⁶

12. The WTO Charter

One of the chief accomplishments of the Uruguay Round was the creation of an international charter for a new permanent international trade organisation (the WTO). The WTO, as a proper international institution, took the place of GATT (which was a provisional arrangement) for the smooth progress of the international cooperation in the trade and economic scenario.

In addition to the general purpose of the WTO (mentioned in the above paragraph), the WTO has some specific tasks to perform³²⁷ which are; (1) to provide a forum for negotiations among the

³²⁵ The Uruguay Round Understanding on Rules and Procedures Governing the Settlement of Disputes [hereinafter the “DSU”].

³²⁶ ‘Understanding the WTO’, 3rd ed, p. 55-6, previously published as “Trading into the Future”, the WTO Information and Media Relations Division. Also available at http://www.wto.org/english/thewto_e/whatis_e/tif_e/understanding_e.pdf

³²⁷ See Matsushita, M., Schoenbaum, Thomas J. and Mavroidis, Petros C., (2006) ‘The World Trade Organisation : Law, Practice, and Policy’, Vol. 1, p. 9, available at http://www.wto.org/english/thewto_e/whatis_e/tif_e/utw_chap1_e.pdf

“Members³²⁸” both for current matters and any future agreements; (2) to administer the system of dispute settlement; (3) to oversee the Trade Policy Review Mechanism [hereinafter the “TPRM”]; and (4) to cooperate as necessary with the IMF and the World Bank, the two other institutions of the Bretton Woods institutions.³²⁹

US and EU Dominance and the WTO negotiations

The WTO as an IEI is constitutionally liberally institutionalised, however. In practice it slightly diverges from liberally institutionalised values³³⁰ as the dominance of US and EU can be observed within the WTO negotiations process. Some examples of imbalanced decision making are discussed below.

According to some scholars,³³¹ the WTO Secretariat does not purport to be an impartial body and play a significant part in supporting the decision-making process at the WTO which is in favour of developed countries. This may be due to the imbalance of the composition of the WTO staff. Nearly 80% of the WTO members are developing countries but only 20% of the WTO’s staff is from developing countries.³³²

As the WTO is based on equal voting system, the large economic actors– mainly the EC and the US – have to significantly contest in WTO negotiations process. The developing countries with smaller share in international trade have equal standing as of the US and the EU. However, the WTO negotiation process is a tug of war and all the Contracting Parties try to negotiate best for themselves. In this negotiating scenario, the US and the EU frequently join hands as a strategy.

³²⁸ The term “Members” refers to those countries which signed the WTO charter.

³²⁹ WTO Agreement Article III.

³³⁰ REF

³³¹ Fatoumata Jawara (2003) *The cunning bully - EU bribery and arm-twisting at the WTO*. pp2

³³² Fatoumata Jawara (2003) *The cunning bully - EU bribery and arm-twisting at the WTO*. pp2

The first step of their strategy is by convincing different groups of countries, beginning with the large economies with which they have shared agenda.³³³

The confidential consultations between the US and EC results in consultations with Canada and Japan, with significant participation of the WTO Secretariat (the Green Room consultations), to ascertain shared views. Collectively, the US, the EC, Japan and Canada compose the Quadrilateral group which is a strong block which overshadows the WTO negotiation procedure.³³⁴

Another strategy opted by the US was to put non-compliant countries on a black list. Moreover, it was made clear to the black-listed Contracting Parties that slight resistance to Quadrilateral group proposal would cause a total termination of bilateral dialogues in other subjects of mutual advantage. Even some Ambassadors were removed by the Contracting Parties on the request of the US.³³⁵

Another strategy that rarely disappoints is the attraction of aid, debt relief and technical assistance to developing countries. It might be a coincidence but Tanzania (whose Minister was chair of the LDC), obtained multilateral debt assistance from the IMF/WB two weeks after Doha negotiation. It seems to be part of carrot and stick policy of the Quadrilateral group. Similarly, the countries who were strong and who opposed the agenda of the Quadrilateral group, such as India, were isolated and portrayed as 'obstructionists.'³³⁶

Bargaining power in the WTO is a very important factor. Trade between the EU and the EU and their trading partners is quite significant. Large economic powers have the capacity to negotiate

³³³Fatoumata Jawara (2003) *The cunning bully - EU bribery and arm-twisting at the WTO.*

³³⁴Fatoumata Jawara (2003) *The cunning bully - EU bribery and arm-twisting at the WTO.*

³³⁵ The US Trade Representative had put non-compliant countries on a blacklist weeks before Doha, as detailed in a leaked letter between the USTR Robert Zoellick and a Washington based Southern envoy. About six Ambassadors were also removed from Geneva during and after the Doha conference. Fatoumata Jawara (2003) *The cunning bully - EU bribery and arm-twisting at the WTO.*

³³⁶ Fatoumata Jawara (2003) *The cunning bully - EU bribery and arm-twisting at the WTO.*

for extra concessions in multilateral trade negotiations process.³³⁷ Whether trade bargaining is form of reciprocal assurances of market opening or coercions of market closure, or a mixture of both. Big economies are at favourable position to bargain in the WTO negotiation process than countries with considerably small economies.³³⁸ However, as some developing countries have emerged as economic powers, such as China, India, and Brazil, the bargaining dominance of the developed countries is considerably reduced. The key to the WTO negotiations is to form effective coalition be it a developed or the developing country.³³⁹

In short, despite divergence of WTO practices from the liberal institutional values, there is a hope that one day developing countries which are occasionally dominated by developed countries (mainly the US and EU) will gain economic strength and will be in a position to mitigate the dominance of the developed countries in WTO system. Whereas in IMF and World Bank dominance of the developed countries (mainly US and EU) is constitutionally embedded in these institutions through the weighted voting system. Thus, there is less likelihood that a developing country can mitigate dominance of the US and EU in Bretton Woods institutions.

C. Conclusion:

This chapter has documented the historical background and evolution of the IELR. The IELR is rooted in the events arising from the World Wars period. The US emerged as the most dominant power after WW II and created the international regime as a hegemon. At that time, the global

³³⁷ Melo, J. de and A. Panagariya eds. (1993), *New Dimensions in Regional Integration*, New York, Cambridge University Press.

³³⁸ Richard H. Steinberg (2002), *In the Shadow of Law or Power? Consensus-Based Bargaining and Outcomes in the GATT/WTO*. *International Organization*, Vol. 56, No. 2, pp. 339-374.

³³⁹ Kent Jones (2009), *Green Room Politics and the WTO's Crisis of Representation*, 9(4) *Progress in Development Studies* 349.

economy was based on realism so all the institutions created at that time and which sustained had realist aspects in them. The best examples of such institutions are the IMF and the World Bank.

The US used these institutions as a tool for its foreign policy. These institutions had a really tough time surviving in the growing liberally-institutionalised global economy mostly attributed to GATT than the WTO. The main reason for the survival of these institutions was due to historical events, such as several economic crises and the Soviet Union fallout. These events placed countries in a vulnerable position due to the deficiency of money and under-development, thus leaving the no option then to rely on these IEIs (such as IMF).

Unfortunately, the application of the Bretton Woods System remained incomplete, as one of the pillars of this system, the ITO, ceased to exist as an international trade organisation. However, GATT, which was formed as a provisional setup until the formation of the ITO, gradually filled the gaps in the Bretton Woods Structure left by the failure of the ITO.

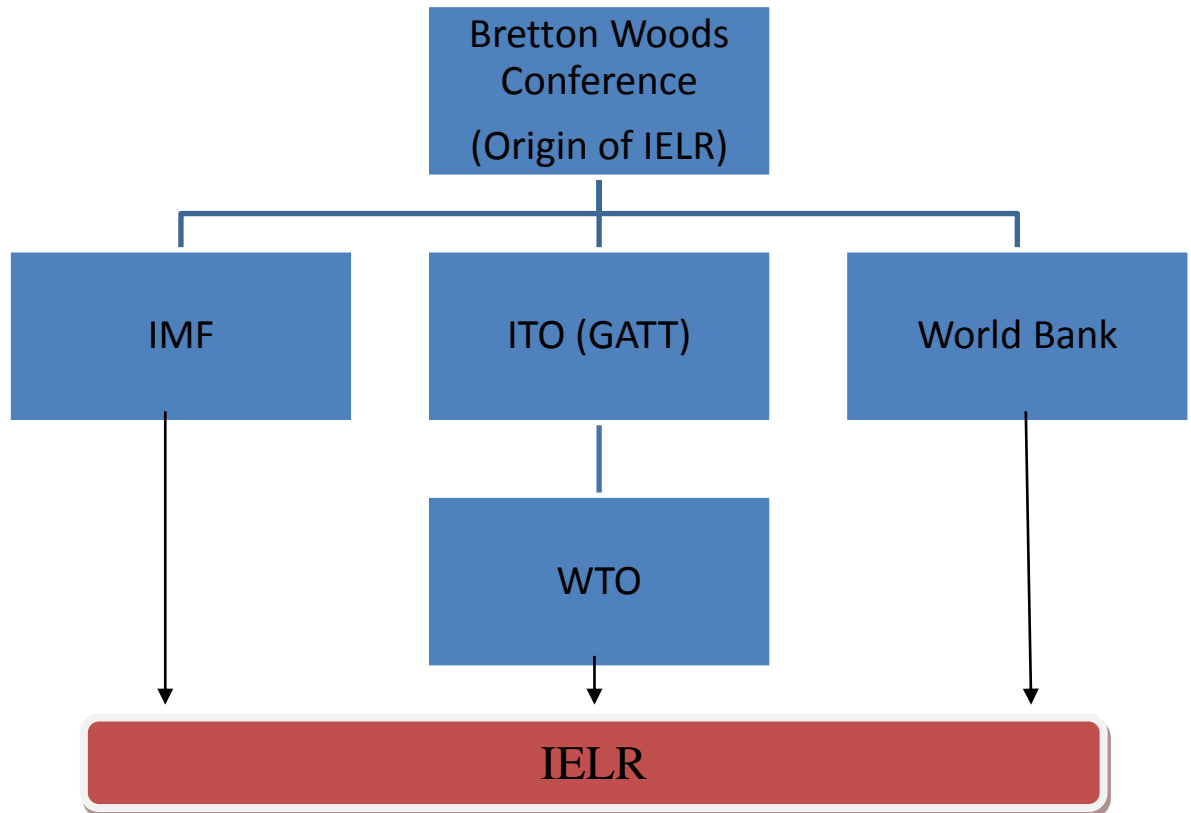
It is widely accepted, and also shown in this chapter, that GATT played a central role in shaping post-WW II trade policy. Through the eight rounds of trade negotiations that followed the inception of GATT in 1947, the average tariffs on goods have fallen considerably, from over 40% to less than 4%. Finally, in 1995, in result of the Uruguay Round, the WTO was created as a formal international trade organisation to fill the gap left in the Bretton Woods Structure. Over this period of time, membership of GATT (and its successor, the WTO) has risen from 23 countries to 153, which shows how effective this international organisation is in the international economic scenario.

The WTO emerged with complete and effective IEIs which covered all aspects of trade and also other components of the Economic Cycle. The current IELR, which is mainly based on IEIs (as the main non-state actors) gets its power and source from the IEIs. The most important of these

IEIs are the IMF, the World Bank and the WTO. All these IEIs were originally part of the Bretton Woods Economic structure and the current IELR arose from the Bretton Woods structure. The figure at the end of the chapter summarises the evolution of the IELR.

This chapter focused on the history and evolution of the current IELR in which IEIs play a central role, but this regime no longer needs the hegemon to run the regime, as it is based on liberal institutionalism. The next two sections are dedicated to highlighting the institutional role of the IMF (including related discussion of the World Bank) and the WTO in the context of the IELR and the Economic Cycle.

Figure 4



SECTION TWO:

A. Introduction

As discussed in the theoretical framework and shown in the preceding chapter, the interdependence of national economies has necessitated states to cooperate with each other to tackle the implications of this. Sovereign states cooperate with each other to set the rules of the game for the global economy in order to reap collective gains. The most common and effective way of cooperation at international level is through international organisations. The sovereign states as rational units give up part of their sovereignty by allowing IELs to tackle the implications of globalisation and interdependence. The IELs, in their institutional capacities, set the rules of the game for the global economy and collectively these rules takes the form of a regime i.e. the IELR.³⁴⁰

The foundations of the current IELR were laid down by the US who was the hegemon at that time.³⁴¹ However, over time, the dominance of the US has decreased but the IELR is still effective and strong. As mentioned in the theoretical chapter, this thesis looks at the IELR through the liberal institutionalist lens. In other words, the existence of a hegemon is not vital for the effective functioning of the regime, and this is because rational states always calculate their own interest or benefit in cooperation.³⁴²

This section highlights the role of the IMF in its institutional capacity in setting the rules of the game in its area of specialisation. Moreover, these rules of the game create certainty and predictability within the international economic framework. This certainty and predictability acts

³⁴⁰ Chapter II.A.1 on page 25

³⁴¹ Chapter III.B on page 100

³⁴² Chapter II.B.1.b)(2) on page 62

as a stimulus in the international economic framework which leads to a more stable and balanced growth of the global economy.

B. Argument

The argument put forward in this thesis is that this global economy is liberally institutionalised and is governed by the IELR. The IELR's main source of strength is in the IELs which have contributed significantly towards the success of the current regime. The IMF is one of the most important constituents of this regime.

The IELs, in their institutional capacities, set the rules of the game of the global economy. The current IELR is not reliant on the continuous existence of a hegemon. The main reason for the rational sovereign states to give up part of their sovereignty and cooperate with each is to reap the collective gains. This approach is the liberal institutionalists viewpoint which emphasises cooperation for mutual gain.³⁴³ However, if we look at the IMF's functioning, we can identify the existence of realist insight within it and it is still being dominated by a hegemon (US). The realist approach of these institutions is judged on the basis of decision-making and the involvement of members (other than the hegemon).

As a result, Section Two shows that the IMF currently plays an important institutional role even though it does not explicitly acknowledge it. It is highly involved in making the rules of the game for the international economic scenario, and thereby structuring the IELR. The argument put forward here is that the effectiveness of the IMF is limited by its refusal to openly

³⁴³Chapter II.B.1.b)(2) on page 62

acknowledge this institutional role: acknowledging that it has this institutional role would allow it to fulfil its role more effectively.

However, even if this institutional role was fully acknowledged, the IMF remains handicapped by their institutional structure, which gives excessive control to wealthier states (specially the US). As a result, these IEIs are not well designed to properly fulfil their institutional role.

Liberal Institutionalism and the IMF

The rational free will of the sovereign states to cooperate with each other for the collective benefit of all is the essence of liberal institutionalism.³⁴⁴ Persistent cooperation in liberal institutionalism is not as a result of subjugation but instead due to collective gain. Contribution to the running of or decision-making within the IEI tells whether the weak members are forced (which also includes not having any alternative) to be part of cooperative arrangement or whether they are cooperating of their own rational free will. To further elaborate this point the next paragraph sheds light on voting and decision-making within the IMF.

Voting and decision making in the IMF (realist aspect)

The Board of Governors is the sovereign body of the IMF and each country is represented by a governor; most commonly, a country's central bank governor or the Minister of Finance assumes that role. The Board of Governors meets once a year. Therefore, for day-to-day business, the Board of Governors delegates its powers to the Executive Board. The Executive Board is comprised of twenty-four members, and each of the following eight countries has the opportunity to nominate a director for the Executive Board: United States, Japan, Germany, France, United

³⁴⁴ Keohane, Robert O. and Nye, Joseph S. (1989), *Power and Interdependence: World Politics in Transition*. Second Edition, Harper Collins Publisher, p231.

Kingdom, Saudi Arabia, China, and Russia. The remaining sixteen directors are selected (mostly elected) by groups of states.³⁴⁵

In the IMF, decision-making is based on a weighted voting system. In principle, the larger the economy, the greater the voting rights. This approach allows the bigger economies to squeeze the smaller economies and run the IMF for their own benefit. However, even this is not wholly true, because emerging economies are significantly under-represented in IMF decision-making (see the table below). The minimum voting requirement to get anything passed is 85% of the vote and the US alone has 16.78% of the vote, meaning that the US's approval is necessary in order to get any decision passed by the Executive Board.

Table 5 Voting Rights in the IMF, 1945–2011 (in percent) and GDP (in percent) of share in world.

COUNTRY	% Voting Rights (1945)³⁴⁶	% Voting Rights (2011)³⁴⁷	% GDP share of world total (2011)³⁴⁸	% GDP share of world total (2016)³⁴⁹
Industrialised Countries :	67.5			
United States	32.0	16.78	19.382	17.770
Japan	–	6.24	5.665	4.953
Germany	–	5.82	3.875	3.356
France	5.9	4.30	2.826	2.494
United Kingdom	15.3	4.30	2.882	2.605
Oil Producing Countries:	1.4			
Saudi Arabia	–	2.81	0.839	0.838

³⁴⁵ See generally, Toussaint, Eric and Millet, Damien (2010), DEBT, THE IMF, AND THE WORLD BANK: Sixty Questions, Sixty Answers. Available at: <http://www.cadtm.org/Debt-the-IMF-and-the-World-Bank>

³⁴⁶ Voting Rights in the IMF, 1945–2000 (in percent). Source: Yves Tavernier, French National Assembly Finance Commission Report on the Activities and Control of the IMF and the World Bank, 2000

³⁴⁷ IMF Members' Quotas and Voting Power, and IMF Board of Governors Last Updated: June 22, 2011. Available at: <http://www.imf.org/external/np/sec/memdir/members.aspx>

³⁴⁸ IMF, World Economic Outlook Database, April 2011. Available at: <http://www.imf.org/external/pubs/ft/weo/2011/01/weodata/weorept.aspx?pr.x=35&pr.y=12&sy=2011&ey=2016&scsm=1&ssd=1&sort=country&ds=.&br=1&c=223%2C924%2C922%2C456%2C132%2C134%2C534%2C158%2C12%2C111&s=PPPSH&grp=0&a=>

³⁴⁹ IMF, World Economic Outlook Database, April 2011. Available at: <http://www.imf.org/external/pubs/ft/weo/2011/01/weodata/weorept.aspx?pr.x=35&pr.y=12&sy=2011&ey=2016&scsm=1&ssd=1&sort=country&ds=.&br=1&c=223%2C924%2C922%2C456%2C132%2C134%2C534%2C158%2C12%2C111&s=PPPSH&grp=0&a=>

DC:	31.1			
Russia	–	2.39	3.001	2.941
China	7.2	3.82	14.316	18.002
India	5.0	2.34	5.617	6.632
Brazil	2.0	1.72	2.943	2.880

The dominance of the US has been documented earlier in Chapter III (History and Evolution of the IELR). The US used the IMF and the World Bank as a tool for its foreign policy and only if a country was within the orbit of the US was it then welcomed. The main contributors to the current regime (IELR) originate from the Bretton Woods Conference; that is the IMF and the World Bank. The US, being the most dominant power after WWII, created the IMF and World Bank with the support of UK,³⁵⁰ for which it also needed to take into account the collective gain of other members. However, it is evident from history that the US made its dominance clear from the very beginning.³⁵¹

Over the passage of time other countries also gained economic strength. The voting power of the US reduced from 32% in 1945 to 16.87% in 2012. UK's voting strength reduced from 15.3% to 4.3%. The EU collectively also enjoys a veto power in the IMF. Initially it was the US and UK's hegemony but over the passage of time Europeans emerged as a significant economic power. They didn't challenge US hegemony and instead participated in the US hegemonic system and gained strength. Therefore, it is no more only US's dominance but a mutual dominance of US and EU.

More recently, the realist aspect of the IMF, while operating within in the liberal institutional framework of the IELR, can be judged by criticism made by the Meltzer Commission which was

³⁵⁰ See the above table UK had 15.3 % of the IMF votes i.e., it also enjoyed veto power.

³⁵¹ See, History and Evolution of IELR: Chapter III.B.1 on page 101

formed by the US Congress. It states in its report that “[t]he United States use the IMF as a vehicle to achieve their political ends.”³⁵² This point made here is that the IMF is significantly involved in setting the rules of the game but at the same time, it intentionally does not want to highlight this role, reason being to simply avoid criticism and discussion about the equal (or relevantly reasonable) involvement of less developed countries.

This thesis does not assert that there should be complete democratic decision-making in the IMF because in the current international political economic scenario, it does not seem possible.³⁵³ (There exists a highly optimistic view in the context of democracy in the international system which calls for completely democratising all IEIs.³⁵⁴) However, this chapter only calls for the incorporation of democratic values³⁵⁵ into the IMF institutional framework, because, then, the IMF can easily and comfortably focus on its institutional role. This institutional role, which the IMF does not explicitly state, is essential for enhancing certainty and predictability in the global economic scenario.

The IMF makes and promotes global regulations and its focus is on the achievement of its goals without explicitly stating or emphasising its rule-making role. This may be due to a lack of the democratic values in its institutional framework which are essential for a rational state to

³⁵² INTERNATIONAL FINANCIAL INSTITUTION ADVISORY COMMISSION (US Congress), known as the Meltzer Commission, 2000. Available at: <http://www.house.gov/jec/imf/meltzer.htm>

³⁵³ See Dahl, Robert A. 1999. Can International Organizations Be Democratic? A Skeptic’s View. In Ian Shapiro and Casiano Hacker-Cordón, eds., *Democracy’s Edges*. London and New York: Cambridge University Press. And also see, Philippe Schmitter: ‘Is it Really Possible to Democratize the Europolity?’ SOG Working Paper.

³⁵⁴ Archibugi, Daniele and David Held (eds.). 1995. *Cosmopolitan Democracy, An Agenda for a New World Order*. Cambridge: Polity Press.

³⁵⁵ In the current discussion this thesis supposes, indeed contends, that the most significant democratic values are the following: first, equivalent respect for the essential benefits of all persons; second, decision-making regarding public order via principles, mutual consideration; and third, common respect for people as those who are guided by reason. Keohane, Robert O. and Buchanan, Allen (2006). *The Legitimacy of Global Governance Institutions*. *Ethics and International Affairs*, 20(4): 405-437.

cooperate for mutual gain.³⁵⁶ Despite the absence of democratic values within the IMF framework, its rational constituents actively follow it. As discussed in chapter III (History and Evolution of the IELR), this is due to the absence of any other alternative in the event of desperate monetary need.³⁵⁷

The big economies that have a major stake in IMF financing have a higher percentage of voting rights. However, over time, the IMF's role as an IEI has evolved.³⁵⁸ Now, it is not only involved in financing but also in global regulations to a significant extent. Therefore, decision-making or involvement in the formation of global regulations should involve its members substantially. This would also increase the accountability of the IMF as an IEI.³⁵⁹ However, the financing role could still be mainly controlled by the major stakeholders.

The IMF needs to split its institutional role from the financing role in order to function better and with more strength, in order to enhance certainty and predictability in the global economic scenario, for the simple reason that it becomes easier to improve a role or function if the IMF clearly admits its institutional role.

Thus, this section maintains that, idealistically, the IMF needs to separate its financing role from its global regulation-making and enforcement function (through its institutional role). Moreover,

³⁵⁶ Ibid

³⁵⁷ Chapter III (History and Evolution of IELR) p100

³⁵⁸ For good discussion about the evolving role of the IMF and World Bank see generally, Singh, Dalvinder (2007). 'The Role of the IMF and World Bank in Financial Sector Reform and Compliance: An Outline,' 18 *European Business Law Review*; see also, Boughton, James M. (2004). *The IMF and the Force of History: Ten Events and Ten Ideas That Have Shaped the Institution*. IMF working paper 04/75. Available at: <http://imf.org/external/pubs/ft/wp/2004/wp0475.pdf>. See also, International Monetary Fund (2001) *Financial Organization and Operations of the IMF*, Pamphlet Series No. 45 Sixth Edition;

³⁵⁹ For a good discussion about the accountability and legitimacy of international financial institution decision making, see generally, Alexander, Kern; Dhumale, Rahul; and Eatwell, John, (2005). *Global Governance and International Standard Setting*, in *Global Governance of Financial Systems, The International Regulation of Systemic Risk*, Published to Oxford Scholarship Online: September 2007; see also, Kerwer, Dieter (2005), *Rules that Many Use: Standards and Global Regulation*. *Governance: An International Journal of Policy, Administration, and Institutions*, Vol. 18, No. 4, (pp. 611–632).

the involvement of all members in the formation of global regulations should be made possible, with democratic values embedded in this process. This way, the IMF would create the rules of the game (as part of the IELR) which would be, to a very large extent, free from realistic insight. Furthermore, the IMF requires an effective adjudicating body in order to have a comprehensive institutional structure and function.

These major structural changes (mentioned above) may possibly align the IMF's institutional role with that of liberal institutionalist insight and in doing so, the IMF would become part and parcel of the liberally institutionalised IELR and would have a better chance of improving its institutional role.

C. Section Two Format

This section is divided into two chapters, namely; the IMF and its Legal Framework (Chapter IV) and the Institutional role of the IMF in achieving stable and balanced growth of the global economy through the International Economic Framework (Chapter V). Chapter IV is dedicated to the legal framework of the IMF. From a legal pluralist approach, the IMF's legal framework acts as a superior set of rules in its specialised area. The significance of discussing the IMF's legal framework in this thesis is that it is essential to know the basics for a better understanding of the institutional role of the IMF in achieving stable and balanced growth in the global economy. The next chapter of this section will talk about the IMF's legal framework.

Chapter V is dedicated to characterising the IMF's functions as an institutional role as defined in the theoretical framework. The purpose of this part of the chapter is to show that the IMF has an institutional role and is effectively part of a global regulation-making and implementation process. However, the IMF does not explicitly express its institutional role and thus loses the opportunity to improve upon it

IV. IMF and its legal framework

The importance of this chapter is that it provides a foundation for the next chapter, and deals with the legal basis of the institutional role of IMF in achieving stable and balanced growth within the global economy. Under this heading, the basic legal framework of IMF is discussed, around which its institutional role revolves. The institutional role of the IMF is based on the Articles of Agreement³⁶⁰ and the way in which the IMF operates through its legal framework³⁶¹ to promote global stable and balanced economic growth.

For this purpose, this chapter is divided into three sections: the first relates to the key points to understanding the IMF's legal framework; the second section highlights the purpose of the legal framework; and the third section discusses the main tools of the legal framework. The next subheading refers to the main assumptions related to the IMF's legal framework.

A. Key Points underlining the IMF's Legal Framework

To develop a deeper knowledge of the IMF's legal framework and the ways in which it opts to address concerns surrounding stable and balanced economic growth, it is essential to take into account a couple of key points. The first is that the IMF's legal framework is mainly a part of public international law.³⁶² The approach towards the IMF's legal framework is the legal pluralist approach.

³⁶⁰ Available at <http://www.imf.org/external/pubs/ft/aa/index.htm>

³⁶¹ IMF's legal framework revolves around three important functions which relate to this thesis; they are surveillance, technical assistance, and financial assistance.

³⁶² Zack, Arnold M., Christie, Sarah and Cooker, Chris de, "Review of the International Monetary Fund's Dispute Resolution System" Para 11. Available at: <http://www.imf.org/external/hrd/dr/112701.pdf>. Also see, UN says World Bank and IMF "bound by international law" in Bretton Woods Update No.48 November/December 2005 at <http://www.brettonwoodsproject.org/art-438435>. Also see, ROSS LECKOW (2008), "The IMF's Legal Instruments to Promote Financial Stability", in Current Developments in Monetary and Financial Law (Volume 5) p4. Available at: <http://www.imf.org/external/pubs/nft/2008/cdmf/index.htm>; see also Alexander, Kern, Dhumale, Rahul, and,

This subheading focuses on the operations managed by the IMF's legal framework and its interactive relationship with its constituent member countries. Therefore, this part of the chapter does not delve into the domestic policies of the member countries i.e. the impact of the IMF's legal framework on the domestic legal economic systems of member countries. However, the IMF's impact on domestic systems (legal transplant) will be discussed in the next chapter.³⁶³

A second key point to be considered while exploring the IMF's legal framework is the fact that the IMF is an IEI which came into existence due to the cooperation of sovereign states. This cooperation took the form of a multilateral treaty i.e. the Articles of Agreement of the IMF.³⁶⁴

The Articles of Agreement is the main source of the IMF legal framework and lays down the parameters for its operation. Moreover, being an IO, it has its own rational will and executive function which is essential for its smooth running. Thus, there are two main sources of law for the IMF: its Articles of Agreement and the decision of the Executive Board³⁶⁵ of the IMF.

The first source, the Articles of Agreement of the IMF, lays down the basic reasons for its creation and some of its functions which are essential for the fulfilment of the reasons for its creation. The Articles empower the IMF to require its members to fulfil certain requirements and some of those requirements³⁶⁶ are related to a balanced and stable growth which is achieved

Eatwell, John, (2005). 'Global Governance of Financial Systems, The International Regulation of Systemic Risk.' Published to Oxford Scholarship Online: September 2007 p81; see also, Lastra, R M. (2006).Legal Foundations of International Monetary Stability (Oxford, Oxford University Press) at pp 402-406.

³⁶³ Enforcement of standards and best practices through conditionalities is discussed in the next chapter.

³⁶⁴ IMF was created as a result of the Bretton Woods conference. Chapter III.B.1 on page 101

³⁶⁵ "The Executive Board is responsible for conducting the day-to-day business of the IMF. It is composed of 24 Directors, who are appointed or elected by member countries or by groups of countries, and the Managing Director, who serves as its Chairman. The Board usually meets several times each week. It carries out its work largely on the basis of papers prepared by IMF management and staff." Available at: <http://www.imf.org/external/np/sec/memdir/eds.htm>. Also see, Section two start, p

³⁶⁶ Such as Article of IV and VIII of the Articles of Agreement of the IMF.

through the enhancement of financial stability. The position of Articles of Agreement in the IMF legal structure is similar to that of the constitution in the domestic legal structure.³⁶⁷

As mentioned in the above paragraph, the other main source of law in the IMF legal structure originates from the decisions of the IMF's Executive Board. The Executive Board is the most effective and powerful body of the IMF; it not only deals with routine organisational affairs but also decides policies which guide the IMF's interaction with its members and also looks into the implementation of the IMF's Articles of Agreement.

By making the Executive Board so powerful, the main founding fathers of the IMF, the US and the UK, maintained their control over this institution. All power remains with the Executive Board. Only these two countries had power of veto at that time. This is the hegemonic aspect of the US and its allies (at the inception the major ally was UK) in the IMF, discussed earlier in the introduction of Section Two. The following part of this chapter deals with the basic purpose of the IMF's legal framework.

B. Purpose

The sovereign states gave up part of their sovereignty and cooperated with each other³⁶⁸ in order to create the IMF as an IEI. The main purpose of this cooperation is laid down in Article I of its Articles of Agreement. It does not explicitly refer to balanced and stable growth but there is a direct relevance between the basic purpose of the IMF's functioning, and stable and balanced growth. To get a better grasp of this aspect of the IMF, it would be useful to focus on some of the purposes of the IMF, mentioned in Article I of the Articles of Agreement:

³⁶⁷ This analogy is made by ROSS LECKOW in "The IMF's Legal Instruments to Promote Financial Stability", in *Current developments in monetary and financial law* (Volume 5). Available at: <http://www.imf.org/external/pubs/nft/2008/cdmf/index.htm>

³⁶⁸ However, US being a hegemon led the process of the creation of the IMF.

- Article I (i): “To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.”
- Article I (ii): “To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.”
- Article I (iv): “[T]o assist in the establishment of a multilateral system of payments in respect of current transactions and in the elimination of foreign exchange restrictions which hamper the growth of world trade”.

By looking into the IMF’s purpose, it is clear that there is a direct link between the promotion of stable and balanced economic growth and the IMF.

The spirit of the above-mentioned purpose of the IMF can be rephrased in the following way; the IMF has been created to establish an international monetary system which has free movement of current account payments and transfers between countries, and yet promotes exchange rate stability by obliging its members to opt for prudent economic and financial policies. By establishing such a sound international monetary system, the IMF endeavours to promote international trade through the development of the financial sector which will create investment and stimulate economic growth globally.³⁶⁹

³⁶⁹ Financial sector and international trade is deeply interconnected and there are three views in this context. The first view argues that financial development, which results from financial liberalization leads to economic growth [McKinnon, R.I. (1973), *Money and Capital in Economic Development*, The Brookings Institution, Washington DC; Patrick, H.T. (1966), ‘Financial Development and Economic Growth in Underdeveloped Countries’, *Economic Development and Cultural Change*, Vol. 14, No. 1, 174–89; Fry, M.J. (1973), ‘Manipulating Demand for Money’, in

As has been shown with the help of the Economic Cycle in Chapter II³⁷⁰ of this thesis, expanding international trade is significant in global financial sector development and the financial sector is essential for international trade to grow.³⁷¹ Hence, according to the objectives of IMF, it can be reasonably conceived that it has a significant role to play in achieving stable and balanced growth, as mandated by its constitution.

Moreover, the purpose of the IMF also sheds light on exchange rate stability as an important task of the IMF. Exchange rate stability is essential for financial stability which, in turn, is crucial for the financial sector. For instance, if there is instability in the financial sector of one member country, that country's monetary policy will lose its effect, and will incur large fiscal costs in saving distressed financial institutions, cause capital flight, and intensify economic recession.³⁷²

As the stability and soundness of the financial side of the economy is essential for its development, exchange rate stability objectives become relevant to the stable and balanced growth of the global economy. Therefore, to ensure stability in the international monetary

Michael Parkin (ed.), *Essays in Modern Economics*, Longman, London; De Gregorio, Jose & Guidotti, Pablo E., 1995. "Financial development and economic growth," *World Development*, Elsevier, vol. 23(3), pages 433-448, March; Choe, Chongwoo & Moosa, Imad A., 1999. "Financial System and Economic Growth: The Korean Experience," *World Development*, Elsevier, vol. 27(6), pages 1069-1082, June; Habibullah, M.S. and Y. Eng (2006), 'Does Financial Development Cause Economic Growth? A Panel Data Dynamic Analysis for the Asian Developing Countries', *Journal of the Asia Pacific Economy*, Vol. 11, No. 4, pp. 377-93]. The second view maintains that it is economic growth that leads to financial development [The demand for financial development hypothesis in Patrick, H.T. (1966), 'Financial Development and Economic Growth in Underdeveloped Countries', *Economic Development and Cultural Change*, Vol. 14, No. 1, 174-89. And also see Robinson, Joan (1952). *The Generalization of the General Theory*, in *The Rate of Interest and Other Essays* (London: Macmillan) and Romer, P.M. (1990). "Endogenous Technological Change". *Journal of Political Economy*, 98, S71-S102] in the context of impact of economic growth on financial development.] The third view, however, contends that both development in financial sector and economic growth cause one another [Granger, C. W. J. 1969. "Investigating Causal Relations by Econometric Methods and Cross-Spectral Methods". *Econometrica*, 37, 424-438; Granger, C. W. J. 1980. "Testing for Causality: A Personal Viewpoint". *Journal of Economic Dynamics and Control*, 2,329-352. And also see Lyons, S.E. and Murinde, V. (1994) *Cointegration And Granger-Causality Testing Of Hypotheses On Supply-Leading And Demand-Following Finance*, *Economic Notes*, 23(2), 308- 316].

³⁷⁰ Chapter II.B.3.e) on page 90

³⁷¹ *Supra* note 369

³⁷² See generally, Carlson, Mark A., King, Thomas B., and Lewis, Kurt F. (2008), "Distress in the Financial Sector and Economic Activity". Board of Governors of the Federal Reserve, Washington, DC 20551. available at: <http://www.federalreserve.gov/pubs/feds/2008/200843/revision/200843pap.pdf>

system, the IMF first needs to stabilise the financial systems of the member countries.³⁷³ This is because the financial sectors of countries are interdependent on each other, due to globalisation. Instability will cross borders and hamper the stability of other members' financial systems.³⁷⁴ The globalisation and interdependence of markets has made it necessary to resolve matters pertaining to stable and balanced growth at global level.³⁷⁵

The IMF has learned a great deal from the many crises in the past which were mostly due to financial instability. In practice, the IMF is clear that it is in its domain to look into the stability and development of the financial sectors of its member countries, in order to avoid the repetition of past difficulties (due to the deficiency of any other effective IEI to take on this task). Thus, achieving stable and balanced growth through financial sector stability and development has become closely connected with the purpose of the IMF.³⁷⁶

The following section discusses the relevant functions of the IMF in the context of financial sector stability and development.

C. Functions

The above section talked about the relevance of stable and balanced global economic growth and the objectives of the IMF. This part will focus on the legal bases of the main functions of the

³⁷³ IMF's Factsheet, How the IMF Promotes Global Economic Stability, April 5, 2010. Available at: <http://www.imf.org/external/np/exr/facts/globstab.htm>; see also, Claessens, Stijn and Thomas Glaessner (1997). "Are Financial Sector Weaknesses Undermining the East Asian Miracle," Directions in Development, World Bank.

³⁷⁴ Mendoza, Enrique G. and Quadrini, Vincenzo (2010). Financial globalization, financial crises and contagion Journal of Monetary Economics, Volume 57, Issue 1, Pages 24-39

³⁷⁵ See generally for further details about the financial globalization and how the maximum benefits can be reaped in, Johnson, Simon (approved by) (2007), Reaping the Benefits of Financial Globalization, IMF Discussion Paper, (<http://www.imf.org/external/np/res/docs/2007/0607.htm>); see also, Bordo, Michael and Christopher M. Meissner, 2007, "Foreign Capital and Economic Growth in the First Era of Globalization," Working Paper, University of Cambridge.

³⁷⁶ For an introductory guide to the IMF, its history, and its role in the international financial system. See generally, What is the International Monetary Fund? IMF publication, September 14, 2006. Available at: <http://www.imf.org/external/pubs/ft/exrp/what.htm>

IMF which enable it to achieve its objectives. The main functions, as stated in the Articles of Agreement and performed by the IMF in the furtherance of stable and balanced growth by focusing on financial sector stability and development, are surveillance, technical assistance, and financial assistance.³⁷⁷ It is essential to understand these tools of the IMF in order to explore the IMF's institutional role as an IEI in the balanced and stable growth of the global economy.

1. Surveillance under Article IV³⁷⁸

Article IV of the IMF's Articles of Agreement talks about the most significant function of the IMF: surveillance. Surveillance is carried out by the IMF's relevant department both at bilateral level (which consists of recommendations relating to each member country's policies) and multilateral level (the overseeing of the global economy). The following part of this chapter is dedicated to surveillance at bilateral level.

a) *Bilateral Surveillance*

The goal of surveillance is mentioned in Article IV Articles of Agreement. It is to assist the IMF in supervising the international monetary system to assure its smooth functioning (usually referred to as "multilateral surveillance") and also supervising members' conformity with the commitments stated in Article IV (which amounts to "bilateral surveillance"). Bilateral surveillance is compulsory and all IMF members are obliged to cooperate with the IMF when

³⁷⁷ For details visit generally, <http://www.imf.org/external/about/ourwork.htm>

³⁷⁸ <http://www.imf.org/external/about/econsurv.htm> and also see Factsheet of IMF Surveillance, June 24, 2010, available at: <http://www.imf.org/external/np/exr/facts/surv.htm> , also see, The Fund's Mandate—The Legal Framework, Prepared by the Legal Department of the IMF, Approved by Sean Hagan, 2010, available at: <http://www.imf.org/external/np/pp/eng/2010/022210.pdf>; see also, Mussa, Michael (1997), IMF Surveillance, The American Economic Review Vol. 87, No. 2; Chossudovsky, Michel (1995), 'Effective Global Surveillance': IMF's New Role Economic and Political Weekly, Vol. 30, No. 23; Fratzscher, Marcel and Reynaud, Julien (2011), IMF surveillance and financial markets--A political economy analysis, European Journal of Political Economy, Volume 27, Issue 3, Pages 405-422; see also, Truman, Edwin M. (2010). Strengthening IMF Surveillance: A Comprehensive Proposal, Peterson Institute for International Economics; see also, Alexander, Kern, Dhumele, Rahul, and, Eatwell, John, (2005). 'Global Governance of Financial Systems, The International Regulation of Systemic Risk.' Published to Oxford Scholarship Online: September 2007, p87.

required. Moreover, members need to provide relevant information to the IMF under Section 3(b) of Article IV, and Section 5 of Article VIII of Articles of Agreement. The 2007 Decision³⁷⁹ gives detailed guidance on the operating of bilateral surveillance.³⁸⁰

As is clearly stated above, the basic purpose of IMF-led surveillance is to facilitate the IMF in achieving one of the purposes of its creation. In this context, Article IV appears to be quite significant because it talks about IMF-led surveillance to achieve a sound exchange rate system of currencies between the IMF member countries. In order to achieve this aim of Article IV, it obliges the member countries to follow certain requirements relating to their domestic economic and financial policies. From the legal perspective, IMF-led surveillance is a process of legal pluralism. The purpose of all obligations placed by the IMF on its members (through legal transplant) is to assure a more stable global system of exchange rates (See Box below).

Box 1

Article IV - Obligations Regarding Exchange Arrangements

Section 1. General obligations of members

“Recognizing that the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries, and that sustains sound economic growth, and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability, each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates. In particular, each member shall:

- i) endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances;
- ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions;

³⁷⁹ Factsheet, IMF Surveillance — The 2007 Decision on Bilateral Surveillance, April 5, 2010, available at: <http://www.imf.org/external/np/exr/facts/surv07.htm>

³⁸⁰ Bilateral Surveillance Guidance Note, Prepared by the Strategy, Policy, and Review Department of the IMF, Approved by Reza Moghadam, (2009), p 3, available at: <http://www.imf.org/external/np/pp/eng/2009/102709.pdf>

- iii) avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members; and
- iv) follow exchange policies compatible with the undertakings under this Section.”

Section 3. Surveillance over exchange arrangements

- (a) “The Fund shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations under Section 1 of this Article.”
- (b) “In order to fulfill its functions under (a) above, the Fund shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to those policies. Each member shall provide the Fund with the information necessary for such surveillance, and, when requested by the Fund, shall consult with it on the member's exchange rate policies. The principles adopted by the Fund shall be consistent with cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members, as well as with other exchange arrangements of a member's choice consistent with the purposes of the Fund and Section 1 of this Article. These principles shall respect the domestic social and political policies of members, and in applying these principles the Fund shall pay due regard to the circumstances of members.”

Bearing in mind the above-mentioned purpose of Article IV, the IMF carries out surveillance by checking whether members’ economic and financial policies are in conformity with the members’ commitments to the IMF. Article IV asserts that the IMF should bring all members into the policy compliance process; however, practically speaking, this compliance process has entailed many new exercises in order to achieve its objectives. For example, the practice of surveillance has developed from compliance and now takes the form of a policy discussion whereby the IMF urges the authorities of the member countries concerned to adopt policies (both

internal and external) which the IMF thinks would strengthen the global economy.³⁸¹ This practice of the IMF can be regarded as a compliance plus³⁸² approach towards achieving its purpose by employing the implied power³⁸³ concept of an IO.

The IMF-led surveillance process has three important attributes which need to be considered.³⁸⁴ First, the logic for surveillance of its member countries is mainly to prevent financial crises which would lead to a distortion of the financial sector or vice versa. The IMF strives for this, with the help of surveillance, by convincing the authorities of the member countries concerned to develop their financial sectors by altering their economic and financial policies, prior to falling into a macroeconomic crisis.

Secondly, the IMF-led surveillance exercise is obligatory in its nature and applies to the entire membership. All members are obliged to take part in this surveillance exercise, to seek advice from the IMF and also supply them with all the information needed in order to achieve surveillance objectives.³⁸⁵

Thirdly, in the surveillance process, the IMF has discretion over the issues it raises about the policies of the members concerned, i.e. the content of the IMF's surveillance (consultation process) might vary from member to member, depending on the need for policy compliance in order to ensure a sound financial sector leading to a sound economy.

Generally, the bilateral surveillance process mainly takes into consideration the examination of financial sector and balance sheet vulnerabilities, conclusions reached regarding problems

³⁸¹ For a discussion about the expanding functioning of the IMF in context of the financial sector see, Singh, Dalvinder (2007). 'The Role of the IMF and World Bank in Financial Sector Reform and Compliance: An Outline,' 18 *European Business Law Review*, at 1407-9.

³⁸² It simply means to comply more than the commitments made.

³⁸³ Rama-Montaldo, M. (1970). *International Legal Personality and Implied Powers of International Organizations*, 44 *BYIL* 111, at 139 (1970)

³⁸⁴ Ross Leckow, *The Fund's Legal Instruments to Promote Financial Stability*. Legal Department, International Monetary Fund (2006) para 20, available at: <http://www.imf.org/external/np/seminars/eng/2006/mfl/rl.pdf>

³⁸⁵ Article IV (3) (b) of Article of Agreements of the IMF.

relating to the macro economy and capital flows, and the capacity for and probability of internal and external spillovers. The next section talks about multilateral surveillance under the umbrella of the IMF.

b) Multilateral Surveillance³⁸⁶

The collective will of the members of the IMF to benefit from collective gains has given the IMF the responsibility for and mandate to safeguard the stability of the international monetary system. In this context, Article IV(3)(a) of the Articles of Agreement of the IMF says that the IMF “*shall oversee the international monetary system in order to ensure its effective operation.*” This role, to oversee the international monetary system, requires the IMF to conduct multilateral surveillance. Examples of the IMF’s multilateral surveillance exercises are the World Economic outlook and the Global Financial Stability Report.³⁸⁷

The main aim of multilateral surveillance is to ensure overall stable and balanced economic growth can be achieved through a properly functioning and well-protected global financial sector. As discussed earlier, a well-developed financial sector is significant in achieving stable and balanced growth within the international economic framework.

³⁸⁶ The Fund’s Mandate—The Legal Framework, Prepared by the Legal Department of the IMF, Approved by Sean Hagan, 2010, available at: <http://www.imf.org/external/np/pp/eng/2010/022210.pdf>; for a good discussion about multilateral surveillance see generally, Bird, Graham and Thomas D. Willet (2007). "Multilateral Surveillance: Is the IMF Shooting for the Stars?" World Economics, 8 (4)

³⁸⁷ The Fund’s Mandate—The Legal Framework, Prepared by the Legal Department of the IMF, Approved by Sean Hagan, 2010, para 23, available at: <http://www.imf.org/external/np/pp/eng/2010/022210.pdf>

2. Technical Assistance³⁸⁸

Surveillance is the most effective tool used by the IMF for achieving its objectives in the global economy and the reason for its effectiveness is that surveillance is universally applied to all of its membership, unlike its counterparts^{389, 390}. However, it is not free from shortcomings, the most significant of which is that it is mostly superficial and does not explore in detailed all traits of its members' financial sectors, other than broad macroeconomic policy and its developments.³⁹¹ This is because it is not practical for the IMF to explore and study all aspects of its members' financial sectors. Thus, at this stage, the IMF uses its second tool under Article IV to achieve its objectives, that of technical assistance (TA).

TA is discussed under Section 2(b) of Article V.³⁹² The IMF may provide TA to its members in its expert areas and it extends TA to its concerned members mostly through specialised advice in order to strengthen the institutional capacity of that member in the IMF's area of interest i.e. predominantly the financial sector. TA is not at all mandatory and not universally applied; it is

³⁸⁸ For technical assistance see generally, IEO (2005), Evaluation of the Technical Assistance Provided by the IMF, Volume I & II, team headed by Marcelo Selowsky, available at: <http://www.imf.org/external/np/ieo/2005/ta/eng/013105.htm>; International Monetary Fund (1999), "Review of Fund Technical Assistance: From Technical Assistance to Technical Consultation and Cooperation" (Washington: International Monetary Fund); International Monetary Fund (2000), "Ensuring Alignment of Technical Assistance with the IMF's Policy Priorities" (Washington: International Monetary Fund); International Monetary Fund (2001), "Review of the Technical Assistance by the Legal Department", Office of Internal Audit and Inspection (Washington: International Monetary Fund); International Monetary Fund (2002), "Review of Technical Assistance Policy and Experience" (Washington: International Monetary Fund); International Monetary Fund (2003), "IMF Technical Assistance: Transferring Knowledge and Best Practice" (Washington: International Monetary Fund). Available at: <http://www.imf.org/External/pubs/ft/exrp/techass/techass.htm>; International Monetary Fund (2008), Enhancing the Impact of Fund Technical Assistance. Prepared by the Office of Technical Assistance Management and Approved by Alfred Kammer; IEO (2007). The Governance of IMF Technical Assistance. Independent Evaluation Office of the International Monetary Fund Prepared by Mariano Cortes. Document no. BP/08/13

³⁸⁹ The other two are Technical Assistance and Financial Assistance.

³⁹⁰ Article IV (3) (a): "The Fund shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations under Section 1 of this Article."

³⁹¹ Ross Leckow, The Fund's Legal Instruments to Promote Financial Stability. Legal Department, International Monetary Fund (2006) para 25, available at: <http://www.imf.org/external/np/seminars/eng/2006/mfl/rl.pdf>

³⁹² The IMF's authority to provide TA is set forth in Article V, Section 2(b) of the Articles of Agreement under which the IMF "may", upon request, provide technical assistance harmonious with the objectives of the IMF. Article V, Section 2(b) reads in pertinent part: "If requested, the Fund may decide to perform financial and technical services, including the administration of resources contributed by members, that are consistent with the purposes of the Fund."

purely up to members to ask for TA from the IMF whilst, on the other hand, it depends on the IMF whether they want to extend TA to a member.³⁹³

The IMF mostly looks for the stable and balanced growth of economy by providing TA which is mainly dedicated to the building of the institutional capacity of the member concerned in the area of their financial sector. Under the TA programs, the IMF staff mainly assist the authorities of the member countries by working closely with them to support them in strengthening their organisational structure in the area of their financial sector, the central bank and financial supervisory agencies' operations and the transfer of knowledge regarding these operations.³⁹⁴

Most commonly, member countries request assistance from the IMF in identifying and suggesting solutions to financial sector weaknesses in their systems. In this context, the IMF and World Bank have started a joint project to evaluate vulnerabilities in the financial sectors of member countries at their request. This program is called the Financial Sector Assessment Program³⁹⁵ which promotes international standards and codes³⁹⁶ for financial, fiscal, and statistical management. Moreover, it takes measures to strengthen initiatives against money

³⁹³ DISSEMINATION OF TECHNICAL ASSISTANCE INFORMATION, Prepared by the Office of Technical Assistance Management and the Legal Department of the IMF, Approved by Alfred Kammer and Sean Hagan (2008), para 8, available at: <http://www.imf.org/external/np/pp/eng/2008/040308b.pdf>

³⁹⁴ The IMF extends its technical services in areas of its speciality, for example; in tax policy, macroeconomic policy, revenue administration, monetary policy, expenditure management, financial sector sustainability, the exchange rate system, and financial and macroeconomic statistics. IMF Factsheet of Technical Assistance, 2010, Available at: <http://www.imf.org/external/np/exr/facts/tech.htm> For core areas of expertise visit <http://www.imf.org/external/pubs/ft/psta/index.htm#annex>

³⁹⁵ IMF Factsheet, The Financial Sector Assessment Program (FSAP), 2010, available at: <http://www.imf.org/external/np/exr/facts/fsap.htm> and for details about the FSAP programs visit <http://www.imf.org/external/np/fsap/fsap.asp>; see also, Kupiec, Paul (2005), "The IMF–World Bank financial sector assessment program: A view from the inside," in Systemic Financial Crisis: Resolving Large Bank Insolvencies, D. Evanoff and G. Kaufman (eds.), Singapore: World Scientific Publishing.

³⁹⁶ IMF Factsheet, Standards and Codes: The Role of the IMF, 2010. Available at: <http://www.imf.org/external/np/exr/facts/sc.htm> ; see also, Jordan, Cally E. and Majnoni, Giovanni (2002). Financial Regulatory Harmonization and the Globalization of Finance. World Bank Policy Research Working Paper No. 2919.

laundering and the funding of terrorism³⁹⁷. The following section will talk about the TA activities provided by the IMF, as mentioned above.

a) *Financial Sector Assessment Program*³⁹⁸

The Financial Sector Assessment Program (FSAP) is the most significant aspect of the IMF's TA operation. The FSAP is a combined initiative of the IMF and the World Bank and was taken on board after the Asian financial crisis in 1999.³⁹⁹ As is clear from its name, it is an assessment program of the financial sectors of its member countries. FSAP encourages its membership towards a deeper collective effort to monitor their own financial systems with the help of the IMF. Its basic aim is to assess in detail the financial sectors of its members and identify on behalf of the national authorities concerned the weaknesses in their financial systems. In addition to the assessment of the member countries' financial sectors, FSAP provides assistance to members in order to develop measures to reduce or overcome the weaknesses they have identified in their financial systems.⁴⁰⁰

³⁹⁷ IMF Factsheet, *The IMF and the Fight Against Money Laundering and the Financing of Terrorism*, 2010. Available at: <http://www.imf.org/external/np/exr/facts/aml.htm> ; see also, Masciandaro, D. (ed.) (2004) *Global Financial Crime: Terrorism, Money Laundering and Offshore Centres*. Aldershot: Ashgate; see also, Alexander, K. 2002. "Extraterritorial U.S. Banking Regulation and International Terrorism." *Journal of International Banking Regulation* 3, no. 4: 307–326.

³⁹⁸ IMF Factsheet, *The Financial Sector Assessment Program (FSAP)*, 2010, available at: <http://www.imf.org/external/np/exr/facts/fsap.htm> and for details about the FSAP programs visit <http://www.imf.org/external/np/fsap/fsap.asp> and also see generally, *Financial Sector Assessment Program—Background Paper*, Prepared by the Staff of the Monetary and Financial Systems Department of IMF, Approved by Tomás J.T. Baliño, 2005. Available at: <http://www.imf.org/external/np/fsap/2005/022205a.pdf>; see also, Gianviti, F. (2002). 'Legal Aspects of the Financial Sector Assessment Program (FSAP)', available at <http://www.imf.org/external/np/leg/sem/2002/cdmfl/eng/gianv2.pdf>; see also, Singh, Dalvinder (2007). 'The Role of the IMF and World Bank in Financial Sector Reform and Compliance: An Outline,' 18 *European Business Law Review*.

³⁹⁹ Alexander, Kern, Dhumale, Rahul, and, Eatwell, John, (2005). 'Global Governance of Financial Systems, The International Regulation of Systemic Risk.' Published to Oxford Scholarship Online: September 2007, p74.

⁴⁰⁰ IMF Factsheet, *The Financial Sector Assessment Program (FSAP)*, 2010, available at: <http://www.imf.org/external/np/exr/facts/fsap.htm>

FSAP stresses the connectivity and interdependence between the functioning of the financial sector and the macro economy. Mostly, it studies the institutional framework of the financial sector and also assesses it in the context of a risk and vulnerability analysis through different types of indicators and stress tests.⁴⁰¹

FSAP is quite a popular TA program of the IMF, as it has been requested and received by more than 120 member countries of the IMF. FSAP also helps the IMF with the improved operation of its other tools, such as surveillance. As it assesses the financial sector of the member country in detail, it gives the IMF an opportunity to study the information for the purposes of surveillance.⁴⁰²

With the same purpose of providing certainty in the framework of the global economic scenario, the IMF has initiated the practice of making and implementing international codes and standards.

The next section talks about these international standards and codes.

b) International Codes and Standards

The IMF and the World Bank have also encouraged its membership to comply with international standards and codes related to the financial sector. This encouragement can be better understood with the insight of legal transplant. For harmonisation purposes, the IMF transplants standards and codes into domestic legal systems. In fact, these IELs have taken on a number of standards

⁴⁰¹ However, over the passage of time new features have been included in the TA activity. For example, more candid and transparent assessments; improved analytical toolkit; more flexible modular assessments, tailored to country needs; better cross-country perspectives; and better targeting of standards assessments. For details visit <http://www.imf.org/external/np/exr/facts/fsap.htm>

⁴⁰² IMF Factsheet, The Financial Sector Assessment Program (FSAP), 2010, available at: <http://www.imf.org/external/np/exr/facts/fsap.htm>

and codes that denote good practice and further, advises its members to absorb these practices into their institutional frameworks for the better functioning of their financial sectors.⁴⁰³

The IMF only sets some of these best practices itself⁴⁰⁴; most are developed by different international bodies that hold some specialisation in their respective areas. Some of the IOs involved in the formation of standards and codes as best practice in their respective fields are;⁴⁰⁵

- *Basel Committee's Core Principles on Banking Supervision;*⁴⁰⁶
- *International Organization of Securities Commission's Objectives for Securities Regulation;*⁴⁰⁷
- *International Association of Insurance Supervisors' Insurance Supervisory Principles;*⁴⁰⁸
- *Committee on Payments and Settlements Systems' Recommendations for Securities Settlement Systems;*⁴⁰⁹
- *Financial Action Task Force's Recommendations in the area of Anti-money Laundering and Combating the Financing of Terrorism.*⁴¹⁰

⁴⁰³ IMF Factsheet, Standards and Codes: The Role of the IMF, 2010. Available at: <http://www.imf.org/external/np/exr/facts/sc.htm> ; see also, Delonis, Robert P., (2004). International Financial Standards and Codes: Mandatory Regulation Without Representation, 36 N.Y.U. J. INT'L L. & POL. 563.

⁴⁰⁴ Standards in the areas of data (<http://dsbb.imf.org/>), fiscal transparency (<http://www.imf.org/external/np/fad/trans/index.htm>), and monetary and financial policy transparency (<http://www.imf.org/external/np/mae/mft/index.htm>) have been developed by the IMF. <http://www.imf.org/external/standards/index.htm>

⁴⁰⁵ IMF Factsheet, Standards and Codes: The Role of the IMF, 2010. Available at: <http://www.imf.org/external/np/exr/facts/sc.htm>

⁴⁰⁶ For details about Basel Committee's Core Principles on Banking Supervision visit: <http://www.bis.org/bcbs/> ;

⁴⁰⁷ For details about International Organization of Securities Commission's Objectives for Securities Regulation visit: <http://www.iosco.org/>

⁴⁰⁸ For details about International Association of Insurance Supervisors' Insurance Supervisory Principles visit: <http://www.iaisweb.org/index.cfm?pageID=41>

⁴⁰⁹ For details about Committee on Payments and Settlements Systems' Recommendations for Securities Settlement Systems visit: <http://www.bis.org/cpss/index.htm>

Besides the above-mentioned standards and codes, there exists a significant degree of best practice in the areas of, for example, corporate governance, monetary and financial policy management, auditing, and accounting.⁴¹¹ After evaluation of a member's conformity with these best practices, the IMF and the World Bank releases a report, called a Report on the Observance of Standards and Codes (ROSC).⁴¹² The basic aim of this reporting procedure is to spot weaknesses in the institutional framework, wherein those weaknesses might be dealt with later by a TA program of the IMF.

In the context of the development of standards, the IMF has also developed standards such as the Special Data Dissemination Standard (SDDS) and the General Data Dissemination System (GDDS) for the purpose of reporting economic data to the markets.⁴¹³ The benefit to members in adopting these standards is that they attract more investors since they more easily understand the economic statistics of the investing country. Moreover, if the economic development standards are clear and understandable to both the investor and the other market player, then the probability of them overreacting lessens, which adds considerably to the stability of the economy.

⁴¹⁰ For details about Financial Action Task Force's Recommendations in the area of Anti-money Laundering and Combating the Financing of Terrorism visit: http://www.fatf-gafi.org/pages/0,2987,en_32250379_32235720_1_1_1_1_1,00.html

⁴¹¹ In this context, standards have been formed by various international entities, including the World Bank. These are usually assessed by the World Bank; Corporate Governance: Organization of Economic Cooperation and Development's Principles of Corporate Governance; Accounting: International Accounting Standards Board's International Accounting Standards; Auditing: International Federation of Accountants' International Standards on Auditing; and, Insolvency and Creditor Rights: A standard based on the World Bank's Principles for Effective Insolvency and Creditor Rights Systems and the United Nations Commission on International Trade Law Legislative Guide on Insolvency Law is being finalized. <http://www.imf.org/external/np/exr/facts/sc.htm>

⁴¹² Reports on the Observance of Standards and Codes (ROSCs). Available at: <http://www.imf.org/external/np/rosc/rosc.asp>; also visit, http://www.worldbank.org/ifa/rosc_aa.html; International Monetary Fund (2000). Experimental Reports on Observance of Standards and Codes (ROSCs). Washington, DC: IMF.

⁴¹³ Visit Dissemination Standards Bulletin Board at: <http://dsbb.imf.org/>; see generally, Cady, John (2004), Does SDDS Subscription Reduce Borrowing Costs for Emerging Market Economies? IMF Working Paper, Vol. , pp. 1-14.

The next IMF tool for achieving the purpose of its creation is financial assistance which the ensuing part of this chapter highlights.

3. IMF Financial Assistance⁴¹⁴

Surveillance and TA are two instruments which are very useful in the prevention of a financial crisis. However, if a financial crisis emerges, then these preventive measures are placed on the back burner and the crisis-affected country needs an immediate cure. In this scenario, the IMF considers the whole picture and helps the crisis-affected country to stabilise its external position and also the health of its internal financial system. This involves the IMF's third tool in the context of the promotion of financial stability (restoring the financial sector); that is, financial assistance to the country in crisis.

According to the Articles of Agreement, the IMF has the discretion to extend financial assistance to a member country in order to resolve the member's balance of payments difficulties.

Article I of the IMF's Articles of Agreement maintains that the object of loaning by the IMF is "...to give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity."

However, there are strings attached. The reason for this is that the IMF wants to make sure that financial difficulties are fully resolved through comprehensive economic reform.⁴¹⁵ These strings are known as conditionalities and the member country concerned needs to agree and implement these conditionalities in order to obtain financial assistance from the IMF. The IMF provides

⁴¹⁴ For basic knowledge about lending by IMF visit: <http://www.imf.org/external/about/lending.htm>

⁴¹⁵ Moreover, the IMF is not a developmental organisation and thus needs to make arrangement for the recovery of the money lent to the crisis-sick member country.

money in instalments which are spread over the duration of the assistance program; however, the imbursement of the money depends on the member's implementation of the IMF's recommendations and on the achievement of specific economic targets (which is part of the conditionality).

At this stage, I am not going to focus on the types of financial assistance provided by the IMF to its members.⁴¹⁶ However, the focus will be on the rationale for attaching conditions to the financing, the types of conditions attached, the nature of conditionality and its overall effect.

a) *Rationale for Conditionality*

It is highly logical that a lender would want to know and make sure that whoever is in recipient of his loan is capable of returning his money. Otherwise, how can recovery be assured? This is the case with the IMF; it is a financial institution which lends money to member countries with balance of payment difficulties. As the lender, the IMF tries to make sure that the member country has recovered from financial distress and is capable of returning the IMF loan. In this context, the IMF's conditionality is perfectly justified and is also helpful to the member concerned (which is a view very often challenged by many scholars).⁴¹⁷

⁴¹⁶ For a good discussion about IMF financing see generally, Alexander, Kern (2005). *The Fund's Role in Sovereign Liquidity Crises*, in *Current developments in monetary and financial law*. International Monetary Fund.

⁴¹⁷ *Guidelines on Conditionality*, Prepared by the Legal and Policy Development and Review Departments of the IMF, 2002, para 1. Available at: <http://www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.pdf> ; see also, Buirra, Ariel (2003). *An Analysis of IMF Conditionality*, G-24 Discussion Paper No. 22, p3; see also, Alexander, Kern, Dhumale, Rahul, and, Eatwell, John, (2005). 'Global Governance of Financial Systems, The International Regulation of Systemic Risk.' Published to Oxford Scholarship Online: September 2007, p88.

b) Scope of conditionality

The scope of conditionality is mentioned in the guidelines on conditionality provided by the IMF. The text below illustrates the governing principles which outline the scope of the conditionality.

Box 2

Decision 1, paragraph 7, of Guideline on Conditionality: Scope of conditions

“Program-related conditions governing the provision of Fund resources will be applied parsimoniously and will be consistent with the following principles:

(a) Conditions will be established only on the basis of those variables or measures that are reasonably within the member’s direct or indirect control and that are, generally, either (i) of critical importance for achieving the goals of the member’s program or for monitoring the implementation of the program, or (ii) necessary for the implementation of specific provisions of the Articles or policies adopted under them. In general, all variables or measures that meet these criteria will be established as conditions.

(b) Conditions will normally consist of macroeconomic variables and structural measures that are within the Fund’s core areas of responsibility. Variables and measures that are outside the Fund’s core areas of responsibility may also be established as conditions but may require more detailed explanation of their critical importance. The Fund’s core areas of responsibility in this context comprise: macroeconomic stabilization; monetary, fiscal, and exchange rate policies, including the underlying institutional arrangements and closely related structural measures; and financial system issues related to the functioning of both domestic and international financial markets.

(c) Program-related conditions may contemplate the member meeting particular targets or objectives (outcomes-based conditionality), or taking (or refraining from taking) particular actions (actions-based conditionality). The formulation of individual conditions will be based, in particular, upon the circumstances of the member.”

According to this, conditionality can require a member country to achieve certain targets or objectives or it may be required to perform or, in some cases, not perform certain activities.⁴¹⁸

However, these conditions are vital to the success of the IMF financial assistance program and significant for the implementation of the IMF Articles of Agreement and its related policies.⁴¹⁹

⁴¹⁸ Guidelines on Conditionality, Prepared by the Legal and Policy Development and Review Departments of the IMF, 2002, para 7(c). Available at: <http://www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.pdf>

⁴¹⁹ Guidelines on Conditionality, Prepared by the Legal and Policy Development and Review Departments of the IMF, 2002, para 7(a). Available at: <http://www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.pdf>

The last part of Paragraph 7 (a) of Guideline on Conditionality by the IMF (“*In general, all variables or measures that meet these criteria will be established as conditions.*”) makes the scope of the conditionality very wide. However, the following paragraph i.e. 7 (b) of the Guideline tries to limit its scope by elaborating that the conditionality is normally related to the core areas of the IMF’s responsibility but that other things can be included in it with detailed reasoning to do so.⁴²⁰

In short, IMF conditionality is of significant importance to enable the IMF to exist as an effective IO. As discussed earlier in this chapter, an IO’s power to enforce its decisions on a member country is, in fact, the most critical attribute of an IO. Thus, with the help of conditionality, the IMF tends to be an effect IO. The reason why conditionality is so important to the IMF is that it lacks a comprehensive institutional structure, because it lacks an effective adjudicating body.

D. Conclusion

This chapter looks at the legal framework of the IMF which is based on its Articles of Agreement and the decisions of the Executive Board. The IMF endorses stable and balanced global economic growth which is an essential goal of the liberally institutionalised (rational) international community. This goal is achieved by the IMF by means of its primary activities, which comprise surveillance, technical assistance, and financial assistance. The legal bases of these activities have been documented in this chapter. However, a significant trait of the IMF’s

⁴²⁰ For example IMF can use conditionality as a tool to get implementation of standards and codes by the member countries. [Access to the CCL (contingent-credit lines) is subject to the adherence of, at least: “(1) subscription to and use of the IMF’s Special Data Dissemination Standards, which guide countries making economic and financial data available to the public; (2) compliance with the Basle Core Principles for Banking Supervision; (3) use of the IMF-designed code on fiscal transparency; and (4) use of the IMF-designed code on transparency in monetary and financial policies. A more comprehensive analysis of adherence would be possible where a Report on Observance of Standards and Codes (ROSC) has been prepared. ROSCs include assessment of adherence to seven other sets of standards and codes.” IMF Executive Board Meeting 17 November, 2000.] [FSF, Report of the follow-up group on incentives to foster implementation of standards, September 2000]. See generally, Dr. Benu Schneider (2002). Issues in Implementing Standards and Codes, Paper presented at the ODI conference on International Standards and Codes: The Developing Country Perspective.

methodology in achieving the above-mentioned goal is its emphasis on advice, persuasion, and eventually cooperation (which mostly involves conditionalities for needy countries).

V. The Institutional role of the IMF in achieving stable and balanced growth in the global economy through the International Economic Cycle

The ideal institutional role of an IEI has been discussed in detail in the theory chapter.⁴²¹ This chapter is dedicated to highlighting the institutional role of the IMF. This institutional role of the IMF, which the IMF itself does not explicitly admit to, actually does exist and contributes significantly (as part of the IELR) to enhancing the certainty and predictability of the rules of the game in the international economic scenario.

As discussed in the theoretical framework, the Economic Cycle constitutes a causal relationship between financial sector development and the expansion of international trade.⁴²² Thus this chapter tries to characterise the IMF's functioning in an institutional role (as described in the theoretical framework) in the context of both constituents of the Economic Cycle (the financial sector and international trade). The purpose of this exercise is to show that the institutional role of the IMF does exist and that the IMF needs to explicitly pay more attention to its institutional role. This institutional role has a direct link with the stable and balanced growth of the global economy through the Economic Cycle, therefore, improvement in the institutional role would lead to better opportunities for achieving a more stable and balanced growth of the global economy.

In this context, this chapter is divided into two parts, A and B. Part A is dedicated to the IMF's contribution to the development of the global financial sector and part B is devoted to the IMF's

⁴²¹Chapter II.A.3 on page 38

⁴²² Chapter II.B.3.e) on page 90

contribution to the promotion of international trade. As a whole, this chapter highlights the IMF's contribution as an IEI in promoting the certainty and predictability of the rules of the game within the IELR. The following part of the chapter will examine the IMF's international institutional role in achieving economic growth through the development of the global financial sector (Patrick's supply lead hypothesis⁴²³).

A. IMF and Financial Sector Development

The purpose of this subheading is to explore the role played by the IMF in promoting economic growth through the development of the global financial sector. The role of the IMF is viewed in its institutional capacity as an IEI (which is discussed in chapter II). The institutional role of the IMF rests on its functioning in its legislative and normative capacity; and executive and administrative capacity. The IMF lacks a judicial and quasi-judicial function, which is a significant part of the institutional role. Even with this significant deficiency, the IMF has managed to contribute towards the Economic Cycle.

As discussed in the preceding chapter on the IMF's legal framework, the development of the financial sector comes within the direct domain of the IMF. The reason for this is to ensure financial stability and balanced economic growth for which financial sector development is quite crucial.⁴²⁴ Thus, the following part of the chapter discusses the role of the IMF in its legislative and normative capacity in the development of the global financial sector. This legislative and normative functioning is part of the institutional role of the IMF which is also part of the IELR.

⁴²³ Chapter II.B.3.a) on page 73

⁴²⁴ Chapter IV part (B) Purpose of IMF on page 139

1. ***Legislative and normative capacity of the IMF and development of the financial sector***

The legislative and normative functioning of the IMF is part of its institutional role, which contributes positively to the IELR by enhancing the certainty and predictability of the rules of the game in its area of specialisation. This part of the chapter will discuss all the acts of the IMF which increase certainty and predictability within its area of speciality; any act which produces the effect of a law will be discussed under this subheading.

The IMF acts which come under this category are quite limited. They are, for example, the creation of certain standards and codes, best practice, the decisions of the Executive Board and policy advice.⁴²⁵ All the above-mentioned acts are non-binding norms or rules, which the IMF creates and supports in order to fulfil the purpose of its creation. These norms and rules fall under the category of “*soft law*”. However, when these norms are backed by IMF conditionality,⁴²⁶ then they have a binding effect on the member country upon which the condition is imposed.⁴²⁷

Before turning to look at the effects of the IMF’s soft laws, it is essential to elaborate upon the term “soft law”. It should be mentioned here, also, that there is no clear cut and largely- accepted definition of soft law by scholars.⁴²⁸

⁴²⁵ The IMF legal framework allows the IMF to carry on functions which are necessary to achieve its goals.

⁴²⁶ This point is discussed in the later part of the chapter. See Chapter V.B.4.b)(3) on page 210

⁴²⁷ See generally, Brinsmead, Simon (2007), Rulemaking in ICAO, the ILO and the IMF: The Rise of Standards. Available at SSRN: <http://ssrn.com/abstract=1002758>

⁴²⁸ SHELTON, D.(2003), International Law and “Relative Normativity”, in EVANS M.D. (ed.), International Law, , p. 166. See also, Borgia, Fiammetta (2010), New Governance Mechanisms in International Economic Law: The Role of Soft Law. Society of International Economic Law (SIEL), Second Biennial Global Conference, University of Barcelona, July 8-10, 2010. Available at SSRN: <http://ssrn.com/abstract=1633984>

See also, Definition by Professor Harris that “soft law consist of written instruments that spell out rules of conduct that are not intended to be legally binding, so that they are not subject to the law of treaties and do not generate the opinio juris required for them to be state practice contributing to custom. See HARRIS, D.J., 2004. Cases and materials on international law. 6th. London: Sweet & Maxwell, p. 62.

In particular, soft law is comprised of the acts, such as rules, guidelines, standards, and other arrangements, of all the players within the international community which are of regulatory nature and which have a non-binding effect.⁴²⁹ These soft laws cannot be termed traditional legal law; however, these soft laws are based upon the concept of traditional legally-binding norms, which again are based on the logic whereby repeated practice makes things right and proper. The intensity of the duty imposed by these soft laws is less than that of a legally-binding obligation. This is due to the fact that the institution which creates these soft laws has no authority to create obligatory rules of the game and because these soft laws are not backed by sanctions.⁴³⁰

These soft laws are deficient of the essential normative element to produce enforceable rights and obligations, yet they can produce a legal effect.⁴³¹ As these soft laws cannot be termed as proper laws on the one hand and non-law on the other, these soft laws come somewhere in-between as they are not proper enforceable laws but can have considerable influence on the existing binding obligations of international law.⁴³²

Recently, it has been observed that scholars place more emphasis on compliance with these soft laws rather than exploring their nature and effect.⁴³³ This is because these soft laws are more often taken as facts, even though very often they are not laws themselves but a technique to bind

⁴²⁹ (“[t]he international rules, guidelines, standards, and other arrangements that govern financial regulation are not of a legally binding nature and are therefore generally referred to as ‘international soft law.’” Alexander, Kern, Dhumale, Rahul, and, Eatwell, John, (2005). ‘Global Governance of Financial Systems, The International Regulation of Systemic Risk.’ Published to Oxford Scholarship Online: September 2007, chapter 4: International Soft Law and the Formation of Binding International Financial Regulation, at p134.

⁴³⁰ Borgia, Fiammetta (2010), *New Governance Mechanisms in International Economic Law: The Role of Soft Law*. Society of International Economic Law (SIEL), Second Biennial Global Conference, University of Barcelona, July 8-10, 2010. Available at SSRN: <http://ssrn.com/abstract=1633984>

⁴³¹ Francioni F. (2007), *International “Soft Law”: A Contemporary Assessment*, in LOWE V., FITZMAURICE M. (eds.), *Fifty Years of the International Court of Justice, Essays in Honor of Sir Robert Jennings*, Cambridge, p. 168.

⁴³² Van, Hoof G.J.H. (1983), *Rethinking the Sources of International Law*, p. 187. See also, Borgia, Fiammetta (2010), *New Governance Mechanisms in International Economic Law: The Role of Soft Law*. Society of International Economic Law (SIEL), Second Biennial Global Conference, University of Barcelona, July 8-10, 2010. Available at SSRN: <http://ssrn.com/abstract=1633984>

⁴³³ CHAYES, A. (1995), *The New Sovereignty: Compliance with International Regulatory Agreements*.

countries without making binding rules.⁴³⁴ However, this technique (the process of soft law) is highly successful in the global financial regulatory system due to the flexible nature of these laws. Moreover, for an optimal effect of the soft laws, the key is the right mix between hard and soft law in a specific issue area.⁴³⁵

In short, soft law is anything which has the effect of a law but is not actually a law, as it lacks the basic element for anything to be termed as law i.e. enforcement. The following section is dedicated to the IMF's role in the creation of soft law. First, we will look at standards and codes, followed by the IMF as the source of conventions and the decisions of the Executive Board.

a) Standards and Codes

The most common form of soft law created by the IMF is standards and codes. Standards and codes are the rules of the game set by the institutions so that policies can be drafted in accordance with these rules. Once policies are made in conformity with these rules of the game and created by an institutional set-up, then their implementation becomes quite easy. Moreover, it is long been recognised that a good institutional set-up with standards and codes has a positive effect on the economic functioning of a country. With the passage of time, it is observed that if a country implements standards and codes, both domestic and international, then this adds to the economic performance and efficiency of that country by reducing the transaction costs.⁴³⁶

⁴³⁴ VELLAS, P. (1990), *Aspects du droit international économique*, Pedone, Paris, p. 18. See also, Borgia, Fiammetta (2010), *New Governance Mechanisms in International Economic Law: The Role of Soft Law*. Society of International Economic Law (SIEL), Second Biennial Global Conference, University of Barcelona, July 8-10, 2010. Available at SSRN: <http://ssrn.com/abstract=1633984>

⁴³⁵ A very good discussion on the soft laws and financial regulations see, Alexander, Kern, Dhumale, Rahul, and, Eatwell, John, (2005). 'Global Governance of Financial Systems, The International Regulation of Systemic Risk.' Published to Oxford Scholarship Online: September 2007, chapter 4: International Soft Law and the Formation of Binding International Financial Regulation, at p134,137,138.

⁴³⁶ The Standards and Codes Initiative—Is It Effective? And How Can It Be Improved? Prepared by the Staffs of the International Monetary Fund and World Bank, Approved by Mark Allen and Danny M. Leipziger (2005). p8. Available at: <http://www.imf.org/external/np/pp/eng/2005/070105a.htm> ; see also, Alexander, Kern, Dhumale, Rahul, and, Eatwell, John, (2005). 'Global Governance of Financial Systems, The International Regulation of

The IMF has been active in the process of formation of standards and codes; for example, for economic data-reporting to markets, Special Data Dissemination Standard (SDDS) and the General Data Dissemination System (GDDS).⁴³⁷ The IMF has also formed standards in the fields of fiscal transparency, and monetary and financial policy transparency.⁴³⁸ These standards and code add certainty to economic data-reporting and predictability through a bottom-up approach in fiscal and monetary policies. This whole process is part of the IMF's institutional role as part of the IELR.

The following section within this subheading will review the standards and codes developed by the IMF as an IEI in its normative capacity.

(1) *Special Data Dissemination Standard (SDDS)*

One of the causes of financial crisis in 1990s was information deficiencies which highlighted the need for data standardisation. In this context, the IMF instigated the data standards program to improve member countries' data transparency and to support their advancement of reliable statistical systems.⁴³⁹ From the perspective of data standardisation, the IMF formed the Special Data Dissemination Standard (SDDS) in 1996 to enable it to guide countries when they access capital markets, by disseminating important data. This is both important and helpful to all the market participants in the evaluation of the economic condition of the countries concerned. This process increases the predictability of the international economic system. Moving along the same

Systemic Risk.' Published to Oxford Scholarship Online: September 2007, chapter 4: International Soft Law and the Formation of Binding International Financial Regulation, at p143.

⁴³⁷ Visit Dissemination Standards Bulletin Board at: <http://dsbb.imf.org/>

⁴³⁸ <http://www.imf.org/external/standards/index.htm>

⁴³⁹ During Mexico crisis in 1994, the international financial community realised the important contribution of data transparency, macroeconomic and financial data, for facing the setbacks of globalization and lowering the chances of acute financial instability. See generally, Gil-Diaz, Francisco (1998). THE ORIGIN OF MEXICO'S 1994 FINANCIAL CRISIS, An Interdisciplinary Journal of Public Policy Analysis Volume 17, Number 3.

lines, in 1997, the IMF launched the General Data Dissemination System (GDDS) which provided an enhanced framework (one step further on from the SDDS) to countries that endeavoured to build up their statistical systems.⁴⁴⁰

**(2) *The Code of Good Practices on Fiscal
Transparency***⁴⁴¹

The code of Good Practices on Fiscal Transparency is an initiative by the IMF which recognises a collection of standards and codes in order to facilitate governments in ensuring a transparent picture of the governments' financial position. These codes of Good Practices on Fiscal Transparency are adopted completely voluntarily by governments (but if backed by conditionality, then it becomes somehow binding). This code is a bottom-up approach adopted by the IMF whereby it provides basic principles based on reason. Moreover, if adopted by governments, then it is observed that public confidence (which also includes investors) in the accuracy and strength of fiscal policy is increased.

The code of Good Practices on Fiscal Transparency was created in 1998 and in 2007, it was revised by the IMF (Executive Board). The purpose of the above-mentioned code is to streamline and support the development of the international financial architecture. The following are the basic principles on which the Code of Good Practices on Fiscal Transparency is developed.

⁴⁴⁰ International Monetary Fund (2007), *The Special Data Dissemination System: guide for subscribers and users*, [Washington, D.C.]

⁴⁴¹ For details about the Code of Good Practices on Fiscal Transparency (2007) visit : <http://www.imf.org/external/np/fad/trans/code.htm>

Clarity of roles and responsibilities: The above-mentioned code states that there should be a clear-cut distinction between public and private domains. Moreover, the policies and administrative functioning of the public sector should be unambiguous and open to the public.

Open budget processes: The second principle provides a guideline regarding the budget process. It asserts that the information provided in the budget should be easy to analyse and accountability-oriented. A budget should clearly state the goals of the fiscal policy and the supposition draw on in devising the budget, and should also mention the main fiscal risks and revenue collection method.

Public availability of information: Information relating to the budget should be published periodically so that it is easily available to public, whether it is for the past, present or coming year's budget.

Assurances of integrity: The whole budgetary process should be carried out within recognised standards and should be subject to independent examination.

The above principles are based on simple reasoning and any country following the Code would eventually benefit, as there is a direct link between fiscal policy and development of the financial sector.⁴⁴² Thus, this initiative by the IMF is a notable contribution in its normative capacity towards the development of the global financial sector which is essential for the stable and balanced growth of the global economy.

⁴⁴² See generally, Caballero, Ricardo J., and Arvind Krishnamurthy, 2004, "Fiscal Policy and Financial Depth," NBER Working Paper No. 10532 (Cambridge, Massachusetts: National Bureau of Economic Research). Catão, Luis, and Marco E. Terrones, 2005, "Fiscal Deficits and Inflation," *Journal of Monetary Economics* (Vol. 52, No. 3), pp. 529–54. Also see, Hauner, David, *Fiscal Policy and Financial Development* (January 2006). IMF Working Paper, Vol. , pp. 1-26, 2006. Available at SSRN: <http://ssrn.com/abstract=888171>

**(3) Code of Good Practices on Transparency in
Monetary and Financial Policies⁴⁴³**

In order to support the framework of the international financial and monetary system, the IMF, in 1998, developed a code of good practices on transparency in monetary and financial policies. In this context, the IMF relied upon the cooperation of the Bank for International Settlements, a representative group of central banks, financial agencies, and other international and regional organisations involved in the development process.

This code basically asserts that governments should streamline their current practices with good practices proposed by the IMF in the context of monetary and financial policies. These soft law contributions by the IMF (in the form of codes) are a clear contribution in its institutional capacity towards the IELR.

b) IMF as a forum for the adoption of conventions

As discussed earlier in this chapter, an IO, in its norm-making capacity, often emerges as a forum for conventions which sometimes results in a normative effect.⁴⁴⁴ The following part of the subheading is dedicated to the IMF as a forum for the adoption of conventions.

**(1) Financial Soundness Indicators (FSI) Metadata
Conventions⁴⁴⁵**

⁴⁴³ For details about Code of Good Practices on Transparency in Monetary and Financial Policies visit: <http://www.imf.org/external/np/mae/mft/code/index.htm> ; see also, Fridriksson, Ingimundur (2000). *Code of Good Practices on Transparency in Monetary and Financial Policies*, in *Monetary Bulletin*, A Quarterly Publication of the Central Bank of Iceland 2000/3.

⁴⁴⁴ See above chapter II.A.3.a)(2)(a) on page 42

⁴⁴⁵ See generally, Sundararajan, V. (2002). *Financial soundness indicators: analytical aspects and country practices*. Washington, DC: International Monetary Fund. And also visit: <http://fsi.imf.org/MTCovns.aspx>

The IMF, together with the help of the international community (which includes international institutions)⁴⁴⁶, developed Financial Soundness Indicators (FSIs), the purpose of which was to assist macro-prudential analysis and the evaluation of the strong points and weaknesses of the financial systems of the countries concerned. The FSIs are very important in the surveillance program of the IMF and the World Bank. If the weaknesses of any country's financial system are identified in good time, then there is a greater chance of avoiding a crisis situation, which is highly negative for global economic stability and growth. Thus, these Metadata conventions on FSI fall under the category of soft law creation by the IMF.

(2) *Assumptions and Data Conventions*⁴⁴⁷

Below are mentioned some of the very basic conventions used by the *World Economic Outlook*. However, these data conventions and assumptions are clarified by the IMF, thereby creating certainty in the context of their usage.

- *Domestic economy series are expressed in billions of national currency units.*
- *External accounts series are expressed in billions of U.S. dollars.*
- *"Billion" means a thousand million; "trillion" means a thousand billion.*
- *Missing data are indicated by "n/a".*
- *Blank row means that data are not available or not applicable.*

⁴⁴⁶ Experts from 17 member countries and 6 international and regional agencies met on October 29–30, 2003 to discuss the latest draft of the IMF's Compilation Guide on Financial Soundness Indicators. Available at: <http://www.imf.org/external/pubs/ft/survey/2003/111703.pdf#fsi>

⁴⁴⁷ Assumptions and Data Conventions, World Economic Outlook. Available at <http://www.imf.org/external/pubs/ft/weo/data/assump.htm>

- "/" means between years or months (for example, 2008/2009) to indicate a fiscal or financial year.
- In the reports, shaded areas indicate IMF staff projections.
- Minor discrepancies between sums of constituent figures and totals shown reflect rounding.

c) Decisions/Guideline of the Executive Board:

In the IMF's organisational framework, the Executive Board is the most effective and powerful body. The highest decision making body of the IMF is the Board of Governors⁴⁴⁸ but with the exception of certain powers, the remainder are delegated to the Executive Board. The Executive Board is consist of 24 Directors and a Managing Director, who serves as its Chairman of the Executive Board. The Executive Board is responsible for the daily routine functioning of the IMF. In this context, the Executive Board meets a couple of times a week in order to run the IMF.⁴⁴⁹

In accordance with Section 15 of the By-Laws of the IMF, "*the Executive Board is authorized by the Board of Governors to exercise all the powers of the Board of Governors except those conferred directly by the Articles of Agreement on the Board of Governors.*"⁴⁵⁰

Moreover, according to section 16, "*the Executive Board is authorized by the Board of Governors to adopt such Rules and Regulations, including financial regulations, as may be*

⁴⁴⁸ "The Board of Governors, the highest decision-making body of the IMF, consists of one governor and one alternate governor for each member country. The governor is appointed by the member country and is usually the minister of finance or the governor of the central bank. All powers of the IMF are vested in the Board of Governors. The Board of Governors may delegate to the Executive Board all except certain reserved powers. The Board of Governors normally meets once a year." [<http://www.imf.org/external/np/sec/memdir/members.htm>]

⁴⁴⁹ <http://www.imf.org/external/np/sec/memdir/eds.htm>

⁴⁵⁰ <http://www.imf.org/external/pubs/ft/bl/bl15.htm>

*necessary or appropriate to conduct the business of the Fund. Any Rules and Regulations so adopted, and any amendments thereof, shall be subject to review by the Board of Governors at their next regular meeting.*⁴⁵¹

In light of the above by-laws of the IMF, it is very clear that the Executive Board has a prominent role in the rule-making process of the IMF. The scope of this rule-making process is limited to that mentioned in Article I of the Articles of Agreement of the IMF. However, in very rare incidences in the past, the Executive Board imposed its decisions on its members even with the institutional acts for which they had not committed for. The exchange rate stability system was completely destroyed in 1971 and was replaced by a new exchange rate mechanism based on floating currencies. To formally bind its members, it was necessary for the IMF to amend the Article of Agreement, but in order to temporarily bind its members before the alteration in its Article of Agreement, the Executive Board approved the guiding principle for floating exchange rate system.⁴⁵²

Another example of the Executive Board's decision-making⁴⁵³ process leading to a set of rules of great importance is the Executive Board's decision on bilateral surveillance.⁴⁵⁴ In 2007, the IMF

⁴⁵¹ <http://www.imf.org/external/pubs/ft/bl/bl16.htm>

⁴⁵² Sands, P., and Klein, P. (eds), (2001) 'Bowett's law of International Institutions', London: Sweet & Maxwell, 5th ed. p 288. See also, footnote 97.

⁴⁵³ For details about the Executive Board's programs visit: <http://www.imf.org/external/ns/cs.aspx?id=89>

⁴⁵⁴ IMF Executive Board Adopts New Decision on Bilateral Surveillance Over Members' Policies Public Information Notice (PIN) No. 07/69 June 21, 2007. Available at: <http://www.imf.org/external/np/sec/pn/2007/pn0769.htm>

implemented a new **Decision on Bilateral Surveillance over Members' Policies**, which replaced its own Decision on Surveillance Over Exchange Rate Policies⁴⁵⁵ passed in 1977.

This subheading has discussed rule-making by the IMF's Executive Board through its decision-making process; however, the decisions are limited to the scope of the IMF function and powers mentioned in its Articles of Agreement. The legislative and normative capacities of the IMF have also been considered and the ways in which IMF enhances financial sector development in its legislative and normative capacities. The next subheading looks at the IMF's executive and administrative functioning as an IEI in the development of the financial sector, promoting certainty and predictability of the rules of the game in the global economic scenario.

2. *Executive and administrative authority of the IMF and development of the sector*

The IMF, with its executive and administrative authority, has a highly significant and effective role in the development of the financial sector. In the financial sector development scenario, the main focal point of the IMF's role is on FSAP and governance issues. But first of all, this subheading refreshes our previous knowledge of the executive and administrative role of an IEI.⁴⁵⁶

The effectiveness of an IEI depends on the implementation of institutional acts.⁴⁵⁷ Thus, to ensure the implementation and execution of institutional acts is effective, IEIs are sometimes empowered with executive and administrative authority. However, exercise of this authority is

⁴⁵⁵ "Surveillance over Exchange Rate Policies," Decision No. 5392-(77/63), April 29, 1977. See also Review of the 1977 Decision on Surveillance Over Exchange Rate Policies Preliminary Considerations. Prepared by the Policy Development and Review Department of the IMF and Approved by Mark Allen (2006).

⁴⁵⁶ See, chapter II.A.3.b) on page 46

⁴⁵⁷ Philippe Sands and Pierre Klein (eds) (2001),. *Bowett's Law of International. Institutions*. London: Sweet & Maxwell. 5th ed. , p 314; and also see, G. Schermers and Niels M. Blokker (1995), *International Institutional Law: Unity Within Diversity*. 3rd edn, The Hague, M. Nijhoff, chapter 10.

curtailed by the concept of legality. It only aims to empower IEIs to provide assistance and supervision of members for the implementation of institutional acts and, in some cases, also empowers the IEIs to exercise sanctioning.⁴⁵⁸

The IMF, for its effective operation, possesses executive and administrative authority. These powers are vital for the implementation of the decisions of the IMF so that it can function smoothly to achieve its goals. In this context, the IMF has a proper institutional structure with an administrative arm which plays a central role in the management of the IMF and its activities. Through this institutional structure (secretariat), the IMF performs its executive or administrative functions to enable it to manage the realisation of institutional acts and supervise compliance with those acts by members.

The use of sanctions by the IMF is not that common; rather it uses conditionality as a tool for the enforcement (compliance) and implementation of its policies. Conditionality, as an enforcement mechanism, will also be discussed in this subheading. However, it is argued by many scholars that the IMF's Executive Board has been extensively empowered with executive authorities. Moreover, the dominance of the US in the Executive Board makes the US the ultimate executive in the IMF.⁴⁵⁹ If the US dominance factor is ignored, and the executive authority used by the IMF observed in the context of development of the global financial sector, then it would not be difficult to come to the conclusion that it has a positive contribution.

⁴⁵⁸ For sanction as means of enforcement see generally; George W. Downs (1998), *Enforcement and the Evolution of Cooperation*, 19 MICHIGAN JOURNAL OF INTERNATIONAL LAW 319; Doxey, Margaret P. (1996), *International sanctions in contemporary perspective*. Basingstoke: Macmillan. 2nd edition; Abram Chayes, Antonia Handler Chayes (1998), *The new sovereignty: compliance with international regulatory agreements* /. Harvard University Press; and also see, Philippe Sands and Pierre Klein (eds) (2001), *Bowett's Law of International Institutions*. London: Sweet & Maxwell. 5th ed., p 324.

⁴⁵⁹ See generally, Woods, Ngaire (2006). *Whose institutions?* in *The Globalizers: The IMF, the World Bank and Their Borrowers*, Cornell University Press, Ithaca.

This following part begins by looking at FSAP and then the governance issues dealt with by the IMF in its executive authority in order to promote financial sector development which is an essential element in achieving the stable and balanced growth of the global economy within the international economic cycle.

a) FSAP

FSAP is the most noteworthy and the most popular⁴⁶⁰ aspect of the IMF's TA operation. It is the combined initiative of the IMF and the World Bank and an assessment program of the financial sectors of its member countries. FSAP allows its membership, in a deeper collective effort, to monitor their own financial systems with the help of the IMF. Its basic aim is to assess in detail the financial sectors of its members and identify for concerned national authorities the weaknesses in their financial systems. In addition to assessment of member countries' financial sectors, FSAP provides assistance to the members concerned in order to develop measures to reduce or overcome the weaknesses identified in their financial systems.⁴⁶¹

FSAP mostly studies the institutional framework of financial sectors and also assesses it in the context of a risk and vulnerability analysis using different types of indicators and stress tests.⁴⁶²

In this vulnerability analysis scenario, FSAP is considered as the most important program for

⁴⁶⁰ FSAP is quite popular TA program of the IMF, as it has been requested and received by more than 120 member countries of the IMF. IMF Factsheet, The Financial Sector Assessment Program (FSAP), 2010, available at: <http://www.imf.org/external/np/exr/facts/fsap.htm>

⁴⁶¹ IMF Factsheet, The Financial Sector Assessment Program (FSAP), 2010, available at: <http://www.imf.org/external/np/exr/facts/fsap.htm>; see also, Chapter IV.C.2.a) on page 150.

⁴⁶² However, over the passage of time new features have been included in the TA activity, such as more candid and transparent assessments; improved analytical toolkit; more adaptable sectional reviews, personalised to specific member's requirements; improved cross-country outlooks; and improved directing of standards assessments. For details visit <http://www.imf.org/external/np/exr/facts/fsap.htm>; see also, INTERNATIONAL MONETARY FUND and THE WORLD BANK (2003). Analytical Tools of the FSAP. Prepared by the Staffs of the World Bank and the International Monetary Fund Approved by Cesare Calari and Stefan Ingves, at p5-20; see also, see Blaschke W., Matthew T. Jones, G. Majnoni, and S. M. Peria, Stress Testing of Financial Systems: An Overview of Issues, Methodologies, and FSAP Experiences, 2001, IMF Working Paper, WP/01/88.

financial sector examination by the IMF.⁴⁶³ In light of FSAP, the IMF is able to use its tools (surveillance, TA and financial assistance) effectively to develop the financial sector.

Objectives of FSAP: There are two main objectives of the FSAP program; firstly, it is a supportive program which facilitates countries in detecting and putting an end to financial sector weaknesses and thus supporting the prevention of crises; and secondly, the endorsement of financial sector development and efficacy, thus supporting economic growth.⁴⁶⁴

IMF publications related to FSAP's policy and reviews have, in addition, identified some of its **intermediate objectives** before it achieves its final objectives, mentioned above. Some of the intermediate objectives of FSAP are as follows:

- Regular evaluation and screening of financial systems to spot a system's strong points, weak points, and potential threats to the system. This also covers the implementation of standards and codes.
- Making policies for the enhancement of financial sector development.
- Spotting technical assistance and development requirements.
- Regular coverage and assessment of global financial system.⁴⁶⁵

The standards typically assessed in FSAP:⁴⁶⁶ As FSAP is an assessment program, it generally assesses countries' financial sectors in the light of certain standards; however, which standards are used for assessment differs from case to case. The following are some of the common standards used for assessment purposes:

⁴⁶³ Evaluation of the Financial Sector Assessment Program (FSAP), Issues Paper, Prepared by the Independent Evaluation Office, 2004.

⁴⁶⁴ Ibid

⁴⁶⁵ In practice this meant the development of a common template for FSAP assessment of both vulnerability and development issues. The generic template was to serve as starting point and initial guideline - not to be applied mechanically - and the FSAP team was to develop a country specific focus based on the structure of the country's financial system and evaluation of priorities for both stability and sectoral development. (IMF-World Bank Financial Sector Assessment Program (FSAP), SM/99/116).

⁴⁶⁶Supra note 463 footnote 17.

- IMF Code of Good Practices on Transparency in Monetary and Financial Policies (MFP Code);⁴⁶⁷
- Basel Core Principles for Effective Banking Supervision (BCP);⁴⁶⁸
- Core Principles for Systematically Important Payment Systems (CPSIPS);⁴⁶⁹
- International Organization of Securities Commissions (IOSCO) Objectives and Principles of Securities Regulation (IOSCO Principles);⁴⁷⁰
- International Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICP);⁴⁷¹ and
- The Financial Action Task Force (FATF) Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT).⁴⁷² This last standard is to be considered in all cases.

In addition, there are other standards and guiding principles commonly utilised in the FSAP study. These comprise: (i) the OECD's Corporate Governance Principles;⁴⁷³ (ii) World Bank's

⁴⁶⁷Chapter V. A. 1. a) (3) at page 167

⁴⁶⁸For details about Basel Core Principles for Effective Banking Supervision visit: <http://www.bis.org/bcbs/>

⁴⁶⁹For details about Core Principles for Systematically Important Payment Systems visit: <http://www.bis.org/cpsps/index.htm>

⁴⁷⁰For details about Objectives and Principles of Securities Regulation visit: <http://www.iosco.org/>

⁴⁷¹For details about International Association of Insurance Supervisors (IAIS) Insurance Core Principles visit: <http://www.iaisweb.org/index.cfm?pageID=41>

⁴⁷²For details about The Financial Action Task Force (FATF) Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism visit: http://www.fatf-gafi.org/pages/0,2987,en_32250379_32235720_1_1_1_1_1,00.html

⁴⁷³For details about OECD's Corporate Governance Principles visit: http://www.oecd.org/document/49/0,3343,en_2649_34813_31530865_1_1_1_1,00.html

Principles for Effective Insolvency and Creditors Rights;⁴⁷⁴ (iii) CPSS-IOSCO's Recommendations for Securities Settlement System (RSSS);⁴⁷⁵ and (iv) International Accounting and Auditing Standards.⁴⁷⁶

The institutional framework of the IMF takes advantage of the FSAP program by using its assessments in the process of conducting surveillance and providing TA and financial assistance to its member countries. For instance, FSAP makes an assessment of a member country and concludes that it is not complying fully with the norms created or supported by the IMF. In this case, the IMF will have three fronts to operate on; first, this information will be used in the context of mandatory surveillance under Article IV; second, this information can be used to provide better, more detailed TA to the member countries who request it; third, before extending financial assistance to a member country, the IMF can attach conditions to it and these conditions can be based on information obtained from the FSAP.

The figure below⁴⁷⁷ illustrates FSAP functioning in a very straightforward way. FSAP makes an assessment of the financial risks and vulnerabilities⁴⁷⁸ of its member countries. Moreover, it analyses institutional, structural and market features, as well as compliance with the standards and codes by its member countries.

⁴⁷⁴For details about World Bank's Principles for Effective Insolvency and Creditors Rights visit: http://www.worldbank.org/ifa/rosc_icr.html

⁴⁷⁵ For details about CPSS-IOSCO's Recommendations for Securities Settlement System visit: <http://www.bis.org/publ/cpss46.htm>

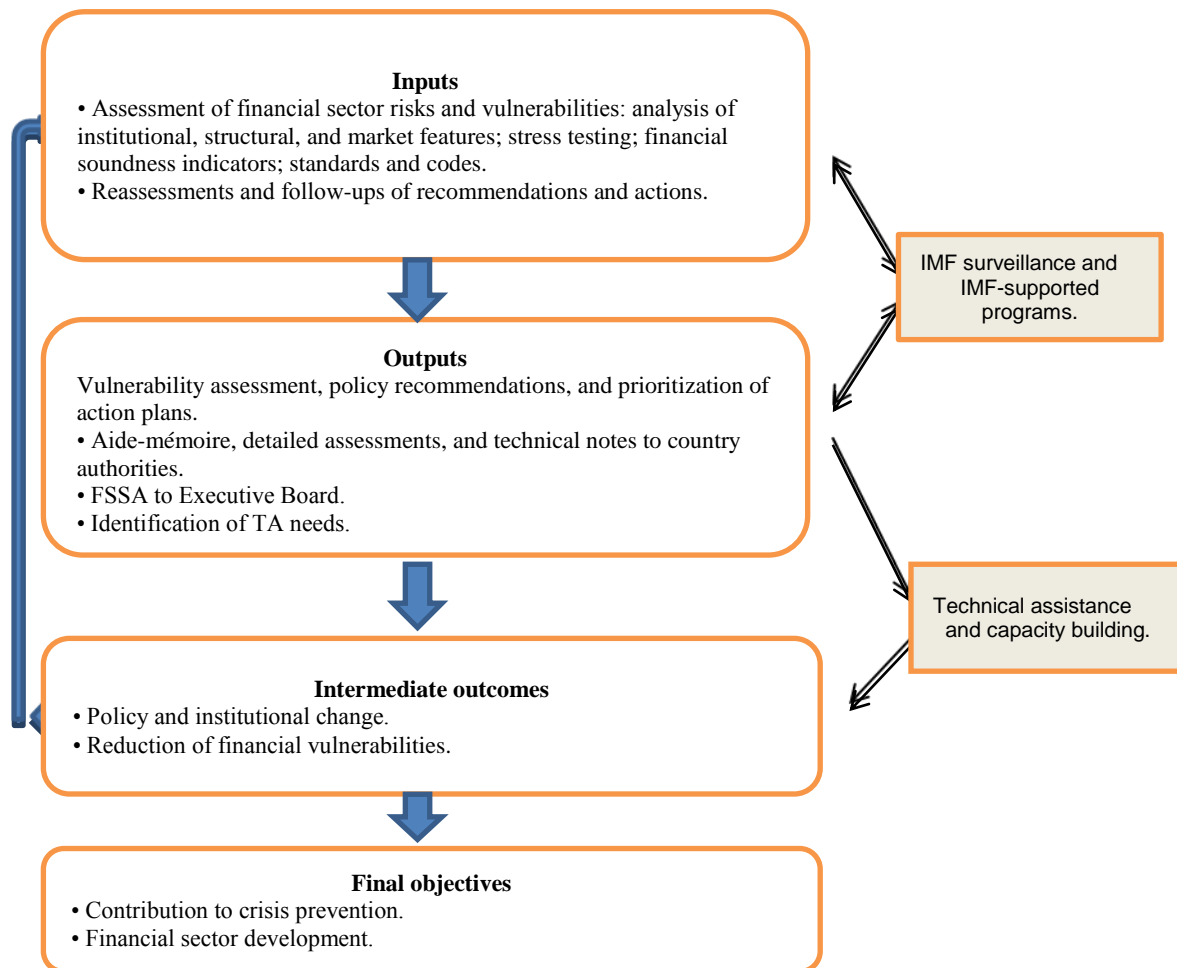
⁴⁷⁶ For details about International Accounting and Auditing Standards: http://www.worldbank.org/ifa/LessonsLearned_ROSC_AA.pdf

⁴⁷⁷ For FSAP Framework see, IMF (2004) Independent Evaluation Office Annual Report. Available at: <http://www.imf.org/External/NP/ieo/2004/ar/figure.pdf>

⁴⁷⁸ The assessment of vulnerabilities comprise the review of prudential regulation and supervision, liquidity management (financial policies, instruments, and market arrangements), arrangements for crisis management (financial safety nets, frameworks for bank and corporate restructuring and bankruptcy), maturity and development of market infrastructure, systemic risk in payment systems, and vulnerabilities from macroeconomic shocks. The analytical tools include stress testing for macro-financial linkages stemming from macroeconomic shocks and the use of financial soundness indicators (FSI) for evaluation and monitoring. It also comprises in-depth evaluation of observance of international standards and codes in three broad areas: financial sector regulation and supervision, institutional and market infrastructure, and policy transparency. See Evaluation of the Financial Sector Assessment Program (FSAP), Issues Paper, Prepared by the Independent Evaluation Office, 2004. p8.

This valuable and technical information is used in the process of surveillance and consultation by the IMF under Article IV. The output of this assessment is also helpful in the TA process of the IMF. Once the weaknesses of a member country are identified, then it becomes easier for the IMF to provide TA to the member concerned upon request.

This whole process is in cyclic form, i.e. once the action on the FSAP assessment is taken, it is re-assessed by FSAP in order to identify any other weaknesses in the financial system of the member concerned. This FSAP framework, along with the IMF's organisational function in its executive authority, yields two final outcomes: first, contribution towards financial crisis prevention, and secondly, financial sector development.

Figure 5 FSAP Framework⁴⁷⁹

The above figure elaborates the FSAP framework with two final objectives: contribution towards crisis prevention and the development of the global financial sector. These two objectives of FSAP are extremely important in the international economic framework. As FSAP is a joint initiative of the World Bank and the IMF, it involves a considerable degree of administrative and

⁴⁷⁹ For FSAP Framework see, IMF (2004) Independent Evaluation Office Annual Report. Available at: <http://www.imf.org/External/NP/ieo/2004/ar/figure.pdf>

executive functioning in this process. However, it is the most successful program of the IEs in their executive function, in the context of the economic cycle.

Another aspect of FSAP needs to be highlighted; that in which the IMF, in its executive authority (through its tools, surveillance, TA and conditionality), operates in order to ensure financial sector development, i.e. by tackling governance issues. The IMF supports good governance through its wide range of approaches, such as technical assistance, policy advice, and program conditionality. The policy transparency codes (both codes of Good Practices on Transparency in Monetary and Financial Policies, and Good Practices on Fiscal Transparency) developed by the IMF comprise a highly significant effort made by the IMF in order to endorse good governance, which in turn leads to the development of the financial sector⁴⁸⁰.⁴⁸¹ The following section will consider governance and the role of the IMF in that context.

b) The IMF's role in the context of governance issues

In general terms, governance means extensive interaction between citizens and government. Governments mainly interact with their citizens through policies and these policies, if economic or related to the economy, become the concern of the IMF, as those policies can affect the stability of the financial sector, both domestic and global. Here, the IMF enters the picture to look for two main policy concerns relating to its expertise; firstly, the extent and nature of

⁴⁸⁰ The IMF is concerned about poor governance because it is an obstacle to growth and a threat to economic stability. It contributes to good governance through its policy advice, technical assistance, and program conditionality. It does so within its areas of expertise that covers the effective and transparent handling of public wealth and up holding of a stable, economic, regulatory and legal environment. See, Udaibir S. Das and Marc Quintyn, Crisis Prevention and Crisis Management: The Role of Regulatory Governance. IMF Working Paper No. 02/163. p13

⁴⁸¹ Anton Op de Beke, IMF Activities to Promote Good Governance and Combat Corruption --An Overview, IMF, Policy Development and Review Department, 2002.

transparency and the accountability of policies and policy makers; and, secondly, the degree of compliance with policies concerned with global best practice and standards.⁴⁸²

The 1997 Guidance Note on the IMF's role in the context of governance issues asserts that the IMF is the most effective institution to tackle governance issues with the help of two tools: technical assistance and policy advice.⁴⁸³ These tools are applied with a two-pronged approach, that is: the development of public sector resource management and administration⁴⁸⁴; and by endorsing the expansion and continuance of transparency and stability in the regulatory regime for private sector efficiency.⁴⁸⁵

However, there is a limit to the IMF's role in the context of governance issues, wherein it should only look into an issue's economic aspects when the issue concerned can considerably influence macroeconomic functioning.⁴⁸⁶

⁴⁸² Moreover, the IMF is also concerned with the corruption issue as well. The economic consequences of corruption can be serious. It reduces investment and the rate of economic growth [Udaibir S. Das and Marc Quintyn, *Crisis Prevention and Crisis Management: The Role of Regulatory Governance*. IMF Working Paper No. 02/163.] Governance and corruption has direct relation. Evidently, bad governance entails more inducements and further space for corruption. The advancement of good governance, hence, supports to avert corruption. See, Anton Op de Beke, *IMF Activities to Promote Good Governance and Combat Corruption --An Overview*, IMF, Policy Development and Review Department, 2002. See also, Woods, Ngaire (2000). *The Challenge of Good Governance for the IMF and the World Bank Themselves*. University College, Oxford, UK.

⁴⁸³ Since 1997, the IMF's contribution in endorsing good governance has increased notably. The core idea has been to promote accountability and transparency in economic policies via endorsement of globally accepted standards, and codes of good practices in fiscal, monetary and financial policy transparency; data dissemination; and banking regulation and supervision. See, Anton Op de Beke, *IMF Activities to Promote Good Governance and Combat Corruption --An Overview*, IMF, Policy Development and Review Department, 2002.

⁴⁸⁴ Development of public sector resource management and administration is achieved via public sector reforms, such as, reforms directed as the central bank, treasury, civil service, public enterprises, expenditure control, the official statistics function, budget management, and revenue collection. [THE ROLE OF THE IMF IN GOVERNANCE ISSUES--GUIDANCE NOTE (1997). Available at: <http://www.imf.org/external/np/sec/nb/1997/nb9715.htm#I2>]

⁴⁸⁵ This can be achieved by stability and transparency in the price mechanism, banking systems, and exchange and trade regimes and their associated rules. [THE ROLE OF THE IMF IN GOVERNANCE ISSUES--GUIDANCE NOTE (1997). Available at: <http://www.imf.org/external/np/sec/nb/1997/nb9715.htm#I2>]

⁴⁸⁶ THE ROLE OF THE IMF IN GOVERNANCE ISSUES--GUIDANCE NOTE (1997). Available at: <http://www.imf.org/external/np/sec/nb/1997/nb9715.htm#I2>

Below are mentioned the roles performed by the IMF⁴⁸⁷ in its organisational capacity to promote governance in order to provide a healthier environment for the development of the financial sector.

- ***Governance in IMF policy advice:*** As part of the surveillance program, the IMF furnishes its membership with relevant policy guidance, and in most situations, this policy guidance includes governance problems.
- ***Governance in IMF-supported programs:*** As already discussed in the earlier part of this chapter, the IMF extends financial assistance to those member countries suffering balance-of-payments problems whereby they can reinstate an environment for economic growth. However, the extent of financial assistance significantly depends upon the good governance level of the country concerned. So, in order to access prompt and reasonable financial assistance from the IMF, countries support good governance in their respective countries.
- ***Governance in IMF technical assistance:*** In conjunction with financial assistance, surveillance, and TA is also one of the key tools of the IMF. The IMF, via TA, plays a significant role in the endorsement of good governance. This goal is achieved through TA in two ways; firstly, by enhancing the capacity of the member countries to implement standards and codes based on good practice; and secondly, to help them to develop appropriate policies to achieve good governance.

⁴⁸⁷ Anton Op de Beke, *IMF Activities to Promote Good Governance and Combat Corruption --An Overview*, IMF, Policy Development and Review Department, 2002.

3. Conclusion

This subheading illustrates how the IMF has an effective institutional role (legislative and normative, and, executive and administrative) which the IMF does not explicitly refer to. The reason that the IMF avoids explicit acceptance of its institutional role is because it wants to avoid discussion regarding the realist aspects of the IMF. However, this part of the chapter has clearly documented that the IMF as an IEI contributes significantly, through its institutional role, to the development of the global financial sector (see the table below).

Table 6

IO's Institutional role	IMF's Institutional Role promoting certainty in global economic scenario	Effect on Development of Global Financial Sector
Legislative or Normative	<ul style="list-style-type: none"> • Conventions • Standards and Codes • Decisions of Executive Board 	Positive: By setting of the rules of the game IMF increases certainty and predictability of rules of the game which have positive effect on the development of financial sector.
Executive and Administrative	<ul style="list-style-type: none"> • Surveillance • Technical Assistance • Enforce Compliance (Conditionality) • FSAP • Governance Issue 	Positive: The executive and administrative functioning helps to implement the rules, which again increases certainty and predictability of rules of the game which have positive effect on the development of financial sector.
Judicial or Quasi-Judicial	N/A	

The table above summarises the partial institutional role of the IMF⁴⁸⁸ in context of the financial sector development. In its legislative and normative capacity, the IMF through the decisions of the Executive Board, being forum for conventions and via its involvement in the standards and

⁴⁸⁸ The institutional role of the IMF is incomplete because it's institutional structure lacks an adjudicative organ which is important for a complete institutional role.

codes; contributes positively towards the development of the global financial sector. Moreover, the IMF also contributes positively towards financial sector development through its executive and administrative functioning which includes the surveillance, TA, conditionality, FSAP and governance issues. As mentioned in the theoretical framework, financial sector development is crucial for the stable and balanced growth of the global economy.

B. IMF and International Trade

This chapter looks at the role of the IMF in its institutional capacity in achieving a more stable and balanced growth of the global economy through the international economic cycle. In this context, the preceding subheading emphasised the IMF's contribution as an IEI, using the certainty of rules in the development of the international financial sector which in turn leads to economic growth. Working along the same lines, this subheading will focus on the institutional role of the IMF in the endorsement of international trade in the international economic cycle.

As discussed in the theoretical framework, the international institutional role contributes positively towards the IELR which creates certainty and predictability of the rules of the game within the global economic scenario.⁴⁸⁹ Thus, this subheading focuses on the institutional role of the IMF in the promotion of the international trade of its member countries.

1. Introduction

The IMF has a direct link with international trade.⁴⁹⁰ It deals with trade matters for two reasons: first, it is a part of its core macroeconomic scheme; and, secondly, the economic conditions of any economy, which includes financial conditions as well, are heavily influenced by trade policy, provided trade amounts to be a major part of that economy.⁴⁹¹

In addition, the IMF's activities in the context of trade issues are directed at endorsing economic growth and financial sector stability. Trade environments which lack rules of the game in trading scenarios give undue space for trading parties to use too much discretion. Too much discretion leads to uncertainty which in turn leads to inadequate conditions for proper economic

⁴⁸⁹ See chapter II.A.3 on page 38

⁴⁹⁰ Rose, Andrew K. (2005), Which International Institutions Promote International Trade? *Review of International Economics*, Vol. 13, No. 4, pp. 682-698. Available at SSRN: <http://ssrn.com/abstract=806319>

⁴⁹¹ For Board guidance on trade-related priorities, see Concluding Remarks by the Acting Chair, Trade Issues—Role of the Fund (BUFF/01/143, September 20, 2001) and Concluding Remarks by the Acting Chair, Market Access for Developing Country Exports—Selected Issues (BUFF/02/165, September 18, 2002).

functioning, financial assistance usefulness, and good governance. Moreover, trade reforms can be extremely helpful in economic growth policies as trade policies lock parties into international commitments and are also helpful for locking countries into obligations within other fields.⁴⁹² Trade policies and balance of payments issues are directly linked to each other⁴⁹³; trade policies influence balance of payments and countries' revenues, which in turn affects the stability of global financial sector.⁴⁹⁴

Balance of payment issues are dealt reasonably by the IMF, which provides financial assistance to countries when they need money for trade adjustments. The IMF tackles the certainty of balance of payment financing through the Trade Integration Mechanism "TIM", which endeavours to enhance the certainty of the availability of resources provided by the IMF.⁴⁹⁵

The IMF, through its second key tool, TA, extends its expertise in the field of international trade to addressing member countries' data standardisation, and customs, tax and tariff reform.⁴⁹⁶

These reforms, supported by the IMF, also endeavour to reduce the (adverse) consequences (if any) of liberalization on government revenue.⁴⁹⁷ The IMF also contributes to the enhanced Integrated Framework⁴⁹⁸ through TA, which is directed towards enhancing the inclusion of

⁴⁹² For example, regulatory reforms through external commitments, strengthening market disciplines on enterprises and banks, or reducing the scope for corruption.

⁴⁹³ For an econometric analysis of trade policy on BOP see generally, Dasgupta, Partha and Joseph E. Stiglitz (1974). Benefit-Cost Analysis and Trade Policies. *Journal of Political Economy* Vol. 82, No. 1, pp.1-33. Also see, Thirlwall, A. P., and Amelia Santos-Paulino (2004), The impact of trade liberalization on exports, imports and the balance of payments of developing countries. *The Economic Journal*, Volume 114, Issue 493.

⁴⁹⁴ IMF (2005). Review of Fund Work on Trade. Prepared by the Policy Development and Review Department, para 3.

⁴⁹⁵ IMF (2010). Selected Decisions and Selected Documents of the IMF, Thirty- Fifth Issue -- Trade Integration Mechanism. Prepared by the Legal Department of the IMF As updated as of December 31, 2010

⁴⁹⁶ See generally, IMF (2005). Dealing with the Revenue Consequences of Trade Reform (Background Paper for Review of Fund Work on Trade), Prepared by the Fiscal Affairs Department, Approved by Teresa Ter-Minassian; see also, Keen, Michael (ed.), 2003, *Changing Customs: Challenges and Strategies for the Reform of Customs Administration* (Washington DC: International Monetary Fund).

⁴⁹⁷ See generally, Ebrill, Liam P., Janet Stotsky, and Reint Gropp (1999). Revenue implications of trade liberalization. Washington, D.C.: International Monetary Fund.

⁴⁹⁸ It is discussed in the latter part of this subheading. Chapter V.B.4.b(2) on page 209

international trade reforms, while keeping in view domestic poverty reduction policies. The main purpose of the enhanced Integrated Framework and Aid for Trade is to enable countries to make the best of the international trading system.

The IMF, through its surveillance mechanism under Article IV, identifies the strengths and weaknesses of the member countries' prevailing economies and also works out suitable strategies in order to face challenges emerging from global integration. In addition, the IMF supports countries in taking up trade reforms, unilaterally or multilaterally, based on non-discrimination.⁴⁹⁹

2. Legal Aspect in the context of IMF and Trade

Before moving on to the role played by the IMF in its institutional capacity in the context of matters related to international trade, it would be appropriate to discuss the legal basis on which the IMF can be involved in trade matters. This is important because mostly, in layman's terms, it is assumed that the IMF only deals with monetary and financial issues. The IEI responsible for tackling trade issues is the WTO. The following section talks about the legal basis by which the IMF involves itself in trade issues.

According to Article I (ii) of the IMF's Articles of Agreement, one of the main purposes of the IMF is "to facilitate⁵⁰⁰ the expansion and balanced growth of world trade." So, the IMF's involvement with trade issues is clearly covered by the above-mentioned Article. More precisely, Article IV and V of the Articles of Agreement require the IMF to look into trade issues.⁵⁰¹ Under

⁴⁹⁹ IMF (2011). FACTSHEET, The IMF's Trade Integration Mechanism (TIM).

⁵⁰⁰The term "facilitates" denotes the effect on the growth of international trade that results indirectly from the work of the Fund. As stated by former General Counsel Sir Joseph Gold: "The nuance of the word 'facilitates' in [Article IV] and of the word 'facilitate' in Article I expresses the idea of encouraging or easing and not controlling." Gold, Some Legal Aspects of the IMF's Activities in Relation to International Trade, *Oster. Z. Offentl. Recht Und Volkerrecht* Vol. 36, pp. 157-217, 1986 at 159.

⁵⁰¹ See, Chapter IV.C.1 on page 143

Article IV, the IMF needs to carry out mandatory surveillance in order to check member countries' compliance with their international commitments, which also includes trade commitments if they affect any of the purposes of the IMF.⁵⁰²

In same way, when the IMF extends financial assistance to any member country, under Article V, then it needs to make sure that it will be able to recover its money. So, at this stage, the IMF can impose conditions to secure the recovery of its money, and these conditions can be imposed on matters related to trade. Therefore, according to the above Article and the Executive Board discussion in the context of the 2004 Biennial Surveillance Review, trade policies fall under the IMF's legal authority when they affect member countries' fiscal conditions, exchange rates, and the economic stability and growth scenario.⁵⁰³ In the same way, the Conditionality Guidelines of 2002 assert that trade policy issues should be subject to conditionality in order to fulfil the IMF's objectives.⁵⁰⁴⁵⁰⁵ ⁵⁰⁶

The IMF and the WTO have their own jurisdiction according to their specialisations; that is, the exchange rate and trade policies and practices. If member countries contravene their commitments, then the above-mentioned IEIs have a legal mandate to deal with issues within their jurisdiction.⁵⁰⁷ However, there are sometimes issues which are complicated and fall within the jurisdiction of both of these IEIs. In that case, both IEIs deal with the issue by enforcing the

⁵⁰² See, Rose, Andrew K. (2005), Which International Institutions Promote International Trade? Review of International Economics, Vol. 13, No. 4, p. 683. Available at SSRN: <http://ssrn.com/abstract=806319>

⁵⁰³ The Chairman's Summing Up, Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision (SUR/04/80, August 2, 2004).

⁵⁰⁴ In so doing, Moreover, the Conditionality Guidelines of 2002 also stress on trade-related surveillance and program work, but also describes the work in other areas, including research, technical assistance and outreach and communication.

⁵⁰⁵ Para 2, Review of Fund Work on Trade (2005)

⁵⁰⁶ Annex 1 discusses legal aspects of the Fund's trade-related surveillance and program work. The main author of this Appendix is Ms. D. Siegel (LEG).

⁵⁰⁷ Para 2 of Annex I of Review of Fund Work on Trade (2005).

obligations in their own way.⁵⁰⁸ In any case, the legal jurisdictional relationship of the IMF and the WTO is quite complicated and this chapter does not go into detail.⁵⁰⁹ The following section talks about some of the legal aspects of the IMF's operational tools and international trade.

a) Surveillance

Surveillance is dealt with in detail by Article IV of the Articles of Agreement of the IMF, which makes surveillance an obligatory practice for both members and the IMF. Article IV Section 3 requires the IMF to supervise and carry out *consultative discussions* with its members in order to warrant the effectual functioning of the international monetary system. Article IV Section 3(i), and Section (3)(ii) obliges the IMF to keep an eye on its members to check whether their commitments conform with the general obligations mentioned in Article IV Section 1.⁵¹⁰ The general obligations mentioned in section 1 of Article IV require members to follow the IMF in core and non-core areas of financial and economic policies leading to more stable and balanced growth, and, exchange and exchange rate policies.⁵¹¹ Moreover, the Executive Board in the Biennial Surveillance Reviews in 2000⁵¹² and 2002⁵¹³ elaborates upon the terms 'core' and 'non-

⁵⁰⁸ Under the Fund's Articles, the Executive Board determines compliance with members' obligations under the Articles. A noncomplying member may be subject to sanctions under Article XXVI, ranging from disqualifying to utilise Fund money to stay of voting rights and, eventually, enforced removal from membership. In contrast, the WTO does not itself impose sanctions. Rather, it is the aggrieved member that initiates the dispute resolution procedure and may eventually pursue remedies in the form of countermeasures. This approach reflects the reciprocal nature of the trade concessions that characterized the GATT. The WTO as an organization facilitates the implementation of the agreements in various ways, including providing the mechanism for formal dispute resolution if a complaint is brought by an aggrieved member. The World Trade Organization—Institutional Aspects, SM/94/304, Dec. 20, 1994.

⁵⁰⁹ See The Relationship of the World Trade Organization with the Fund—Legal Aspects, SM/94/303, Dec. 20, 1994; D. Siegel, Legal Aspects of the IMF/WTO Relationship: The Fund's Articles of Agreement and the WTO Agreements, AJIL, Vol. 96, No. 3, p. 561, July 2002.

⁵¹⁰ Chapter IV.C.1 on page 143

⁵¹¹ The legal aspects of surveillance under Article IV were recently discussed in "Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision—Modalities of Surveillance," SM/04/212, Supp. I, Appendix I.

⁵¹² See "Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision" (SM/00/40, February 18, 2000)

core' areas mentioned in section 1 of Article IV, both of which are discussed in the next paragraph.⁵¹⁴

The IMF can include trade related matters in its consultative discussions with its members under certain conditions, discussed below. First, as mentioned by the Executive Board in the Biennial Surveillance Review⁵¹⁵ in 2000, core themes for the IMF consultative discussions for the purpose of surveillance under Article IV include matters related to exchange rate policies and their consistency with macroeconomic policies, balance of payments, capital account flows, financial sector concerns, and all related fields. Trade issues become part of the core sphere for surveillance if any member imposes trade restrictions for balance-of-payments reasons or engages in exchange rate complications.⁵¹⁶

Secondly, non-core subjects can be included in the surveillance process under Article IV if they are capable of influencing members commitments mentioned in subsection (i) and (ii) of Article IV section 1, which relates to financial and economic policies. For example, it happens when a member country who is under surveillance is engaged in trade subsidies which have significant influence on the financial sector or its development process or stability.⁵¹⁷ In the context of trade subjects, the Executive Board, in its review on surveillance in 2002, noted that “*coverage of*

⁵¹³ Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision: Framework and Conduct of Surveillance in 2000-01. Prepared by the Policy Development and Review Department of IMF, 2002. Available at: <http://www.imf.org/external/np/pdr/surv/2002/index.htm>

⁵¹⁴ Annex I of Review of Fund Work on Trade (2005).

⁵¹⁵ See “Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision” (SM/00/40, February 18, 2000)

⁵¹⁶ Such restrictions might indicate the need for “special consultations” with the member. Surveillance Over Exchange Rate Policies, Principles of Fund Surveillance over Exchange Rate Policies, para 2(iii), Dec. No. 5392-(77/63), April 29, 1997, as amended, Selected Decisions, 28th Issue, p. 12. See also, Annex I of Review of Fund Work on Trade (2005).

⁵¹⁷ Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision—Overview, Modalities of Surveillance, Content of Surveillance, and Public Information Notice on the Executive Board Discussion (2004). Available at: <http://www.imf.org/external/np/pdr/surv/2004/082404.htm>, See also, Annex I of Review of Fund Work on Trade (2005).

*trade policies is critical in countries where serious trade distortions hamper macroeconomic prospects....*⁵¹⁸

Thirdly, any trade issue which does not fall within both the core area and the non-core areas of surveillance can be dealt by the IMF through its “policy advice”.⁵¹⁹ It is up to the members to avail themselves of the IMF’s policy advice and there is no obligation in this regard.⁵²⁰ Policy advice is a consultative consideration between the IMF and the member concerned.⁵²¹ The need for policy advice arises if a country’s economic policies, which might be fine for its economy, have global or regional connotations, that is, when a trade policy of a large economy can deeply influence small economies in a region, or where a large economy influences market access for small economies.⁵²²

In short, the IMF can certainly become involved in situations when trade issues fall within the IMF’s area of specialisation or can influence them. Next we look at the legal aspect of the IMF in the context of trade and the usage of conditionality.

b) Conditionality

The use of conditionality in trade related matters is legally empowered by Article V Section 3 of the Articles of Agreement, which talks about using conditionality in order to obtain IMF funding.

Basically, Article V (3) allows the IMF to impose conditions on its membership which are

⁵¹⁸ Biennial Review of the Implementation of the Fund’s Surveillance and of the 1977 Surveillance Decision: Framework and Conduct of Surveillance in 2000-01. Prepared by the Policy Development and Review Department of IMF, 2002, para 9. See also, Annex I of Review of Fund Work on Trade (2005).

⁵¹⁹ See Role of the Fund in Governance Issues, Guidance Note, Statement by the General Counsel, BUFF/97/75, July 23, 1977.

⁵²⁰ Annex I of Review of Fund Work on Trade (2005).

⁵²¹ Article XII, Section 8 of the Fund’s Articles permits the Fund, at any time, “to communicate its views informally to any member on any matter arising” under the Articles. This is consistent with the Fund’s purposes, in particular, as stated in Article I(i) “to promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.”

⁵²² Biennial Review of the Implementation of the Fund’s Surveillance and of the 1977 Surveillance Decision: Framework and Conduct of Surveillance in 2000-01. Prepared by the Policy Development and Review Department of IMF, 2002, para 9. See also, Annex I of Review of Fund Work on Trade (2005).

pursuant to the IMF's Articles of Agreement and are imposed to ensure recovery of the financial assistance extended to its member.⁵²³ Moreover, according to Article I (v) it is one of the purposes for the creation of the IMF: IMF financial assistance is extended to its membership “*to give confidence to members by making the general resources of the IMF temporarily available to them under adequate safeguards, thus providing them with the opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.*” However, the latter part of the same section (Article I (v)) makes financial assistance conditional in that it must be “*subject to adequate safeguards*” from default.

The IMF needs to secure the recovery of its money and in order to do so, it directs conditionalities to policies related to the areas concerned, in this case, trade related policies. For instance, it is the IMF's job to use all legal means to address a trade measure taken by any of its members if it is “destructive of national or international prosperity”.⁵²⁴ While addressing trade policy reform⁵²⁵, the IMF needs to take into consideration the economic consequences of the recommended trade policy reform via conditionalities. For instance, if the IMF imposes a conditionality related to exchange rate policy, it should also address the consequences of this recommended measure, that is, by finding out whether a restrictive trade policy can disturb a new rate of exchange achieved via a flexible exchange rate mechanism.⁵²⁶

⁵²³ See, INTERNATIONAL MONETARY FUND (2005) Review of the 2002 Conditionality Guidelines Prepared by the Policy Development and Review Department In consultation with other Departments Approved by Mark Allen, para 9.

⁵²⁴ Annex I of Review of Fund Work on Trade (2005).

⁵²⁵ Trade policy issues generally includes, arbitrary tariff exemptions or other import subsidies that impact fiscal revenue or the business environment more generally.

⁵²⁶ Gold, The Stand-by Arrangements of the International Monetary Fund, 1970, p. 144. See also, Annex I of Review of Fund Work on Trade (2005).

The use of trade-related conditionality is also approved by the Executive Board in its Guideline for Conditionality, which provides a standard for application of conditionality.⁵²⁷ The main point for application of conditionality is that the conditionalised measure by the IMF is highly significant for the realisation of the objectives of the member's program.⁵²⁸ However, there are limitations to the usage of conditionality; when the IMF imposes conditionality-related reforms, it should make sure that the conditionalised reforms do not clash with the member's other international commitments such as, for example, under the WTO.⁵²⁹

The next subheading is dedicated to the legislative and normative functioning of the IMF in the promotion of international trade.

3. Legislative and Normative functions of the IMF in the endorsement of International Trade

The IMF is an effective IEI with a comprehensive institutional role supporting the IELR which leads to certainty and predictability of the rules of the game within the international economic cycle. As discussed earlier in the theoretical framework, the Economic Cycle is based on two main components; the financial sector and international trade. The preceding part of this chapter has documented the institutional role of the IMF in financial sector development. In the same way, this part of the chapter will show that the IMF has a considerable institutional role in the enhancement of international trade. Thus, by illustrating the IMF's institutional role in stimulating both components of the Economic Cycle, it will be evident that the IMF's

⁵²⁷ INTERNATIONAL MONETARY FUND (2002). Guidelines on Conditionality, Prepared by the Legal and Policy Development and Review Departments (In consultation with other departments) Approved by Timothy F. Geithner and François Gianviti; see also, The Independent Evaluation Office -IEO (2008). The IMF's Approach to International Trade Policy Issues, para 6.

⁵²⁸ Guidelines on Conditionality, Dec. No. 12864-(02/102), Sept. 25, 2002, Selected Decisions, 28th Issue, paras 7(a) & (b), p. 235–36.

⁵²⁹ INTERNATIONAL MONETARY FUND (2002). Guidelines on Conditionality, Prepared by the Legal and Policy Development and Review Departments (In consultation with other departments) Approved by Timothy F. Geithner and François Gianviti, para 11.

institutional role is a significant factor in achieving the stable and balanced growth of the global economy.

However, the IMF does not explicitly admit its institutional role as part of the IELR. Section Two is dedicated to proving that despite being realist, the IMF has an institutional role. Thus, in this context, this subheading tries to establish that the IMF has substantial normative functioning in the field of international trade, which is one of the elements of its institutional role.

The following part of this subheading talks about the legislative and normative role of the IMF. Therefore, any act of the IMF which is related to trade and has the effect of a law will be discussed under this subheading. The IMF's acts which come under this category are quite limited and include, for example, the creation of certain codes, the guideline decisions of the Executive Board and policy advice. All of these are non-binding norms or rules created by the IMF in order to fulfil the purpose of its creation, and fall under the category of soft law.

The following part of the chapter highlights the function of the IMF in its legislative and normative capacity in the area of trade. In this institutional capacity, the IMF enhances certainty and predictability in the international trading scenario: furthermore, certainty and predictability acts as stimulus within the economic cycle which then leads to more stable and balanced growth.

a) Balance of Payments Coding System⁵³⁰

The Balance of Payment system was created by the IMF with the help of other organisations such as the Statistical Office of the European Communities (EUROSTAT), the Organization for Economic Cooperation and Development (OECD), and the European Central Bank (ECB). This

⁵³⁰ Guide to the Balance of Payments Codes for Standard Components and Additional Items, Prepared by: Balance of Payments and External Debt Divisions I and II Statistics Department of IMF (1999), Available at: <http://www.imf.org/external/np/sta/bopcode/guide.htm>

coding system is intended to assist the exchange of data on balance of payments, liquidity of foreign currency, international trade in services, and international investment positions in the global economic scenario.⁵³¹

The basic traits of this code are the reason for its success and acceptability. It is based on complete coverage, it is concise, straightforward, easily automation-compliant, and easily modified.⁵³²

Even though this code has vast acceptability, its scope is somewhat limited. For example, it uses the standard components for international investment positions and balance of payments data as classified in the Balance of Payments Manual, the 5th edition⁵³³; as defined in the Extended Balance of Payments Services (EBOPS)⁵³⁴, as mentioned in the Manual on Statistics of International Trade in Services⁵³⁵; and the categorisation of foreign currency liquidity, as shown in the Data Template on International Reserves and Foreign Currency Liquidity: Operational Guidelines⁵³⁶.⁵³⁷

⁵³¹ <http://www.imf.org/external/np/sta/bopcode/index.htm>

⁵³² Guide to the Balance of Payments Codes for Standard Components and Additional Items, Prepared by: Balance of Payments and External Debt Divisions I and II Statistics Department of IMF (1999), Available at: <http://www.imf.org/external/np/sta/bopcode/guide.htm>

⁵³³ Fifth Edition of the IMF's Balance of Payments Manual, IMF. P4 Available at: <http://www.imf.org/external/np/sta/bop/bopman.pdf>

⁵³⁴ Extended Balance of Payment Services Classification (EBOPS). Available at: <http://www.oecd.org/dataoecd/24/34/2507956.pdf>

⁵³⁵ The Manual on Statistics of International Trade in Services is a joint publication of six agencies: the UN, EC, IMF, OECD, UNCTAD, and WTO. Available at: <http://www.oecd.org/dataoecd/32/45/2404428.pdf>

⁵³⁶ International Reserves and Foreign Currency Liquidity Guidelines. Available at: <http://dsbb.imf.org/Pages/SDDS/SDDSGuide.aspx>

⁵³⁷ Guide to the Balance of Payments Codes for Standard Components and Additional Items, Prepared by: Balance of Payments and External Debt Divisions I and II Statistics Department of IMF (1999), Available at: <http://www.imf.org/external/np/sta/bopcode/guide.htm>

b) Trade related conditionality (conditionality itself being a soft law)

Conditionality being mostly a soft law and sometimes a hard law is itself a legislative act of the IMF in the context of international trade. Trade-related conditionality is discussed in detail as an executive and administrative function of the IMF in the promotion of trade.

c) Executive Board's Staff Guidance on Trade Policy Advice⁵³⁸

The Executive Board is the IMF's most powerful decision-making body. Its decisions and guidelines have the impact of a soft law within the global economic scenario. In 1999, the IMF drafted its trade policy advice guideline which was approved by the Executive Board.⁵³⁹ This guideline was simply a guidance note for IMF staff in the context of their expert advice to member countries. However, this guideline practically directs the IMF's policy towards trade, and therefore has the effect of a soft law.⁵⁴⁰ This policy advice is not at all binding on member countries;⁵⁴¹ however, staff guidelines amount to a normative act of the IMF. Application of this guidance note by staff members eventually led to a more trade-liberalised membership within a stable macro economy.

This Executive Board's guidelines for the IMF allow it to effectively deal with trade-related issues. These guidelines increase the predictability of the nature of IMF policy advice which, if

⁵³⁸ Annex II of Review of Fund Work on Trade (2005).

⁵³⁹ IMF (1999), "Guidelines on Designing and Implementing Trade Policy Reforms" (unpublished Washington: International Monetary Fund).

⁵⁴⁰ See, Annex Table 1. Guidance on the IMF's Approach to International Trade Policy Issues, 1996–2007, in IMF (2009). Guiding the IMF's Involvement in International Trade Policy, background paper 3, in IMF involvement in international trade policy issues / [prepared by an IEO team of Susan Schadler, Ling Hui Tan and Seok-Hyun Yoon] – Washington, D.C. : International Monetary Fund.

⁵⁴¹ Joseph Gold (Legal Counsel during 1946–79) held that, while the IMF has no regulatory authority over trade practices, its "soft" responsibility encompasses policies that encourage or ease the expansion of international trade. As cited in, What Is the Nature of the IMF's Mandate to Cover Trade Policy? in IMF involvement in international trade policy issues / [prepared by an IEO team of Susan Schadler, Ling Hui Tan and Seok-Hyun Yoon] – Washington, D.C. : International Monetary Fund, para 6 at page 4.

backed by conditionalities, has a hard law effect. The following part of this subheading will discuss the guidelines provided by the IMF for its staff in the area of trade, the purpose of discussing these guidelines being to see the way in which they act as soft laws.

- **IMF-recommended reform should first aim at the most obvious problem-creating element.** These include the most restrictive and least transparent factors in the economy concerned, and include mainly non-tariff barriers (NTBs), quantitative restrictions, trade monopolies, restrictive foreign exchange practices that influence trade, quality controls, and customs dealings that take the form of trade restrictions.
- **The application time for the recommend reforms should be adjusted according to the country's circumstances.** In other words, the recommended reform should consider the administrative capability of the country concerned, the initial degree of restrictiveness, and probable modification costs.
- **Quantitative restrictions should be substituted by tariffs of a provisional nature;** however, these new tariffs should not create an extra burden other than those of quantitative restrictions or WTO commitments. On the other hand, export restrictions should be substituted by policies to solve the issues which originally necessitated export restrictions.
- **The focus of IMF-led tariff reforms should be to achieve a straightforward, transparent system, with reasonably low standardised rates.** In an ideal world, the IMF's aim should be to impose tariffs of between 5% and 10% and can provisionally impose import surcharges in order to solve revenue deficits or balance of payments issues. However, import surcharges for longer periods should not be allowed.

- **Customs arrangements and assessment methods should be crystal clear**, with a non-discriminatory approach.
- **IMF-recommended trade reform should be followed by harmonising macroeconomic and other relevant policies.** The reason for doing so is because there is a robust connection between trade policies, real exchange rates levels, and a liberal exchange system. Moreover, trade and fiscal policies have considerable associations.
- **Other planning is needed to reduce the cost of trade reforms.** For example, safety nets and fiscal reforms to counter a temporary rise in sectoral unemployment, or a reduction in revenue through tariff collection.

The guideline provides instructions to the IMF regarding the approach towards regional trade agreements (RTA). The IMF encourages most-favoured-nation (MFN)-based liberalisation, even if it is a regional arrangement. However, the RTAs should comply with relevant member's WTO commitments and the RTAs should be crystal clear and liberalisation-oriented with unambiguous and steady rules of origin.

Moving in the same direction as the above discussion, the Executive Board issued a list of considerations for staff in order to cover all issues related to trade during surveillance. These considerations also have the effect of soft law as they are a source of guidance to IMF staff in the coverage of all trade-related IMF issues. The important factor underlining these considerations was that it covered all direct and indirect core areas of concern for the IMF.

In short, the IMF has a legislative and normative role, but one which is limited, in its institutional capacity towards the enhancement of international trade. The discussion above shows that the IMF successfully adds some degree of certainty and predictability of the rules of the game within the international trading scenario.

4. Executive and Administrative functions of the IMF in the endorsement of International Trade

The IMF, in its executive and administrative capacity, has a reasonable role in the endorsement of international trade. In the international trade scenario, the main focal point of the IMF's role in this context is on surveillance, TA and IMF-led programs for the endorsement of trade (such as, Aid for Trade). But first of all, this subheading refreshes our earlier exploration of the executive and administrative role of an IO.⁵⁴²

The effectiveness of an IO depends on the execution and implementation of its decisions and policies.⁵⁴³ Thus to make implementation effectual, IOs require executive and administrative authority. However, the exercising of this authority is curtailed by the concept of legality and it aims to allow IOs to extend assistance and supervision to members for the implementation of institutional acts and, in some cases, also empowers IOs to exercise sanctions.⁵⁴⁴

As already mentioned earlier in this chapter, the IMF, for its completeness as an IO, possesses executive and administrative authority. These powers are vital for the implementation of the decisions of the IMF so that it can function smoothly to achieve its goals. In this context, the IMF has a proper institutional structure with an administrative arm which plays a central role in the management of the IMF and its activities. Through this institutional structure (secretariat) the IMF performs its executive and the administrative functions so that it can manage the realisation of institutional acts and the supervision of compliance with those acts by the members.

⁵⁴² Chapter II.A.3.b) on page 46

⁵⁴³ Philippe Sands and Pierre Klein (eds) (2001), *Bowett's Law of International. Institutions*. London: Sweet & Maxwell, 5th ed., p 314; and also see, Schermers, G. and Niels M. Blokker (1995), *International Institutional Law: Unity Within Diversity* (3rd edn, The Hague, M. Nijhoff) chapter 10.

⁵⁴⁴ For sanction as means of enforcement see generally; George W. Downs (1998), *Enforcement and the Evolution of Cooperation*, 19 MICHIGAN JOURNAL OF INTERNATIONAL LAW 319; Doxey, Margaret P. (1996), *International sanctions in contemporary perspective*. Basingstoke: Macmillan, 2nd edition; Chayes, Abram and Antonia Handler Chayes (1998), *The new sovereignty: compliance with international regulatory agreements* /. Harvard University Press; and also see, Philippe Sands and Pierre Klein (eds) (2001), *Bowett's Law of International. Institutions*. London: Sweet & Maxwell, 5th ed., p 324.

The use of sanctions by the IMF is not that common; instead, it uses conditionality as a tool for the enforcement (compliance) and implementation of its policies. Conditionality as an enforcement mechanism for compliance with the trade-related policies of the IMF will also be discussed in this subheading. However, there has been a reduction in trade-associated IMF conditionality; this is because the majority of the IMF membership has aligned their trade policies with those encouraged by the IMF. Moreover, the IMF focus is more on surveillance, program work (such as Aid for Trade), research and TA. The following section will begin by looking at surveillance as an executive and administrative tool of the IMF in the promotion of trade.

The executive functioning of the IMF is bound by its legal framework, which is based on the Articles of Agreement and the decisions of the Executive Board.⁵⁴⁵ However, the decisions of the Executive Board are very wide-ranging and as such, give the IMF reasonable space to achieve its goals.

The following part of the chapter looks at the executive and administrative functioning of the IMF as part of its institutional role in the endorsement of international trade. In this context, the IMF's main executive and administrative functions are divided into surveillance, TA and IMF-led programs which support international trade.

a) Surveillance

The IMF's involvement in trade-related matters is legally backed by the IMF's Articles of Agreement and the decisions of the Executive Board.⁵⁴⁶ The surveillance process is discussed in

⁵⁴⁵ IMF Legal Framework chapter IV.A on page 137

⁵⁴⁶ See The Chairman's Summing Up, Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision (SUR/04/80, August 2, 2004). Earlier guidance is contained in Concluding Remarks by the Acting Chair, Trade Issues—Role of the Fund (BUFF/01/143, September 20, 2001) and Concluding Remarks by

detail elsewhere in this chapter and the preceding chapter.⁵⁴⁷ However, the following section of this subheading talks about trade-related bilateral and multilateral surveillance as an administrative act of the IMF.

Bilateral Surveillance

Surveillance is a very important tool of the IMF which serves to keep the IMF and its member countries up-to-date about a variety of issues related to their economy. Bilateral surveillance is surveillance at micro or individual country level. Administrative functioning by the IMF staff in the form of surveillance has contributed somewhat to solving issues pertaining to trade which has considerably helped the trading environment.

In order to perform this administrative function effectively, the Executive Board issued considerations⁵⁴⁸ to the IMF staff in relation to trade-related surveillance. These considerations enable the IMF to cover 75% of trade-related issues during surveillance.⁵⁴⁹ The important factor underpinning these considerations was that it covered all direct and indirect core areas of concern for the IMF.

Multilateral Surveillance

Surveillance comes under the administrative function of the IMF and is part of its institutional role: surveillance at macro level is called multilateral surveillance. This is a long process undertaken by IMF staff in order to assess the macro-economic conditions of the global economy.

the Acting Chair, Market Access for Developing Country Exports—Selected Issues (BUFF/02/165, September 18, 2002).

⁵⁴⁷ Chapter IV.C.1 on page 143 and Chapter V.B.2.a) on page 188

⁵⁴⁸ Footnote **Error! Bookmark not defined. Error! Bookmark not defined.**

⁵⁴⁹ IMF (2005). Review of Fund Work on Trade. Prepared by the Policy Development and Review Department. SM/05/57, Para 27.

In the context of trade, the IMF carries out multilateral surveillance in two chief ways. The first form of multilateral surveillance carried out is the *World Economic Outlook (WEO)*. IMF staff analyse and predict economic conditions in the international economic scenario, which also includes trade topics. The WEO takes a broader approach towards international trade issues, such as concerns relating to the WTO's Doha Round, examining the link between trade and financial integration, and gauging the influence of upcoming trade powers on the international economic scenario.⁵⁵⁰

The second method opted by the IMF for multilateral surveillance is by backing the WTO-led multilateral trade negotiation rounds, e.g. the Doha Round. For this purpose, the IMF has undertaken activities to endorse the Doha Round: conducting technical research papers in its areas of speciality which are mostly requested by the WTO secretariat; Executive Board and Board Committee reviews of the trade issues; publicly supporting WTO-backed trade liberalisation by encouraging its membership to participate actively in the Doha Round;⁵⁵¹ and assisting its members with trade integration⁵⁵²

Besides its contributions towards trade liberalization led by the WTO, the IMF has persistently highlighted the significance of the promising Doha Round agreement and its timely acceptance.

⁵⁵³ Right after the Doha Round of multilateral trade negotiations began in 2001, the IMF issued various statements emphasising the development benefits pertaining to these policies in the

⁵⁵⁰ For details about WEO visit: <http://www.imf.org/external/pubs/ft/weo/2010/01/index.htm>

⁵⁵¹ <http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/EXTARCHIVES/0,,contentMDK:21028421~menuPK:64319206~pagePK:36726~piPK:36092~theSitePK:29506,00.html> . For IMF Communiqués about the WTO visit: <http://www.imf.org/external/news/default.aspx?gType=News&DType=Communiqu%C3%A9s&selCountry=Select+Country&selSubject=World+Trade+Organization&selMonth=Month&selDay=Day&selYear=Year&selMonth1=Month&selDay1=Day&selYear1=Year> . For press releases by the IMF in support of the WTO visit: <http://www.imf.org/external/news/default.aspx?gType=News&DType=Press+Releases&selCountry=Select+Country&selSubject=World+Trade+Organization&selMonth=Month&selDay=Day&selYear=Year&selMonth1=Month&selDay1=Day&selYear1=Year&submitx.x=23&submitx.y=9>

⁵⁵² Financing policy aimed at mitigating certain concerns about the Round (Trade Integration Mechanism).

⁵⁵³ Para 38, Review of Fund Work on Trade (2005).

OECD conferences and at the WTO meeting. The benefits of multilateral trade were one of the key features discussed in letters and speeches made by the Management of the IMF.⁵⁵⁴

A considerable amount of research has been carried out by members of staff, especially on issues pertaining to market access for the exports of developing countries. The research conducted included topics such as analyses of balance of payments safeguards; export subsidies; the financing of losses from preference erosion; fiscal aspects of tariff reform; and a major study of exchange rate volatility and trade.⁵⁵⁵

The IMF governing bodies, such as the International Monetary and Financial Committee (IMFC) have also expressed their conviction in the DDA. The Executive Board Committee has been holding meetings regularly to further their cause before the WTO.⁵⁵⁶

Not only has the IMF provided its full backing to the DDA, it has also worked to highlight the importance of the economic rationale for free trade. This has been achieved via speeches directed at the significance of the agricultural policies of industrialised countries as well as the ability of trade to reduce poverty. Civil society organisations have also been involved in policies pertaining to market access and agricultural subsidies.⁵⁵⁷

Surveillance is one of the most significant tools of the IMF in the context of international trade, and it requires considerable administrative and executive functioning. This executive functioning is part of the institutional role of the IMF which is not highlighted by the IMF, in order to veil its realist insight within the liberally-institutionalized IELR.

⁵⁵⁴ For details see box 3, Review of Fund Work on Trade (2005).

⁵⁵⁵ For details see box 3, IMF (2005). Review of Fund Work on Trade. Prepared by the Policy Development and Review Department. SM/05/57

⁵⁵⁶ *ibid*

⁵⁵⁷ *ibid*

The next subheading deals with the IMF programs which support international trade. These programs fall into the category of the executive and administrative functioning of the IMF which is part of its institutional role.

b) IMF Programs for the endorsement of international trade

The IMF, in its executive and administrative capacity, has remained engaged in several programs for international trade support and development, such as the Trade Integration Mechanism (TIM), Integrated Framework, trade policy reforms (including trade-related conditionality), and trade-related Technical Assistance (TA) programs and institutional building. These efforts are discussed below.

Most of these programs come under the IMF's contribution towards the Aid for Trade program and the IMF's collaboration with other IEIs for the greater effectiveness of efforts made by all the IEIs for trade development. Therefore, before moving towards the efforts contributed by the IMF in its institutional capacity for the endorsement of international trade, the following part of this subheading will briefly discuss the IMF's contribution to Aid for Trade and its collaboration with other IEIs.

Aid for Trade

Due to the decrease in communication and transport costs, international trade has grown significantly over the past few decades, as it is now quite cheap and much easier to access overseas markets. This expansion of international trade is considered a significant factor in global economic growth. However, not all the countries involved in international trade gain from

it; numerous developing countries lack the basic infrastructure and other supply-side limitations to reap the benefits of international trade.⁵⁵⁸

It has been observed worldwide that the expansion of exports is a highly significant factor in a flourishing development process. It quite difficult for an economy to grow without expanding exports and this includes both types of countries with exports as cause or consequence of economic growth.⁵⁵⁹ Approximately sixteen developing countries, which were not oil exporting countries, achieved an economic growth rate of 4.5% or above, with the help export expansion..⁵⁶⁰ Moreover, their share in the international market rose approximately threefold.⁵⁶¹

There are many reasons why countries are not able to gain from international trade, including political and structural factors, domestic policies, macroeconomic policies⁵⁶² and many others. Therefore, the IMF and other responsible international institutions⁵⁶³ are working to assist developing countries (which also includes the least developed countries) to support them in the

⁵⁵⁸ Dorsey, Thomas, What Is Aid for Trade? IMF Policy Development and Review Department, May 23, 2007. Available at: <http://www.imf.org/external/pubs/ft/survey/so/2007/POL0523A.htm>

⁵⁵⁹ The direction of causality is not confirmed between positive link between trade ‘openness’ and incomes of countries. See, J. D. and Warner, A. M. (1995) Economic reform and the process of global integration. Brookings Papers on Economic Activity, 1-118; see also, Rodriguez, Francisco & Dani Rodrik, (2001). "Trade Policy and Economic Growth: A Skeptic's Guide to the Cross-National Evidence," NBER Chapters, in: NBER Macroeconomics Annual 2000, Volume 15, pages 261-338 National Bureau of Economic Research, Inc; see also, Wacziarg, Romain & Welch, Karen Horn, 2003. "Trade Liberalization and Growth: New Evidence," Research Papers 1826, Stanford University, Graduate School of Business.

⁵⁶⁰ Countries includes of different size, human capital, and market access opportunities— ranging from Botswana to Sri Lanka and Pakistan to China and India. Others are Indonesia, Chile, Mauritius, Uganda, Thailand, Malaysia, Taiwan, Cambodia, Singapore, Burkina Faso, and South Korea.

⁵⁶¹ Aid for Trade: Harnessing Globalization for Economic Development Prepared by the Staffs of the World Bank and IMF, 2007. Para 8, Available at: <http://www.imf.org/external/np/pp/2007/eng/080107.pdf>

⁵⁶² Poor macroeconomic policies lead to real exchange rate appreciations and currency overvaluation that reduces competitiveness.[Gelb, A. (ed). 2000. Can Africa Claim the 21st Century? Washington DC, World Bank, also see, Selassie, A.A., B. Clements, S. Tareq, J. K. Martijn, and G. di Bella. 2006. “Designing Monetary and Fiscal Policies in Low-Income Countries”, IMF Occasional Paper 250, and also see, Berg, A. S. Aiyar, M. Hussain, S. Roche, T. Mirzoev, and A. Mahone. 2007. “The Macroeconomics of Scaling Up Aid: Lessons from Recent Experience”, IMF Occasional Paper 253.]

⁵⁶³ Such as the World Bank, the WTO, etc.

trade arena so that they can reap the benefits of international trade. This assistance or Aid for Trade is aimed at solving the supply-side bottlenecks of developing countries so that their exports can expand. Generally, it includes any assistance that finances trade-associated infrastructure, trade-associated technical assistance, and any help in the development of productive capability.⁵⁶⁴

One of the most effective approaches of Aid for Trade is in supporting institutions which help trade through export expansion so allowing countries to benefit from comparative advantage. Such institutions are those associated with tax administration, customs, and the rule of law-oriented institutions so as to form a reliable trading scenario. The trait of institutions can itself act as a comparative advantage because most importers/buyers are only interested in interacting with countries with a minimum standard of institution to ensure a reasonable quality of products and service.⁵⁶⁵

The IMF contributes towards Aid for Trade via its contributions in the Integrated Framework⁵⁶⁶ and the Enhanced Integrated Framework but mostly, its main role is that of technical advisor. However, as discussed earlier in this chapter, the IMF actively supports trade development

⁵⁶⁴ These categories of aid accounted for 24 percent of total official development assistance (\$23 billion) in 2004. Aid for infrastructure, such as roads and ports, accounted for over half the total, with aid for productive capacity (such as support for industry, agriculture, and tourism) accounted for most of the rest. Trade-related technical assistance accounted for about 10 percent, according to estimates from the OECD's Development Assistance Committee.

⁵⁶⁵ See Levchenko, A. (2004). "Institutional Quality and International Trade," IMF Working Paper 04/231; see also, Anderson, J. and D. Marcouiller. (2002). "Insecurity and the Pattern of Trade: An Empirical Investigation," The Review of Economics and Statistics; see also, Francois, J. and M. Manchin. (2007). "Institutions, Infrastructure and Trade," World Bank Policy Research Working Paper 4152; see also, Islam, R. and A. Resheff. (2006). "Trade and harmonization: if your institutions are good, does it matter if they are different?" World Bank Policy Research Working Paper 3907; see also, Ranjan, P. and J.Y. Lee. (2007). "Contract Enforcement and the Volume of International Trade in Different Types of Goods," forthcoming in Economics and Politics. See also, Aid for Trade: Harnessing Globalization for Economic Development Prepared by the Staffs of the World Bank and IMF, 2007. Available at: <http://www.imf.org/external/np/pp/2007/eng/080107.pdf>

⁵⁶⁶ See [http://siteresources.worldbank.org/DEVCOMMIT/Documentation/20651864/DC2005-0016\(E\)-Trade.pdf](http://siteresources.worldbank.org/DEVCOMMIT/Documentation/20651864/DC2005-0016(E)-Trade.pdf).

through trade-associated reforms and imposing alterations on other trade policies through technical assistance, financial support⁵⁶⁷, and policy advice.

Collaboration with other International Institutions

As discussed in the theoretical framework, states cooperate with each other for collective gains. This cooperation led to the formation of the IELR at global level in order to tackle issues related to the interdependence of national economies. The most common method for cooperation is through IEIs, and these IEIs, which are mostly based on collective will, which cooperate with each other for better results. Thus the IMF carries out both formal and informal collaboration in its institutional capacity with other IEIs (mainly the World Bank and the WTO) in order to achieve its goals related to international trade.⁵⁶⁸ The cooperation of these institutions makes them more effective as greater coherence in global economic policies can better help global problems.

This pledge of cooperation takes the form of staff collaboration and institutional consultations, producing pertinent meetings and the exchange of relevant information and documents. Moreover, the IMF has emphasised collaboration and coherence with the WTO on trade issues since the start of the Doha Round.⁵⁶⁹

The goals regarding trade issues are more or less the same for all three international economic institutions (the IMF, the World Bank and the WTO); however, the way in which these

⁵⁶⁷ IMF financial support for trade liberalization. The IMF provides financing through arrangements under its Poverty Reduction and Growth Facility, stand-by arrangements, and extended arrangements to help address the overall balance of payments need, including need resulting from adjustment to trade-related reforms and other trade policy-related shocks. Specific instruments that can be tailored specifically to trade liberalization include the Trade Integration Mechanism (TIM) and the Exogenous Shocks Facility (ESF). [Para 77, Aid for Trade: Harnessing Globalization for Economic Development Prepared by the Staffs of the World Bank and IMF, 2007. Available at: <http://www.imf.org/external/np/pp/2007/eng/080107.pdf>]

⁵⁶⁸ IMF's goals related to international trade are mentioned in Article I (iv) of the IMF's Article of Agreement. see Chapter IV.B on page 139

⁵⁶⁹ IMF (2005). Review of Fund Work on Trade. Prepared by the Policy Development and Review Department. SM/05/57

institutions achieve the same objectives differs. These institutions are specialists in their relevant areas and deal with trade aspects accordingly. For example, the IMF focuses on the general global economic policy structure, the World Bank on development concerns, and the WTO on legal trade obligations.⁵⁷⁰

As mentioned at the beginning of this section, this part of the chapter will discuss the contribution of the IMF in its executive and administrative authority, as part of its institutional capacity. Thus, this institutional role of the IMF in its executive and administrative capacity for the development of international trade is discussed below

(1) Trade Integration Mechanism (TIM)⁵⁷¹

TIM is a program through which the IMF helps out its member countries when they face short-term financial repercussions due to non-discriminatory trade adjustments. The most common and recent trade liberalization based on non-discrimination has taken place in the past few decades and lies mainly under the umbrella of the WTO/GATT.

Trade liberalization is considered a major step towards the uplift of the world economy through enormous economic growth.⁵⁷² In the past five decades, the global economy has grown many times over due to the expansion of international trade which is mostly attributed to the

⁵⁷⁰ *ibid*

⁵⁷¹ Factsheet, The IMF's Trade Integration Mechanism (TIM), 2010. Available at: <http://www.imf.org/external/np/exr/facts/tim.htm>, The Executive Board of the IMF approved the TIM in 2004, for press release visit: <http://www.imf.org/external/np/sec/pr/2004/pr0473.htm>

⁵⁷² See generally, Kneller, Richard, Morgan, C. W. and Kanchanahatakij, Sunti, (2008). Trade Liberalization and Economic Growth. World Economy, Vol. 31, Issue 6; see also, Thirlwall, A.P. (2000). Trade, Trade Liberalisation and Economic Growth: Theory and Evidence. African Development Bank, Economic Research Papers 63.

WTO/GATT trade negotiation rounds.⁵⁷³ Nevertheless, there is still space for further liberalization in order to reap the best out of the gains from trade concept.⁵⁷⁴

However, there could be short-term negative repercussions on some members' economies, due to adjustment costs. These adjustment costs may take the form of short-term export income reductions swelling import bills, thus resulting in balance of payments problems.⁵⁷⁵

The IMF, through TIM, tries to specifically help developing countries balance of payments scenarios by assuring them of the availability of financial assistance from the IMF in the case of balance of payment problems arising from the WTO-led multilateral trade liberalization process (currently due to the Doha Round).

Under the TIM program, the IMF helps member countries in balance of payments distress by providing them with finance in the following ways: firstly, by being prepared to discuss additional lending options with balance of payment-distressed members, such as, Stand-by Arrangements⁵⁷⁶, the Extended IMF Credit Facility⁵⁷⁷, or facilities under the Poverty Reduction and Growth Trust⁵⁷⁸; secondly, by taking into consideration the probable effect on members' balance of payments after the trade adjustments, so as to ascertain suitable lending requirements; and finally, by being prepared to extend additional financial assistance in continuance of the previous lending for the same purpose. This additional lending is made in the case of related unanticipated adjustment costs which occur later on. In other words, the IMF is prepared to assist

⁵⁷³ Chapter III.B.3

⁵⁷⁴ In the multilateral trade liberalization context, the WTO is currently busy in its ongoing Doha Round which has capacity of benefiting all participating countries.

⁵⁷⁵ See also, Supra Note 569

⁵⁷⁶ For Stand-by Arrangements visit: <http://www.imf.org/external/np/exr/facts/sba.htm>

⁵⁷⁷ For Extended IMF Credit Facility visit: <http://www.imf.org/external/np/exr/facts/ecf.htm>

⁵⁷⁸ For the facilities under the Poverty Reduction and Growth Trust visit: <http://www.imf.org/external/pubs/ft/sd/index.asp?decision=8759-%2887/176%29>

its member countries in the case of financial repercussions (BOP problems) arising from the non-discretionary trade liberalization process.

However, there is a limit to IMF financing under TIM whereby TIM does not entertain a balance of payments shortfall if it is the result of the member country's own liberalization action; for instance, a balance of payments shortfall due to a member's reduction in its own import duties.⁵⁷⁹

Overall, the executive functioning of the IMF in the form of extending financial assistance through TIM is a notable contribution towards the development of international trade. The IMF as an IEI boosts the confidence of its member countries to go for trade liberalization by assuring them of financial assistance in the case of temporary fallout from the trade liberalization process. However, TIM has not yet been frequently used by IMF members; so far, only three member countries (Bangladesh, the Dominican Republic, and the Republic of Madagascar) have obtained financial assistance through TIM.

(2) *Integrated Framework*

LDCs have always been on the IMF's priority list. The IMF, in its administrative capacity, contributes to the wellbeing of LDCs by extending its expert advice to the Integrated Framework (IF). The IF is an international initiative in which many international partners are involved.⁵⁸⁰ The main goal of the IF is to use international trade to reduce poverty by developing trade-associated capacity.⁵⁸¹ The IMF's contribution in the IF has been reasonable. It mainly

⁵⁷⁹ IMF (2011). FACTSHEET, The IMF's Trade Integration Mechanism (TIM).

⁵⁸⁰ Core Agencies of the Integrated Framework are IMF, ITC, UNCTAD, UNDP, World Bank, and WTO. <http://www.imf.org/external/np/sec/pr/2003/pr03110.htm>

⁵⁸¹ IMF (2003). Joint Communiqué by the Six Core Agencies of the Integrated Framework—IMF, ITC, UNCTAD, UNDP, World Bank, and WTO. Press Release No. 03/110 July 10, 2003. Available at: <http://www.imf.org/external/np/sec/pr/2003/pr03110.htm>

contributes to the IF through the Diagnostic Trade Integration Studies (DTIS).⁵⁸² The DTIS is a World Bank initiative for the development of LDCs and in the DTIS, the macroeconomic portion is very important and is mostly added by the IMF. Moreover, it provides in-depth reviews of the trade scenarios which are quite helpful to the authorities and donors in project and policy formation.⁵⁸³

Thus, expert advice in the context of the IF is part of the administrative function of the IMF and part of its institutional role. As the IF and development of trade are closely related, the IMF's institutional role contributes towards the development of trade.

(3) Trade policy reforms (including trade-related conditionality)

The IMF, in its executive authority, introduces trade policy reforms to member countries. These trade reforms are mostly aimed at open trade and exchange rate systems in order to achieve good governance and economic growth. Mostly these trade policy reforms involve focusing on medium-term programs to achieve their goals rather than short-term. However, trade policies can be highly instrumental in the short term for achieving governance and fiscal goals; for example, by improving customs administration and dealing with duty exemptions.⁵⁸⁴

These trade policies put forward by the IMF as part of its program are regularly reviewed by IMF staff (in their administrative capacity)⁵⁸⁵ and, backed by the IMF, vary from country to country and are determined according to the requirements needed to attain the set goals of that

⁵⁸² <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/TRADE/0,,contentMDK:20615178~menuPK:1574524~pagePK:148956~piPK:216618~theSitePK:239071,00.html>

⁵⁸³ Supra note 569, Para 32

⁵⁸⁴ See also, Supra note 569, Para 41

⁵⁸⁵ Para 1, Trade Conditionality Under Fund-Supported Programs, 1990–2004 (Background Paper to the Review of Fund Work on Trade), Prepared by the Policy Development and Review Department, Approved by Mark Allen, 2005.

very program. Thus the reason for the introduction of a specific trade policy reform is determined by the goals which the IMF is looking for that member to achieve in a support program.⁵⁸⁶ The main reasons for the introduction of trade policy reforms are expressed in the chart below.

According to this chart, the most common reason for introducing a reform in trade policy is to bring the member countries' trade policies administration to conform with international best practice (streamlining). The efficiency factor comes next in trade policy, followed by revenue, balance of payments and governance issues. Streamlining trade policy with that of the IMF is the most common motive because, by doing so, the member countries have to face less imposition of trade-associated conditionalities.⁵⁸⁷

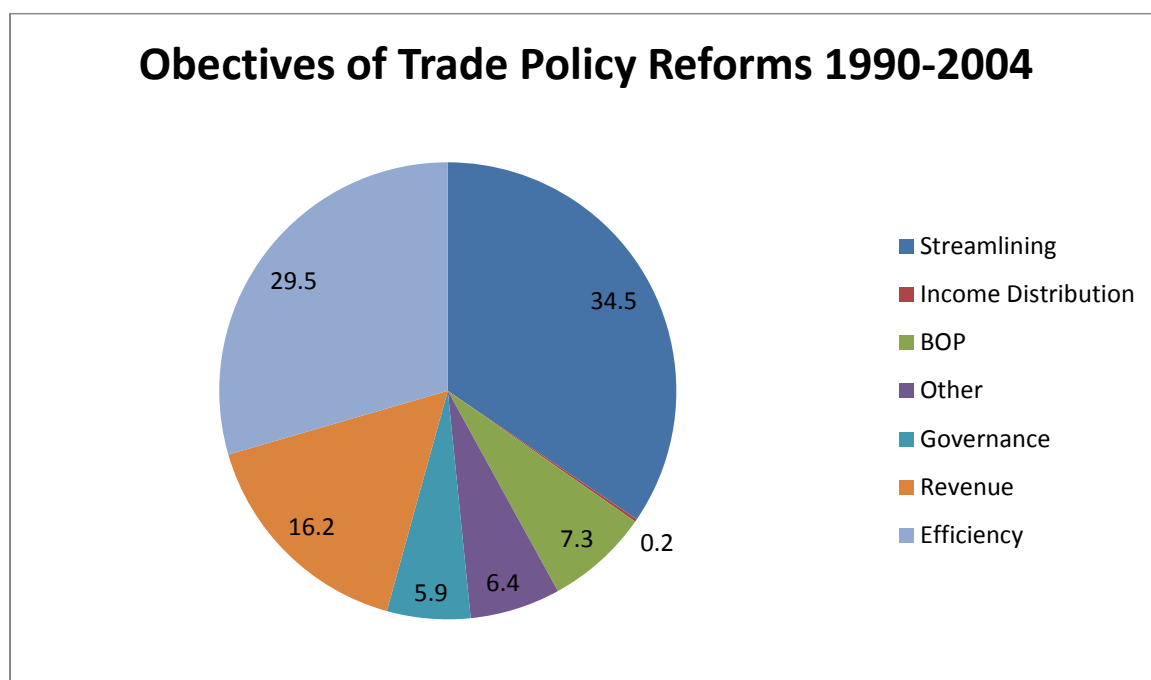


Figure 6 Objectives of Trade Policy Reforms

⁵⁸⁶ Ibid

⁵⁸⁷ Para 6, Trade Conditionality Under Fund-Supported Programs, 1990–2004 (Background Paper to the Review of Fund Work on Trade), Prepared by the Policy Development and Review Department, Approved by Mark Allen, 2005.

Trade policy reforms usually take the form of “general commitments”. These commitments are usually medium-term trade-related commitments which the member countries can easily take up. The more the members commit to in a trade policy, the fewer the conditions imposed upon them by the IMF and the better the options for them to obtain financing through IMF supported programs.⁵⁸⁸

According to IMF research⁵⁸⁹, nearly 75% of the programs under IMF review under surveillance comprise general obligations in context of trade liberalization. In many cases, these liberalization-oriented trade policy reforms were based on detailed liberalization planning and the countries which were subject to these reforms included Egypt, Indonesia, Jordan, Kazakhstan, Mexico, Mongolia, Peru, Tanzania, and Yemen.⁵⁹⁰

Moreover, many trade reform programs comprised detailed direction to enhance trade openness via various methods in accordance with the member country’s conditions. Some of the methods involved committing members to introduce tariff ceilings,⁵⁹¹ the substitution of NTBs and an improvement in customs administration (see figure below).

⁵⁸⁸ Para 9, Trade Conditionality Under Fund-Supported Programs, 1990–2004 (Background Paper to the Review of Fund Work on Trade), Prepared by the Policy Development and Review Department, Approved by Mark Allen, 2005.

⁵⁸⁹ Trade Conditionality Under Fund-Supported Programs, 1990–2004 (Background Paper to the Review of Fund Work on Trade), Prepared by the Policy Development and Review Department, Approved by Mark Allen, 2005.

⁵⁹⁰ For instance, in 1991 Egypt used IMF’s Stand-By Arrangement-supported program. In result of this program the Egyptian government publically showed its intention to decrease tariffs gradually and decrease quotas in exports. Moreover, it also discard all non-tariff import barriers within two years.

⁵⁹¹ In some cases, programs allowed provisional rise in import tariffs—for example, in 1997-2000 Thailand used the Stand-By Arrangement-supported program.

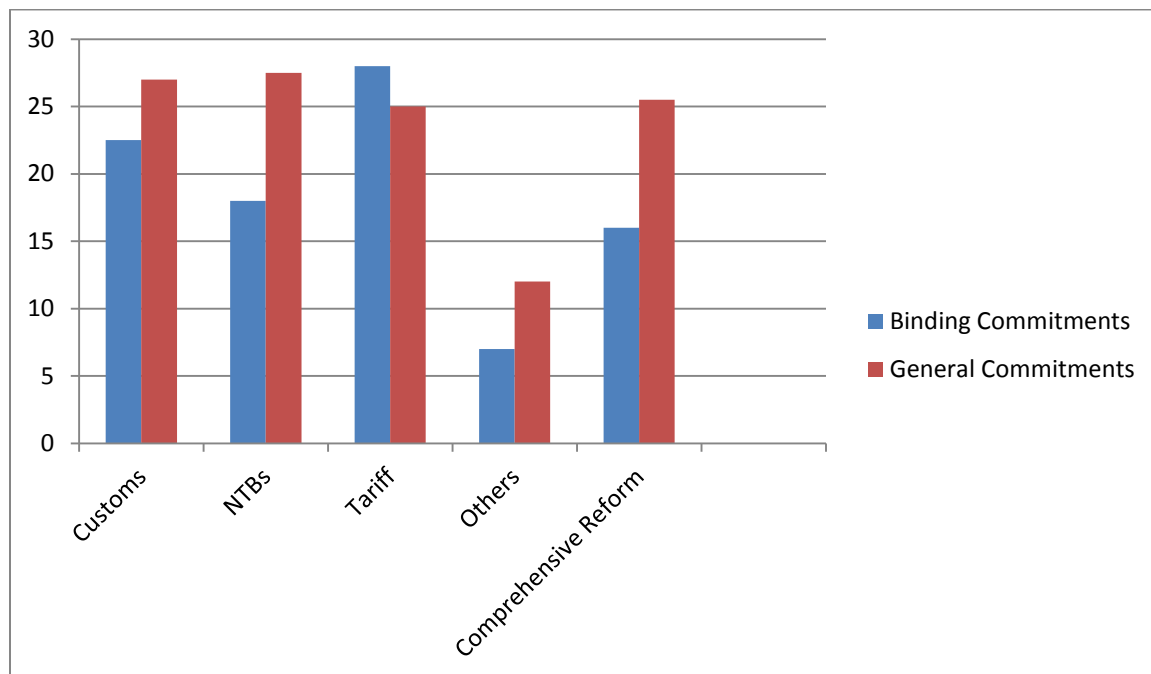


Figure 7 Nature of Program Commitments, 1990-2004 in percentage of program including type of measure. ⁵⁹²

In the IMF-supported programs, trade policy adjustments are quite frequent and mostly the IMF in its executive authority attaches conditions to its financial assistance for the enforcement of these reforms. Thus, for the effective implementation of IMF trade policy reforms, sometimes the IMF uses conditionality as an executive tool in its institutional capacity. The IMF has legal jurisdiction over trade matters if they are related to the IMF's area of expertise. These are no special rules to be followed in cases of trade-associated conditionality and they are dealt with by the IMF in the same way in which it deals with all other issues linked with its financial assistance

⁵⁹² Para 10, Trade Conditionality Under Fund-Supported Programs, 1990–2004 (Background Paper to the Review of Fund Work on Trade), Prepared by the Policy Development and Review Department, Approved by Mark Allen, 2005.

programs.⁵⁹³ Thus, trade-related conditionalities are also governed by the principles laid down in the Guidelines on Conditionality.⁵⁹⁴ The most important condition to be met for the application of conditionality is that it should be highly significant in the adequate accomplishment of the member's IMF-supported reform policy. Mostly, these trade policy reforms involve focusing on medium-term programs to achieve its goals rather than short-term. However, trade policies can be highly instrumental in the short term for achieving governance and fiscal goals, for example, in improving customs administration and dealing with duty exemptions.⁵⁹⁵

According to a review on trade-related conditionality, which is part of the IMF's administrative function, the implementation of trade-related conditionalities was reasonable and was equal to whole conditionality implementation in all sectors. In this review, a sample of countries was selected by the IMF and their implementation of trade-related conditionalities for the period between 1995 and 2003 noted. As mentioned in the table below, 71% of trade-associated conditionalities were implemented on time.⁵⁹⁶

⁵⁹³ As discussed under the subhead chapter V.B.2.b) at page no 190.

⁵⁹⁴ Guidelines on Conditionality, Dec. No. 12864-(02/102), Sept. 25, 2002, Selected Decisions, 28th Issue, paras 7(a) & (b), p. 235–36.

⁵⁹⁵ See, *supra* note 569, Para 41

⁵⁹⁶ Para 30, Trade Conditionality Under Fund-Supported Programs, 1990–2004 (Background Paper to the Review of Fund Work on Trade), Prepared by the Policy Development and Review Department, Approved by Mark Allen, 2005.

Table 7 Trade Conditionality Implementation⁵⁹⁷

	Total	On Time	Late (percent of measures)	Not Implemented (percent of measures)	Rescheduled	Implementation Index¹
Total Measures	100	71	16	9	3	1.62
By Program Type						
EFF ⁵⁹⁸	23	81	10	9	0	1.73
ESAF/PRGF ⁵⁹⁹	57	65	23	8	5	1.57
SAF ⁶⁰⁰	1	25	25	50	0	0.75
Stand-By ⁶⁰¹	19	81	5	12	2	1.69
By Measure Type						
Benchmark	41	57	24	13	6	1.45
Performance Criteria	17	61	19	7	4	1.44
Prior Action	35	93	4	3	0	1.91
Review Clause	7	68	27	5	0	1.64
By Condition Type						
Comprehensive Reform	5	94	6	0	0	1.94
Customs Reform	20	61	29	10	0	1.52
Quantitative	10	65	26	10	0	1.55
Restrictions	3	75	0	0	25	1.75
State Trading	31	79	7	10	3	1.69
Tariffs & Surcharges	9	67	22	11	0	1.56
Licensing	9	67	15	19	0	1.48
Exemptions	14	79	19	2	0	1.77
Others						

¹ The Index assigns a weight of 2 to measures implemented on time, 1 to measures implemented late or rescheduled, and 0 to measures not implemented.

According to the table below; 71% of the total trade related conditionalities were implemented on time and only 9% of the total trade related conditionalities were not implemented. According to the trade implementation index the overall index was 1.62. The Index assigns a weight of 2 to measures implemented on time, 1 to measures implemented late or rescheduled, and 0 to

⁵⁹⁷ Para 30, Trade Conditionality Under Fund-Supported Programs, 1990–2004 (Background Paper to the Review of Fund Work on Trade), Prepared by the Policy Development and Review Department, Approved by Mark Allen, 2005.

⁵⁹⁸ For information about Extended Fund Facility (EFF) visit: <http://www.imf.org/external/np/exr/facts/eff.htm>

⁵⁹⁹ Enhanced Structural Adjustment Facility (ESAF). The ESAF was replaced by the Poverty Reduction and Growth Facility (PRGF) in November 1999. <http://www.imf.org/external/np/exr/facts/esaf.htm>

⁶⁰⁰ Structural Adjustment Facility (SAF).

⁶⁰¹ For details about IMF Stand-By Arrangement, visit: <http://www.imf.org/external/np/exr/facts/sba.htm>

measures not implemented. The implementation of trade related conditionalities were satisfactory as the index was close to 2.

This table comprehensively illustrates the implementation of trade related conditionalities in percentage. Moreover, it characterizes the implementation of the conditionalities by; program type, by measure type and condition type.

According to the program type, the most of the conditions were attached with ESAF/PRGF which was 57% of the total trade related conditions. 65% of the conditions attached with ESAF/PRGF were implemented on time and 8% were not implemented. Least conditions were attached with SAF program that was 1% and only 25% of those conditions were implemented on time.

The type of measures which were most frequently part of the trade related conditionalities were bench marks and prior actions. However, conditions attached as prior actions were implemented 93% with an index of 1.91.

Comprehensive reforms were the most implemented conditionality and its implementation index was 1.94. Most of the conditions were attached in relation to tariffs & surcharges and 79% of them were completed on time.

Other examples of the IMF's administrative function's contribution towards trade development, as part of the review process, are illustrated below.

Box 3 Recent Studies on IMF Trade Conditionality⁶⁰²

Four trade-related reviews were conducted during 1992–2001.

The 1994 review studied the level of trade reform in Fund-supported programs in 59 countries during 1990–93. Results showed that there had been considerable amount of trade reform, majority of which was through quantitative restrictions (QRs) instead of tariff reforms. Trade reforms were hardly seen to be reversed since the real exchange rates appreciated, the domestic tax reform was slow, or the domestic protectionist lobbies made it difficult to resist. Since conflicts were seen between short-term fiscal goals and medium-term trade reform objectives, it was concluded that exchange rate flexibility, liberalization of exchange systems and timely reform of local tax were essential for the sustainability of trade reform.

A later study in 1997 included multiyear Fund arrangements between 1990 and mid-1996. Through the study of case studies it was concluded that majority of the programs focused on reducing trade restrictiveness. It was also shown that clearly specified objectives in the medium term and public announcements led to the goals being met. The rate at which the trade reform was implemented and exercised was hugely determined by financial issues. Where regional trading agreements had a somewhat smaller role in determining the type of trade reform, the World Bank's collaboration was considered to be a major factor.

The 2001 review was done with the perspective of a general analysis of structural conditionality and concentrated on programs during 1997–99. Specific focus was laid on the restrictiveness of trading scenario at the start of programs. Conditionality was attached in context of the most obstructive sides of countries' trade regime. There were only a few cases in which trade policy reform proved to be vital to the program. The tariff reforms that had been introduced had structural conditions that were broad-based, whereas non-tariff barriers (NTBs) were specific to certain sectors and exports. On average, there was less than one condition implemented on the trade flow in a year, which increased slightly during late 1990s due to the increase in the usage of benchmarks. Structural benchmarks, prior actions and program reviews were the main tools used to apply trade conditionality while performance criteria was not used as often, which led to high implementation rates. The WTO accession negotiation as well as the Uruguay Round reforms helped in increasing the member states' acceptance of these trade reforms. The IMF depended on the World Bank to formulate sector-specific policies, despite its decreased participation in operations related to trade in the 1990s.

Sources: Issues and Developments in International Trade Policy, World Economic and Financial Surveys, 1992; International Trade Policies: The Uruguay Round and Beyond: Volume II., World Economic and Financial Surveys, 1994; Trade Liberalization in Fund-Supported Programs, 1997, and Trade Policy Conditionality in Fund-Supported Programs, 2001.

⁶⁰²Trade Conditionality Under Fund-Supported Programs, 1990–2004 (Background Paper to the Review of Fund Work on Trade), Prepared by the Policy Development and Review Department, Approved by Mark Allen, 2005.

In short, this subheading characterised the executive and administrative functions of the IMF in the context of policy reforms and conditionalities for trade enhancement. These functions are a part of the institutional role of the IMF as an IEI.

**(4) Trade-related Technical Assistance (TA) programs
and institutional building**

As already discussed earlier in this chapter, TA is covered under Section 2(b) of Article V,⁶⁰³ according to which, the IMF may provide TA to its members in its area of expertise. The IMF extends TA to the members concerned, mostly through specialised advice, in order to improve the institutional capacity of members in the IMF's area of interest, that is, primarily the financial sector or *any other sector which can influence the financial sector*. Moreover, TA is not at all mandatory and not of universal application; it is purely up to the members to ask for TA from the IMF. Similarly, it depends on the IMF whether they want to extend TA to that member.⁶⁰⁴

As trade issues can affect the financial sector of an economy, the IMF, in its institutional capacity, contributes towards the institutional development of the member concerned within the trade sector through TA. Under the TA programs, the IMF staff, via the Fiscal Affairs Department (FAD), mainly assist the authorities of the member countries by closely working with them to support them in strengthening their organisational structure in the area of trade, for example, contributing towards trade concerns by developing Trade Restrictiveness Index, Aid for Trade, and other activities to develop institutional capacity in the area of trade (such as

⁶⁰³ The IMF's authority to provide TA is set forth in Article V, Section 2(b) of the Articles of Agreement under which the IMF "may", upon request, provide technical services in conformity with the objectives of the IMF. Article V, Section 2(b) reads in pertinent part: "If requested, the Fund may decide to perform financial and technical services, including the administration of resources contributed by members, that are consistent with the purposes of the Fund."

⁶⁰⁴ DISSEMINATION OF TECHNICAL ASSISTANCE INFORMATION, Prepared by the Office of Technical Assistance Management and the Legal Department of the IMF, Approved by Alfred Kammer and Sean Hagan (2008), para 8, available at: <http://www.imf.org/external/np/pp/eng/2008/040308b.pdf>

customs administration).⁶⁰⁵ The aforementioned institutional contributions by the IMF through TA in the trade sector have also been discussed above; however, the Trade Restrictiveness Index is discussed below.

(a) Trade Restrictive Index

The IMF's Trade Restrictiveness Index (TRI) came into being in 1997 in order to analyse *Trade Liberalization in IMF-Supported Programs* (EBS/97/163)⁶⁰⁶. The TRI evaluated the IMF's contribution to the trade liberalization process in countries where the IMF carried out its programs. The TRI stems from a previous IMF index introduced by Kirmani et al⁶⁰⁷ which also examined the IMF's trade-related programs. Unlike the TRI, which is based on a ten point index (where 10 = most restrictive, 1 = most open), Kirmani's index assessed member countries' economies in the light of a three category index: open, moderate and restrictive.⁶⁰⁸ The TRI was intended to assess the restrictiveness of the trade-related policies of the member countries and this gave the IMF good grounds for effective policy discussions with member countries. In fact, it evaluated members' engagement in IMF-supported trade reforms by looking at the change in the level of TRI over the program period.⁶⁰⁹

⁶⁰⁵ The IMF extends its technical services in areas of its speciality, for example; in tax policy, macroeconomic policy, revenue administration, monetary policy, expenditure management, financial sector sustainability, the exchange rate system, and financial and macroeconomic statistics. IMF Factsheet of Technical Assistance, 2010, Available at: <http://www.imf.org/external/np/exr/facts/tech.htm> For core areas of expertise visit <http://www.imf.org/external/pubs/ft/psta/index.htm#annex>

⁶⁰⁶ Trade Liberalization in Fund Supported Programs. August, 27, 1997. Prepared by the Policy Development and Review Department. EBS/97/163.

⁶⁰⁷ Kirmani, Naheed and others, 1994a. Trade Policy Reform in the Countries of the Former Soviet Union., IMF Economic Review No.2. Washington, International Monetary Fund. And also see, Kirmani, Naheed and others, 1994b. International Trade Policies: The Uruguay Round and Beyond. Volume 1. Principal Issues and Volume 2, Back-ground Papers. World Economic and Financial Surveys. Washington, International Monetary Fund.

⁶⁰⁸ Krishna, Kala, Background Paper on the IMF's Trade Restrictiveness Index. National Bureau of Economic Research, The Pennsylvania State University (2009). MPRA Paper No. 21316. Available at: <http://mpra.ub.uni-muenchen.de/21316/>

⁶⁰⁹ Review of the IMF's Trade Restrictiveness Index (Background Paper to the Review of Fund Work on Trade) Prepared by the IMF's Policy Development and Review Department, 2005. Available at: <http://www.imf.org/external/np/pp/eng/2005/021405r.htm>

The TRI is a significant contribution by the IMF towards trade enhancement as it gives a true picture of the current openness of the member countries' economies. Further, it is used to measure the effectiveness of policy reforms introduced by the IMF. In other words, the TRI is a technical instrument to gauge the performance of both the member and the IMF in the application of institutional reforms and is essential for the institutional development of members.

5. Conclusion

This part of the chapter documented the institutional role of the IMF in the context of the international trade sector. It is a common misconception that the IMF does not deal with trade matters. In fact, the IMF deals regularly with trade issues as it comes under its direct mandate. This part of the chapter characterised the IMF's operations relating to the trade sector in terms of its international economic institutional role. In this context, see the table below summarising the discussion included in this part of the chapter. Moreover, as mentioned a number of times in this thesis, the above-mentioned institutional role, as an IEI, is not explicitly portrayed by the IMF.

Table 8 ⁶¹⁰

IEI's Institutional role	IMF	Effect on International Trade
Legislative or Normative	International Architecture for trade (Article VIII) <ul style="list-style-type: none"> • Conventions • Standards and Codes • Decisions of Executive Board 	Positive: By setting of the rules of the game IMF increases certainty and predictability of rules of the game which have positive effect on the development of international trade.
Executive and Administrative	<ul style="list-style-type: none"> • Surveillance (Article IV Staff Reports, Selected Issues Papers, <i>World Economic Outlook</i>) 	Positive: The executive and administrative functioning helps to implement the rules, which again increases certainty

⁶¹⁰ Material for this table is taken from two table and then modified by the author. Doha Development Agenda and Aid for Trade, Prepared by the Staffs of the IMF and the World Bank, 2006. p17 Available at: <http://www.imf.org/external/pp/longres.aspx?id=3886> . And also, see Table on Vehicles of IMF, World Bank, and WTO Trade Policy Advice, Review of Fund Work on Trade (2005)

	<ul style="list-style-type: none"> • Technical Assistance/Capacity Building (Tax and tariff reform, Customs reform) • Support Programs (Regular Fund facilities: Trade Integration Mechanism (TIM) as part of regular Fund facilities, Floating tranches,⁶¹¹ Exogenous Shocks Facility⁶¹²) • Research (clustered around trade-macro linkages, such as Preference erosion,⁶¹³ Tax Revenue and Trade Liberalization,⁶¹⁴ Trade-related Balance of Payments Vulnerabilities⁶¹⁵) • Enforce Compliance (Conditionality) 	and predictability of rules of the game which have positive effect on the international trade.
Judicial or Quasi-Judicial	N/A	

⁶¹¹ Under this financial assistance method, the disbursement of money depends on meeting some targets rather than time and dates. For details see, Khan, Mohsin S. and Sharma, Sunil (2001). IMF Conditionality and Country Ownership of Programs, IMF Working Paper No. 01/142, p23.

⁶¹² IMF FACTSHEET (2011). The Exogenous Shocks Facility- High Access Component (ESF-HAC). Available at: <http://www.imf.org/external/np/exr/facts/esf.htm>

⁶¹³ "Preference erosion" denotes a decrease in the competitive advantage that some exporters have in foreign markets as a consequence of PTA. Preference erosion can happen when the importing country; remove preferences, increase the recipients of preferential treatment, or cut their MFN tariff without changing the preferential tariffs respectively. See generally, Alexandraki, Katerina and Hans Peter Lankes, "The Impact of Preference Erosion on Middle-Income Developing Countries," IMF Working Paper 04/169 (Washington).

⁶¹⁴ Such as, Baunsgaard, Thomas and Michael Keen (2005). Tax Revenue and (or?) Trade Liberalization. Fiscal Affairs Department, IMF Working Paper no. WP/05/112 .

⁶¹⁵ Such as, Allen, Mark (Approved by) 2004, Fund Support for Trade-Related Balance of Payments Adjustments. INTERNATIONAL MONETARY FUND, Prepared by the Policy Development and Review Department

C. Conclusion

This chapter documented the way in which the IMF plays an effective institutional role in the development of the financial sector and international trade. The IMF executes this institutional role reasonably in its executive and administrative authority, and legislative and normative functioning. As discussed in the theoretical framework, this international economic institutional role is part of the IELR.

Moreover, the IMF, through its institutional role, stimulates the Economic Cycle by developing the financial sector and by supporting international trade. The Economic Cycle explains the causal relationship between financial sector development and international trade. Financial sector development leads to economic growth, economic growth promotes international trade, international trade reinforces economic growth, which in turn promotes financial development, leading to a balanced and stable economy.

Therefore the argument presented in this chapter is that if the international community (state and non-state actors) were to focus more on the relationship between the IMF's institutional role (which is part of the IELR) and the Economic Cycle, then there would be a greater chance of achieving stable and balanced growth of the global economy.

By focusing more on this institutional role, I really mean that this relationship needs to be explored more, so that it can be improved accordingly. Currently the IMF, as an IEI, is functioning according to its goals. In other words, the IMF has certain objectives and to accomplish those objectives, the IMF functions as per its requirements. However, if it defines its functioning as an institutional role, then it will better achieve its goals.

The IMF does not explicitly define its institutional role, it only defines its objectives. The reason for focusing only on its objectives and not on its institutional role is as discussed earlier. At the

beginning of section two in part one of Chapter IV, it was alleged that the IMF deliberately does not define its institutional role because it does not want to address legitimacy (of legislative and normative functions) and accountability (of executive and administrative functioning) issues related to the IMF.⁶¹⁶ This is because discussion of these issues will explicitly reveal the IMF's realist insight to the liberally institutionalised IELR.⁶¹⁷

As discussed, the importance of democratic values, legitimacy, and accountability in the IELR is paramount. Sovereign states cooperate with each other for collective gains within the IELR which is liberally institutionalized. This IELR is mainly made up of IEIs (as non-state actors), thus the IMF tries to maintain its realist aspect (benefitting the US) whilst being an important part of the liberally institutionalized IELR.

⁶¹⁶ For a good discussion about legitimacy and accountability see generally, Ch 2: Global governance and international standard setting, in Alexander, Kern, Dhumale, Rahul, and, Eatwell, John, (2005). 'Global Governance of Financial Systems, The International Regulation of Systemic Risk.' Published to Oxford Scholarship Online: September 2007, p43, 44. See also, Petersmann, Ernst-Ulrich (ed.) (2005). *Reforming the world trading system: legitimacy, efficiency, and democratic governance* / with the assistance of James Harrison. New York : Oxford University Press.

⁶¹⁷ For a good discussion about IMF, surveillance, conditionality, voting and its realist aspect see generally, Chapter 3: International legal framework for international financial regulations, in Alexander, Kern, Dhumale, Rahul, and, Eatwell, John, (2005). 'Global Governance of Financial Systems, The International Regulation of Systemic Risk.' Published to Oxford Scholarship Online: September 2007, p112.

Section Three: WTO

A. Introduction:

This thesis maintains that IEIs are the main framework of the IELR and of those IEIs, the most effective are the IMF, World Bank and the WTO. The IELR creates certainty and the predictability of the rules of the game in the global economic scenario which then acts as a stimulus in the economic cycle, leading to a stable and balanced growth of the global economy.

In connection with this, the previous section (Section Two) identifies the IMF's institutional role (both legislative/normative and executive and administrative roles) in the IELR and its effects on the Economic Cycle. The purpose of identifying this institutional role is because the IMF itself does not explicitly admit to this institutional role. The main reason for not explicitly characterising the IMF's functioning in an institutional role is that the IMF does not want to reveal its realist approach. However, if this institutional role was clearly identified, then it would become easier to improve upon it, which would then enable the IMF to contribute more effectively towards a more stable and balanced growth of the global economy.

This unidentified institutional role of the IMF evolved over a period of time,⁶¹⁸ thus it has some key structural deficiencies which are significant hurdles for the IMF in becoming the optimal IEI in the context of IELR.⁶¹⁹ These structural deficiencies are; decision-making with realistic insight; focusing more on legal transplant than on legal harmonisation; and the lack of an

⁶¹⁸ The IMF has evolved as an important IEI in context of financial global regulation. This evolution of the IMF's role took place because there was and still there is a vacuum or need for global financial regulations and there is no other IEI to do this job. Thus even with realist approach and lacking democratic values, it is followed widely (possibly due to legal transplant) in a liberally institutionalized global economy because there is no viable alternative.

⁶¹⁹ See, the main argument of Section Two on page 130

effective adjudicating system. Section Two argues that if these key deficiencies are addressed and structural institutional changes made, then idealistically the IMF could contribute in a much better way towards the IELR and the Economic Cycle. However, realistically, such major institutional changes in the IMF are not possible because the dominant powers (mainly the US) would be unlikely to give up their dominant position in the global regulatory architecture so easily.

Evidently, the IMF needs a number of structural changes made to it as an IEI in order for it to become liberally institutionalized and more effective in the context of the economic cycle. As mentioned above, the main structural changes include, for example, decision-making without the realistic insight; a greater focus on legal harmonization rather than on legal transplant, and an effective adjudicating system. However, the US, which is strong enough to influence the global economy, is not particularly interested in changing the IMF structure, since it holds the most dominant position (hegemon) in the IMF system. In other words, the dominant countries (especially the US) are not keen to lose their dominance within the global economy and in fact, they have increased IMF functioning/powers over decades through the concept of implied powers.

This section is a response to the previous section on the IMF and asserts that as the IMF is not interested (in fact incapable without consent of the US) to overcome its structural deficiencies. On the other hand, the WTO does not have the deficiencies like the IMF. Moreover, this section also shows that the WTO is capable to perform similar functions like the IMF in the area of financial sector. That is the WTO can set the rules of the game for global financial sector.

B. Argument:

As discussed above, there are practical implications for the modification of the institutional structure of the IMF. Thus, this section (Section Three) argues, on the basis of practicality, that the WTO, which is so far the most effective IEI in the IELR to affect the international economic cycle, can practically enhance its role in financial sector development. By doing this, the WTO could become the optimal IEI in the IELR and could, in fact, lead the IELR.

For this purpose, this section documents the comprehensive institutional role of the WTO as part of the IELR. As the international economic cycle takes into account both the financial sector and international trade, so this section will highlight the WTO's institutional role (legislative/normative, executive/administrative authority and quasi-judicial functioning) in the development of both. In addition, this section tries to overcome the common misconception that the WTO deals only with trade and has little to do with the development of the financial sector. This misconception is refuted by highlighting the WTO's involvement in the development of the global financial sector. The WTO's involvement in financial sector development is limited as compared to the IMF. But whatever the WTO contributes is based on relatively legitimate process and is accountable to the Contracting Parties while respecting democratic values.

So, the WTO has the institutional capacity to assume the role of the IMF by enhancing its role in financial sector development. This way, more stable and balanced growth of the global economy can be achieved, keeping all the liberally institutionalized values (cooperation with free will for collective gains) intact.

An obvious question arises here; why can the WTO be reformed yet the IMF cannot? Given that the US has an interest in not allowing the WTO to be used as a way of getting around its control of the IMF, the answer to this is simple. The US is the hegemon in the IMF's institutional structure and has the power to veto anything. Therefore, any move to undermine its dominance

can be vetoed by the US, whereas the WTO is a liberally institutionalized IEI and respects democratic values. So the collective free will of the WTO membership could push for enlargement of the WTO's role in financial sector development. The US has no veto in the WTO so if the member countries so wish, they can call for an increase in the role of the WTO.

In short, Section Three focuses on the WTO's institutional contribution in the IELR and its enormous effect on the Economic Cycle. This section considers the institutional set-up of the WTO to be more comprehensive than that of any other IEI in the IELR. Its institutional role is highly diverse and does not lack the institutional deficiencies of the IMF, in that the WTO is liberally institutionalized, respects democratic values and has an effective adjudicating system. Moreover, this section maintains that, realistically or practically speaking, the realist/dominant powers in the IMF (especially the US) would not easily relinquish their influence on global regulation.

Institutional and structural changes to the IMF seem nearly impossible to achieve, whereas slight modification to the role of the WTO in the context of financial sector development is a more realistic and practical approach, as compared to major structural changes to the IMF. This way, the soft laws (global regulations)⁶²⁰ would not lack democratic values and would also be subject to the WTO adjudication process. The WTO's Committee on Trade in Financial Services contributes towards global financial regulation in the form of soft laws, but on a very small scale. It needs to contribute more to the financial sector and this does not require major structural change. Therefore, this section calls for the enhancement of the WTO's institutional role in the context of financial sector development which is a more viable, practical and realistic solution to

⁶²⁰ The expansion of the role of the FSC of the WTO in the creation of soft laws in short run and could also be made part of the hard binding commitment in the long run.

the current dilemma within the IELR, i.e. the legitimacy and effectiveness of the rules of the game.

C. Section Three Format:

The first part of this section (Chapter VI) discusses in detail the legal framework of the WTO, which has a high normative effect within the IELR and which lays down the parameters for the institutional role of the WTO. The second part (Chapter VII) deals with the institutional role of the WTO in the promotion of international trade. The chapter VII, in order to avoid repetition, is brief and only emphasis on the issues which are not raises in other chapters. The third part (Chapter VIII) of this section focuses on the institutional role of the WTO in the development of the global financial sector and calls for the expansion of its institutional role in this area. Thus, part two (Chapter VII) and three (Chapter VIII) of this section highlight the institutional role of the WTO as a stimulus in the international economic cycle, leading to a more stable and balanced growth of the global economy.

VI. WTO and its legal framework

This chapter will look into the norm-making function of the WTO in order to promote stable and balanced growth of economy global economy. The institutional role of the WTO is based on the WTO Charter and its framework agreements (discussed below).The WTO operates in the international economic framework, promoting the stable and balanced growth of the global economy through its legal framework.

This chapter begins by discussing the WTO Charter and then moves on to the Dispute Settlement System (DSS) and the Trade Policy Review Mechanism (TPRM). The WTO Charter and its framework agreements create certainty in the rules of the game and the DSS and TPRM increase predictability within the global economic scenario. Overall, the WTO stimulates the Economic Cycle which leads to achieving more stable and balanced growth of the global economy.

The WTO legal framework is based on liberal institutionalism and is an important part of the IELR. It is highly essential to the WTO's legal framework to understand the way in which the WTO, through its institutional framework, affects the international economic cycle. The institutional role of the WTO, in the context of financial sector development and international trade, are discussed in Chapters VII and VIII respectively. Therefore, this chapter provides a foundation for the next two chapters.

A. The WTO Charter⁶²¹

As discussed earlier in Section one, Chapter III (evolution of current global economic scenario), GATT was a temporary setup for the ITO in the Bretton Woods system.⁶²² However, the ITO did not come to fruition and GATT partially took the place of the ITO. The WTO Charter, which

⁶²¹ The WTO Charter (WTO Agreement) is the agreement which formed the WTO.

⁶²² Chapter III.B page 100

created the WTO, provided a better institutional setup than GATT⁶²³ and it filled the gaps left in the Bretton Woods economic structure (by cooperating with the IMF and the World Bank).

This part of the chapter discusses the general characteristics of the WTO charter, decision-making within the WTO and its basic principles.

1. Characteristics of the WTO Charter

First, the WTO carries on the conventional ideas and practices of GATT.⁶²⁴ All the basic principles are the same but its application is enhanced by not limiting it only to goods (it also applies to intellectual property and the services sector). In other words, the WTO not only incorporated GATT but also added new subjects to it.

Secondly, the WTO charter itself is limited to creating the institutional procedural structure for the smooth progress and effective execution of the rules agreed in the multilateral trade negotiation rounds.⁶²⁵ Moreover, the WTO charter incorporates in its annexes⁶²⁶ all the agreements which were a result of the Uruguay Round. Thus, the WTO Charter is a framework of agreements.

⁶²³ GATT was never created as an international organisation, thus it had many “birth defects”. Some of them were: (1) The lack of an agreement giving the GATT a legal personality and creating its institutional structure; (2) It was created for temporary usage; (3) it built grandfather rights (which allowed the Contracting Parties not to implement GATT provisions where those provisions were in conflict with the national legislation that had already been in place at the time of accession of GATT); (4) Uncertainty and misunderstanding about the GATT’s power, decision making capacity and legal standing [see Matsushita, M., Schoenbaum, Thomas J. and Mavroidis, Petros C., (2006) ‘The World Trade Organisation : Law, Practice, and Policy’, Vol. 1, p. 3, available at http://www.wto.org/english/thewto_e/whatis_e/tif_e/utw_chap1_e.pdf; also see Jackson, John H., (1998) ‘Designing and Implementing Effective Dispute Settlement Procedures: WTO Dispute Settlement’, The WTO as an International Institution, Editor: Krueger, Anne O., p.161-3]

⁶²⁴ The WTO Charter reaffirms the pre-existing trade regime of the GATT, as the GATT 1994 is part of the WTO Charter, Annex 1A. See Footer, Mary E. (2006). *An Institutional and Normative Analysis of the World Trade Organisation* (Leiden and Boston: Martinus. Nijhoff Publishers), p3.

⁶²⁵ Permeable WTO Charter: “[T]herefore, to develop an integrated, more viable and durable multilateral trading system encompassing the General Agreement on Tariffs and Trade, the results of past trade liberalization efforts, and all of the results of the Uruguay Round of Multilateral Trade Negotiations.”

⁶²⁶ Annexes are discussed in the latter part of this chapter.

Thirdly, the WTO charter is an effectual realisation of the Uruguay Round. The new “GATT 1994” takes the place of the old “GATT 1947”⁶²⁷ and in doing so, the Contracting Parties circumvented the constraints of the amending clauses of the old GATT, which made things more convenient.

The WTO charter set up, for the first time, an institutional structure with fundamental legal authority for its Secretariat, a Director General, and other affiliated bodies such as the General Council. Like many other international organisations, the WTO also obliges Contracting Parties to avoid intruding into the internal affairs of the organisation. Thus, this institutional structure is vital for the WTO to perform its executive and administrative function.⁶²⁸

Fourthly, the WTO charter puts forward considerably better prospects for the future growth and development of institutional-based international economic cooperation. This institutional cooperation reflects liberal institutionalism. This cooperative approach, based on an institutional setup, provides better opportunities for future negotiation and the development of global economic rules or methods to solve the ever-emerging problems of the world economy.

The next subheading highlights the modalities of the WTO Charter.

2. Constituents/ Modalities of the WTO Charter⁶²⁹

The WTO charter itself is limited to institution formation and operational measures, but its constituent annexes contain detailed and substantial rules. The structure of these annexes is of importance and they are part of the WTO legal framework. These annexes have a very wide

⁶²⁷ The GATT 1994 consists of the GATT 1947 plus twelve separate agreements on trade in goods (sectoral and additional rules/disiplines), six understandings and the GATT schedule of tariff bindings; see The results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Texts (Geneva: WTO, 1999) 17-32; see also, *infra* note 630

⁶²⁸ Chapter II.A.3.b) on page 46

⁶²⁹ See Matsushita, M., Schoenbaum, Thomas J. and Mavroidis, Petros C., (2006) ‘The World Trade Organisation : Law, Practice, and Policy’, Vol. 1, p. 8. And also, see Kenen, Peter B., (1994) ‘Managing the World Economy: Fifty Years After Bretton Woods’, Institute for International Economics, p. 136-8.

scope and cover almost all areas related to international trade. These annexes are mentioned below and will be referred to where necessary.

Annex 1 contains the substantial texts, or “multilateral agreements,” which are comprised of the considerable results of the Uruguay Round. All these are an obligatory, single package set of rules, in the sense that they impose compulsory commitments on all members of the WTO. The Annex 1 text consists of:

- Annex 1A: This includes GATT 1994, the revised and all-inclusive GATT agreement with its ancillary agreements⁶³⁰, and the immense schedules of tariff concessions that form a large part of the official treaty text.
- Annex 1B: This includes GATS and also assimilates a series of schedules of concessions.
- Annex 1C: This includes the TRIPS agreement.

Annex 2 consists of the dispute settlement rules, which are mandatory for all members, and which form a unitary dispute-settlement system encompassing all the agreements listed in annexes 1, 2 and 4.

Annex 3 consists of the TPRM procedure, under which the WTO will evaluate and report on the overall trade policies of each member country on a regular basis.

Annex 4 consists of four “plurilateral agreements,” acceptance of which is optional for members. This is a slight departure from the single package acceptance technique. The agreements currently included in Annex 4 are:

- The agreement on Trade in Civil Aircraft

⁶³⁰ GATT 1994 appended agreements are; the Agreement on Agriculture, the Agreement on Sanitary and Phytosanitary Measures, the Agreement on Textiles and Clothing, the Agreement on Technical Barriers to Trade, the Agreement on Antidumping, the Agreement on Valuation, the Agreement on Preshipment Inspection, the Agreement on Rules of Origin, the Agreement on Import Licensing, the Agreement on Subsidies and Countervailing Measures and the Agreement on Safeguards.

- The agreement on Government Procurement
- The International Dairy Agreement
- The International Bovine Meat Agreement

The WTO legal framework is based on a comprehensive institutional foundation. This legal framework which is comprised of WTO agreements can be classified into three broad categories. These broad categories are; normative (all WTO framework of Agreements), executive (especially Annex 3 related to TPRM) and adjudicative (Annex 2 on DSS).

3. Decision-making in the WTO/ Organisational Hierarchy⁶³¹

Decision-making is indeed the most significant process of any international institution. The main reason for this is that it is a method by which the individual will of each member is coordinated and becomes the collective will of the members of that organisation. This collective will of the members is also the independent will of the organisation.⁶³² Decision-making, here, is referred to as the conclusion of any debate within an organisation, therefore, it might relate to normative, executive or even adjudicative matters.⁶³³

The WTO is managed by Contracting Parties (member governments) and all important decisions are made by the members collectively. The member governments can be represented by ministers (who meet at least once every two years) or by their ambassadors or delegates (who meet regularly in Geneva). Normally decision making is done by consensus.⁶³⁴ This decision-

⁶³¹ For further details on the WTO decision making hierarchy visit: http://www.wto.org/english/thewto_e/whatis_e/tif_e/org1_e.htm

⁶³² Schermers, G. and Blokker, Niels M. (2003), *International Institutional Law: Unity Within Diversity*. 4rd edn. M. Nijhoff publishers, para 703-704.

⁶³³ Footer, Mary E. (2006). *An Institutional and Normative Analysis of the World Trade Organisation* (Leiden and Boston: Martinus. Nijhoff Publishers), Chapter III on decision making in the WTO.

⁶³⁴ Article IX (1) of the WTO Agreement.

making within the WTO makes it poles apart from the IMF and World Bank (both of which are based on a weighted voting system⁶³⁵) as a liberally institutionalized IEI.

The decision-making process is the most important indicator for determining whether an organisation is a liberally institutionalised or realist body. WTO decision-making is clearly liberally institutionalized and each member has one vote, irrespective of the size of its economy. Every member has a say and a right to initiate discussion in the WTO (at all forums)⁶³⁶. This discussion then leads to conclusions which then require decisions.

This trait of the WTO enables it to counter the illegitimacy issue which is normally ignored within the IMF. By illegitimacy, I mean the deficit of democratic values and a collective will for collective gains.⁶³⁷ Moreover, the whole WTO institutional structure is liberally institutionalized in the context of the above discussion.

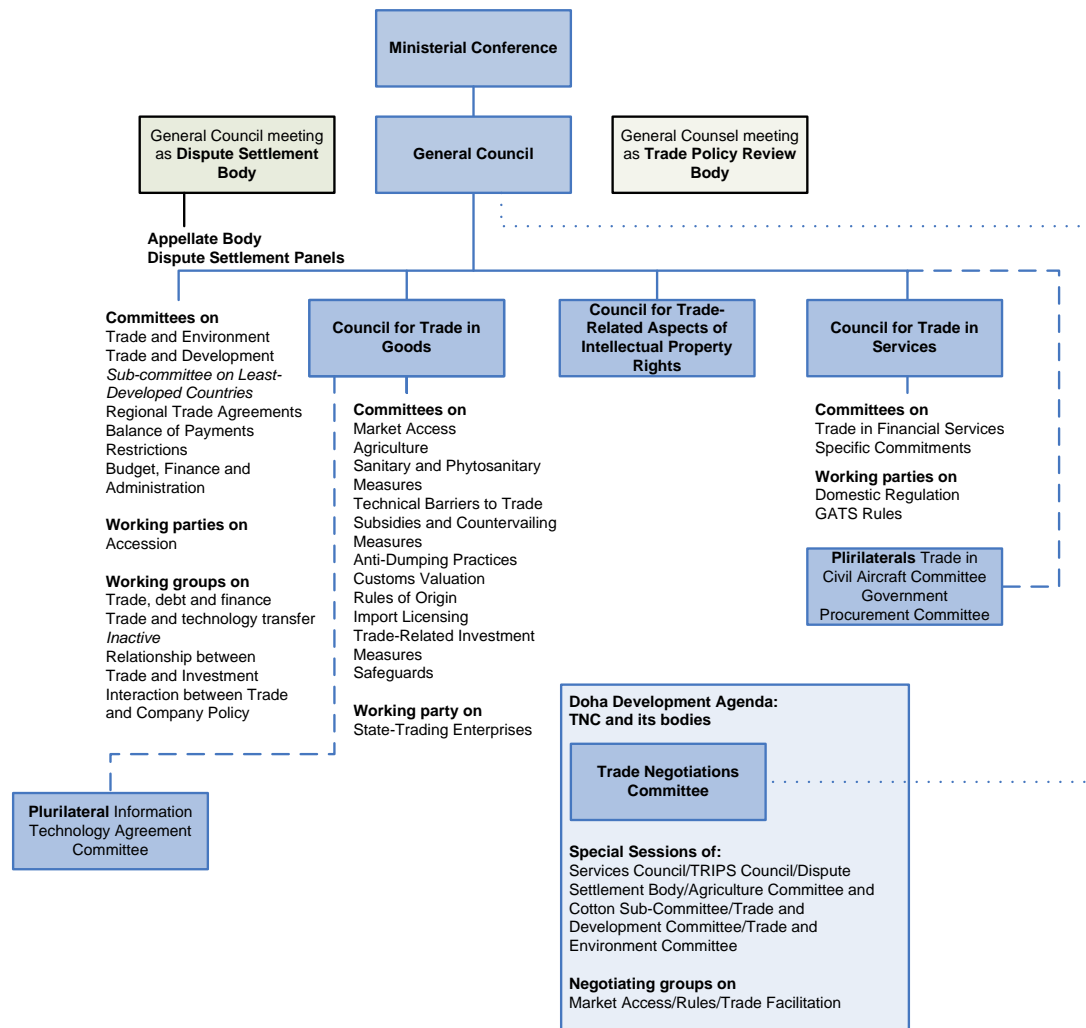
The WTO has a proper pyramidal organizational structure. The higher body's decision supersedes the decision of the lower body. Thus, there are different decision-making levels in the WTO setup. The following section discusses the hierarchy in decision-making in the WTO structure but before that, the structural hierarchy of the WTO is illustrated in the figure below.

⁶³⁵See, Weighted voting in the IMF on page 130

⁶³⁶ Schermers, G. and Blokker, Niels M. (2003), *International Institutional Law: Unity Within Diversity*. 4rd edn. M. Nijhoff publishers, page 494. And also see, Footer, Mary E. (2006). *An Institutional and Normative Analysis of the World Trade Organisation* (Leiden and Boston: Martinus. Nijhoff Publishers), p133.

⁶³⁷Ibid 2

Figure 8 WTO Structure⁶³⁸



- Key**
- Reporting to General Council (or a subsidiary)
 - - - Reporting to Dispute Settlement Body
 - - - - Plurilateral committees inform the General Council or Goods Council of their activities although these agreements are not signed by all WTO members
 - Trade negotiations Committee reports to General Council

⁶³⁸Understanding the WTO, 3rd ed, p. 103, previously published as “Trading into the Future”, the WTO Information and Media Relations Division. Also available at http://www.wto.org/english/thewto_e/whatis_e/tif_e/understanding_e.pdf

a) Level One: The Ministerial Conference

This is the highest authority in the WTO representing its members. The member countries take decisions through the various councils and committees, which comprises all the WTO members. Topmost in the hierarchy is the Ministerial Conference which has to meet at least once every two years and can take decisions on all matters relating to any of the WTO constituent agreements.

b) Level Two: General Council

The General Council is second in the hierarchy and deals with the routine work which is carried out between Ministerial Conferences. To handle day-to-day issues, the General Council takes three forms:

- The General Council⁶³⁹
- The Dispute Settlement Body⁶⁴⁰
- The Trade Policy Review Body⁶⁴¹

According to the WTO agreement, all three have the same members as the General Council, but their name changes according to the purpose for which they are meeting. For example, The General Council assembles as the Dispute Settlement Body and the Trade Policy Review Body to supervise procedures for settling disputes between the Contracting Parties and to analyse

⁶³⁹ The General Council looks after daily routine work in the absence of the Ministerial Conference and for further details about the scope and functions of the General Council visit: http://www.wto.org/english/thewto_e/gcounc_e/gcounc_e.htm

⁶⁴⁰ When the General Council is adjudicating disputes between the WTO members, it takes the form of the DSU. For details visit: http://www.wto.org/english/tratop_e/dispu_e/dispu_e.htm

⁶⁴¹ When the General council is reviewing the trade policies of the WTO members, it takes the form of the Trade Policy Review Body. For further details visit: http://www.wto.org/english/tratop_e/tpr_e/tpr_e.htm

members' trade policies. All three of them are comprised of the WTO members and they are answerable to the Ministerial Conference.

c) Level Three:

At the third level, there are three councils which consist of WTO members and are also answerable to the General Council; each of the councils deals with a different aspect of trade and are as follows:

- The Council for Trade in Goods (hereinafter the “Goods Council”)
- The Council for Trade in Services (hereinafter the “Services Council”)
- The Council for TRIPS (hereinafter the “TRIPS Council”)

As indicated by their names, all three are accountable for the WTO's functioning in their relevant fields.

In addition, there are six committees, with limited scope, at level three of the hierarchy and which also report to the General Council, still comprised of all the Contracting Parties. They deal with issues such as the environmental concerns, trade and development, administrative matters, and regional trading engagements. In addition, at the Singapore Ministerial Conference in December 1996, new committees were created to deal with transparency in government procurement, investment and competition policy, and trade assistance.

d) Level Four:

At the fourth level lie the subsidiary bodies of the three level three councils of the hierarchy.

They are as follows:

The Goods Council is comprised of 11 sub-committees dealing with their specialised areas.⁶⁴² Again, all these committees are comprised of the WTO members and they report to the Goods Council. Besides these 11 committees, two more bodies are answerable to the Goods Council; they are the Textiles Monitoring Body and State Trading Enterprises.

The Services Council's subordinate committees deal with specific commitments, domestic regulations, financial services, and GATS rules.

At the second hierarchical level, the Dispute Settlement Body also has two subordinate bodies: the dispute settlement "panels" of experts selected to decide unsettled disputes, and the Appellate Body that looks into appeals.

As mentioned at the beginning of this subheading, WTO decisions are made on the basis of consensus. However, if consensus is not made at the lower level of the organisation, then the matter is referred to the higher body for a decision.⁶⁴³ If the higher body cannot achieve consensus, then the majority vote applies.⁶⁴⁴ However, negative consensus is required in order to block dispute-settling system rulings.⁶⁴⁵

⁶⁴² These committees are: Market access, Agriculture, Sanitary and Phytosanitary measures, Technical barriers to trade, Subsidies and countervail, Anti-dumping, Customs valuation, Rules of origin, Import licensing, Investment measures, Safeguards

⁶⁴³ According to the Rule 33 of the Rules of the Procedure for Sessions of the Ministerial Conferences and Meetings of the General Council, WT/L/161 (25/07/1996) together with the Rules of the Procedure as adopted by the other WTO councils and committees, are reproduced in OMC/WTO Rules of the Procedure of the Meeting of the WTO Bodies (Geneva: WTO Secretariat, 1997). Also see, Footer, Mary E. (2006). *An Institutional and Normative Analysis of the World Trade Organisation* (Leiden and Boston: Martinus. Nijhoff Publishers), p36.

⁶⁴⁴ Article IX (3) of the WTO Agreement. However, 2/3 majority (qualified majority) is required if for accession of new member. Article XII (2) of the WTO Agreement. For a detailed discussion see, Footer, Mary E. (2006). *An Institutional and Normative Analysis of the World Trade Organisation* (Leiden and Boston: Martinus. Nijhoff Publishers), p136 and p152.

⁶⁴⁵ GEORGIEV, DENCHO, *The Decision Making Process in the World Trade Organisation*, in GEORGIEV, DENCHO and KIM VAN DER BORGHT eds. (2006): *Reform and Development of the WTO Dispute Settlement System*; London: Cameron, May. Also see, Footer, Mary E. (2006). *An Institutional and Normative Analysis of the World Trade Organisation* (Leiden and Boston: Martinus. Nijhoff Publishers), p143.

Decision-making, as documented above, is the main spirit of the WTO and is clear evidence of its being liberally institutionalized. This is the reason why there is more room for the WTO to adapt and modify itself in the light of complex issues of the IELR. The collective will of the members has the tendency to adapt itself for greater collective gain.

The next part of this chapter highlights the basic principles of the WTO as reflected in all the WTO frameworks of agreement.

4. Fundamental Principles of the WTO⁶⁴⁶

The WTO agreements consist of bulky legal texts which deal with the wide range of activities conducted under its umbrella. The text covers wide-ranging areas such as agriculture, textiles and clothing, banking, telecommunications, government purchases, industrial standards and product safety, food sanitation regulations, intellectual property, and many more. However, all the texts of the WTO have one thing in common: the fundamental principles of a multilateral trading system on which the whole WTO is based. Reasonable knowledge of these principles is essential for a better understanding of the WTO legal framework.

The main principles of the WTO institutional framework are briefly discussed below.

a) Trade without discrimination

The most important of the fundamental principles of the WTO is trade without discrimination and this principle of non-discrimination is found in the WTO charter in two forms; namely, MFN, and the National Treatment. Both of these aspects of the principle of non-discrimination are discussed below.

⁶⁴⁶ For further details about the fundamental/ basic principles of WTO visit: http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm

(a) MFN: Under WTO framework, Contracting Parties cannot normally discriminate between other Contracting Parties. A trade advantage given to any member has to be extended, without any discrimination, to all other WTO members. This principle is called MFN treatment.

According to this principle a trade benefit means advantage, favour, privilege or immunity in the form of: (1) any type of charges related to imports and exports; (2) the system of imposing tariffs; (3) the rules and procedures related with imports and exports; (4) local taxes and other local charges; and (5) the rules and prerequisites influencing sales, purchase, distribution, transportation of the product.

MFN principle is so significant that it is the first article of GATT, the second of GATS and the fourth article of TRIPS, although, within each agreement, the same principle is dealt to some extent in a different way. Collectively, these three agreements encompass all three foremost areas of trade within the WTO.

There are certain exceptions allowed with respect to the MFN principle. For instance, (1) a member can give special treatment to developing countries under the Generalized System of Preferences⁶⁴⁷ [hereinafter the “GSP”] and, under the GSP, there can be regional or global arrangements among the developing countries themselves for the reduction of mutual tariffs; (2) benefits and concessions can be extended to neighbouring countries so as to assist border traffic;⁶⁴⁸ (3) Custom Unions⁶⁴⁹; (4) restrictive measures against any member on the basis of

⁶⁴⁷ GSP is a “preferential tariff system extended by developed countries (also known as preference giving countries or donor countries) to developing countries (also known as preference receiving countries or beneficiary countries). It involves reduced MFN Tariffs or duty-free entry of eligible products exported by beneficiary countries to the markets of donor countries.” For details visit: <http://www.eicindia.org/eic/certificates/genralized-bg.htm>

⁶⁴⁸ Article XXIV.3.a of GATT 1994

⁶⁴⁹ Article XXIV.5 of GATT 1994

Article XX of GATT 1994; (5) restrictions on any member on the basis of security reasons under Article XXI of GATT 1994.

In services, countries are also allowed some exceptions to the general rule but in very limited circumstances. The WTO agreements only authorise these exceptions under strict conditions.

(b) National Treatment: According to this principle, a member country has to treat foreign and local commodity alike. This principle applies only after the imported product has entered the local market. The National Treatment principle is also extended to local and foreign services, and to foreign and local patents, trademarks and copyrights. This principle is integral part of all three main WTO agreements (Article 3 of GATT, Article 17 of GATS and Article 3 of TRIPS); however, its applicability is slightly different in each of these agreements.

The National Treatment principle is only applicable post entry into the domestic market. Therefore, if custom duty is charged on the import of a product, then this is not an infringement of the National Treatment principle.

b) Gradual Freer trade via negotiations

Bringing down trade restrictions is one of the best possible methods of promoting free trade. The trade restrictions in this context are of two types; tariff and non-tariff barriers. Tariff Barriers include, for example, customs duties, and non-tariff barriers, including actions such as import bans or selective quantitative restriction through quotas.

Since GATT's formation in 1947–48, there have been eight rounds of trade negotiations. A ninth round, the Doha Round is currently in progress. The primary focus of the initial rounds was the reduction of customs duties on imported products. This gradual tariff reduction process through trade negotiations produced fruitful results. By the mid-1990s, industrial countries' custom duties on industrial products had reduced progressively to less than 4%.

However, by the 1980s, the Contracting Parties had diversified multilateral trade negotiations and included non-tariff barriers in their agenda.

Abruptly opening up markets can lead to unavoidably serious consequences, thus this needs to be carried out in a more gradual manner. The WTO agreements encourage member countries to bring in adjustments gradually, via progressive liberalization. In this context, developing countries are usually given more time than developed countries to adjust themselves according to their scheduled commitments.

c) Predictability

Stability and predictability is essential for the efficient running of an economic system. It encourages investment, creates jobs and increases overall competition (which eventually benefits the consumer as he gets more choice at lower cost). The Contracting Parties, by creating the WTO, have attempted to strengthen the multilateral trading system, based on clear and unambiguous rules and commitments, which makes the business atmosphere more predictable and stable.

The WTO does this by binding the member countries to the fulfilment of their commitments. All of the WTO members have agreed to a commitment (bound rates) which is known to everyone; for example, putting a ceiling on the customs duties rate. The members can charge less than the bound rates but cannot exceed them. Mostly, the rates actually charged by the countries are the same as the bound rate. However, a Contracting Party can modify its committed rates but only through negotiations with other Contracting Parties concerned. One of the successes of the Uruguay Round was to bring the maximum amount of trade under binding commitments. The purpose of doing this was to increase certainty and stability in the multilateral trading scenario.

The WTO, in other ways, has also attempted to enhance predictability and stability in the trading system. One way in which it has achieved this is by discouraging its members to use quotas and other non-tariff barriers: another is by obliging member countries to make unambiguous and transparent trade rules (by disclosing their policies and practices overtly within the country or by informing the WTO). This transparency is further enhanced, both domestically and multilaterally, when the national trade policies are reviewed by the Trade Policy Review Mechanism of the WTO.

d) Promoting fair competition

The WTO, to a layman, is known as a “free trade” organisation, but this is not precisely true. The WTO does permit tariffs and, in restricted conditions, other methods of protection. More precisely, it is a rule based system which promotes fair, open and competition trade.

The rules on non-discrimination (MFN and National Treatment) are designed to secure fair conditions of trade, but sometimes, countries misuse non-discrimination rules by exporting products below cost to gain market share (dumping) and or by subsidising a product to make it relatively cheaper. The WTO deals with all these sorts of scenarios and has established rules to ascertain criteria for fairness and unfairness, and the way governments should react, precisely in case of imposing extra import tariffs as compensation for the harm resulted by unfair trade.

e) Encouraging development and economic reform

The WTO system encourages development towards a better multilateral trading regime. The majority of the nations of the world (thus also the majority of WTO members) are still developing, therefore, the WTO, with this in mind, has successfully engaged most of the developing countries in the multilateral trade negotiations process. It has achieved this by

adopting the GATT approach towards developing countries (i.e. by giving them more flexibility to fulfil their commitments). In addition, the WTO provides special assistance and trade concessions to developing countries, through its various agreements.

Special attention is given to LDCs. The WTO stresses that industrialised countries should speed up market access for products exported by less-developed countries, and also increase technical assistance to them. With regards to all of this, the WTO along with its members are still undergoing a learning process. The existing Doha Development Agenda takes into account developing countries' apprehension and the problems they face in implementing the Uruguay Round agreements.

These above-mentioned principles define the spirit of the WTO legal framework. All WTO rules and related practices must uphold these principles. The next part of this chapter highlights the legal basis of the institutional role of the WTO.

B. Legal Basis for Institutional Role

The WTO Agreement provides a legal basis to the WTO as an IEI to perform its institutional role. Article III is based on the theoretical division between the various attributes of public authority. Under this concept, the public authority has internal and external engagements. The internal engagements are dealt with by three public functions: legislative, executive and adjudicative.⁶⁵⁰ By keeping to the above-mentioned concept of public authority, the ideas put forward by Article III become clear. Article III:1 talks about the executive function of the WTO, followed by Article III:2, the legislative, and Article III:3 deals with the adjudicative function.

⁶⁵⁰ See Article I, II and III of the US Constitution.

The extended part of the executive functioning is dealt with in Article III:4 which is about the TPRM. Lastly, Article III:5 deals with the external affairs.⁶⁵¹

The remaining part of this subheading will briefly discuss the institutional basis of the WTO which is based on its institutional role (executive, legislative, and the adjudicative functioning). Moreover, the TPRM and the relationship with the other organisations are also briefly discussed.

1. Executive Function

The importance of the executive and administrative functioning of an IEI was discussed in the theoretical framework.⁶⁵² The WTO Agreement in Article III:1 legally empowers the WTO to perform an executive function in order to move the law into action. Article III:1 states that the WTO “shall facilitate the implementation, administration and operation” of the WTO framework of Agreements. The executive and administrative functioning of the WTO is carried out by the WTO Secretariat, the Ministerial Conference, General Council, and various other bodies of the WTO, some of whom were discussed earlier.⁶⁵³

The executive and administrative functioning of the WTO will be discussed in detail in Chapters VII and VIII in the context of the Economic Cycle. However, in connection with the institutional role of the WTO, the next subheading will highlight the legal basis of the legislative functioning of the WTO.

2. Legislative Function

The WTO framework of Agreements forms a large part of the IELR and encompasses a code of conduct for the global economy, especially international trade. Moreover, it is the result of the

⁶⁵¹ Wolfrum, Rudiger; Stoll, Peter-Tobias; and Kaiser, Karen /Editors (2006). WTO - Institutions and Dispute Settlement (Max Planck Commentaries on World Trade Law), p30.

⁶⁵² Chapter II.A.3.b) on page 46

⁶⁵³ Chapter VI.A.3 on page 233.

horizontal and vertical expansion of international law in the Uruguay Round because the WTO framework of Agreements includes not only an increase in verity and the number of norms but also an increase in the scope and coverage of the subject matter.⁶⁵⁴

These agreements have a huge normative effect on the global economic scenario and are a substantial part of the IELR. They are discussed in detail in the next two chapters, which highlight the institutional role (which includes the normative) of the WTO in the context of the Economic Cycle. However, the current scope of the legislative functioning of the WTO is quite limited and is discussed below.

The normative and legislative functioning of the WTO is quite important. Article III:2 deals with the legislative functioning of the WTO as part of its institutional role. The WTO's legislative functioning is limited (as compared to the normative effect of the WTO framework of Agreements) because it itself cannot enact laws as legislator. It, as an IEI, provides the forum for law creation.⁶⁵⁵

The legislative function of the WTO takes two forms: the creation of primary treaty rules and the creation of secondary treaty rules. Primary treaty rule-making involves rules which control the behaviour of its members and have a prescriptive and prohibitive effect. The secondary treaty rules emerge from the primary treaty rules and involve the revision, modification, interpretation, and application of the primary treaty rules.⁶⁵⁶

⁶⁵⁴ This idea was put forwarded by Wolfgang Friedman (1964), *The changing structure of the International Law* (New York: Columbia University Press) p5, 6 and 9. Also see, Footer, Mary E. (2006). *An Institutional and Normative Analysis of the World Trade Organisation* (Leiden and Boston: Martinus. Nijhoff Publishers), p182.

⁶⁵⁵ Petersmann, Ernst-Ulrich (1996-97). *Northwestern Journal of International Law and Business* 18, 398, 438.

⁶⁵⁶ See generally, Wellens, K.C. (1995). *Some Reflections on Current Trends*, in *Diversity in Secondary Rules and the Unity of International Law* 3, 27 (L.A.N.M. Barnhorn & K.C. Wellens eds.) Martinus Nijhoff Publishers. Also see generally, Footer, Mary E. (2006). *An Institutional and Normative Analysis of the World Trade Organisation* (Leiden and Boston: Martinus. Nijhoff Publishers), chapter IV.

Overall, the legislative and normative functioning of the WTO is extremely important. This thesis calls for the expansion of this norm-making institutional role of the WTO. Legislative and normative functioning results in the creation of norms and these norms can be categorised as principles, rules and standards.

Principles are the highest ranking; they are the foundational assumptions for a legal regime.⁶⁵⁷ Then there are rules which reflect the principles and control the behaviour of members at operational level.⁶⁵⁸ Last of all are the standards which relate to the expected behaviour, resulting from the rules.⁶⁵⁹

3. Adjudicative Function

The Uruguay Round agreement established a more organised method with more plainly-defined steps in the dispute settlement procedure. It established an efficient discipline for the settlement of cases, with flexible time limits set within the different stages of the procedure. Article III:3 calls for the WTO to have an autonomous adjudicative system in order to resolve disputes related to issues falling under the WTO's jurisdiction.

The agreement also stressed the need for the quick settlement of disputes for the effective performance of the WTO. It lay down in substantial detail the processes and the schedule to be adhere in adjudication. It would normally take less than one year, but up to 15 months, if a case were to stretch to its full course from the first ruling to appeal.⁶⁶⁰

⁶⁵⁷ Arend, A.C. (1999). *Legal Rules and Institutional Society*. Oxford University Press, p14.

⁶⁵⁸ *Ibid*, p13, 15.

⁶⁵⁹ Footer, Mary E. (2006). *An Institutional and Normative Analysis of the World Trade Organisation* (Leiden and Boston: Martinus. Nijhoff Publishers), p186.

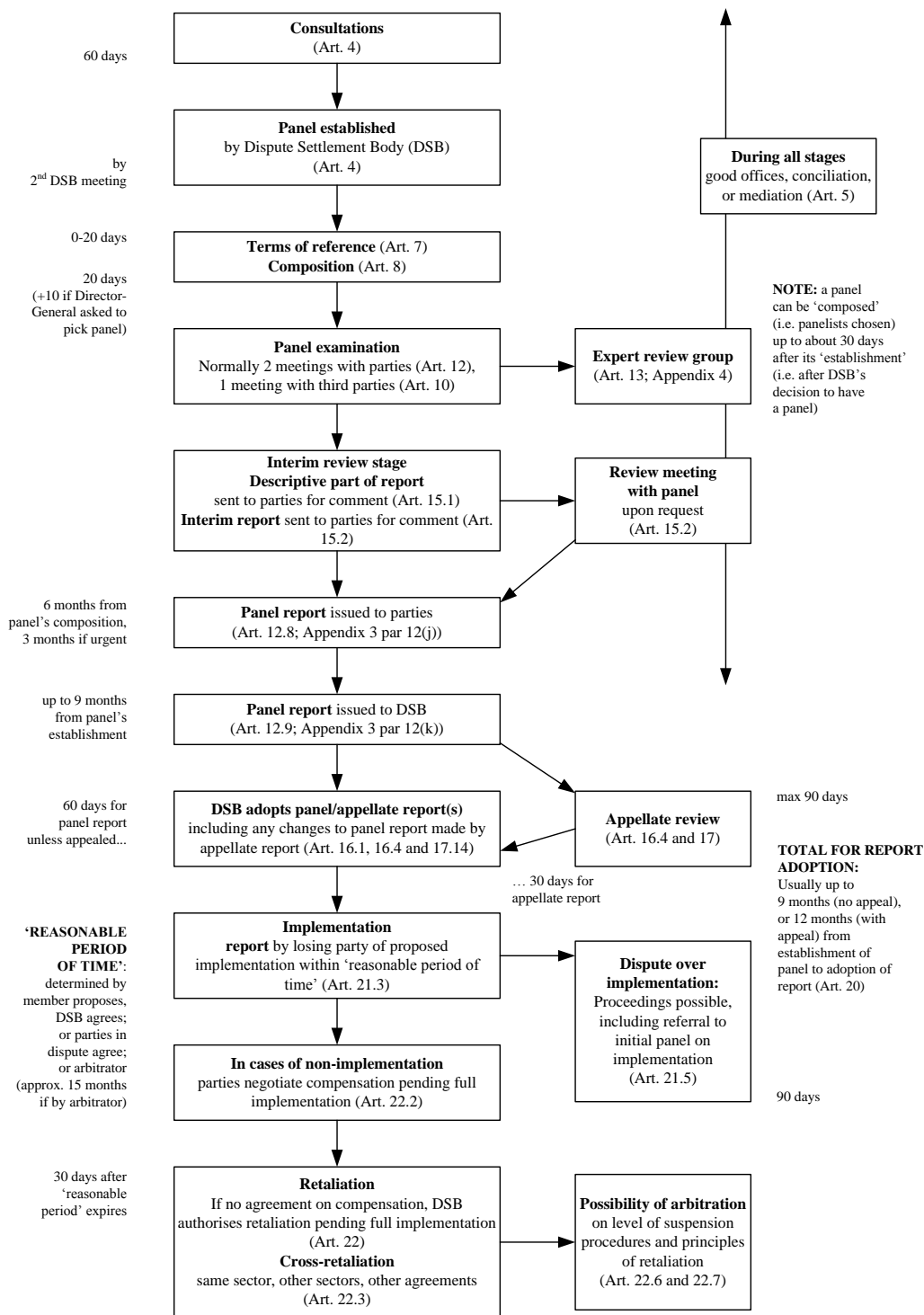
⁶⁶⁰ 'Understanding the WTO', 3rd ed, p. 55-6, previously published as "Trading into the Future", the WTO Information and Media Relations Division. Also available at http://www.wto.org/english/thewto_e/whatis_e/tif_e/understanding_e.pdf

According to the Uruguay Agreement, the Dispute Settlement Body has exclusive authority to set up panels of specialists to review the cases, and to agree or disagree with the panels' and appellant body's conclusions. It supervises the execution of the rulings and recommendations of the panels, and has the authority to allow a country to retaliate if another country does not act in accordance with its decision. The procedure followed under DSU is given below:

- First stage: The first stage is the consultation stage; the countries in dispute have to talk to each other to find out if they can resolve their differences between themselves. If they fail to resolve the matter by themselves, then help and mediation can be requested from the WTO Director-General. This consultation process can last up to 60 days, before taking any other action.
- Second stage: In cases where the consultations fail, the complaining country can ask for the formation of a panel. The country against whom the panel formation was requested can only block its formation the first time and if the Dispute Settlement Body⁶⁶¹ [hereinafter the "DSB"] meets for a second time for the same matter, then panel formation cannot be blocked. It takes up to 45 days for a panel to be selected, plus 6 months for the panel to decide.

⁶⁶¹ When the General Council is adjudicating disputes between the WTO members, it takes the form of the Dispute Settlement Body. http://www.wto.org/english/tratop_e/dispu_e/dispu_e.htm

Figure 9 The Panel Process⁶⁶²



⁶⁶² See 'Understanding the WTO', 3rd ed., p. 59, previously published as "Trading into the Future", the WTO Information and Media Relations Division. Also available at http://www.wto.org/english/thewto_e/whatis_e/tif_e/understanding_e.pdf

The panel is basically set up to assist the DSB with its decisions regarding the dispute. However, the report of the panel is difficult to overturn because it can only be set aside by consensus in the DSB. The panel's decisions have to be supported by the cited agreements. Usually, within six months the Panel passes its decision the Contracting parties concerned. Although in urgent situations such as matter pertaining to perishable commodities, the Panel submits its report within three months.

4. TPRM

As part of the executive and administrative authority of the WTO, one of its main functions is that of surveillance of the national trade policies of all the contracting parties. At the heart of this surveillance functionality lies the Trade Policy Review Mechanism (TPRM).

The TPRM is conducted by the Trade Policy Review Body (TPRB) which is actually the WTO General Council and is composed of all the Contracting Parties. The review process is more or less like a peer review; however, the bulk of the leg-work, which is essential for coordination, is done by the WTO Secretariat.⁶⁶³

The TPRM, as an interim measure, was formed in Montreal, at the half-way review of the Uruguay Round, in December 1988.⁶⁶⁴ Later, in 1994, in the Marrakesh Agreement (Article III), the Ministers decided to give TPRM a permanent place in the WTO system and in 1995, TPRM came into force and, this time, the service trade (which includes trade in financial services) and intellectual property were also brought within its scope.

⁶⁶³ TRADE POLICY REVIEWS: BRIEF INTRODUCTION, Overseeing national trade policies: the TPRM Available at: http://www.wto.org/english/tratop_e/tpr_e/tp_int_e.htm

⁶⁶⁴ In December 1988, ministers met in Montreal, Canada. At this meeting, ministers agreed to conclude early results in relation to some issues. For details visit: http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact5_e.htm

The *objective* of the TPRM⁶⁶⁵ is to play a role in enhancing compliance with WTO rules, disciplines and commitments (related to the financial services trade) by all Contracting Parties. It encourages transparent policy-making in the financial services trade sector. It acts as a forum for the Contracting Parties to study and analyse the trade policies (including policies related to financial services) of the Contracting Party whose trade policy is under review. The number of reviews a Contracting party is required to undergo depends on the Contracting Party's share in world trade. The EC, the US, China and Japan, having the largest share in world trade, are reviewed every two years. The 16 next- largest economies are reviewed every four years and the remaining members have to undergo a review every six years. A total of 324 reviews of 140 Contracting Parties had been conducted⁶⁶⁶ by the end of 2010.⁶⁶⁷

The content of the review by the TPRB has remained more or less the same for a decade. The report of the review by the Secretariat has four sections. The first section reviews the economic environment of the Contracting Party concerned and takes into consideration trade, exchange rates, output, investment, public finances, employment, and matters pertaining to the macro economy. The second section of the TRPB report relates to the trade policy in detail. It takes into account, for example, the institutional framework in the context of trade policy, trade policy objectives, and PTA.

The third section reports the examination of trade practices and policies in light of the measures taken by the Contracting Parties and issues related to rules of origin, technical regulations, custom procedures, etc. which have a direct impact on imports. Similarly, it reports on measures related to documentation, restrictions, taxes, subsidies, etc. which have a direct impact on the

⁶⁶⁵ The purposes of the TPRM, as stated in Annex 3 of the Marrakesh Agreement, consist of assisting the efficient working of the multilateral trading system by improving the transparency in trade policies of the Contracting Parties.

⁶⁶⁶ REPORT OF THE TPRB for 2010, WTO document no. WT/TPR/269.

⁶⁶⁷ http://www.dfat.gov.au/trade/negotiations/2002_trade_policy_review.html

relevant contracting party's exports. In addition, this section looks into the Contracting Party's measures related to production and trade, for example, competition policy, government procurement, intellectual property rights, and state-owned enterprises. The fourth section looks at trade policies by sector.

The Trade Policy Review *process* can be broken up into three steps.⁶⁶⁸ These three steps are discussed below.

1. Preparation of reports:

The first step is the preparation of reports by the WTO Secretariat. For this purpose, the Secretariat sends questionnaires to the Contracting Party under review and also gathers some basic information regarding the concerned Contracting Party's status in relation to the content of the review report.⁶⁶⁹ Then, members from the Trade Policy Review Division of the WTO Secretariat visit the Contracting Party concerned in person and talk through unanswered questions with them. After this meeting, the Secretariat sends a draft report to the Contracting Party concerned for verification of the content of the report. Once that is done, then a final report is produced and is distributed to other Contracting Parties (this must be done at least five weeks before the TPRB sits). Interested Contracting Parties deliver their written questions to the Secretariat (this should be done two weeks before the TPRB convenes), and finally, the Secretariat highlights the important issues and circulates the report one week before the TPRB meets.

2. Review meeting:

⁶⁶⁸ See Annex 3 of the WTO Agreement and the TPRB's rules of procedure – WTO 2008. Rules of Procedure for Meetings of the Trade Policy Review Body: WT/TPR/6/ Rev.2. Also see, The WTO's Trade Policy Review Mechanism: How to Create Political Will for Liberalization, ECIPE Working Paper No. 11/2009.

⁶⁶⁹ Examples of different sources accessed by the secretariat are the Contracting Party's official web pages, reports by other international institutions, NGOs, academic work, etc.

The TPRB is open to all the Contracting Parties and headed by a chairperson elected by each member. The review meeting lasts for nearly two half-days.

3. Dissemination:

The policy statement from the Contracting Party concerned and the Secretariat's final report are made public at the end of the meeting in the form of a press conference and details of the meeting are published online. In addition, the Contracting Party under review is required to respond to all unanswered questions within one month.

5. External Relations

Article III:5 and Article V of the WTO Agreement talk about the WTO's external relations with the other IEIs. These Articles call for cooperation with the other relevant IEIs so as to attain better coherence in global economic policymaking which is essential for the collective gain. In this connection, the WTO has developed a preferential relationship with the IMF and the World Bank.

C. Conclusion:

This chapter documented the general characteristics of the WTO charter, decision-making within WTO and its basic principles. Moreover, this chapter discussed the legal basis for the WTO's institutional role. This institutional role is discussed in detail in the next two chapters in the context of the Economic Cycle.

VII. The WTO's Role as an IEI in Promotion of a Stable and Balanced Growth of the Global Economy through Enhancement of International Trade in the Economic Cycle

A. Introduction

The section three argues that the WTO is the most effective IEI within the IELR. The reason being that it comprehensively affects the Economic Cycle the most. This chapter will focus on the institutional role of the WTO in the endorsement of international trade within the international economic framework. As mentioned in the theoretical framework, this institutional role lies at the heart of the certainty and predictability of the rules of the game. Therefore, this chapter will highlight the institutional role of the WTO (i.e. the role of the WTO in its legislative and normative capacity, executive and administrative capacity and adjudicative capacity) in the promotion of international trade, which then completes the Economic Cycle by stimulating economic growth, followed by the development of the financial sector (Patrick's demand side development of the financial sector).

As the WTO's institutional role in context of international trade expansion is not much challenged in the global economic scenario and in order to avoid the repetition of the substance of other chapters, this chapter will very briefly discuss the WTO's institutional role. However, WTO's contribution towards the intellectual property is something which is not discussed in other chapters and is therefore discussed reasonably in this chapter. The significance of the intellectual property and the international trade is very high in the international trading scenario and is also discussed in this chapter.

Article II (1) of the WTO Agreement states clearly that “[t]he WTO shall provide the common institutional framework for the conduct of trade relations among its Members in matters related to the agreements and associated legal instruments included in the Annexes to this Agreement.”

As evident from the above article, the WTO has a clear and uncontested mandate in relation to international trade. Moreover, the institutional contribution of the WTO, in the context of the promotion of international trade, is highly significant.

In order to avoid repetition, this chapter will briefly discuss the institutional role of the WTO in general, in terms of the enhancement of international trade. The institutional role is reviewed in general; that is, it also includes the financial services sector. It briefly takes an overview of the whole trade sector. However, this chapter also talks specifically about the WTO’s contribution in the context of research and development, since innovation is a key one of the main stimuli of international trade. In this context, this chapter examines the Trade Related-Aspects of Intellectual Property Rights (TRIPS) agreement.

The following part of this subheading reviews the role of the WTO in its legislative and normative capacity in the promotion of international trade.

1. Legislative and Normative Functioning

The WTO framework of agreements, as discussed in the previous chapter, has a significant normative effect on the international economic framework. Therefore to avoid repetition, this chapter will focus on the legislative functioning of the WTO as an IEI, which also has a normative effect and which creates certainty and predictability of the rules of the game in the global trading scenario.

The WTO is a rules-based, member-driven organisation thus all rule-making processes involve negotiation between members. In connection with this, there are three types of legislative

instrument within the WTO framework which contribute significantly to international trade law in creating certainty and predictability within the global trading scenario. These three legislative or normative instruments are the principles, rules and standards produced by the WTO system.⁶⁷⁰ There are two types of rule under WTO treaty law: primary treaty rules and secondary treaty rules. Primary rules comprise multilateral treaty and they regulate the rights and responsibilities of the WTO Contracting Parties. These primary treaty rules instruct the Contracting Parties to take a particular action or alternatively, prohibit them from certain acts. On the other hand, secondary treaty rules⁶⁷¹ are subsidiary to primary treaty rules and derive their legality from the primary treaty rules. In addition, secondary treaty rules deal mostly with the functioning, interpretation and modification of primary treaty rules, and usually, the process of secondary treaty rule-making leads to the development of primary treaty rules.

a) Primary rule-making under the WTO legal framework

The WTO primary treaty rules are comprised of rights and commitments which the Contracting Parties are obligated to adhere to as part of an IO. It includes the formation and modification of legally binding and non-binding ('soft' law)⁶⁷² principles, rules and standards: these three types of norms created by the WTO are briefly discussed below.

The highest in the normative hierarchy in terms of primary rule-making are the 'Principles'. They are the basic assumptions that act as the foundation of any legal regime, its rules and standards.⁶⁷³ As Fitzmaurice affirms: '[B]y a principle, or general principle, as opposed to a rule,

⁶⁷⁰ This concept was also discussed in chapter VII.

⁶⁷¹ See K.C, Wellens (1994) 'Diversity in Secondary Rules and the Unity of International Law: Some Reflections on Current Trends, XXV NYBIL, 3-37 at 7.

⁶⁷² Chinkin, Christine (2000), 'Normative Developments in the International Legal System' in Dinah Shelton (ed.), *Commitment and Compliance, the Role of Non-Binding Norms in the International Legal System* (Oxford: Oxford University Press, 2000) 21-42.

⁶⁷³ Arend, Anthony Clark (1999), *Legal Rules and International Society* (New York, Oxford: Oxford University Press) 14.

even a general rule, of law is meant chiefly something which is not itself a rule, but which underlies a rule, and explains or provides the reason for it.⁶⁷⁴ The principles of National Treatment, MFN and market access are all good examples of principles acting as the foundation of all WTO rules, regulations and standards.⁶⁷⁵

The next in the WTO normative hierarchy are the ‘Rules’, which are based on the general principles and they closely regulate the behaviour of the Contracting Parties in accordance with WTO principles. All the Contracting Parties are required to follow the rules.⁶⁷⁶ An example of a rule emerging from the principle of MFN is Article II (1) of GATS: “[E]ach Member shall accord immediately and unconditionally.”

Last in the WTO normative hierarchy are the ‘Standards’ which deal with the behaviour that each of the Contracting Parties is expected show towards another and thus involves assessment. The standards create the legitimate expectations of each Contracting Party regarding the actions of the other Contracting Parties.⁶⁷⁷ They are usually in conjunction with rules; however, they should not be confused with rules. An example of a standard with the conjunction of a rule and emerging from the principle of MFN is Article II (1) of GATS: “[E]ach Member shall accord immediately and unconditionally (rule) to services and service suppliers of any other Member treatment no less favorable (standard) than that it accords to like services and service suppliers of any other country.”

⁶⁷⁴ Fitzmaurice, G. (1957), ‘The general principles of international law considered from the stand-point of the rule of law’ 92 *Receuil des Cours* 1-227, at 7.

⁶⁷⁵ See Footer, Mary E. (2006). *An Institutional and Normative Analysis of the World Trade Organisation* (Leiden and Boston: Martinus Nijhoff Publishers), p185.

⁶⁷⁶ See Danilenko. Gennady M. (1993). *Law-making in the international Community* (Dordrecht: Nordhoff Publishers, 1993) 8.

⁶⁷⁷ *Supra* note 675 at 186.

b) Secondary rule-making by the WTO

Secondary rule-making is mainly carried out for the purpose of revising the primary treaty rules. In most cases, the mandate for the secondary treaty rules originates from the main treaty to be amended.⁶⁷⁸ Article XX of the WTO Agreement deals with the amendments of agreements under the WTO framework, therefore, in this way, the WTO has a comprehensive methodology for ensuring its normative effectiveness is up-to-date, for more certain and predictable rules of the game.

The next part will consider the role played by the WTO, as an IEI in its administrative and executive capacity, in strengthening the global trading scenario.

B. Executive and administrative authority

As mentioned elsewhere in this thesis,⁶⁷⁹ the executive and administrative functioning of an IEI is crucial for the effectiveness of any IO. This particular attribute of the IEI enables it to implement its decisions: failure to implement its decisions would result in a useless IO. Thus, to make the implementation and execution of institutional acts operative, IOs need to be vested with executive and administrative authority.

The executive and administrative functioning of the WTO as an IEI in the development of international trade has already been discussed in the previous chapters.⁶⁸⁰ Thus, this chapter, in order to avoid repetition, does not go into the detail of the executive functioning of the WTO as part of its institutional role. The next subheading will briefly examine the adjudicative functioning of the WTO as an IEI in the development of international trade.

⁶⁷⁸ Supra note 671

⁶⁷⁹ See chapter headings no.II.A.3.b) V.A.2 V.B.4 VI.B.1 VIII.B

⁶⁸⁰ See generally, chapter subheadings; II.A.3.b), VI.B.1, VIII.B, VI.B.4

C. Judicial and Quasi-Judicial Functioning of the WTO in the endorsement of International Trade

The improvement of certainty and predictability in terms of the rules of the game within a system helps the system to develop. The adjudicative functioning of the WTO is notable in its jurisdiction to improve the certainty and predictability of the rules of the game within the international trading scenario. The adjudicative process is carried out by the DSS of the WTO and has been discussed in detail in the preceding chapters.⁶⁸¹

One of the most noteworthy accomplishments of the Uruguay Round multilateral trade negotiations was making the DSS as a mandatory part of the WTO system. This adjudicative functioning makes the WTO the most effective IELR. Eric White said:

“The WTO Dispute Settlement system is a remarkable achievement. The WTO has succeeded in creating a frequently used compulsory dispute settlement system producing binding results that can be enforced. Nowhere else in international law are all these characteristics combined.”⁶⁸²

Even though the WTO DSS’s overall contributions are significant in settling disputes within its jurisdiction,⁶⁸³ there is still room for improvements.⁶⁸⁴ By room for improvements I mean that nothing is absolutely perfect and flawless. Therefore, despite being overall an effective

⁶⁸¹ Chapter VI.B.3 and Chapter VIII.C

⁶⁸² White, E. (2003), quoted in Stoler, A.L., ‘The WTO dispute settlement system: did we get what the negotiators wanted?’, paper presented at the International Bar Association Conference, Future Directions in WTO Dispute Settlement, Geneva, 16 March, mimeo. As cited by Read, R. (2005). Trade dispute settlement mechanisms: the WTO dispute settlement understanding in the wake of the GATT. Lancaster University Management School Working Paper 2005/012.

⁶⁸³ Davey, William J. (2005). The WTO dispute settlement system. *Journal of International Economic Law* Vol. 8 No. 1

⁶⁸⁴ Shaffer, Gregory (2005). Weaknesses and proposed improvements to the WTO Dispute Settlement System: an economic and market-oriented. (Prepared for WTO at 10: A Look at the Appellate Body, Sao Paulo, Brazil, May 16-17, 2005). Available at: <http://www.ppl.nl/bibliographies/wto/files/5300a.pdf> ; see also, Faisal A.S.A. Albashar & A.F.M. Maniruzzaman (2010), Reforming the WTO Dispute Settlement System: A Rethink of the Third Party Right of Access to Panel and Appeal Processes from Developing Countries' Perspectives. *Journal of World Investment & Trade* Volume 11, Number 3.

institution, the DSS is slightly more advantageous to the developed countries. This may be due to lack of resources to finance adjudicating process or due ineffective remedies (from a small economy's perspective) or some other reason but the fact is that developing countries are in majority and still there are very few case initiated by them.

J.H. Jackson acknowledged some the main achievements of the WO DSS as follows:⁶⁸⁵ “It established a unified dispute settlement system covering all of the WTO Agreements. It enshrines the precedent of plaintiff governments to initiate a panel process and prevents defendants from blocking the process. It established a new appellate procedure, including a negative consensus requirement for the acceptance of an appellate ruling.”⁶⁸⁶

In short, DSS of the WTO is an effective institution. Majority of the scholars consider it to be a successful system which has contributed quite positively towards the international economic law. However, it is not free from criticism which is discussed in the later part of the thesis.⁶⁸⁷

The next subhead is about the WTO's contribution towards the promotion of innovation. This aspect of the WTO is separately discussed because the innovation has a significant role in creating comparative advantage and thus making room for trade. By promoting innovation the WTO directly promotes the international trade.

⁶⁸⁵ Jackson, J.H. (1998b), ‘Designing and implementing effective dispute settlement procedures: WTO dispute settlement, appraisal and prospects’, in Krueger, A.O. (ed.), *The WTO as an International Organization*, pp. 161-80.

⁶⁸⁶ See Read, R. (2005). *Trade dispute settlement mechanisms: the WTO dispute settlement understanding in the wake of the GATT*. Lancaster University Management School Working Paper 2005/012.

⁶⁸⁷ Room for Improvement VIII.C.5, p337.

D. TRIPS

1. Introduction

The link between innovation and promotion of international trade is directly proportional. Innovation is considered as the most important factor in most of the trade theories. For this reason this part of the thesis sheds lights on the institutional role played by the WTO in promotion of innovation which then stimulates the international trade.

Literature related to economic growth puts enormous stress on the role played by the international economic institutions in the growth process; for example, protecting and promoting Intellectual Property (“IP”) rights. The importance of the role of the economic institutions is often discussed, as these institutions can influence to a significant extent the productivity of organisations (by supporting and promoting innovation) and can, ultimately, affect the growth rate of a country. This is because the IP rights and ability (and interest) of organisations to innovate are directly proportional to each other.⁶⁸⁸

This sub-section is dedicated to analysing the role of the WTO in the promotion and protection of Intellectual Property Rights (IPRs). For this purpose, I shall discuss in general IP and IPRs, the need for IPR protection, the structure of Trade Related Intellectual Property Rights (TRIPS) and the role of the TRIPS Council in the implementation and enforcement of TRIPS.

What is property? Property, in simple words, is a collection of legal rights to exert control over some thing.⁶⁸⁹ The legal system (in its jurisdiction) classifies the different types of things that can be characterised as property, along with the scope of rights associated with them. For example, a

⁶⁸⁸ Acemoglu, Daron & Kostas Bimpikis & Asuman Ozdaglar, (2008). "Experimentation, Patents, and Innovation," NBER Working Papers 14408.

⁶⁸⁹ Honore, A. (1977), 'Ownership', in P. Smith (ed.), *The Nature and Process of Law* (Oxford University Press, New York), pp. 370-375. See also Dreyfuss, R. (1989), 'General Overview of the Intellectual Property System', in V Weil and J. Snapper (eds.), *Owning Scientific and Technical Information* (Rutgers University Press, New Brunswick, NJ), pp. 17-40.

car owner has legal rights to possess, use, destroy, transfer, sell, or rent his car. However, different legal systems impose certain limits on those rights, such as obligating him to drive the car safely (as defined by the legal system), and to follow the rules set by the legal system when selling, transferring, renting or destroying the car. In other words, property is a collection of legal rights (as defined by the legal system) according to which a person (also including artificial persons) exercises his rights to control some thing.⁶⁹⁰

Along the same lines, the concept of property includes a collection of an individual's rights towards an object with relation to society.⁶⁹¹ For instance, if there were no people, then there would be no need for the concept of property, as it is a collection of the rights of persons (including artificial persons as well). Objects are classified as property so that they can be identified and represented socially and legally as a collection of a person's rights and duties with regard to that object. Hence, the notion of property portrays a three sided relationship between an object, an individual and the society.⁶⁹²

Property law has evolved over the course of time for the protection and promotion of individual rights within evolving technological, social, and economic scenarios. A brief reference to the history of the evolution of the property law will enable a better understanding of the concept of property. During Medieval Europe⁶⁹³, land was considered as the most prominent type of object that people might possess, use, rent, buy, or sell. Thus property laws, at that time, were mainly comprised of a collection of rights related to land i.e. real property (to possess, use, rent, buy, or sell) in order to protect the economic interests of individuals. Similarly, during the Renaissance

⁶⁹⁰ D. B. Resnik, A Pluralistic Account of Intellectual Property. *Journal of Business Ethics*, Vol. 46, No. 4 (Sep., 2003), pp. 319-335. Available at: <http://www.jstor.org/stable/25075110>

⁶⁹¹ Feinman, J. (2000), *Law 101: Everything You Need to Know About the American Legal System* (Oxford University Press, New York).

⁶⁹² Resnik, D. B. (2003). A Pluralistic Account of Intellectual Property. *Journal of Business Ethics*, Vol. 46, No. 4, pp. 319-335. Available at: <http://www.jstor.org/stable/25075110>

⁶⁹³ In that era feudalism was the dominant political economy.

era⁶⁹⁴, feudalism was abolished and a new class of businessman surfaced. So, in order to cater to the economic interests of these businessmen, such as the trade of moveable items (e.g. harvested crops, livestock, etc.), laws were developed to recognise moveable items as property.⁶⁹⁵ In the same way, during the Industrial Revolution⁶⁹⁶, the economic players (both natural and artificial persons participating in the economy) became more dependent on the utility of information and ideas, and so the legal system recognized IP.⁶⁹⁷

“Intellectual property refers to creations of the mind: inventions, literary and artistic works, and symbols, names, images, and designs used in commerce.”⁶⁹⁸ As IP relates to intangible properties, it demands special legal protection because they are non-exclusive and non-exhaustive in nature i.e. more than one individual can possess and use the same item of intellectual property without preventing another from possessing or using it.⁶⁹⁹ For instance, more than one individual can, at the same time, possess and use the same computer program, poem, or the same song. Thus, to cater for the need to protect the economic interests of the economic players concerned, IP laws allow persons to possess exclusive rights to control things that are non-exclusive in nature.⁷⁰⁰

What is the need for the protection of IPRs at international level? The new growth theory emphasises the contribution of technological enhancement in the economic growth process, and as discussed earlier in the ‘Economic Cycle’, that economic growth is the key to achieving

⁶⁹⁴ 14th–17th centuries.

⁶⁹⁵ May, C. (1998). Thinking, Buying, Selling: Intellectual Property Rights in Political Economy', *New Political Economy* 3(1), 59-78.

⁶⁹⁶ The Industrial Revolution was a period in the late 18th and early 19th centuries.

⁶⁹⁷ In this context, England passed its first patent statute in 1623 and its first copyright statute in 1710. The U.S. adopted its first copyright and patent statutes in 1790. For further discussion see, Miller, A. and M. Davis (2000). *Intellectual Property: Patents, Trademarks, and Copyright* (West Publishing, St. Paul, MN). And see also, Foster, F. and R. Shook (1993) *Patents, Copyrights, and Trademarks*, 2nd ed. (John Wiley and Sons, New York).

⁶⁹⁸ <http://www.wipo.int/about-ip/en/>

⁶⁹⁹ Hettinger, E. (1989). 'Justifying Intellectual Property', *Philosophy and Public Affairs* 18, 31-52.

⁷⁰⁰ The reason why intellectual properties are non exclusive is that information and ideas have no particular location in time and space: they are abstract objects. For further discussion see, *Supra* note 695 and also see, *supra* note 692

financial development, ultimately leading to a stable financial system. In this way, therefore, there is a possible link between IPR protection and economic stability. Research and development (R&D) is considered to a major source of innovation, improving existing products or developing new ones. Therefore, to maintain the interest of those players involved in R&D, TRIPS came into force during the Uruguay Round, setting the minimum IPR protection standards for WTO members.

As IP is non-exclusive and non-exhaustive, it requires special attention since a lack of IPR protection could undermine the incentive to invest in R&D; IPR protection is vital for the restoration of that incentive to participate in the R&D process.⁷⁰¹ The relationship of R&D and innovation is highlighted in the new growth theory⁷⁰². The economic growth models used in the new growth theory rely on the notion that entrepreneurs invest in R&D with the expectation of profiting from their inventions. Moreover, innovation also contributes to the public stock of knowledge which reduces the time and cost associated with further R&D in the future. IPR protection not only protects IP but also motivates further innovation, as the knowledge inherent in patent right is then accessible to other prospective inventors (when they buy a patent from the creator).⁷⁰³ Therefore, it is strongly argued that the rate of innovation and rate of economic growth are directly proportional to each other.⁷⁰⁴

Enhanced IPR protection can also affect the volume of trade. For instance, through technology transfer (through technology licensing and inwards investment flow), the productivity of local

⁷⁰¹ There may exist natural motivations to invent. See, Maskus, Keith E. (2000) *Intellectual Property Rights in the Global Economy*. Washington DC: Institute for International Economics.

⁷⁰² For a detailed discussion of new trade theory see, for example, Romer, P.M., (1990) 'Endogenous Technological Change', *Journal of Political Economy*, Vol. 98, S71-S102; *Supra* note 206

⁷⁰³ *Supra* note 701

⁷⁰⁴ Falvey, Rod; Neil Foster, and David Greenaway (2006), *Intellectual Property Rights and Economic Growth*, *Review of Development Economics*, 10(4), 700–719

industry can be enhanced significantly and the volume of imports potentially affected.⁷⁰⁵ On the other hand, companies can also increase the export of their patented goods into foreign markets with strong IPR protection (in view of the fact that IP protection decreases the possibility of piracy) and, as a result, foreign companies' market power would be enhanced as the ability of local companies to imitate the patent good is reduced.⁷⁰⁶

There is no crystal clear relationship between FDI and IPR protection; however, economic literature argues that a poorly-protected IPR system negatively affects the general investment scenario, which further discourages FDI.⁷⁰⁷

Empirical data shows that IPR protection and innovation (due to increased R&D investment) are directly proportional to the GNP of an economy. Therefore, stronger IPR protection helps stimulate innovation and technological progress, both of which ultimately have a positive impact on economic growth. With the significance of IPR protection in mind, it was during the Uruguay Round of multilateral trade negotiations that TRIPS came into force, setting minimum IPR protection standards for WTO members.⁷⁰⁸

The TRIPS Agreement amounts to a significant effort made by the WTO members to reduce discrepancies in the global IP protection level. It sets out the minimum standards of IP protection to be provided by each member to his fellow WTO member's IP. The purpose of establishing minimum IPR protection is to achieve long-term benefits for society, i.e. the protection of IPR in order to promote innovation (which, as discussed above, leads to economic growth) whereby

⁷⁰⁵ For verification of growth helping knowledge spillovers via trade, see Coe, David T. and Helpman, Elhanan (1995). International R&D Spillovers. NBER Working Paper Series

⁷⁰⁶ In their experimental findings, Maskus and Penubarti discovered that higher IPR protection has a positive effect on imports. [However, their research puts forward that enhanced IP protection will encourage imports, they qualify this with respect of imports into developing countries. Thereby, probably resulting in displacement of domestic producers and adversely affecting their economic growth and industrialization.] See, Maskus, Keith E. and Mohan Penubarti, 1995, "How Trade-Related Are Intellectual Property Rights?" *Journal of International Economics*, vol. 39, 227-248

⁷⁰⁷ *Supra* note 704

⁷⁰⁸ *Ibid*

when the protected period expires, then IP enters the public domain. The next subheading will review the structure of the TRIPS agreement in order to gauge its contribution towards achieving IPR protection.

2. Overview of the TRIPS Agreement

The TRIPS agreement is built upon the legal base provided by earlier conventions of the World Intellectual Property Organization (WIPO), including the Paris and Berne Conventions. It was the first time international law relating to IP imposed a minimum protection level obligation on WTO members. The TRIPS agreement takes into account an extensive range of IP: copyright and related rights⁷⁰⁹; trademarks⁷¹⁰ including service marks; geographical indications including appellations of origin; industrial designs; patents including the protection of new varieties of plants; the layout-designs of integrated circuits; and undisclosed information including trade secrets and test data.

a) Basic Principles

Similar to GATT and GATS, TRIPS also accounts for non-discriminatory provisions, such as National Treatment and most-favoured-nation treatment (MFN): Article 3 deals with National Treatment and Article 4 takes into account MFN treatment.

⁷⁰⁹ Copyright is the legal right to control the production and selling of a book, play, film, photograph or piece of music. [<http://dictionary.cambridge.org/define.asp?key=17095&dict=CALD>].

⁷¹⁰ Trademark is a name or a symbol which is put on a product to show that it is made by a particular producer and which cannot be legally used by any other producer. [<http://dictionary.cambridge.org/define.asp?key=84276&dict=CALD>]

b) Intellectual Property Conventions

The relationship between TRIPS and other WIPO conventions is elucidated in Article 2.2 of TRIPS, which states that nothing in the TRIPS agreement shall diminish the existing obligation levels established under the Paris, Berne and Rome Conventions and the Washington Treaty. These conventions did not cover some aspects of IP; however, TRIPS takes care of these areas and thereby adds a notable number of new or higher standards.

c) Main Features

For a better understanding of TRIPS, its main features are discussed below:

(1) Standards

The TRIPS agreement obliges all WTO members to provide minimum required standards to fellow members to protect all chief areas of IP. For all of the chief areas of IP, the scope, duration, exceptions and subject matter to be protected are made quite clear in the TRIPS agreement.

The basic standards imposed by TRIPS are the existing standards set out by the main conventions of the WIPO, such as the Paris Convention and the Berne Convention in their most recent versions, which need to be complied with as a starting point for the TRIPS IP protection standards. There is one exception: the obligation of the Berne Convention on moral rights is not included in TRIPS. Other than that, all the provisions of these conventions are included in the TRIPS agreement, thus are applicable to all WTO members. In this context, Articles 2.1 and 9.1

of TRIPS deal with the provisions of the Paris Convention and the Berne Convention, respectively.

In addition, the TRIPS agreement adds a number of additional standards to be followed; these provisions were added because the standards set out in the pre-existing conventions were not sufficient. It is for this reason that the TRIPS agreement is also referred as the Berne and Paris-plus agreement.

(2) Enforcement

Enforcement refers to the procedures laid down in the TRIPS agreement that entail action and remedy to affected IP holders. The enforcement provisions of the TRIPS agreement have two basic purposes: firstly, to ensure that IP holders are provided with an effective means of enforcement of their rights and secondly, to ensure that the enforcement mechanism does not create barriers to genuine and lawful trade and further, extends protection against the abuse of their IPRs.⁷¹¹

In addition, TRIPS also aims to ensure that the provisions on the protection of IPR in the TRIPS agreement can be enforced by the right holders themselves.⁷¹² Thus, the provisions directly look into the ability of the right holders to defend their IPRs effectively on a global scale.

In this way, the enforcement part of TRIPS takes into account the domestic methods and solutions for the implementation of IPRs. The enforcement section (Part III of TRIPS) comprises

⁷¹¹ Otten, A. and H. Wager (1996). Compliance with TRIPS: The Emerging World View, 29 Vanderbilt J. Transnational Law., 391, 393, at p403.

⁷¹² Smith, Pamela J. (1997), "Are Weak Patent Rights a Barrier to U.S. Exports?" Journal of International Economics, forthcoming, at p 30.

general principles which are applied to all IPR implementation processes⁷¹³. Furthermore, TRIPS sets out obligations on civil and administrative processes and remedies⁷¹⁴, provisional measures⁷¹⁵, special obligations related to border measures⁷¹⁶ and criminal course of action⁷¹⁷.

(3) Dispute settlement

In the case where any WTO member is dissatisfied with the enforcement and implementation by a fellow member, then TRIPS refers such a case to the WTO's dispute settlement procedure.

As with the WTO's general policy, the TRIPS agreement gave adequate time to its members to align their national laws according to its obligations. In this context, developed countries were expected to comply with TRIPS in the shortest possible time and less developed countries were allowed more time. As discussed above, TRIPS sets out only a minimum level of standards for IPR protection, so leaving room to employ the maximum level of standards for IPR protection.

d) Enforcement of TRIPS and the role of the Council on TRIPS

The WTO obliges all its members to align their national legislative and administrative practices and judicial arrangements with the TRIPS agreement in order to ensure the effective implementation of IPR protection. For this purpose, the WTO has provided an institutional arrangement in the form of the TRIPS Council which is designed to promote compliance.⁷¹⁸ The

⁷¹³ Article 41, obliges members to ensure fair and equitable enforcement procedure without unreasonable delays which has option of judicial review in it as well.

⁷¹⁴ Article 42 to 49 of TRIPS deals with civil and administrative procedures and remedies.

⁷¹⁵ Article 50 of TRIPS deals with provisional measures.

⁷¹⁶ Article 51 to 60 of TRIPS deals with special requirements related to border measures.

⁷¹⁷ Article 61 of TRIPS deals with criminal procedures.

⁷¹⁸ Braithwaite, John, and Peter Drahos. 2000. *Global Business Regulation*. New York: Cambridge University Press. Ch. 10, pp. 175-221, p64.

TRIPS Council, situated at the heart of the WTO arrangements, ensures transparency of implementation and enforcement through scrutiny and surveillance.⁷¹⁹

(1) *The TRIPS Council, scrutiny and surveillance*

The TRIPS Council is responsible, on behalf of the WTO, for scrutinising and monitoring national measures taken for the implementation of TRIPS.⁷²⁰ Article 63.2 of the TRIPS agreement describes the TRIPS Council's above-mentioned role. It obliges all WTO members to notify the TRIPS Council of the relevant national laws and regulations so that all other members are given an opportunity to review each other's implementation and enforcement legislation and mechanisms for IPR protection.

Once the transitional period for the compliance with TRIPS expires, then the process of scrutiny by the TRIPS Council begins. All WTO members concerned (those whose transitional period has expired) are obliged to submit two documents to the TRIPS Council for scrutiny. The first document is related to Article 63.2 and notification, in which the member country concerned notifies the TRIPS Council of compliance of their national laws with the TRIPS agreement. Then the TRIPS Council sends a questionnaire relating to their compliance, and from the answers, the second set of documents required by the TRIPS Council is devised so that it can monitor enforcement. After the submission of these documents, the scrutinisation process starts, in which all WTO members are given an opportunity to ask further questions in relation to the compliance of the national laws of the country under scrutiny.

⁷¹⁹ See generally, Matthews, Duncan (2002). "Trade-Related Aspects Of Intellectual Property Rights: Will The Uruguay Round Consensus Hold?" CSGR Working Paper No. 99/02. Centre for the Study of Globalisation and Regionalisation (CSGR), University of Warwick.

⁷²⁰ For a fuller discussion of the role of the TRIPS Council see Geuze, M. & Wager, H. (1999). WTO Dispute Settlement Practice Relating to the TRIPS Agreement, Journal of International Economic Law, Vol. 2, No. 2

There are additional benefits of the TRIPS Council's scrutinisation process, such as the fact that it encourages members to clarify misunderstandings which, if not clarified, would lead to disputes. It also helps members to identify each other's deficiencies in the laws and regulations notified (peer review). Moreover, the interpretation and implementation strategies of different countries are revealed, so that other countries can also benefit from them.⁷²¹ In the TRIPS mechanism of IPR protection, the TRIPS Council occupies a vital position, and it has contributed significantly in the promotion, protection and enforcement of IPR. For an account of the day-to-day activities of the TRIPS Council, visit the WTO official website⁷²².

e) Conclusion

In short, the WTO has successfully established a regime of improved standards for IPRs globally. This has been achieved mainly via the TRIPS mechanism, along with the dispute settlement system of the WTO. However, difficult problems remain, particularly in terms of implementation in developing countries: some of the common features of the LDCs' legal systems are that IPRs are subject to inconsistent coverage, uncertain terms of protection, arbitrary transferability, and inadequate enforcement.⁷²³

As discussed earlier in this chapter, economic growth is the main driver of the 'Economic Cycle'. This subsection documents the importance of innovation in the economic growth process and the WTO's role in the promotion and protection of innovation, which stimulates international trade and ultimately leads to a more stable and balanced growth of the global economy.

⁷²¹ Otten, Adrian (1998). "Implementation of the TRIPS Agreement and Prospects for its Further Development", 1 *Journal of International Economic Law* 525.

⁷²² http://www.wto.org/english/tratop_e/trips_e/trips_e.htm

⁷²³ *Supra* note 720

E. Conclusion

This chapter briefly documented the institutional role of the WTO in promotion of the international trade. The reason for a shallow discussion was; firstly to avoid repetition and secondly the WTO's institutional contribution is not generally contested by scholars. Never the less, this chapter discussed the legislative and normative function with a different style (as compared preceding chapter), briefly touched the executive and administrative functioning, and DSS. Moreover, the last part of this chapter reasonably highlighted the link between innovation and the international trade, and the WTO's institutional role in this context.

Working on the same lines, the next chapter discusses substantially contribution made by the WTO in the area of financial sector. These contributions are not much but has the potential to expand.

VIII. Institutional Role of the WTO in the Development of the Global

Financial Sector

Section Three argues that the WTO is the most effective IEI in the IELR and that the WTO needs to expand its institutional role in the context of financial sector development. The reason for the expansion of the WTO's institutional role in financial sector development is the IMF's failure to explicitly adapt its institutional role in line with liberal institutionalism. As discussed in the theoretical framework, the current regime, i.e. the IELR is based on liberal institutionalism and to become an effective part of this regime, the IMF needs to modify its institutional structure.⁷²⁴

The major element of financial sector development is contributed by the IMF which is not a liberally institutionalized IEI (in contrast with the current global economy).⁷²⁵ Being a realist body, the IMF underperforms due to its lack of explicit institutional functioning as part of its institutional role. The main reason for the IMF's inadaptability in real terms within the current regime is the hegemonic attitude of the US which holds the power of veto in the IMF. Taking into account the US' interest in maintaining its dominance within global financial regulation, it seems highly unlikely that the IMF would embark upon structural changes.⁷²⁶

On the other hand, within the WTO, all members have equal status and they cooperate with each other freely for collective gain. The collective gain in the current regime equates to achieving a more stable and balanced growth of the global economy. Thus, the WTO has the option to

⁷²⁴ Supra note 619

⁷²⁵ This thesis assumes that the current IELR is based on liberal institutionalism. For detailed discussion see, chapter II.B.1.b)(2) on page 62

⁷²⁶ Supra note 619

increase its role in financial sector development, in order to assume the rules of the game-setting function of the IMF.⁷²⁷

In this connection, this chapter is dedicated to highlighting one aspect of the comprehensive institutional role of the WTO in the context of the Economic Cycle; that is, the development of the financial sector. As discussed in the theoretical framework, the development of the global financial sector (Patrick's supply lead hypothesis) leads to the expansion of international trade through economic growth. The other aspect of the Economic Cycle was discussed in the previous chapter and which shows the WTO's institutional role in the promotion of international trade, leading to the development of the financial sector (Patrick's demand followed hypothesis of financial sector development) thus completing the whole cycle. If either one or both aspects of the Economic Cycle are stimulated, then it leads to a more stable and balanced growth of the global economy.⁷²⁸

The role of the WTO is viewed in its institutional capacity as an IEI. The development of the financial sector comes within the direct domain of the WTO and the reason for this is to ensure financial sector liberalization and economic growth. The following section of this subheading considers the role of the WTO in its legislative and normative capacity in the development of the global financial sector.

A. Legislative and normative capacity

This section will highlight the legislative and normative capacity of the WTO, as an IO, in creating legal certainty and predictability in the global financial sector. In order to do that, the following part of the subheading will look at the relevant rules and member's commitments

⁷²⁷ See, the main argument of Section Three on page 224

⁷²⁸ Chapter II.B.3.e) on page 90

obligated by the WTO Charter and its constituent annexes. As the financial sector is covered by GATS, the most relevant of the WTO agreements is therefore GATS, along with its Annexes on Financial Services, Protocols on GATS and Understanding on commitments in Financial Services.

As discussed in the preceding chapter (Chapter VI: WTO's Legal Framework), the WTO has a vast normative framework which is based on the WTO framework of Agreements and the decisions of the various WTO bodies. These decisions include decisions in the context of rule-making, DSB decisions and decisions in the context of executive functioning. However, this subheading will only deal with the WTO framework Agreements affecting the financial sector and the rule-making process adopted by various WTO bodies in the context of the financial sector. This rule-making process is currently very limited but this thesis calls for the expansion of this function of the WTO in the context of financial sector development.

The following subhead will shed light on the normative effects of the GATS in context of the financial services sector.⁷²⁹

1. GATS

a) Introduction

The formation of GATS during the Uruguay Round and its entry into force on 1 January 1995 was one of the milestone accomplishments of the Contracting Parties.⁷³⁰ GATS was mainly inspired, in essence, by the same ideas as its counterpart in goods trade, GATT. Both GATT and GATS have a propensity to (1) establish a reliable and consistent system of international trading;

⁷²⁹ This section of chapter is drawn from, Wolfrum, Rudiger; Peter-Tobias Stoll & Clemens Feinaugle eds. (2008), *WTO-Trade in Services*, Max Planck. Commentaries on World Trade Law and information available on the WTO website (www.wto.org).

⁷³⁰ The terms "Contracting Parties" and "members" are interchangeable terms.

(2) guarantee fair and impartial dealing⁷³¹ with all Contracting Parties; (3) enliven economic growth through clear-cut policy obligations; and (4) endorse trade and development by expanding liberalization.⁷³²

GATS, along with its annexes, is the most relevant agreement in the WTO legal framework of agreements in the context of the financial sector. It does not endeavor to regulate the content and scope of the financial regulations. However, it mainly attempts to make certain that these regulations do not needlessly acts as obstacles in the international trade.⁷³³ Moreover, it enhances the certainty and predictability of the rules of the game through its normative effect on the financial sector side of the Economic Cycle, which in turn leads to a more stable and balanced growth of global economy.

The services sector, which includes financial services, is governed by GATS and its associated agreements. The significance of GATS in the context of financial services matters rests primarily in its principles for controlling cross-border trade in financial services and its discipline of domestic regulations.⁷³⁴ Therefore, to understand the normative effect of the institutional role of the WTO, it is important to understand GATS: its purpose, scope, structure, functioning and types of obligations, all of which are discussed below.

⁷³¹Principle of non-discrimination is embodied in MFN and National Treatment clauses in both the GATS (Article II and Article XVII respectively) and the GATT (Article I and III respectively).

⁷³² See, The General Agreement on Trade in Services (GATS): objectives, coverage and disciplines. Available at: http://www.wto.org/english/tratop_e/serv_e/gatsqa_e.htm

⁷³³ See Alexander, Kern (2008). The GATS and Financial Services: Liberalisation and Regulation in Global Financial Markets, in Andenas, Mads and Kern, Alexander (eds). The World Trade Organisation and Trade in Services . Leiden: Martinus Nijhoff Publishers, p561.

⁷³⁴ Ibid p569.

b) Basic Purpose

The basic intention of the Contracting Parties in the formation of GATS as stated in its preamble [hereinafter the “Preamble”] is to play an important role in trade development "under conditions of transparency and progressive liberalization and as a means of promoting the economic growth of all trading partners and the development of developing countries".⁷³⁵ Hence, according to the Preamble, trade expansion and growth is not intended to be a final objective in itself but a method to enhance development and growth. Further, the Preamble clearly emphasises the use of trade expansion as a basic tool for growth and development. In this context, one of GATS’ goals is to increase the involvement of developing countries in the services trade (including financial services) so that they can further develop in this area.

According to the Preamble, the financial sector development process is based on two broad concepts: firstly, to ensure the enhanced transparency and certainty of applicable rules and regulations (in the financial sector); and secondly, by using a stage-by-stage process to develop the (financial) services sector, for example, by progressively expanding market access and broadening National Treatment in relation to foreign financial services and financial service suppliers (discussed in detail in the earlier part of the chapter)⁷³⁶. In this way, the creation of any rule and its application should be based on these two concepts.

Before getting to the detail of this chapter, it is necessary of grasp the definition of the financial services trade under GATS and the next heading deals with the definition of the services trade and its modes of supply.

⁷³⁵ Paragraph 2 of the Preamble express the intention behind the basic purpose for the creation of the GATS.

⁷³⁶ Chapter VI.A.4.a) on page 239; see also footnote 750; also see, Chapter VIII.A.1.e)(1)(c) on page 291

c) Definition of Services Trade and Modes of Supply

The definition of the services trade under GATS is considerably more extensive than the BOP concept⁷³⁷ of the services trade. The GATS' definition of the services trade covers all aspects of trade in the services sector and is divided into four types, subject to the territorial presence of the supplier and consumer at the time of the transaction. According to Article I:2⁷³⁸ of GATS, the four modes in which services can be supplied are as follows:

(a) Mode 1 (Cross-border trade):

In this mode, a service is supplied from the territory of one Contracting Party into the territory of another Contracting Party, (e.g. where a financial consulting company operating in the UK provides services to customers in Pakistan).

(b) Mode 2 (Consumption abroad):

In this mode, a service is supplied in the territory of one Contracting Party to a service consumer of another Contracting Party (i.e. when a service is consumed by a national of one Contracting Party in the territory of another Contracting Party), for example, where a national of country A has moved abroad as a tourist, student, or patient to consume the respective services.

(c) Mode 3 (Commercial presence):

In this mode, a service is supplied by the supplier of one Contracting Party⁷³⁹, through commercial presence, in the territory of another Contracting Party. The service is

⁷³⁷ The BOP definition of the Services focuses on residency rather than nationality, that is when a service is being exported if it is traded between residents and non-residents. [Balance of Payment Manual, paragraphs. 158-168, 185,186 <http://www.imf.org/external/np/sta/bop/BOPman.pdf>]

⁷³⁸ Article I:2 of GATS: "For the purposes of this Agreement, trade in services is defined as the supply of a service: (a) from the territory of one Member into the territory of any other Member; (b) in the territory of one Member to the service consumer of any other Member; (c) by a service supplier of one Member, through commercial presence in the territory of any other Member; (d) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member." See also, Supra note 733 p571

provided within the territory of country A by a locally established subsidiary, affiliate or representative office of a foreign-owned and controlled company (e.g. a Pakistan-owned and -controlled bank provides banking services to a UK resident, through its branch located in the UK).

(d) Mode 4 (Movement of natural persons):

In this mode, services are provided through the presence of the service providers from the territory of one Contracting Party to another Contracting Party. This can be done by services provided through the presence of natural persons of a Contracting Party in the territory of any other Contracting Party (e.g. a financial consultant from India provides a service within the UK as an independent (consultant) supplier or employee of a service supplier company i.e. in this case a financial consultancy firm).

From a practical and commercial perspective, there may often be a link between all four modes of supply. For instance, a Pakistani company (e.g. a financial consultancy firm which is controlled and owned within Pakistan) established in the UK [under Mode 3 which refers to a commercial presence of a foreign company in another country] may employ nationals from India [under Mode 4 which refers to the movement of natural persons from one Contracting Party to another in order to provide services] to export financial consultancy services cross-border [via mode 1, which deals with services supplied from the territory of one Contracting Party into the territory of any other Contracting Party] into the US, Canada, and so on. Similarly, business visits to the UK by a foreign national involved in the business (in this case, the above-mentioned financial consultancy firm) may also consume services in the UK under mode 2 [which refers to

⁷³⁹ The supplier from a Contracting Party means that the company which is supplying the services is owned and controlled within the territory of that Contracting Party.

the services consumed by a national of one Contracting Party in the territory of another Contracting Party].

This heading clarifies the meaning of services under GATS and the modes within which it can be supplied: the next heading is about the scope and application of GATS as an agreement.

d) Scope and Application⁷⁴⁰

The scope and application of GATS is vast and it takes into account all the ‘measures’ taken by the Contracting Parties in relation to trade in the services sector.⁷⁴¹ The measures which are discussed in Article I:1 are all those measures that are taken by the Contracting Parties at all levels such as central, regional or local government level, or even by non-governmental authorities (when they exercise powers delegated to them by governmental authorities).⁷⁴² Further, reference is made in Article XXVIII (a) to GATS, regarding the possible types of “measures” (mentioned in Article I.1 of the GATS) taken by the Contracting Parties. It includes all measures carried in the shape of a law, regulation, rule, procedure, decision, administrative action, or in any other action of the Contracting Parties which has the same effect as of the above-mentioned measures⁷⁴³ i.e. those which can influence trade in the financial services sector.

⁷⁴⁰ Li, Guojun (2010). NATIONAL TREATMENT UNDER THE GENERAL AGREEMENT ON TRADE IN SERVICES. Published in Cambridge Student Law Review, vol. 6, no. 1 Summer (2010), pp. 74-93; see also, Munin, Nellie (2010). Legal Guide to GATS (Alphen aan den Rijn: Kluwer Law & Business, 2010), chapter VI: GATS Scope of Application; see also Alexander, Kern (2008). The GATS and Financial Services: Liberalisation and Regulation in Global Financial Markets, in Andenas, Mads and Kern, Alexander (eds). The World Trade Organisation and Trade in Services . Leiden: Martinus Nijhoff Publishers, 2008.

⁷⁴¹ Article I:1 of GATS: “This Agreement applies to measures by Members affecting trade in services.”

⁷⁴² Article I:3 (a) of GATS: ““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.”

⁷⁴³ Article XXVIII (a) of GATS: ““measure” means any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form.”

However, Article XXVIII (c) of GATS limits the scope of the term “measures” used in Article I.1 of GATS.⁷⁴⁴ According to this article, the “measures” under discussion are only related as follows: firstly, to the purchase, payment or use of a service; secondly, to the access to and use of services which are required by the Contracting Parties to be offered to the public generally⁷⁴⁵; thirdly, to the presence of persons⁷⁴⁶ from a Contracting Party for the supply of a service in the territory of another Contracting Party.

Bearing in mind the huge applicability and scope of GATS, the Contracting Parties in this context have classified the services sector into 12 core areas.⁷⁴⁷ However, for the purposes of the current discussion, the financial services sector is most relevant. These 12 core sectors are further divided into a sum of some 160 sub-sectors.⁷⁴⁸ The Contracting Parties may impose limitations on any of the services sectors or sub-sectors, in the light of the market access⁷⁴⁹ and national

⁷⁴⁴ The Article XXVIII(c) of GATS also limits the scope of the GATS. See generally, Altinger, Laura and Alice Enders (1996). *The Scope and Depth of GATS Commitments*. *The World Economy* Volume 19, Issue 3, pages 307–332.

⁷⁴⁵ Example of the services offered to the public are mostly big network industries, e.g. in the transport, postal, energy and communication sectors, but the term also covers any other economic activity subject to public service obligations [Commission of the European Communities, *Green Paper on Services of General Interest*, Brussels, Com (2003) 270 final.]. In addition, the following White Paper of the Commission explicitly acknowledges the general (non-economic) interest in social services such as health, long-term care, social security and social housing [Commission of the European Communities, *White Paper on Services of General Interest*, Brussels, Com (2004) 374 final, at 16.].

⁷⁴⁶ Including commercial presence.

⁷⁴⁷ Business services, Communication services, Construction and related engineering services, Distribution services, Educational services, Environmental services, Financial services, Health-related and social services, Tourism and travel-related services, Recreational, cultural and sporting services, Transport services. Document MTN.GNS/W/120 contains the Services sectoral classification list, which is available at: http://www.wto.org/english/tratop_e/serv_e/serv_sectors_e.htm

⁷⁴⁸ List of 160 sub-sectors in the Services Sector under the WTO are given in the Annex 1. The list is available at the WTO website at: http://tsdb.wto.org/Includes/docs/W120_E.doc

⁷⁴⁹ All Contracting Parties have full access to the other Contracting Parties' markets. However, a Contracting Party may impose perfectly legitimate limitation on market access in the light of Article XVI of the GATS. Market Access Commitments according to GATS' Article XVI are: "(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 favorable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule [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

treatment provisions under GATS.⁷⁵⁰ In this context, each of the WTO members has provided details in their schedule of commitments under GATS.⁷⁵¹

As is clear from the above examples,⁷⁵² the modes of financial services cover a reasonably broad sphere of the financial sector. However, the Annex on Financial Services defines financial services as those which are comprised of “insurance and insurance related services” and “banking and other financial services.”⁷⁵³ Thus, in the context of the banking sector, this definition has a broad application, covering:

“[A]cceptance of deposits, lending of all types, financial leasing, payment and money transmission services, Guarantees and commitments, trading money market

territory. 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[Subparagraph 2(c) does not cover measures of a Member which limit inputs for the supply of services.]; (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.”

⁷⁵⁰ In the light of National treatment clauses under the GATS, a Contracting Party should give same type of treatment to other Contracting Parties and should not discriminate between foreign and local services or services suppliers. However, if a Contracting Party has held some limitations on the National Treatment clauses under GATS Article XVII then that unfavorable and different treatment is perfectly legitimate. For example to a Contracting Party requiring a foreign bank to establish its branches in every village, a condition to enter its economy, is perfectly legitimate.

According to Article XVII of GATS National Treatment is: “(1) In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favorable than that it accords to its own like services and service suppliers [Specific commitments assumed under this Article shall not be construed to require any Member to compensate for any inherent competitive disadvantages which result from the foreign character of the relevant services or service suppliers.]. (2) A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service suppliers. (3) Formally identical or formally different treatment shall be considered to be less favorable if it modifies the conditions of competition in favor of services or service suppliers of the Member compared to like services or service suppliers of any other Member.”

⁷⁵¹ All schedule of commitments by all the Contracting Parties are available at: http://www.wto.org/english/tratop_e/serv_e/serv_commitments_e.htm

⁷⁵² Chapter VIII.A.1.c) at page no. 278

⁷⁵³ Annex on Financial Services, para 5(a).

instruments, foreign exchange, derivative products, exchange rate and interest rate instruments, securities and financial assets, money broking, asset management, settlement and clearing services for financial assets, provision and transfer of financial information, advisory or intermediation services and insurance services."⁷⁵⁴

However, there are exceptions to the application of GATS and its annexes. These exceptions are discussed below.

Exception in the context of financial services:

Measures affecting the supply of financial services which have exemption from the application of GATS are those which are exercised by governmental authorities.⁷⁵⁵ The logic for excluding governmental measures from the GATS' ambit has two angles; firstly, the Contracting Parties did not want to give up sovereignty over their domestic policy objectives and secondly, for the application of the broader GATS objectives, the Contracting Parties need some sort of flexibility to take measures according to their own domestic policy parameters.

However, GATS makes it explicitly clear that governmental authorities' measures which are exempted from the application of GATS are not to be connected with services supplied on a commercial basis or in competition with one or more service suppliers⁷⁵⁶. A typical example of financial services exempted under Article I: 3 (b) is where the operations of a central bank or monetary authority are excluded from the application of GATS.⁷⁵⁷

⁷⁵⁴ Annex on Financial Services, para 5(a); see Alexander, Kern (2008). *The GATS and Financial Services: Liberalisation and Regulation in Global Financial Markets*, in Andenas, Mads and Kern, Alexander (eds). *The World Trade Organisation and Trade in Services*. Leiden: Martinus Nijhoff Publishers, 2008. P570.

⁷⁵⁵ Article I:3 (b) of the GATS: "For the purposes of this Agreement: (b) 'services' includes any service in any sector except services supplied in the exercise of governmental authority;"

⁷⁵⁶ Article I:3 (c) of GATS: "For the purposes of this Agreement: (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."

⁷⁵⁷ Li, Xuan (2002-03). *Interactive Role of Gats Commitment and Dynamics of Chinese Economic Reform in the Context of Banking Liberalization*, World Trade Institute, P 18.

Furthermore, the jurisdictional scope of GATS does not cover the state's regulations related to cross-border capital flows and capital account liberalisation.⁷⁵⁸

The application and scope of GATS can be much better understood if the structure of GATS is clear in our minds. The next heading explains the structure of GATS and how it works.

e) The structure of GATS and obligation

GATS lay down multilateral rules and commitments which deal with the Contracting Parties' measures which can influence trade in services. It has two parts; first, the framework agreement containing the rules (which includes a Preamble, 29 Articles and the Annexes) and second, the national schedules of commitments in which each Contracting Party lay down the extent of access it is ready to promise to the foreign service suppliers.⁷⁵⁹

GATS obligations can be classified into two main categories. These categories are the general obligations of GATS (which are applied to all the Contracting Parties), and the specific commitments/conditional obligations of the individual Contracting Party to remove or reduce existing tariff levels and other barriers to trade in services.⁷⁶⁰ The existence of these sector-specific commitments of the Contracting Parties makes room for the negotiation process to take place between the other Contracting Parties. The Contracting Parties are free to negotiate whatever they like (freedom to determine their own level of obligation or freedom to determine the level of the opening up of their services sector) with their counterparts (other Contracting

⁷⁵⁸ See, Bernard M. Hoekman, Michel M. Kostecki - *The Political Economy of the World Trading System: The WTO and Beyond*. (Oxford: OUP), p 259. Also see, Alexander, Kern (2008). *The GATS and Financial Services: Liberalisation and Regulation in Global Financial Markets*, in Andenas, Mads and Kern, Alexander (eds). *The World Trade Organisation and Trade in Services*. Leiden: Martinus Nijhoff Publishers, 2008. P571.

⁷⁵⁹ For a better understanding of the structure see figure below. Figure 10 GATS Legal Structure in context of Financial Services on page 309. See also, Supra note 733 p570.

⁷⁶⁰ Other barriers may include subsidies, licensing, safeguards etc.

Parties) in context of specific commitments. This flexible nature of the negotiation process has made GATS one of the least controversial areas under the umbrella of the WTO.⁷⁶¹

The above-mentioned obligations under the umbrella of GATS/WTO are discussed below.

(1) Obligations under GATS

The two types of commitments/obligations under GATS are:

(a) Unconditional General obligations

These are the obligations which are universally applicable to all sectors of services, such as MFN treatment⁷⁶² and transparency. These unconditional obligations are discussed below.

(i) Most-Favored-Nation Treatment:⁷⁶³

GATS, like its counterpart in mercantile trade, GATT, states that a Contracting Party must be treated by another Contracting Party with no less favourably than any other Contracting Party.⁷⁶⁴

However, in certain situations (where specific measures are mentioned in the Annex on Article II Exemptions), GATS permits Contracting Parties to take exemption from the MFN principal.⁷⁶⁵

According to some scholars, the MFN principle can exclude some agreements which are based on mutual recognition and reciprocity. For example, the Basel Committee allows its members to ascertain the appropriateness of a foreign bank's home country regulatory system as a

⁷⁶¹Zutshi, B.K. "Services Sector Negotiations: Issues and State of Play." www.unescap.org/tid/publication/chap4_2278.pdf at p44.

⁷⁶² MFN treatment has some exceptions as mentioned in the Annex on Article II Exemptions. However, the exemptions are subject to a 5 year periodical review by the Council for Trade in Services.

⁷⁶³ See generally, Horn, Henrik & Mavroidis, Petros C., 2001. "Economic and legal aspects of the Most-Favored-Nation clause," *European Journal of Political Economy*, Elsevier, vol. 17(2), pages 233-279.

⁷⁶⁴ Article II of the GATS.

⁷⁶⁵ Annex On Article II Exemptions. However, the exemptions are subject to a 5 year periodical review by the Council for Trade in Services. Moreover, the right (MFN) was given but it was limited to the first round only and now only when a new country becomes a Contracting Party, it can negotiate the MFN principal with other already existing Contracting Parties, as a part of the accession package.

requirement for permitting it to work in the host country's markets. Thus, there is a possibility that the Basel Committee's principles of supervision might conflict the home-host country's measures with those of the MFN principle.⁷⁶⁶ However, this viewpoint is countered by the argument that all the above-mentioned measures are part of the prudential carve-out under the Annex of Financial Services.⁷⁶⁷

(ii) Transparency:

One of the main hurdles for conducting business in a foreign jurisdiction is the deficiency of information regarding relevant laws and regulations in that jurisdiction. Especially in the financial services trade, domestic regulation acts as the main barrier.⁷⁶⁸ GATS has tried to solve this problem by making transparency an unconditional obligation. Article III and Article III bis⁷⁶⁹ of GATS deals with this issue.

According to this obligation, all measures taken by the Contracting Parties in relation to the services sectors ought to be published or otherwise made publicly accessible. Further, all the aforesaid measures must be notified to the WTO authority concerned (in the case of services, the Services Council is the competent authority). In addition, the Contracting Parties (who may have taken some measures affecting the operation of GATS) ought to make sure that they respond to

⁷⁶⁶ The example and the discussion are taken from the Alexander, Kern (2008). *The GATS and Financial Services: Liberalisation and Regulation in Global Financial Markets*, in Andenas, Mads and Kern, Alexander (eds). *The World Trade Organisation and Trade in Services*. Leiden: Martinus Nijhoff Publishers, 2008. P573. Also see, Marchetti, Juan (2003) 'What Should Financial Regulators Know About the GATS?', unpublished paper for the World Trade Organisation. As cited by Kern Alexander. Moreover, for a good discussion about the GATS and transparency, see generally, Alexander, Kern (2007) "The GATS and financial services: the role of regulatory transparency." *Cambridge Review of International Affairs*, 20(1): 111-132.

⁷⁶⁷ The prudential carve-out highlights out rightly the right and ability of the governments to take prudential measures, though, prudential carve outs significantly bothers the global policy setters as it gives enormous discretion to governments do anything under the umbrella of prudential deduction. *Supra* note 733 at 561.

⁷⁶⁸ See, Keiyo, Iida and Julia Nielson (2002) *Transparency in domestic regulation: practices and possibilities* (Paris: OECD)

⁷⁶⁹ Article III deals with the unconditional obligation imposed by the GATS, however, Article III bis gives the Contracting Parties immunity from the application of Article III if the information concerned is of confidential nature.

all the queries of the other Contracting Parties in relation to that specific measure's impact on the GATS functioning (this can be done by establishing proper inquiry points).⁷⁷⁰

(b) General Obligations

These obligations are an important part of the GATS structure. Some of the general obligations which have more relevance to the financial services sector are discussed below.

(i) Domestic Regulation:

GATS has given leverage to the Contracting Parties to formulate their domestic regulations in relation to the services sector (including financial services). However, Article VI of GATS places limitations on the exercise of power and requires the Contracting Parties to take reasonable, objective, and impartial measures (in this case, in formulating domestic regulations). The idea behind this obligation is that domestic regulations should not be used by the Contracting Parties for the purpose of creating unnecessary trade barriers. This implies that the "necessity test" could be useful to find out whether a Contracting Party's qualification and licensing conditions or technical standards do or do not circumvent the Contracting Parties obligations.⁷⁷¹

For example, in a Dispute Settlement case under the WTO, *US: Measures Affecting the Cross-Border Supply of Gambling and Betting Services* (WTO Dispute DS285), Antigua alleged that the US measures⁷⁷² affecting the cross-border supply of gambling and betting services were inconsistent with GATS Articles VI:1 and VI:3 (relating to domestic regulations). However, the

⁷⁷⁰ GATS Article III (4)

⁷⁷¹ Alexander, Kern (2008). *The GATS and Financial Services: Liberalisation and Regulation in Global Financial Markets*, in Andenas, Mads and Kern, Alexander (eds). *The World Trade Organisation and Trade in Services*. Leiden: Martinus Nijhoff Publishers, 2008. P579.

⁷⁷² According to the US measures under dispute were taken in the light of the three US federal criminal statutes, known as the Wire Act, the Travel Act and the Illegal Gambling Business Act. [United States first written submission, para. 43; second written submission, para. 25.]

panel decreed that the measures were not inconsistent with Article VI of GATS and did not create any unnecessary barriers to trade.

However, if any services supplier is unsatisfied with a domestic regulation (which has resulted in some sort of licensing or qualification requirement), and thinks that the domestic regulation concerned is a discretionary and purposeful obstacle to trade, then, in that case, the services supplier has been given the right under Article VI of GATS to question the domestic regulator about the status of his application to obtain license, or ask for the justification for its rejection. In addition, if the service supplier is still unsatisfied, then the host Contracting Parties are required to provide a transparent administrative appeal process to that service supplier.⁷⁷³

Therefore, domestic regulations can be made in the context of financial services but they need to meet the criteria mentioned above. Moreover, the dissatisfied financial services supplier can pursue a transparent administrative appeal process.

(ii) Payments and Transfers

The purpose of GATS' multilateral trade liberalization in the services sector can only be realised if the associated international transfers and payments are allowed.⁷⁷⁴ Moreover, international transfers and payments are also dealt with by the IMF. GATS Article XI (read with Article XII)

⁷⁷³Article VI:2 (a) of GATS states that, "Each Member shall maintain or institute as soon as practicable judicial, arbitral or administrative tribunals or procedures which provide, at the request of an affected service supplier, for the prompt review of, and where justified, appropriate remedies for, administrative decisions affecting trade in services. Where such procedures are not independent of the agency entrusted with the administrative decision concerned, the Member shall ensure that the procedures in fact provide for an objective and impartial review." See also, Pierre Sauve (2001), *Open Services Markets Matter*, p10. Available at: www.cid.harvard.edu/cidtrade/Papers/Sauve/OSMMRSCRev1.doc

⁷⁷⁴ Lehmann, Alexander; Tamirisa, Natalia T.; Wieczorek, Jaroslaw (2003), *International Trade in Services: Implications for the Fund*, IMF Policy Discussion Paper No. 03/6, p3.

liberalises international transfers and payments and also simultaneously recognises the role of the IMF in this context.⁷⁷⁵

The wording of Article XI is relatively intricate; it states that “A member shall not apply restrictions on international transfers and payments for (current as well as capital) transactions relating to specific commitments unless (i) restrictions are applied to safeguard the balance of payments in accordance with Article XII GATS,⁷⁷⁶ (ii) in case a general exception applies in accordance with Article XIV and XIV bis GATS,⁷⁷⁷ (iii) in case an exception applies in accordance with para. 2 (a) of the Annex on Financial Services,⁷⁷⁸ (iv) in the case of current transactions, if consistent with the rights and obligations of the members of the IMF under the IMF Agreement,⁷⁷⁹ or (v), in the case of capital transactions, at the request of the IMF⁷⁸⁰”.⁷⁸¹

In short, as a general rule, GATS prohibits any restriction on international transfers and payments but allows restrictions in such circumstances as those discussed above. The next obligation relevant to the context of financial services deals with the restriction to safeguard the balance of payments and is discussed below.

⁷⁷⁵ Zapatero, Pablo. 2006. Searching for Coherence in Global Economic Policymaking. Penn State. International Law Review 24 (3): 595-627, p595 and p600.

⁷⁷⁶ Also see, Wolfrum, Rudiger; Peter-Tobias Stoll & Clemens Feinäugle eds. (2008), WTO-Trade in Services, Max Planck Commentaries on World Trade Law, p261.

⁷⁷⁷ Ibid p289, 329.

⁷⁷⁸ Also see, Wolfrum, Rudiger; Peter-Tobias Stoll & Clemens Feinäugle eds. (2008), WTO-Trade in Services, Max Planck Commentaries on World Trade Law, p618. Also see, Lehmann, Alexander; Tamirisa, Natalia T.; Wiczorek, Jaroslaw (2003), International Trade in Services: Implications for the Fund, IMF Policy Discussion Paper No. 03/6, p9, 19, 21.

⁷⁷⁹ Siegel, D.E. (2002), Legal Aspects of the IMF/WTO Relationship: The Fund's ... and the WTO Agreements, 96 American Journal of International Law, p.561, 584.

⁷⁸⁰ See, Lehmann, Alexander; Tamirisa, Natalia T.; Wiczorek, Jaroslaw (2003), International Trade in Services: Implications for the Fund, IMF Policy Discussion Paper No. 03/6, p19,

⁷⁸¹ Footer, Mary E. and Carol George (2005), The General Agreement on Trade in Services, in Macrory, P.F.J./Appleton, A.E./Plummer, M.G. (eds.): The World Trade Organisation: Legal, Economic and Political Analysis, New York: Springer 2005, pp799, 842. Also see, Wolfrum, Rudiger; Peter-Tobias Stoll & Clemens Feinäugle eds. (2008), WTO-Trade in Services, Max Planck Commentaries on World Trade Law, p246,249,253.

(iii) Restrictions to Safeguard the Balance of
Payments

Article XII deals with restrictions to safeguard the balance of payments. According to this article, Contracting Parties are permitted, under certain circumstances, to limit trade in services so as to safeguard their balance of payments and external financial position. Balance of payments comprises two main elements. The first component is the capital account which records the net result of public and private investment flowing in and out of the country. The second component is the current account which portrays the country's overall balance on goods and services, and also net income such as interests and dividends and net transfer payments.⁷⁸² A country's balance of payments may therefore be damaged either by a deficit in capital or by a current account in which the overall outflows are more than the inflows. In such a scenario, the Contracting Parties have permission to take measures in order to solve their balance of payment and external financial problems. The solution commonly involves actions which try to improve the affected country's current account by reducing imports and/or increasing exports, with the consequential negative cost on free trade.⁷⁸³

Balance of payment restrictions equate to a contingency plan in cases where a Contracting Party is suffering from BOP difficulties. BOP difficulties have an adverse effect on the financial sector of any country. It can also lead to crisis which is why BOP restrictions entail significant involvement of the IMF. The sooner the BOP conditions improve, the better it is for the financial sector. Therefore, GATS tries to tackle BOP issues, but with heavy involvement of the IMF.

⁷⁸² Lowenfeld, Andreas F. (2003). *International Economic Law*, Oxford University Press, p15-17.

⁷⁸³ See, Wolfrum, Rudiger; Peter-Tobias Stoll & Clemens Feinaugle eds. (2008), *WTO-Trade in Services*, Max Planck Commentaries on World Trade Law, p259.

Other obligations take account of the recognition of qualifications and criteria, monopolies' and exclusive services providers' measures in the services sector, business practices and competition, and general exceptions (similar to those incorporated in GATT).

(c) Conditional Obligations (Specific commitments):

A specific commitment is an obligation that a Contracting Party makes in the context of market access and National Treatment to a specific services sector (including the sub-sectors). All the specific commitments are put forward by the Contracting Parties in the form of a list (schedule) and only the services sector is subject to specific commitments which are listed in the schedule (positive list approach). Almost all the Contracting Parties have made horizontal commitments⁷⁸⁴, in which an obligation extends to all sectors.

Provided that the Contracting Party has not made any sort of reservation in respect of a schedule of specific commitments, the Contracting Party is fully obligated by the principles of market access and National Treatment. So, if a Contracting Party is unable or unwilling to stick to the principles of market access and National Treatment, it can make reservation in that respect. For instance, a Contracting Party wants to limit the number of foreign companies in its market (allowing the free flow of companies is one of the six elements of market access⁷⁸⁵), but has no concerns regarding the other five market access elements. In that case, the Contracting Party has

⁷⁸⁴ Horizontal commitment is the commitment in which obligations are applicable across all the sectors. They are guiding principles which are to apply throughout all members and are set out in Part II. The major horizontal commitments include MFN treatment, transparency and the enhanced involvement of developing countries.

⁷⁸⁵ Article XVI: 2 of GATS. See footnote 749

to make reservation to complete the market access principle. The reservations are applied in respect of each of the four modes of service supply concerned.

It has been identified by some scholars that actual practice and commitment made in the context of the financial sector under GATS is highly divergent. This aspect of the application of the commitments falls under the other institutional role of the WTO in its executive functioning which will be discussed later in this chapter.⁷⁸⁶

In connection with this, the following section discusses the principles of National Treatment and market access for a better understanding of GATS' normative functioning.

(i) National Treatment:

National Treatment means that a Contracting Party must apply the same type of treatment to other Contracting Parties and should not discriminate between foreign and local services or services suppliers. A typical example of a measure amounting to an infringement of the principle of National Treatment is when a local country, despite treating foreign and local services identically, changes the conditions for the competition in benefit of the local country's services and service suppliers.

As mentioned above, if a Contracting Party uses a specific commitment of exempting itself from the National Treatment obligation regarding a specific services sector or sub-sector, then it is perfectly legal to do so. In a WTO DSU case, *US: Measures Affecting the Cross-Border Supply of Gambling and Betting Services* (WTO Dispute DS285), Antigua and Barbuda alleged that US measures⁷⁸⁷ affecting the cross-border supply of gambling and betting services were inconsistent

⁷⁸⁶ Barth J., Marchetti J., Nolle D. and Sawanggoenyuang W. (2006), "Foreign.Banking: Do Countries' WTO Commitments Match Actual Practice?", WTO Working Paper (Economic Research and Statistics Division).

⁷⁸⁷ See footnote no 772

with the National Treatment commitments of the US under Article XVII of GATS. However, Antigua and Barbuda could not demonstrate that the US' above-mentioned measures were inconsistent with its commitment under GATS and moreover, the Panel exercised judicial economy regarding the US measures and National Treatment commitment's consistency.⁷⁸⁸

(ii) Market access:

A specific commitment in respect of market access is invoked if any measure places a limitation on access to a freer market. The measures which result in limiting market access are mentioned in the definition of market access, and they are: "limitations on the number of service suppliers; limitations on the total value of service transactions or assets; limitations on the total number of service operations or on the total quantity of service outputs; limitations on the total number of natural persons that may be employed in a particular service sector or where a service supplier may employ measures which restrict or require specific types of legal entity or joint venture; limitations on the participation of foreign capital."⁷⁸⁹

In a WTO DSU case, *US: Measures Affecting the Cross-Border Supply of Gambling and Betting Services* (WTO Dispute DS285), Antigua and Barbuda alleged that US measures⁷⁹⁰ affecting the cross-border supply of gambling and betting services affected the market access conditions under Article XVI of GATS. The Panel and the Appellate Body were satisfied with Antigua and Barbuda's demonstration and held that the measures taken by the US in the context of the cross-border supply of gambling and betting services were inconsistent with GATS Articles XVI:1 and

⁷⁸⁸ See generally, Thayer, James D., (2004). *The Trade of Cross-Border. Gambling and Betting: The WTO Dispute Between Antigua and the United States*, DUKE L. & TECH. REV.

⁷⁸⁹ Article XVI: 2 of GATS. See footnote 749

⁷⁹⁰ See footnote no 772

XVI: 2(a) and 2(c), as these measures were not covered by the exemptions (Article XIV of GATS) of market access in the national schedule of commitment.⁷⁹¹

Additional commitments are any commitments that are not covered by the provisions of market access and National Treatment. They commonly take into account non-discriminatory domestic regulations, particularly those relating to licensing and qualification matters.⁷⁹² The most prominent example of an additional commitment is the Understanding on Commitments in Financial Services.⁷⁹³

The agreement part of the GATS structure is simple and can be understood just as any other international trade agreement. However, the second part of GATS, which comprises the national schedules of commitments by all the Contracting Parties, is a comparatively more complicated document than the tariff schedule lists under GATT⁷⁹⁴. The national schedule of commitments is a Vertical commitment⁷⁹⁵ which only applies to sectors where a government has scheduled commitments in respect of Market Access and National Treatment and can be better explained with the help of an illustration (Pakistan's vertical commitment in the Financial Services sub-sector, Banking Services).

⁷⁹¹ Original Panel report, paras. 6.421 and 7.2(b)(i); Appellate Body report, para. 373(C)(ii). See also, supra note 788

⁷⁹² Article XVIII; deal with additional commitments under GATS.

⁷⁹³ Understanding on commitments in financial services is discussed in the later part of this chapter VIII.A.2.c) on page 300

⁷⁹⁴ The national schedule of commitments under GATS is a reasonably complex document as compared to schedule of tariff under the GATT. The tariff schedule under GATT, is very simple which lists one tariff rate per product, whereas, a national schedule of commitments comprise of at minimum eight entries per sector (that is national treatment and market access commitments for each of the four modes of supply). [http://www.wto.org/english/tratop_e/serv_e/cbt_course_e/c2s6p1_e.htm]

⁷⁹⁵ The vertical commitments apply to those services sectors or sub-sectors, which a government has chosen to open up for competition. Each government must provide a schedule of commitments, that is, which sector it will open up and when: however, there are no minimum requirements as to how extensive the schedule should be. For the vertical commitments the National Treatment principle (Article XVII) and Market Access (Article XVI) is of particular importance. These commitments are made on an exclusive basis so that they only apply to the extent a member chooses and specifies in its schedule. This is an 'opt-in' procedure. [Kennedy, Matthew. (1995). "Services join GATT: an analysis of the General Agreement on Trade in Services." International Trade Law & Regulation.]

Table 9

Sector (or sub sector)	Limitations on Market Access	Limitations on National Treatment	Additional Commitments
Banking Services: ⁷⁹⁶ The following: 1. Acceptance of deposits and other repayable funds from the public. (CPC No.81116 ⁷⁹⁷) 2. Lending of Consumer credit, mortgage credit, and financing of commercial transactions.	Mode (1) Unbound, Mode (2) Unbound, Mode (3) R3 ⁷⁹⁸ , Mode (4) None	Mode (1) Unbound, Mode (2) Unbound, Mode (3) Unbound, Mode (4) None	

The above table/chart shows the Banking Services schedule of Pakistan. It displays the four-column format. The first column indicates the sector or sub-sector concerned, whilst the second column specifies any limitations on market access that fall within the six types of restrictions mentioned in Article XVI:2⁷⁹⁹ of GATS. The third column includes any limitations that Pakistan wishes to impose on National Treatment under Article XVII⁸⁰⁰ of GATS, and in the last column,

⁷⁹⁶ The entries under market access or national treatment may lay within a range with one ends with full commitments without limitation (“none”) and on the other end complete freedom to take any measure falling under the Article concerned (“unbound”). Available at: http://www.wto.int/english/tratop_e/serv_e/guide1_e.htm

⁷⁹⁷ United Nations provisional Central Product Classification (CPC) Available at: <http://unstats.un.org/unsd/cr/registry/regcst.asp?Cl=9&Lg=1>

⁷⁹⁸ R3 : Subject to economic needs test and approval of Corporate law Authority of Pakistan, the central bank may grant licenses for establishment of locally incorporated subsidiaries. – Maximum share holding of a foreign financial institution in the local subsidiary not to exceed 30%. – Permission of the central bank required for investment in shares of a banking company in excess of 4% of paid up capital of the local company. [Dr. Mushtaq Ahmad, Pakistan And The GATS: An Assessment Of Policies And Future Prospects. Available at: <http://siteresources.worldbank.org/INTRANETTRADE/Resources/Ahmad.pdf>]

⁷⁹⁹ All Contracting Parties have full access to the other Contracting Parties’ markets. However, a contacting Party may impose perfectly legitimate limitation on market access in the light of Article XVI of GATS. Also see footnote ⁷⁴⁹

Pakistan can undertake any additional commitments under Article XVIII⁸⁰¹ (in this case, Pakistan has not undertaken any additional commitments, therefore the column is empty).

The specific commitments with their normative impact enhance certainty and predictability within the financial sector of a given Contracting Party, which further leads to the development of the financial sector of the domestic economy. Moreover, the cumulative effect of the development of individual financial sectors results in the development of the global financial sector.

2. Framework Agreements

One of the main elements of the GATS structure is its Annexes which cover different area of the services sector, such as movement of natural persons, air transport services, telecommunications, and financial services, amongst others. These annexes are applicable unconditionally to all Contracting Parties. However, this thesis will limit its scope to the Annexes which have some relevance to financial sector development.

a) Annex on Financial Services:

As is clear from its name, this annex is created by the Contracting Parties to deal with issues relating to the supply of financial services. As financial services are considered highly critical to the stability of any economy, it is the first sector affected by financial instability, and therefore it requires special treatment.⁸⁰² Financial services are defined in paragraph 5 (a) of this annex as:

⁸⁰⁰ The National Treatment clauses under GATS Article XVII, a Contracting Party can put some limitations on the other Contracting Parties and give favorable and different treatment to its own services suppliers. Also see footnote 750

⁸⁰¹ Article VXIII of the GATS: “Members may negotiate commitments with respect to measures affecting trade in services not subject to scheduling under Articles XVI or XVII, including those regarding qualifications, standards or licensing matters. Such commitments shall be inscribed in a Member's Schedule.”

“A financial service is any service of a financial nature offered by a financial service supplier of a Member. Financial services include all insurance and insurance-related services, and all banking and other financial services (excluding insurance).”

The scope of this annex is discussed in Paragraph 1(a), which explicitly excludes services supplied by governmental authorities in their non-commercial capacity. Further, paragraph 6 of this annex clearly excludes all public entities from the scope of this annex and defines “financial services supplier,” as a public entity if it acts as a “government, a central bank, or a monetary authority” carrying out governmental functions, but not including those entities carrying out financial services on commercial bases, or any private body that carries out those same functions. Similarly, by inference, private entities carrying out the same responsibilities as central banks are regarded as public entities and thus not subject to the disciplines of GATS [Paragraph 5(c) of the GATS Annex on Financial Services].

This annex not only defines financial services but also provides rules and parameters to the contracting parties to take prudential measures in order to protect their investors, depositors and insurance policy holders, and to ensure the integrity and stability of the financial system.⁸⁰³

Paragraph 2 (a) of the Annex on Financial Services gives the contracting parties absolute power to take prudential measures.

“Notwithstanding any other provision of the Agreement, a member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policyholders, 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. Where such measures do not conform with the provisions of the Agreement, they shall not be used

⁸⁰² Supra note 195, Also see Alexander, K. (2003). *The World Trade Organisation and Financial Stability: The Balance between Liberalisation and Regulation in the GATS*. Cambridge Endowment for Research in Finance Cambridge University.

⁸⁰³ Paragraph 2(a) of the GATS Annex on Financial Services.

as a means of avoiding the Member's commitments or obligations under the Agreement."⁸⁰⁴

Without doubt, these prudential measures, which are frequently mentioned to as "*prudential carve-out*", have been a major point of debate for all negotiators and scholars. The main reason for this is that there is no limit to the application of the prudential carve-out. Having said that, the latter part of the same paragraph puts a limit on the usage of this prudential carve-out, and it may not be used as a tactic to create unnecessary hurdles for other Contracting Parties.⁸⁰⁵

There are no guiding principles for the qualification of a prudential measure and this, to some extent, undermines the concept of legal certainty under GATS in relation to financial services. Many scholars have proposed that the international best practices and standards developed by specialised international financial institutions could be used to ascertain whether a measure was really introduced for prudential reasons or whether it is an unnecessary obstacle to trade in financial services.⁸⁰⁶ However, this proposal received considerable criticism, as most of the

⁸⁰⁴GATS Annex on Financial Services, para. 2(a).

⁸⁰⁵The first sentence of paragraph 2 (a) is commonly referred as prudential carve-out which allows a Contracting Party to take prudential regulatory acts resulting in barriers in trade in financial service. [WTO Secretariat, GUIDE TO THE URUGUAY ROUND AGREEMENTS 176 (Kluwer Law International 1999).] However, the second sentence of paragraph 2 (a) puts a condition on the first sentence, that the prudential measures shall not be employed as a way to circumvent Contracting Parties' obligation under the GATS. Some scholars assert that the scope of the prudential carve-out is unclear. [Kalypso Nicolaidis and Joel Trachtman (2000) 'Policed Regulation to Managed Recognition' in P. Sauve & R.M. Stern, eds., GATS 2000 (Washington DC: Brookings Institute)(arguing that '[t]he scope of this "prudential carve-out" is unclear') p. 255.] For further detailed discussion about prudential carve-outs see, Kern Alexander, THE WORLD TRADE ORGANISATION AND FINANCIAL STABILITY: The Balance between Liberalisation and Regulation in the GATS. Cambridge Endowment for Research in Finance Cambridge University.

⁸⁰⁶See WTO Doc. S/CSS/W/71, Communication from Switzerland (that prudential regulation should be interpreted according standards set by international bodies, ie. Basel Committee), and WTO Doc.S/CSS/W/27, Communication from United States (that GATS obligations and commitments should not prejudice a member's prudential regulatory discretion). Moreover, role of the GATS in context of financial regulation is to make sure that the domestic regulations are reasonable, transparent, objective and impartial and is essential to guarantee standard of financial services in their countries. Necessity Test is not part of the prudential carve-out that is the Contracting Parties are not obliged to give clarification for the use of these regulations. See, Alexander, Kern (2008). The GATS and Financial Services: Liberalisation and Regulation in Global Financial Markets, in Andenas, Mads and Kern, Alexander (eds). The World Trade Organisation and Trade in Services. Leiden: Martinus Nijhoff Publishers, 2008, p562.

standard-setting institutions, such as the Basel Committee, lack legitimacy and accountability because their decision-making procedure involves few rich countries.⁸⁰⁷

Paragraph 3 of the Annex on Financial Services propagates the enhanced harmonization of the measures pertaining to prudential carve-outs by negotiation and acknowledging other contracting parties prudential regulatory standards. In this way, the members will tie, each others practices, to some extent, by referring to mutually-acknowledged regulatory practices. Moreover, paragraph 3(b) encourages contracting parties to make bilateral and multilateral pacts or any other method that would look like a prudential carve-out through the eyes of mutually-recognised minimum regulatory standards and practices.

In the case of any dispute between contracting parties about a prudential measure or any other issue related to the financial services sector or trade, the issue is to be referred to the DSU of the WTO. However, this annex requires the selected members of the DSB to be experts in the area of financial services matters.⁸⁰⁸

Finally, the Financial Services Annex contains a detailed list of definitions in its paragraph 5, which serves as the nomenclature for the purpose of making schedules of financial services commitments.

In short, the Annex on Financial Services, which is an integral part of the GATS agreement, is an effective contribution by the WTO as an international economic organisation in its normative capacity. This annex enhances certainty in the financial services trade sector by defining financial services, providing guidance to the Contracting Parties to set some sort of standards and

⁸⁰⁷ See, Alexander, K. (2003). *The World Trade Organisation and Financial Stability: The Balance between Liberalisation and Regulation in the GATS*. Cambridge Endowment for Research in Finance Cambridge University.

⁸⁰⁸ Paragraph 4 of the GATS Annex on Financial Services.

in the case of dispute, making it compulsory for the DSB to take expert advice in connection with disputes related to the financial services trade. The following subheading relates to the Understanding on the commitments in financial services. It is not applicable to all WTO members, only those who have signed it, however, almost all the developed countries have signed, making it applicable to most of the global financial sector.

b) *Second Annex on Financial Services*

The Second Annex on Financial Services only deals with the procedure for further negotiations on financial services commitments, leading to the 1995 interim agreement (Second Protocol). Nowadays, this annex has historical status only.

c) *Understanding on commitments in financial services*⁸⁰⁹

The Understanding on Commitments in Financial Services (hereinafter “Understanding”) is a document binding on those members who have signed it. This document is incorporated in the GATS list of the schedule of commitments in the form of additional commitments. Those Contracting Parties who have bound themselves to further liberate their financial sector have made reference to the Understanding as a cross-reference in the specific schedule of commitments. Under the Understanding, Contracting Parties take up advanced and more vigorous set of market access and National Treatment commitments that allow non-discriminatory access to financial services providers from the rest of the Contracting Parties of the WTO.⁸¹⁰ Thirty-one WTO members (counting the EU as one member) have taken up the Understanding as an additional commitment.

⁸⁰⁹http://www.wto.org/english/tratop_e/serv_e/21-fin_e.htm# Article

⁸¹⁰The Understanding It is an optional document and is part of additional commitments See text of the Understanding on commitments in financial services at: http://www.wto.org/english/tratop_e/serv_e/21-fin_e.htm#

The total global economic share of the financial services trade in 2009 was more than 607.3 Billion USD⁸¹¹ and most of it is taken up by developed nations who have bound themselves to additional commitments under GATS via the Understanding. Therefore the effect of the Understanding on the global financial sector is enormous. As the Understanding is an additional commitment, some of the important clauses of the Understanding are discussed below, and as an integral part of the GATS/WTO agreements, it has a significant normative effect on the global financial sector.

Paragraph B (1) of the Understanding is related to monopoly rights. This paragraph is an addition to Article VIII of GATS, thus it serves as an additional step towards further liberalization. The purpose of this paragraph is to bind its signatories over and above their ordinary commitment under GATS Agreement, that is, to list in their schedule the existing monopoly rights and opt for ways to abolish it or curtail its scope.

Paragraph B (2) of the Understanding is concerned with granting MFN and National Treatment to the financial services providers of other Contracting Parties in relation to the sale or purchase of financial services by public bodies of other Contracting Parties.

Paragraph B (3) and Paragraph (4) of the Understanding binds its signatories to give National Treatment and allow non-resident financial services suppliers of the other Contracting Parties to

⁸¹¹Insurance exports 77200 Million USD +Insurance imports 129465 Million USD = Total Insurance related trade (1) 206.665 Billion USD
Financial Services exports 284635 Million USD + Financial Services imports 115985 Million USD = Total Financial Services related trade (2) 400.62 Billion USD
Total Financial Services trade of 15 big economies is (1) + (2) = 607.285 Billion USD
World Trade Organisation, International Trade Statistics 2010, page 145. Available at:http://www.wto.org/english/res_e/statis_e/its2010_e/its10_trade_category_e.pdf

supply their services as a principle (as an intermediary or via an intermediary) in the area of insurance-related services⁸¹² and allow its residents to purchase those services.

Paragraph B (5) of the understanding binds its signatories to allow extensive commercial presence (established or expanding or acquisition) of financial services providers from other Contracting Parties in their territories. Moreover, these financial services suppliers can introduce any new type of financial services (under Paragraph B (7)). This clause has been quite effective in the financial liberalization process.

Paragraph B (8) of the Understanding obliges its signatories not to avert the transfer or processing of financial information (which includes electronic transfer plus its equipment). However, signatories have full freedom to assure data protection.

Paragraph B (9) of the Understanding obliges its signatories to allow the temporary physical entry of the representatives of financial service suppliers to establish their commercial presence in their country.

Paragraph B (10) of the Understanding obliges its signatories to do their level best to abolish or curtail any non-discriminatory measures related to those activities mentioned in the subparagraphs of Paragraph B (10) relating to financial services supply.

⁸¹²B (3) of the Understanding: “Each Member shall permit non-resident suppliers of financial services to supply, as a principal, through an intermediary or as an intermediary, and under terms and conditions that accord national treatment, the following services:- (a) insurance of risks relating to: (i) maritime shipping and commercial aviation and space launching and freight (including satellites), with such insurance to cover any or all of the following: the goods being transported, the vehicle transporting the goods and any liability arising therefrom; and (ii) goods in international transit; (b) reinsurance and retrocession and the services auxiliary to insurance as referred to in subparagraph 5(a)(iv) of the Annex; (c) provision and transfer of financial information and financial data processing as referred to in subparagraph 5(a)(xv) of the Annex and advisory and other auxiliary services, excluding intermediation, relating to banking and other financial services as referred to in subparagraph 5(a)(xvi) of the Annex.”

Paragraph C of the Understanding ensures the National Treatment principle in explicit situations in which a signatory cannot avoid extending National Treatment to the financial services suppliers of other Contracting Parties.

In the knowledge that the Understanding was adopted by almost all developed economies, the major proportion of the financial services trade, therefore, involves these economies only. Therefore, this impacts considerably on the global financial services trade scenario and obviously, it has a clear positive impact on the growth of the financial services sector.

d) Second Protocol to GATS⁸¹³

The second Protocol constituted the main part of the 1995 interim agreement. It only deals with specific commitments and MFN exemptions.

e) Fifth Protocol to GATS⁸¹⁴

The main importance of the Fifth Protocol is that it improved commitments in the context of market access and National Treatment, and reduced the number of MFN exemptions.⁸¹⁵

In 1997, the financial services agreement was signed.⁸¹⁶ This agreement consists of three legal documents;⁸¹⁷ first, the Fifth Protocol to GATS⁸¹⁸; second, the decision to adopt the Fifth Protocol;⁸¹⁹ and third, the Decision of December 1997 on Commitments in Financial Services.⁸²⁰

⁸¹³ WTO (1995): Second Protocol to the General Agreement on Trade in Services, WTO document no. S/L/11. Available at: http://www.wto.org/english/tratop_e/serv_e/2prote_e.htm

⁸¹⁴ WTO (1997): Fifth Protocol to the General Agreement on Trade in Services. Available at: http://www.wto.org/english/tratop_e/serv_e/5prote_e.htm

⁸¹⁵ Kampf, Roger (1998). Financial Services in the WTO: Third Time Lucky, International Trade Law and Regulation, Vol. 4 Issue 3, July 1998, Sweet & Maxwell, Oxford.

⁸¹⁶ WTO: PRESS/1928 July 1995 Financial services agreement confirmed: Statement by Chairman. Available at: http://www.wto.org/english/news_e/pres95_e/addpr2.htm

⁸¹⁷ Wang, Wei (2005). National Treatment in Financial Services in the Context of the Gats/WTO, in Norton, Joseph J. and Christos Hadjiemmanuil (editors), Global financial sector development. British Institute of International and Comparative Law.

⁸¹⁸ WTO Document: S/L/45

So far, the above discussion has highlighted the WTO as an IEI which has played a significant role, in its normative capacity, in the development of the global financial sector. However, this role is not only limited to hard law binding commitments but has considerable influence on the development of soft law related to the development of the financial sector. The following part will focus on the soft law-making process in the area of the financial sector by the WTO, through its Committee on the Financial Services. This process is part of the legislative functioning of the WTO.

3. Soft law making process by the Committee on Trade in Financial Services and decisions of different WTO bodies

The Committee on Trade in Financial Services (hereinafter Financial Services Committee or FSC) is one of the subsidiary committees of the Council for Trade in Services⁸²¹, which is itself a subsidiary body of the General Council of the WTO. Right after the inception of the WTO Agreement in 1995, the Council for Trade in Services created the FSC in its decision regarding institutional design and the effective application of GATS and other financial services trade-related commitments.⁸²²

The Council for Trade in Services has the mandate to create any subsidiary body through its institutional decisions. This mandate is give to the Council for Trade in Services under Article XXIV of GATS.⁸²³ GATS has given the Council for Trade in Services the authority to establish

⁸¹⁹ WTO Document: S/L/44

⁸²⁰ WTO Document: S/L/50

⁸²¹ Other subsidiary committees are committee on specific commitments and working parties on GATS rules. Detail about the council for trade in services and its committees is available at: http://www.wto.org/english/tratop_e/serv_e/s_coun_e.htm#decision

⁸²² WTO: Decision on Institutional Arrangements for the General Agreement on Trade in Services. Decision no. S/L/1, 4 April 1995, para. 3.

⁸²³ Article XXIV of GATS: 1) The Council for Trade in Services shall carry out such functions as may be assigned to it to facilitate the operation of this Agreement and further its objectives. The Council may establish such subsidiary bodies as it considers appropriate for the effective discharge of its functions. 2) The Council and, unless

subsidiary bodies and assign them with tasks. In this connection, the Council for Trade in Services passed the institutional decision which created the FSC.⁸²⁴ According to the mandate, the Council for Trade in Services can expand the functioning of the FSC by giving it the task of standard-setting and application; alternatively, it could also create a new subsidiary body to accomplish the above-said task.

Paragraph 3 of the decision on institutional arrangements⁸²⁵ created the FSC and laid out its mandate in paragraph 2, which comprises a list of tasks in addition to any other responsibilities that the Council for Trade in Services may decide upon. The decision on institutional design clearly leaves the FSC's mandate open for any future "responsibilities assigned to it by the Council for Trade in Services." The list of the current responsibilities of the FSC is discussed in the latter part of this chapter.⁸²⁶

One of the main functions of the FSC⁸²⁷ is to act as a forum for the discussion and exchange of views between national finance ministers and experts in the context of the regulations which relate to the financial services sector. This approach of involving financial experts is new to the GATS system because originally GATS/WTO engaged trade negotiators and representatives.⁸²⁸ The reason for involving the financial representatives of the Contracting Parties is that the

the Council decides otherwise, its subsidiary bodies shall be open to participation by representatives of all Members.
3) The Chairman of the Council shall be elected by the Members.

⁸²⁴ WTO: Decision on Institutional Arrangements for the General Agreement on Trade in Services. Decision no. S/L/1, 4 April 1995.

⁸²⁵ WTO: Decision on Institutional Arrangements for the General Agreement on Trade in Services. Decision no. S/L/1, 4 April 1995.

⁸²⁶ Chapter VIII.B on page no 310.

⁸²⁷ Other important function is to act as a monitoring body, overseeing both the implementation of legal commitments under the relevant Protocols and the specific progress of China under the Protocol on the Accession of the People's Republic of China. [WT/L/432, 23 November 2001, Section 18.]

⁸²⁸ For a detailed discussion on the functioning of the FSC, see Windsor, Joseph (2008). The WTO Committee on Trade in Financial Services: The Exercise of Public Authority within an Informational Forum. Special Issue: Public Authority & International Institutions in German Law Journal Vol. 09 No. 11.

financial sector is critical to international trade; the central nervous system of the international trade, in effect.⁸²⁹

As mentioned above, the FSC's main activities (which are of some importance) involve the sharing and explanation of financial regulatory information with the financial experts of the Contracting Parties.⁸³⁰ The Council for Trade in Services has given the FSC substantial scope⁸³¹ which enables the FSC to act as a forum for technical discussion. Mainly, the FSC provides a forum for the clarification of GATS and its related documents in the financial sector, to the advantage of developing countries.

In addition, to some extent, the FSC acts as a forum for standard-setting and notice-and-comment rulemaking.⁸³² The FSC does not take it as its main function (although the Institutional Decision document does not explicitly prohibit the FSC in this context) but it performs a considerable role in its facilitation through the networking of soft law-making throughout the well-regulated financial sector.⁸³³

⁸²⁹Peter Morrison, *The Liberalisation of Trade in Financial Services and the General Agreement on Trade in Services*, 5 SINGAPORE JOURNAL OF INTERNATIONAL & COMPARATIVE LAW 593, 593 (2001); J. Steven Jarreau, *Interpreting the General Agreement on Trade in Services and the WTO Instruments Relevant to the International Trade of Financial Services*, 25 NORTH CAROLINA JOURNAL OF INTERNATIONAL LAW & COMMERCIAL REGULATION 1, 8 (1999).

⁸³⁰See Schmidt-Aßmann, in this issue ("Here, even more than in national administrative law, it holds true: administrative law is first and foremost law on the administration of information!"); Daniel C. Esty, *Good Governance at the Supranational Scale*, 115 YALE LAW JOURNAL 1490, 1533 (2006).

⁸³¹ WTO: Decision on Institutional Arrangements for the General Agreement on Trade in Services. Decision no. S/L/1, 4 April 1995

⁸³² In BLACK'S LAW DICTIONARY 1358 (Bryan A. Garner, Editor in Chief, 8th ed., 2004) informal rulemaking is defined as: Agency rulemaking in which the agency publishes a proposed regulation and receives public comments on the regulation, after which the regulation can take effect without the necessity of a formal hearing on the record. Informal rulemaking is the most common procedure followed by an agency in issuing its substantive rules. -- Also termed notice-and-comment rulemaking.

⁸³³ Windsor, Joseph (2008). *The WTO Committee on Trade in Financial Services: The Exercise of Public Authority within an Informational Forum*. Special Issue: Public Authority & International Institutions in German Law Journal Vol. 09 No. 11.

The FSC has some role to play in the setting of standards⁸³⁴, to some extent like Basel II or the Core Principles of the Joint Forum of the Basel Committee, the IOSCO, and the IAIS.⁸³⁵ The reason for the FSC to have a potential role in soft law creation is that it provides a forum for finance ministers and other financial experts to sit and discuss regulatory issues. These members of the committee overlap with those within the international financial community who sit on international standard-setting bodies. In other words, the FSC provides a forum for such frontline standard-setters to share regulatory issues with the other participants of the FSC. This sharing or persuasion involved regarding financial regulatory matters with less-developed countries is termed the “proselytization of minimum standards-soft law” by developed countries.⁸³⁶

Conclusively, in view of the WTO’s legislative and normative role regarding the development of the global financial sector through its provision of the certainty of the rules of the game, it is clear from the above discussion that the WTO has a legislative and normative role towards this very aspect. Not only has it hard law binding commitments in the field of the global financial sector but it also plays a limited role in the development of soft law in the same area. The overall clarity and certainty of rules in the global financial sector scenario is enhanced by the legislative and normative activities of the WTO. As discussed earlier, that certainty of the rules in any sector strengthens it, as all the players can make decisions in the light of those rules.

⁸³⁴ For a Committee debate about what role the Committee and the WTO have in standard-setting, see S/FIN/M/42, 12 November 2003, paras. 49-69. See also, Kern Alexander, the author argues that the WTO lacks institutional capacity and expertise to develop international standards. Moreover, it does not lay down parameters for the measures under prudential carve-outs; therefore, the prudential carve-outs should be understood in light of benchmarks created by other IEs. For this purpose, the WTO needs to increase its collaboration with other IEs. Alexander, Kern (2008). *The GATS and Financial Services: Liberalisation and Regulation in Global Financial Markets*, in Andenas, Mads and Kern, Alexander (eds). *The World Trade Organisation and Trade in Services*. Leiden: Martinus Nijhoff Publishers, p564.

⁸³⁵ See, *supra*, note 63; *The Joint Forum, Core Principles: Cross-sectoral Comparison* (BIS ed., 2001), available at: <http://www.bis.org/publ/joint03.pdf>.

⁸³⁶ David Zaring, *Informal Procedure, Hard and Soft*, in *International Administration*, 5 CHICAGO JOURNAL OF INTERNATIONAL LAW 547, 585-592 (2004-2005), at 583. See also *Supra* note 833

In addition, this chapter suggests that the FSC has the mandate and should expand its role in the development of the financial sector. By doing so, the FSC could assume some of the functioning of the IMF. In other words, global financial regulations could originate from a liberally institutionalized IEI rather than from a realist body.

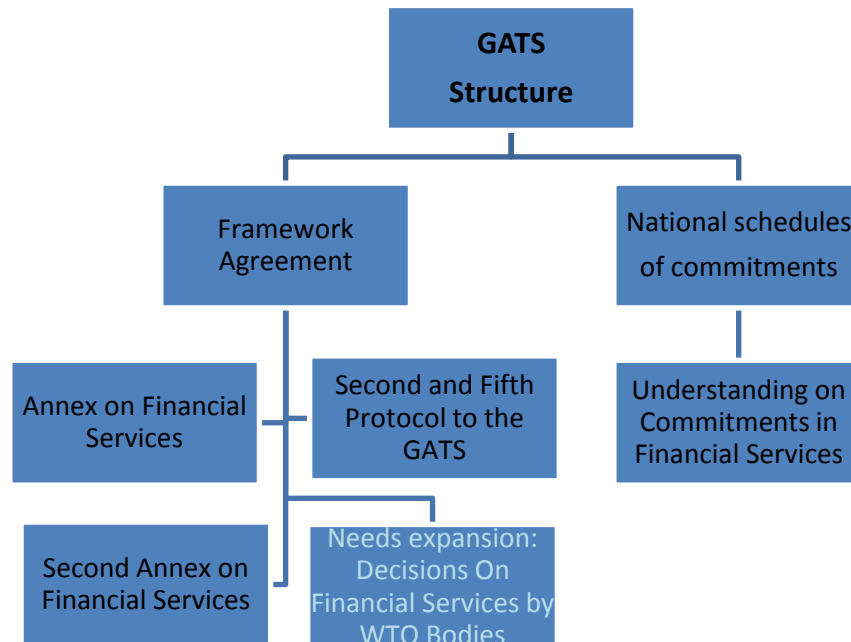
The FSC so far works on the basis of consensus; however, there are no clear rules for decision-making within the FSC. It may be that this issue has not been addressed because nobody has raised such an issue. However, the FSC has contributed substantially to the financial sector in its legislative capacities. All hard law legislative functioning by the WTO is carried out by the FSC, such as the creation of protocols (the second and fifth) and the Understanding.

In short, GATS, with its associated agreements and the results of the legislative functioning of the FSC, comprises the most influential legal documents (within the WTO framework of agreements) which affect financial sector development of the Economic Cycle. As already discussed in the theoretical framework (international economic framework), financial sector development is highly essential for a more stable and balanced growth of the global economy.

However, there is still room for the FSC to expand its function and in doing so, the FSC could take on some of the functions of the IMF, such as setting the rules of the game for the global financial sector. As the WTO is liberally institutionalized and respects democratic values, its soft laws would not bother its constituents, plus these soft laws could be made hard laws if made part of the specific commitment of individual members.

The next section examines the role played by the WTO as an IEI, in its administrative and executive capacity, in the development of the global financial sector. But before that, the comprehensive figure below illustrates the legal structure of GATS in the financial services sector.

Figure 10 GATS Legal Structure in context of Financial Services



B. Executive and administrative authority

As noted earlier in this chapter, the executive and administrative functioning of an IEI is highly critical to the effectiveness of any organisation. The real effectiveness of an IO lies in the execution and implementation of institutional acts.⁸³⁷ In case, the members are given a choice in the implementation and execution of rules of the game then there is a high possibility that members might not implement the rules of the game and thus leaving the IO completely ineffective. Hence, for the realisation of the implementation and execution of institutional acts, IOs must be given adequate executive and administrative authority.

These powers are vital for the implementation of the decisions of IOs so that they can function smoothly and achieve their goals. This aspect of the IOs' function is quite important and thus all the IOs have a proper institutional structure with an administrative arm, or Secretariat, which plays a central role in the management of the organisation and its activities. Through this institutional structure, the IOs perform their executive or administrative functions so that they can manage the realisation of institutional acts and the supervision of compliance with those acts by the members.⁸³⁸

There are no hard and fast rules regarding the authority of IOs; the way an IO oversees compliance with its rules of the game depends upon the authority awarded to it by the treaty which created it and also by subsequent practices adopted for this purpose.

The WTO, as an IO, relies heavily on its Secretariat⁸³⁹. It has 629 staff members and is headed by a Director-General. The Secretariat itself has no decision-making powers and only technically

⁸³⁷ Supra note 457

⁸³⁸ Philippe Sands and Pierre Klein (eds) (2001),. *Bowett's Law of International. Institutions*. London: Sweet & Maxwell. 5th ed. , p 297

⁸³⁹ These secretariats are considered to be a highly essential organ of IOs. For instance, the GATT secretariat was the only organ of the GATT which became part of the WTO. For detail see Article XVI (2).

and professionally assists the Contracting Parties in the different councils and committees.⁸⁴⁰ The highest level in the WTO institutional structural hierarchy is the Ministerial Conference⁸⁴¹.

The General Council comes in at the second level in the hierarchy and take three forms; the General Council⁸⁴², the Dispute Settlement Body⁸⁴³ and the Trade Policy Review Body⁸⁴⁴. The members are the same as the General Council in all three forms of the General Council, but their name changes according to the purpose for which they are meeting. For example, The General Council assembles as the Dispute Settlement Body and the Trade Policy Review Body to supervise procedures for settling disputes between the Contracting Parties and to analyse members' trade policies. All three of them are comprised of WTO members and they are answerable to the Ministerial Conference. In view of the executive and administrative authority in relation to financial sector development, the body concerned is the General Council.

The body which is third within the hierarchy of the executive and administrative functioning in the development of the financial sector (which is part of the services sector) is the Council for Trade in Services.

The Committee on Trade in Financial Services (FSC) comes at the fourth level and is a specialised body with executive and administrative authority in relation to issues regarding the

⁸⁴⁰ For an overview of the WTO Secretariat visit: http://www.wto.org/english/thewto_e/secre_e/intro_e.htm

⁸⁴¹ The Member countries take decisions through various councils and committees, which comprises of all the WTO members. Topmost in the hierarchy is the Ministerial Conference which has to meet at least once every two years. The Ministerial Conference can take decisions on all matters relating to any of the WTO constituent agreements. Available at: http://www.wto.org/english/thewto_e/minist_e/minist_e.htm

⁸⁴² The General Council is responsible for doing the day to day routine work in the absence of the Ministerial Conference and for further details about the scope and functions of the General Council visit: http://www.wto.org/english/thewto_e/gcounc_e/gcounc_e.htm

⁸⁴³ When the General Council is adjudicating disputes between WTO members, it takes the form of the DSU. For details visit: http://www.wto.org/english/tratop_e/dispu_e/dispu_e.htm

⁸⁴⁴ When the General council is reviewing the trade policies of WTO members, it takes the form of the Trade Policy Review Body. For further details visit: http://www.wto.org/english/tratop_e/tpr_e/tpr_e.htm

trade in financial services. The main function of the WTO in financial sector development is undertaken through this committee. It is very rare for the recommendations of this committee to be reversed by the Council for Trade in Services. The following section of the chapter looks at the functioning of the various WTO committees in their executive and administrative authority at different levels in the WTO hierarchy in the development of the financial sector.

1. **The Committee on Trade in Financial Services (FSC)**

The first and the most efficient body (in context of financial services trade) within the WTO institutional framework for the application of executive and administrative authority is the FSC, which was created following a decision of the Council for Trade in Services.⁸⁴⁵ This decision was taken according to Article XXIV of GATS which allows the Councils to form “[a]ny subsidiary bodies” in order to establish a working framework.⁸⁴⁶ In the light of the Decision on Institutional design, the FSC’s mandate (which is obviously in relation to the financial services sector) is as follows:⁸⁴⁷

- a) To review and continually survey the application of GATS and the Annex on Financial Services to the financial services sector;
- b) To formulate proposals or recommendations on any matter relevant to financial services;
- c) To consider proposals for amendment of the Annex on Financial Services and to make recommendations, where appropriate, to the Council for Trade in Services in this respect;

⁸⁴⁵ Decision on Institutional Arrangements for the General Agreement on Trade in Services. S/L/1, 4 April 1995, para. 3.

⁸⁴⁶ Also see Article IV:6 WTO Agreement.

⁸⁴⁷ See Supra note 833

- d) To provide a forum for technical discussion and conduct studies and examination of national measures and of the financial services sections of members' schedules of specific commitments and lists of MFN exemptions;
- e) To provide technical assistance to developing countries, whether already members or seeking membership, regarding GATS obligations in the financial services sector; and
- f) To cooperate with other subsidiary bodies under GATS or any international organisations active in the financial services sector.

In the light of the above mandate, the FSC arranges discussions on issues in connection with trade in financial services and suggests proposed solutions to the Council for Trade in Services to enable them to make an appropriate decision. Moreover, the FSC has to continually conduct reviews and carry out surveillance of the application of GATS in the field of the financial services sector, and provide an effective specialised forum to scrutinise and discuss issues relating to the regulatory developments affecting the financial services trade.⁸⁴⁸ In other words, the FSC arranges meetings and provides discussion forums for financial sector specialists and national finance ministers to discuss issues pertaining to the Contracting Parties' financial regulations. The FSC acts as a scrutinising body and it supervises both the realisation of legal obligations under the related GATS Protocols, and the improvement of China in the light of the Protocol on the Accession of the People's Republic of China.⁸⁴⁹

⁸⁴⁸http://www.wto.org/english/tratop_e/serv_e/s_coun_e.htm#decision

⁸⁴⁹ WT/L/432, 23 November 2001, Section 18.

a) FSC as a Monitoring Body

Even after the formation of GATS and the WTO, negotiations continued regarding the schedule of specific commitments by the Contracting Parties. A number of agreements were signed by the Contracting Parties in the form of Protocols to the GATS agreement; the agreements, which were made in context of the financial services sector, are the Second and Fifth Protocols. The Second Protocol has not had any legal significance post-1st July 1996;⁸⁵⁰ however, the obligations attached to GATS through the Fifth Protocol are of legal significance in the present global financial services sector.

The FSC monitors the progress made by all the Contracting Parties towards the acceptance of new financial services sector commitments under the Protocols.⁸⁵¹ Almost all the Contracting Parties have adhered to the obligations under the Fifth Protocol except Brazil, Jamaica, and the Philippines, thus the FSC is still monitoring these countries with respect to the Fifth Protocol.⁸⁵²

The FSC uses naming-and-shaming as a tool to ensure the Contracting Parties adhere to their obligations in respect to financial services.⁸⁵³

b) FSC as a Reviewing Body

On 10th November 2001, China acceded to the WTO following the decision of the Ministerial Conference, known as the Chinese Accession Protocol.⁸⁵⁴ The reason for their devising a

⁸⁵⁰In 1995 negotiations were held in WTO in context of financial services (Second Protocol) and in conclusion of these negotiations 29 Contracting Parties (taking the EU as one) upgraded their schedules of specific commitments. Those enhanced commitments were annexed to the Second Protocol to the GATS. It entered into force on 1 September 1996 except for a small number of countries which were unable to ratify internally. In April the 1997 negotiations started again so the legal importance of the Second protocol ended.http://www.wto.org/english/tratop_e/serv_e/finance_e/finance_fiback_e.htm

⁸⁵¹ Regarding the Second Protocol, see S/L/13, 24 July 1995, para. 3; regarding the Fifth Protocol, see S/L/44, 3 December 1997, para. 3.

⁸⁵²See STATUS OF ACCEPTANCES OF THE FIFTH PROTOCOL TO THE GENERAL AGREEMENT ON TRADE IN SERVICES, available at: http://www.wto.org/english/tratop_e/serv_e/finance_e/finance_status_5prot_e.htm; S/FIN/M/53, 30 November 2006, paras. 3-7.

⁸⁵³Supra note 833

separate protocol for China's accession was because several Contracting Parties raised concerns regarding the Chinese legal system's adjustability to WTO law.⁸⁵⁵ Thus, according to Section 18 of the Chinese Accession Protocol, the FSC is required to carry out a review of the finance sector of China and submit a report to the Council for Trade in Services which then reports to the General Council, regarding the application of WTO law to the Chinese trade scenario.⁸⁵⁶ The FSC is one of fifteen other subsidiary bodies who are required to carry out the Transitional Review Mechanism with regards to China.⁸⁵⁷

Paragraph 1 of Section 18 of the Chinese's Accession Protocol requires the FSC (as a specialised body of the WTO in the field of financial services) to "review, as appropriate to [its] mandate, the implementation by China of the WTO Agreement"; and China is obliged to "provide relevant information". The FSC's authority to review is quite broad and covers all legal, administrative, and regulatory domains. However, the review mechanism by the FSC simply involves monitoring and reporting; it lacks the mandate to enforce WTO law.⁸⁵⁸

⁸⁵⁴ WT/L/432, 23 November 2001. See also Xin Zhang, Implementation of the WTO Agreements, 23 NORTHWESTERN JOURNAL OF INTERNATIONAL LAW & BUSINESS 383, 408-410 (2003).

⁸⁵⁵ The main reason being China's "socialist market economy," the relatively high number of state-owned enterprises, and the one-party system. See Julia Ya Qin, WTO Regulation of Subsidies to State-owned Enterprises (SOEs) – A Critical Appraisal of the China Accession Protocol, 7 JOURNAL OF INTERNATIONAL ECONOMIC LAW 863 (2004); Zhang (note 27), at 409-410.

⁸⁵⁶ The six reports thus far have been formulaic: S/FIN/7, 25 October 2002, S/FIN/11, 4 December 2003; S/FIN/13, 26 November 2004; S/FIN/15, 23 September 2005; S/FIN/17, 30 November 2006; S/FIN/19, 14 November 2007. See also *Supra* note 833

⁸⁵⁷ Council for Trade in Goods, Council for Trade-Related Aspects of Intellectual Property Rights, Council for Trade in Services, Committees on Balance-of-Payments Restrictions, Market Access (covering also ITA), Agriculture, Sanitary and Phytosanitary Measures, Technical Barriers to Trade, Subsidies and Countervailing Measures, Anti-Dumping Measures, Customs Valuation, Rules of Origin, Import Licensing, Trade-Related Investment Measures, Safeguards, Trade in Financial Services. ACCESSION OF THE PEOPLE'S REPUBLIC OF CHINA, WTO document no: WT/L/432, 23 November 2001.

⁸⁵⁸ See William Steinberg, Monitor with No Teeth, 6 UNIVERSITY OF CALIFORNIA DAVIS BUSINESS LAW JOURNAL 2, section IV (2005). And also see, Windsor, Joseph (2008). The WTO Committee on Trade in Financial Services: The Exercise of Public Authority within an Informational Forum. Special Issue: Public Authority & International Institutions in German Law Journal Vol. 09 No. 11.

c) Decision-making in the FSC

The general decision-making practice adopted by the FSC is consensus. So far, no annual report submitted to the Council for Trade in Services provides evidence of any formal disagreement between FSC members.⁸⁵⁹ This unanimous decision-making lends considerable weight to the reports submitted to the Council for Trade in Services and due to this unanimity in the decision process, the Council for Trade in Services has never disputed the FSC's reports.⁸⁶⁰

d) Dual directional dissemination Aspects of the FSC

The FSC disseminates information related to the financial services sector on two levels. The first involves information transmission from national level to international level. It happens when the FSC acts as a forum where all the national financial representatives and experts concerned discuss issues related to the schedule of specific commitments. In this process, the Contracting Parties, of their own accord, provide relevant information at these meetings regarding their up-to-date developments in the financial services sector. A good example of the dissemination of information from national to international level is the FSC's monitoring obligations under the Fifth Protocol.⁸⁶¹

⁸⁵⁹ This has the effect that—at least from an external point of view—disagreement in the FSC is minimised, appearing only occasionally in the minutes as disagreement expressed during meetings but not as formal nays. Indeed, nothing like voting is apparent from the Committee's documents. Members are thus able to record objections and express concerns in the Committee's documents—even apparently anonymously. One example can be seen in the minutes of an early meeting in 1995. Negotiations in the financial services sector had been extended beyond GATS's entry into force. The months leading up to the Second Protocol on financial services were contentious. See, Armin von Bogdandy & Joseph Windsor, Annex on Financial Services, in VI MAX PLANCK COMMENTARIES ON WORLDTRADE LAW 640-666 (Rüdiger Wolfrum, Peter-Tobias Stoll & Clemens Feinäugle eds., 2008).

⁸⁶⁰ See, Windsor, Joseph (2008). The WTO Committee on Trade in Financial Services: The Exercise of Public Authority within an Informational Forum. Special Issue: Public Authority & International Institutions in German Law Journal Vol. 09 No. 11.

⁸⁶¹ Ibid

The second level of dissemination of information, from international to national level, takes place when the FSC publishes its annual reports and other documents, detailing their decisions and the minutes of their meetings (which are not always made public)⁸⁶².

As discussed above, the FSC has a lot to do with the administrative and executive functioning of the WTO in the development of the global financial sector. There are other subsidiary bodies of the Council for Trade in Services which have a mandate to deal with matters pertaining to the development of the financial sectors of the Contracting Parties; however, these subsidiary bodies have not provided substantial evidence, from their practices, of their direct contribution to the development of the global financial sector.

2. Other subsidiary bodies of the Council for Trade in Service

The other subsidiary bodies of the Council for Trade in Service are namely the Committee on Specific Commitments, the Working Party on Domestic Regulation, and the Working Party on GATS Rules. As these subsidiaries do not have a direct impact on the global financial services sector, this thesis will briefly discuss their administrative and executive role in the development of the financial sector.

a) The Committee on Specific Commitments

The Committee on Specific Commitments is one of the subsidiary bodies of the Council for Trade in Services. As is evident from its name, this committee's main task relates to the specific commitments made by the Contracting Parties in their schedule of commitments under GATS. Mainly, this committee looks into rectifications or improvements in the schedule of

⁸⁶² This transfer of information is not identical with a transfer of the information to the public at large, because FSC documents, in particular the minutes of meetings, are initially circulated as "restricted" among members before eventually being derestricted and made generally accessible. See, Procedures for the Circulation and Derestriction of WTO documents, Decision of 14 May 2002, WTO document no: WT/L/452, 16 May 2002.

commitments of the Contracting Parties, by discussing with the Contracting Parties changes in their schedule of specific commitments. To accomplish this task, the committee has drafted a procedure for changes in the schedule of commitments⁸⁶³ and guidelines for the scheduling of specific commitments⁸⁶⁴ in order that the Council for Trade in Services may adopt them.

The Committee on Specific Commitments acts an administrative tool in the WTO system for the making of any changes in the Contracting Parties schedule of specific commitments under the GATS. So, if a Contracting Party wants to make changes to its specific commitments related to financial services, then it has to do this via this committee.

b) The Working Party on Domestic Regulation

The Working Party on Domestic Regulation is a subsidiary body of the Council for Trade in Services and is comprised of the Contracting Parties. This body drafts disciplines⁸⁶⁵ relating to technical standards, and licensing and qualification requirements for all service sectors (including financial services) in the context of their domestic regulations. This working party merely oversees the domestic regulations of the Contracting Parties and gives its constituents the opportunity to define (via very loose guidelines) the parameters of domestic regulations.⁸⁶⁶

⁸⁶³WTO, Procedures for the Certification of Rectifications or Improvements to Schedules of Specific Commitments, ADOPTED BY THE COUNCIL FOR TRADE IN SERVICES ON 14 APRIL 2000. WTO DOCUMENT NO: S/L/84.

⁸⁶⁴WTO, GUIDELINES FOR THE SCHEDULING OF SPECIFIC COMMITMENTS UNDER THE GENERAL AGREEMENT ON TRADE IN SERVICES (GATS), Adopted by the Council for Trade in Services on 23 March 2001. WTO document no: S/L/92.

⁸⁶⁵WTO, ARTICLE VI:4 OF THE GATS: DISCIPLINES ON DOMESTIC REGULATION APPLICABLE TO ALL SERVICES, Note by the WTO Secretariat, 1 March 1999. WTO document no: S/C/W/96. And also see, WTO, INTERNATIONAL REGULATORY INITIATIVES IN SERVICES, Background note by the WTO Secretariat, 1 March 1999. WTO document no: S/C/W/97.

⁸⁶⁶The Contracting Parties does not clearly define parameters in context of the domestic regulations, which also includes the prudential carve-out under the Financial Services Annex. In this way this committee is under utilised.

The Council for Trade in Services is the most relevant body of the WTO in the context of the financial sector. However, the WTO is a sizeable IEI with a complex structure and it has other bodies through which it performs its executive and administrative functioning regarding matters related to the financial sector. The following subheading takes a look at these bodies and their role in the development of the global financial sector.

3. Other WTO Bodies

There are other bodies within the WTO structure which, in their executive and administrative authority, have relevance to the financial services sector. These bodies are discussed below.

a) WTO Trade Policy Review Body

One of the most noteworthy executive and administrative functions of the WTO is the surveillance of the domestic trade policies of all the Contracting Parties. The main role in this surveillance process is carried out via the Trade Policy Review Mechanism (TPRM). The TPRM has already been discussed in the preceding chapter;⁸⁶⁷ however, the executive and administrative aspect of TPRM is briefly outlined below.

Trade policies are reviewed by the Trade Policy Review Body (TPRB) which is one of the forms of the WTO General Council⁸⁶⁸ and thus constitutes all the Contracting Parties. The TPRM is based on peer review methodology and the administrative leg-work is carried out by the WTO Secretariat.⁸⁶⁹

⁸⁶⁷ Chapter VI.B.4 on page 250

⁸⁶⁸ The General Council becomes the TPRB when conducting the review under TPRM. Similarly the General Council becomes DSB when adjudicating dispute within WTO.

⁸⁶⁹ http://www.wto.org/english/tratop_e/tpr_e/tp_int_e.htm

The TPRB acts as a platform for the Contracting Parties to review the trade policies of the Contracting Party concerned, including policies related to financial services. The purpose is to see whether the Contracting Party concerned is complying with the WTO rules, disciplines and commitments relating to the financial services trade.

The Trade Policy Review process can be broken down into three steps,⁸⁷⁰ each of which has been discussed in Chapter VI.⁸⁷¹ However, they deal with the preparation of reports (identifying issues of concern), meeting to conduct reviews and then finally publishing the decisions made in the meeting.

The next WTO body is the committee on Balance of Payments Restriction which has an executive role in the context of the financial sector.

**b) Committees on Balance-of-Payments Restrictions
(hereinafter "BOP Committee")**

The WTO's executive and administrative role in issues related to the BOP difficulties of the Contracting Parties are dealt with by the BOP Committee. Financial sector stability and BOP difficulties are directly associated with each other. The BOP Committee reviews requests from Contracting Parties for derogations from their international commitments and for a short-term increase in provisional safeguards. However, it may only be a preemptive or strategic move to impose restrictions for some other ulterior purpose, thus the review by the BOP Committee of these measures related to BOP are essential for a fair trading environment.

⁸⁷⁰ See Annex 3 of the WTO Agreement and the TPRB's rules of procedure – WTO 2008. Rules of Procedure for Meetings of the Trade Policy Review Body: WT/TPR/6/ Rev.2. Also see, The WTO's Trade Policy Review Mechanism: How to Create Political Will for Liberalization, ECIPE Working Paper No. 11/2009.

⁸⁷¹ Chapter VI on page 250

Article XII of GATS⁸⁷² deals with the BOP restrictions in the services sector which allow Contracting Parties to impose restrictions when they are facing BOP problems “[i]n the process of economic development or economic transition” in order to maintain “[a] level of financial reserves adequate for the implementation of its programme of economic development or economic transition.” However, paragraph 2 of the same article places qualifications upon the restrictions, whereby the measure in question shall not be discriminatory; it shall not be inconsistent with the IMF’s Articles of Agreement; it shall not needlessly harm the commercial, economic and financial benefits of any other Contracting Party; it shall amount to the least possible necessary to tackle the BOP situation; it shall be short-term and provisional till the BOP situation improves. Moreover, paragraph 5 of Article XII obliges the Contracting Parties to immediately consult the BOP Committee to review the measures employed and which are assessed according to paragraph 5(c).⁸⁷³

The WTO, under Article XII of GATS, independently reviews and decides whether a restrictive measure is consistent with the WTO rules or not.⁸⁷⁴ However, following the logic of the *India-Balance of Payments* case⁸⁷⁵, the GATS BOP Committee cannot supersede the jurisdiction of the Panel and Appellate Body.

4. Conclusion

This chapter documented the executive and administrative functioning of the WTO as an IEI in the field of the financial services sector. As discussed above, the WTO has many bodies which

⁸⁷² Chapter VIII.A.1.e)(1)(b)(iii) on page no.290

⁸⁷³ Article XII 5(c) Such consultations shall assess the balance-of-payment situation of the Member concerned and the restrictions adopted or maintained under this Article, taking into account, inter alia, such factors as: (i) the nature and extent of the balance-of-payments and the external financial difficulties; (ii) the external economic and trading environment of the consulting Member; (iii) alternative corrective measures which may be available.

⁸⁷⁴ The IMF only assists in the statistics and facts.

⁸⁷⁵ Available at: http://www.wto.org/english/tratop_e/dispu_e/90abr.pdf

exert executive functioning whilst the administrative functioning is carried out by the WTO Secretariat. On point to be noted here is that all the WTO bodies are comprised of the Contracting Parties, thus executive functioning is carried out by the Contracting Parties collectively under the umbrella of the WTO to reap collective gains (i.e. the development of financial services trade). As the WTO is liberally institutionalised, it takes account of democratic values in this whole executive functioning process, by reaching decisions via consensus.

The executive and administrative functioning increases the certainty and predictability of the rules of the game within the global financial sector. As discussed in the theoretical framework, this certainty and predictability of the rules of the game acts as a stimulus in the Economic Cycle which leads to a more stable and balanced growth of the global economy.

The next subheading will review the judicial and quasi-judicial functioning of the WTO as an IEI in the development of the global financial sector.

C. Judicial and Quasi-Judicial Functioning of the WTO in endorsement of International Financial Sector Development

This subheading highlights the WTO's institutional role, in its judicial and quasi-judicial capacity as an IEI, in the development of the financial services sector of its members. It seems quite proper that the role of WTO's adjudicative function can positively affect the financial services sector of its constituents. However, the link is the same as discussed earlier⁸⁷⁶, i.e. the enhancement of certainty and predictability within a system and its development, and, in this

⁸⁷⁶ Chapter II.A.2 on page 28. Also, for a detailed discussion about legal certainty and financial development see generally, Ross Levine (1999), Law, Finance, and Economic Growth. *Journal of Financial Intermediation* 8, 8–35. Also see, King, R. G., and Levine, R. (1993). Finance, entrepreneurship, and growth: Theory and evidence, *J. Monet. Econ.* 32, 513–542. Also see, Levine, R. (1998). The legal environment, banks, and long-run economic growth, *J. Money CreditBanking* 3(Pt.2), 596–613. Demirgüç-Kunt, A., and Maksimovic, V. (1998). Law, Finance, and Firm Growth, *Journal of Finance* 53, 2107–2137. Laporta, R., Lopez-de-Silanes, F., Shleifer, A., and Vishny, R. W. (1998). Law and finance, *J. Polit. Econ.* forthcoming.

case, the enhancement of certainty and predictability in the development of the financial services sector.

It is a well-known fact that any comprehensive IO requires an enforcement and adjudicative mechanism to achieve its goals. Likewise, the Contracting Parties of the WTO Agreement, in recognition of compliance with their obligations, established the current WTO dispute settlement system during the Uruguay Round of Multilateral Trade Negotiations. The WTO dispute settlement system (DSS) resolves all disputes between its constituents pertaining to its operating framework. It exists to thwart the negative impact of unsettled issues in the international trading regime and it also minimises the inequity between Contracting Parties with huge disparities in their economies, and instead resolves all disputes according to WTO rules.⁸⁷⁷

The main objective of the WTO DSS is to facilitate the international trade regime's security and predictability⁸⁷⁸. International trade is understood as the exchange of goods and services between Contracting Parties and the WTO DSS only deals with Contracting Parties; however, mostly this trade is carried out by private economic participants which cannot directly approach the WTO DSS for adjudication of their trade concerns. Nevertheless, these market participants (which include state and non-state participants) require stability, certainty and predictability in the governing laws, rules and regulations related to their commercial activity, in financial services sector rules, and the regulations and laws governing the financial services sector. The more the laws, rules and regulation are stable, certain and predictable, the better the system develops.

Therefore, the WTO, in its institutional capacity (in this adjudicative capacity), via the DSS provides a fast, efficient, dependable and rule-oriented system to adjudicate disputes pertaining

⁸⁷⁷ A Handbook on the WTO Dispute Settlement System, WTO Secretariat Publication prepared for publication by the Legal Affairs Division and the Appellant Body (2004).

⁸⁷⁸ Article 3.2 of the Dispute Settlement Understanding (DSU): "The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system..."

to compliance with the WTO Agreement. Furthermore, by establishing exclusive jurisdiction to reinforce the rules of the game⁸⁷⁹, the DSS brings more certainty, predictability and security to the international trading regime⁸⁸⁰ which helps significantly in the development of the financial services sector.

The WTO Dispute Settlement Understanding (DSU) is an agreement which governs the rules and procedures pertaining to the settlement of disputes emerging from any of the agreements listed in Appendix 1 to the DSU⁸⁸¹, which also includes the financial services sector as part of GATS.⁸⁸² The remainder of this subheading will talk about the robustness of the DSS in creating certainty, predictability and security in the IELR. In this context, the following section will discuss the different methods of settling disputes under the DSU, the WTO bodies involved in this process, the dispute settlement process itself and the WTO disputes related to the financial services trade sector.

1. Pathways for dispute settlement:

There are a number of ways in which disputes are settled in the DSS: mediation, conciliation and a Good Office, Arbitration, and Adjudicative process (Panel and Appellant Body). In domestic judicial systems, these out-of-court solutions are referred to as an alternative means of dispute resolution; however, under the WTO framework, they are part of the main DSS and are not

⁸⁷⁹ Article 23 of the DSU not only excludes unilateral action but it also precludes the use of other forums for the resolution of a WTO-related dispute.

⁸⁸⁰ A Handbook on the WTO Dispute Settlement System, WTO Secretariat Publication.

⁸⁸¹ Appendix 1 of DSU:- AGREEMENTS COVERED BY THE UNDERSTANDING: (A) Agreement Establishing the World Trade Organisation (B) Multilateral Trade Agreements (Annex 1A Multilateral Agreements on Trade in Goods, Annex 1B: General Agreement on Trade in Services, Annex 1C: Agreement on Trade-Related Aspects of Intellectual Property Rights, Annex 2: Understanding on Rules and Procedures Governing the Settlement of Disputes) (C) Plurilateral Trade Agreements (Annex 4: Agreement on Trade in Civil Aircraft, Agreement on Government Procurement, International Dairy Agreement and International Bovine Meat Agreement.

⁸⁸² DSU Article 1.1: "The rules and procedures of this Understanding shall apply to disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 to this Understanding.."

considered as an alternative method of resolving disputes.⁸⁸³ These methods are briefly discussed below.

a) Mediation, Conciliation and Good Office

Article 3.7 of the DSU favours the idea whereby Contracting Parties settle their disputes through mutual understanding⁸⁸⁴; however, the mutually-agreed solution must be consistent with the WTO framework agreements. Moreover, mutually-agreed solutions should also be notified to the DSB and the relevant Councils and Committees⁸⁸⁵ so that other Contracting Parties have reasonable access to information relating to settlements between other Contracting Parties.

Sometimes, an independent person assists to resolve the dispute between Contracting Parties and help them arrive at a mutual understanding. If the parties to the dispute agree, then the DSU provides good office, conciliation and mediation facilities to enable parties to come to a conclusion.⁸⁸⁶ The Director-General of the WTO offers the services of the independent person for the purpose of good office, conciliation and mediation.⁸⁸⁷

Basically, the good office provided by the DSU amounts to logistical support to assist the parties at dispute to resolve their grievances in a productive environment. On the other hand, in conciliation, a third person becomes involved in the settlement negotiations between the parties.

The mediation process is one step ahead of the conciliation process. In this process, the mediator

⁸⁸³ A Handbook on the WTO Dispute Settlement System, WTO Secretariat Publication prepared for publication by the Legal Affairs Division and the Appellant Body (2004) p 92.

⁸⁸⁴ Article 3.7 of DSU: "A solution mutually acceptable to the parties to a dispute and consistent with the covered agreements is clearly to be preferred."

⁸⁸⁵ Article 3.6 of the DSU: "Mutually agreed solutions to matters formally raised under the consultation and dispute settlement provisions of the covered agreements shall be notified to the DSB and the relevant Councils and Committees."

⁸⁸⁶ Article 5.1 of the DSU: "Good offices, conciliation and mediation are procedures that are undertaken voluntarily if the parties to the dispute so agree."

⁸⁸⁷ Article 5.6 of the DSU: "The Director-General may, acting in an ex officio capacity, offer good offices, conciliation or mediation with the view to assisting Members to settle a dispute."

may also propose a solution as a contribution to the settlement process; however, suggestions by the mediator are not binding on the disputed parties.⁸⁸⁸

The WTO encourages Contracting Parties to settle their disputes mutually at any stage in the DSS. So, even if the parties take the issue to the Panel, Appellant Body or arbitration, they can still continue separately with a mutual resolution process.⁸⁸⁹

b) Arbitration under Article 25 of the DSU

The Contracting Parties in dispute can resort to arbitration under Article 25.1 of the DSU.⁸⁹⁰ However, the parties need to decide on the procedure and the governing rule for the arbitration process, including the selection of the arbitrator. Moreover, once the parties have agreed on the procedure, rules and arbitrator, then arbitration becomes binding on them.

Before starting arbitration proceedings, the disputing Contracting Parties need to inform all other Contracting Parties of the arbitration agreement and must allow other interested Contracting Parties to join the arbitration process. The arbitration award, which is binding on the Contracting Parties involved, must be notified to the DSB and also to the Councils and Committees concerned. Regarding the implementation and enforcement of the arbitration award, the provisions of Articles 21 and 22 of the DSU apply.⁸⁹¹

c) Adjudicative pathway (Panel and Appellant Body)

⁸⁸⁸ A Handbook on the WTO Dispute Settlement System, WTO Secretariat Publication prepared for publication by the Legal Affairs Division and the Appellant Body (2004) p 94.

⁸⁸⁹ Article 5.5 of the DSU: "If the parties to a dispute agree, procedures for good offices, conciliation or mediation may continue while the panel process proceeds."

⁸⁹⁰ Article 25.1 of the DSU: "Expeditious arbitration within the WTO as an alternative means of dispute settlement can facilitate the solution of certain disputes that concern issues that are clearly defined by both parties."

⁸⁹¹ Article 25.4 of the DSU: "Articles 21 and 22 of this Understanding shall apply mutatis mutandis to arbitration awards."

In the adjudicative process of the DSS, disputes are settled by the Panels and the Appellant Bodies. The panels are in charge of the adjudication of disputes between Contracting Parties in the first instance. If either of the disputing Contracting Parties involved is unsatisfied with the ruling of the panel, then they can appeal against it to the Appellant Body. The adjudicative process, type of complaints, and the bodies involved in the DSS are discussed below.

2. WTO Bodies involve in the DSS:

This subheading provides a basic introduction of the WTO bodies involved in the DSS: the Dispute Settlement Body (DSB), panels, Appellant Body and arbitrators, all of whom are discussed below.

a) Dispute Settlement Body

Composition and functions of the DSB: The General Council, which is composed of all Contracting Parties, takes the form of the DSB when settling disputes between its constituents.⁸⁹²

It is a political body which is responsible for overseeing the whole dispute settlement process within the framework of the WTO. It meets regularly, as envisaged by Article 2.3 of the DSU⁸⁹³, usually once a month.

The DSB has the mandate to form panels and the Appellant Body⁸⁹⁴, adopt their rulings, and closely observe the enforcement and implementation of these rulings. Moreover, the DSB can

⁸⁹² Article IV.3 of the WTO Agreement: “The General Council shall convene as appropriate to discharge the responsibilities of the Dispute Settlement Body provided for in the Dispute Settlement Understanding. The Dispute Settlement Body may have its own chairman and shall establish such rules of procedure as it deems necessary for the fulfillment of those responsibilities.”

⁸⁹³ Article 2.3 of the DSU: “The DSB shall meet as often as necessary to carry out its functions within the time-frames provided in this Understanding.”

⁸⁹⁴ Article 2.1 of the DSU: “The DSB shall inform the relevant WTO Councils and Committees of any developments in disputes related to provisions of the respective covered agreements.”

allow trade sanctions in cases where the losing Contracting Party does not comply with the rulings and recommendations of the panel and the Appellant Body.⁸⁹⁵

According to Article 2.4 of the DSU, *Decision Making in the DSB* is carried out by consensus.⁸⁹⁶

By consensus, as per Article 2.4 of the DSU, means that none of the members of the DSB explicitly opposes the proposed decision of the DSB meeting. However, once the panel or the Appellant Body is formed, then it is mandatory for the DSB to approve their report or recommendations unless there is a consensus against it (i.e. negative consensus). If any party is not happy with the ruling or recommendations of the DSS, then that party has to convince all the remaining members of the DSB to agree to consensus against that ruling or recommendation.⁸⁹⁷

b) Panel

Panels are composed usually of three panelists who are well-qualified governmental and/or non-governmental individuals. Some previous experience in a relevant field is preferred, such as: previous involvement in panel cases; the representation of any Contracting Party in any WTO councils or committees; having worked in the WTO Secretariat; being a scholar of international

⁸⁹⁵ DSU Article 22.2: “[A]ny party having invoked the dispute settlement procedures may request authorization from the DSB to suspend the application to the Member concerned of concessions or other obligations under the covered agreements.” See also, GATS Article XXIII:2: ‘If the DSB considers that the circumstances are serious enough to justify such action, it may authorize a Member or Members to suspend the application to any other Member or Members of obligations and specific commitments in accordance with Article 22 of the DSU.’

⁸⁹⁶ Article 2.4 of the DSU: “Where the rules and procedures of this Understanding provide for the DSB to take a decision, it shall do so by consensus (The DSB shall be deemed to have decided by consensus on a matter submitted for its consideration, if no Member, present at the meeting of the DSB when the decision is taken, formally objects to the proposed decision.).

⁸⁹⁷ Article 6.1 of the DSU: “[U]nless at that meeting the DSB decides by consensus not to establish a panel.” And also see, Article 16.4 of the DSU: “[T]he report shall be adopted at a DSB meeting⁸⁹⁷ unless a party to the dispute formally notifies the DSB of its decision to appeal or the DSB decides by consensus not to adopt the report.” And also see, Article 17.14 of the DSU: “An Appellate Body report shall be adopted by the DSB and unconditionally accepted by the parties to the dispute unless the DSB decides by consensus not to adopt the Appellate Body report.” See also, Article 22.6 of the DSU: “[T]he DSB, upon request, shall grant authorization to suspend concessions or other obligations within 30 days of the expiry of the reasonable period of time unless the DSB decides by consensus to reject the request.” Also see, A Handbook on the WTO Dispute Settlement System, WTO Secretariat Publication prepared for publication by the Legal Affairs Division and the Appellant Body (2004) p 18.

trade law or policy; or has acted as a senior trade policy officer of a Contracting Party.⁸⁹⁸

Moreover, the independence of the panelist should also be ensured.⁸⁹⁹

The *function* of panels is to assist the DSB in settling disputes within the DSS. It is the first stage of the adjudication process within the DSS. The panel is required to assess the issue impartially in the light of current facts and the WTO framework Agreements. These impartial findings are reported to the DSB who then make a recommendation or ruling regarding the disputed matter. During this process of adjudication, panels should consult frequently with the parties in dispute in order to develop a mutual understanding.⁹⁰⁰

c) Appellant Body

The Appellant Body is a permanent body of seven members responsible for revisiting the legal aspects of the reports of panels at the request of either party to a specific dispute. It is the second and final stage of the adjudication process in the DSS.

The Appellant Body was created by the DSB in 1995.⁹⁰¹ Its members are appointed unanimously by the DSB for a term of four years. These members do not represent their countries but the whole of the WTO membership. It has its own Secretariat for administrative purposes.

3. Types of Complaints under GATS

Cause of action is quite important in any type of dispute. Under GATS, the Contracting Parties have recourse to the DSS for ‘violation’ and ‘non-violation’ of WTO agreements. These two

⁸⁹⁸ Article 8.1 of the DSU.

⁸⁹⁹ Article 8.2 of the DSU.

⁹⁰⁰ Article 11 of the DSU.

⁹⁰¹ Decision to creating Appellant Body was taken by the DSB on 10/02/1995. See WTO document no. WT/DSB/1 dated on 19/06/1995.

causes of action are basically similar to those in GATT Article XXIII.⁹⁰² Under GATS (Article XXIII), any Contracting Party can approach the DSS if it ascertains that its rights under the WTO Agreements have been violated due to either (1) the failure of another Contracting Party to carry out its commitments under GATS ('violation complaints')⁹⁰³, or (2) the application of a measure by another Contracting Party, whether or not it conflicts with the provisions of the Agreement ('non-violation complaints').⁹⁰⁴

So, for whatever reason, a Contracting Party can approach the DSS, provided it relates to the international trade regime. The reason why the DSS entertains non-violation complaints is that it aims to promote fair competition among WTO members.⁹⁰⁵

4. Adjudicative process in the DSS

The adjudicative process in the DSS involves three stages: (1) bilateral consultations; (2) adjudicative process before a panel, subject to appellate review; (3) implementation and enforcement under surveillance by the DSB.⁹⁰⁶ These three stages are discussed below briefly in the context of GATS (which includes the financial services sector)⁹⁰⁷ but for a better understanding, refer, first of all, to the flow chart illustrating the dispute settlement process within the WTO framework.

⁹⁰² GATT Article XXIII: 'If any Member 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 Member to carry out its obligations under this Agreement, or (b) the application by another Member of any measure, whether or not it conflicts with the provisions of the Agreement, or (c) the existence of any other situation,'.

⁹⁰³ GATS Article XXIII:1: 'If any Member should consider that any other Member fails to carry out its obligations or specific commitments under this Agreement, it may with a view to reaching a mutually satisfactory resolution of the matter have recourse to the DSU.'

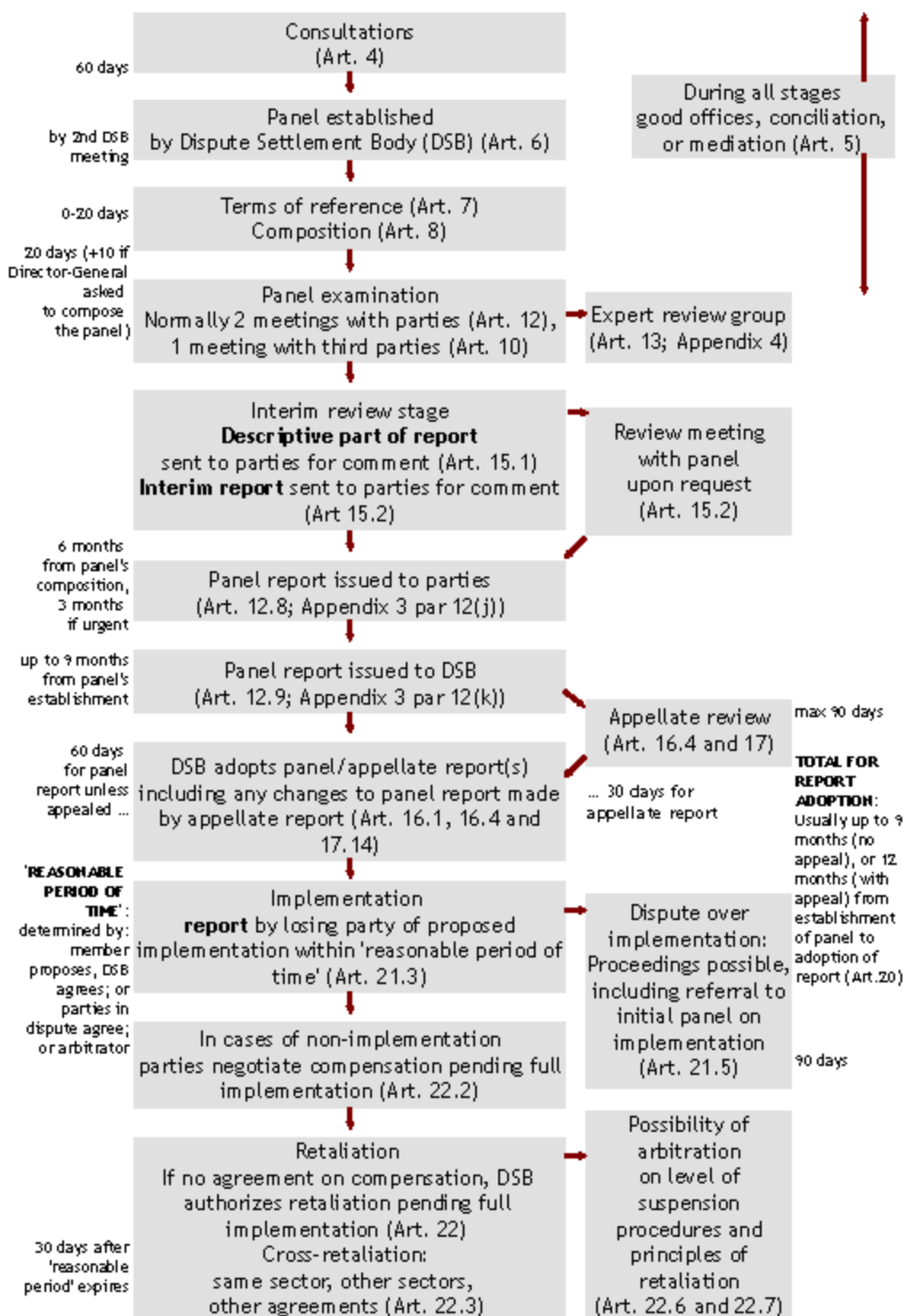
⁹⁰⁴ Article XXIII(3) of GATS provides: If any Member considers that any benefit it could reasonably have expected to accrue to it under a specific commitment of another Member under Part III of this Agreement is being nullified or impaired as a result of the application of any measure which does not conflict with the provisions of this Agreement, it may have recourse to the DSU.

⁹⁰⁵ Werner Zdouc, 'WTO Dispute Settlement Practice Relating to the GATS' (1999) 2 JIEL 295.

⁹⁰⁶ Werner Zdouc, 'WTO Dispute Settlement Practice Relating to the GATS' (1999) 2 JIEL 295.

⁹⁰⁷ http://www.wto.org/english/tratop_e/dispu_e/dispu_settlement_cbt_e/c6s1p1_e.htm

Figure 11 Flow chart of the Dispute Settlement Process⁹⁰⁸



⁹⁰⁸ See Chapter VI Figure 9 and also visit: http://www.wto.org/english/tratop_e/dispu_e/dispu_settlement_cbt_e/c6s1p1_e.htm

a) Consultation:

The *consultation* process is the first step in the dispute settlement process wherein the complainant requests the Contracting Party concerned to discuss violation of its rights under the WTO framework by the latter. In the context of consultations, GATS lays down two different consultation methods in Article XXII. The first method relates to bilateral consultations which are governed by the procedure set down in the DSU for all disputes under the WTO framework.⁹⁰⁹ The second method relates to the ‘multilateral consultations’ process, under which either the Council for Trade in Services (CTS) or the Dispute Settlement Body (DSB) facilitates the consultation process.⁹¹⁰ As the multilateral consultation process is not mentioned in the DSU, it can be only requested once the bilateral consultations are unsuccessful.⁹¹¹ However, so far, none of the Contracting Parties have requested multilateral consultation.⁹¹²

For the financial services sector (and other services sectors which also require expert input), GATS emphasises that the DSS should involve specialists in those areas. The *Financial Services Annex* specifies that panelists should have the necessary expertise in prudential issues and other financial matters.⁹¹³

⁹⁰⁹ GATS Article XXII:1: ‘Each Member shall accord sympathetic consideration to, and shall afford adequate opportunity for, consultation regarding such representations as may be made by any other Member with respect to any matter affecting the operation of this Agreement. The Dispute Settlement Understanding (DSU) shall apply to such consultations.’

⁹¹⁰ GATS Article XXII:2: ‘The Council for Trade in Services or the Dispute Settlement Body (DSB) may, at the request of a Member, consult with any Member or Members in respect of any matter for which it has not been possible to find a satisfactory solution through consultation under paragraph 1.’

⁹¹¹ It is unclear at what point bilateral consultations may be deemed to have failed to find a satisfactory solution. Under DSU Article 4.7, ‘[i]f [bilateral] consultations fail to settle a dispute within 60 days after the date of receipt of the request for consultations, the complaining party may request the establishment of a panel. The complaining party may request a panel during the 60-day period if the consulting parties jointly consider that consultations have failed to settle the dispute.’

⁹¹² Werner Zdouc, ‘WTO Dispute Settlement Practice Relating to the GATS’ (1999) 2 JIEL 295.

⁹¹³ Para. 4 of the Financial Services Annex.

b) Panel and Appellant Body Stage:

Establishment of a panel: Once all consultations to resolve the dispute have been in vain, then the complainant can *request the DSB to form a panel* to decide on the dispute. According to Article 4.7 of DSU⁹¹⁴, the complainant needs to wait 60 days after the request for consultation, and can request the formation of a panel if the parties jointly consider that consultations were unsuccessful in resolving the issue. The request to form a panel is made in writing to the Chairman of the DSB and as the DSB does not require consensus for the formation of panels⁹¹⁵, the panel is formed without delay.

Composition of the panel: As there are no permanent members, it is composed afresh for each individual dispute. The panel should comprise three or five members, each of whom should be appointed according to Article 8 of the DSU.

The panel procedure: The panel acts as an unbiased body following its formation and composition. The first task undertaken by the panel is to set up a calendar for its work.⁹¹⁶ The panel can exercise some degree of flexibility in its process, after having taken the parties to the dispute into their confidence. However, generally the panel process is dealt with according to Article 12, Appendix 3 to the DSU. Appendix 3, paragraph 12 to the DSU provides tentative dates and deadlines for the main steps of the panel process (see below), such as, dates for filing submissions, oral hearings, and of the interim and final panel reports.

⁹¹⁴ Article 4.7 of DSU: “If the consultations fail to settle a dispute within 60 days after the date of receipt of the request for consultations, the complaining party may request the establishment of a panel. The complaining party may request a panel during the 60-day period if the consulting parties jointly consider that consultations have failed to settle the dispute.”

⁹¹⁵ Article 6.1 of the DSU requires a negative consensus of the DSB for not establishing a panel.

⁹¹⁶ Article 12.3 of the DSU: “[F]ix the timetable for the panel process...”

Table 10

1.	Receipt of the first written submissions of the parties: (a) Complaining party: (b) Party complained against:	3-6 weeks 2-3 weeks
2.	First substantive meeting with the parties; third party session:	1-2 weeks
3.	Receipt of written rebuttals of the parties:	2-3 weeks
4.	Second substantive meeting with the parties:	1-2 weeks
5.	Issuance of descriptive part of the report to the parties:	2-4 weeks
6.	Receipt of comments by the parties on the descriptive part of the report:	2 weeks
7.	Issuance of the interim report, including the findings and conclusions, to the parties:	2-4 weeks
8.	Deadline for party to request review of part(s) of report:	1 week
9.	Period of review by panel, including possible additional meeting with parties:	2 weeks
10.	Issuance of final report to parties to dispute:	2 weeks
11.	Circulation of the final report to the members:	3 weeks

Findings, conclusions and recommendations and suggestions on implementation: This is the last part of the panel's report in which they give reasons for upholding or rejecting the claimant's assertions. This is based on a detailed analysis of relevant law, bearing in mind the assertion made by the parties and the factual situation as it emerged from evidence presented to the panel.⁹¹⁷

Interim review: The interim review is mandated by Article 15 of the DSU. It is a formal and a comprehensive report concerning the whole dispute. As is evident from its name, it is not yet declared final. This is an important stage as it provides the parties with a complete picture of the final report and gives them a chance to request the panel to look into issues before circulation of the final report.

⁹¹⁷Article 12.7 of the DSU: "[T]he panel shall submit its findings in the form of a written report to the DSB. In such cases, the report of a panel shall set out the findings of fact, the applicability of relevant provisions and the basic rationale behind any findings and recommendations that it makes."

Issuance and circulation of the final report: Approximately two weeks after the interim review, the final report is issued and distributed among the parties.

Adoption of panel reports: Contracting Parties are not obligated by the panel's report unless submitted and adopted by the DSB. The DSB has to adopt the panel report unless there is negative consensus or the parties appeal against the findings of the panel to the Appellate Body, which, in turn, has the mandate to change or even reverse the final decision. However, the DSB is bound to adopt the decision of the Appellant Body.⁹¹⁸

Appellate review: This is the second and final platform which adjudicates disputes between Contracting Parties. The appellate review is governed by the document 'Working Procedures for Appellate Review'.⁹¹⁹ This document prefers decision-making by consensus; however, if consensus is not achieved then the majority decision prevails. The report of the Appellate Body should take into account all legal issues and panel interpretations that have been brought to appeal.⁹²⁰ The Appellate review process should conclude its proceedings within 60 or a maximum of 90 days from the filing of the notice of appeal.

The Appellate Body has a mandate to maintain, amend or reverse the legal findings and decisions of the panel.⁹²¹ The report of the Appellate Body must be adopted by the DSB unless negative consensus is reached in the context of this report.

⁹¹⁸ Article 16.4 of the DSU) "[T]he report shall be adopted at a DSB meeting unless a party to the dispute formally notifies the DSB of its decision to appeal or the DSB decides by consensus not to adopt the report."

⁹¹⁹ WTO, Working procedures for appellate review. WTO document no. WT/AB/WP/6 dated 16 August 2010.

⁹²⁰ Articles 17.6 of the DSU: "An appeal shall be limited to issues of law covered in the panel report and legal interpretations developed by the panel." and Article 17.12 of the DSU: "The Appellate Body shall address each of the issues raised in accordance with paragraph 6 during the appellate proceeding."

⁹²¹ Article 17.13 of the DSU: "The Appellate Body may uphold, modify or reverse the legal findings and conclusions of the panel."

c) *Implementation and Enforcement:*

Implementation and enforcement are the most important attributes for any effective IO. The WTO DSS not only adjudicates matters between Contracting Parties but also provides an effective mechanism for the implementation and enforcement of its recommendations and rulings. In the context of implementation and enforcement, GATS Article XXIII:2 follows the wording of GATT Article XXIII:2, and also refers to Article 22 of the DSU, for ‘compensation and the suspension of concessions’ in cases of non-compliance.⁹²²

Article 22 of the DSU talks about the modalities for retaliation, related arbitration procedures, and review by the DSB of the compliance or retaliation. In other words, the winning Contracting Party in the DSS can request permission from the DSB to suspend concessions if the losing Contracting Party does not comply with the adjudication of the DSB.⁹²³ Article DSU 22.3 states that the withdrawal of tariff reductions should first be made within the same (service) sector,⁹²⁴ or under the same agreement, and only as a fall-back option under another agreement covered by the WTO.⁹²⁵

The dispute settlement system works on the footing of contractual remedies, whereby the infringement of WTO rules by one Contracting Party gives adversely-affected Contracting Parties the right to withdraw commitments of equivalent value in order to rebalance their respective rights and obligations. However, the decision to retaliate is entirely up to the

⁹²²GATS Article XXIII:2: ‘If the DSB considers that the circumstances are serious enough to justify such action, it may authorize a Member or Members to suspend the application to any other Member or Members of obligations and specific commitments in accordance with Article 22 of the DSU.’

⁹²³DSU Article 22.2.

⁹²⁴DSU Article 22.3(f)(ii) and fn. 14 thereto specify that in the ‘Services Sectoral Classification List’ (MTN.GNS/W/120) identifies 11 main service sectors.

⁹²⁵Werner Zdouc, ‘WTO Dispute Settlement Practice Relating to the GATS’ (1999) 2 JIEL 295.

aggrieved Contracting Party itself, just as the decision to correct a violation rests with the sovereign decision of the violator.⁹²⁶

Retaliation is the last resort available to the Contracting Party who won the dispute. There is considerable criticism of the process of retaliation and the basic concept behind it. Many scholars maintain that two wrongs cannot make a right, and because violation of WTO rules is considered as welfare loss, by retaliating, the result is double welfare loss. Moreover, there is also considerable criticism of retaliation in relation to developing countries; for example, how could Antigua's trade sanctions affect the US? In other words, massive inequalities between economic and political systems can render the last resort of retaliation useless for small economies.⁹²⁷

However, in my opinion, if the winning contracting party is allowed to sell or transfer its retaliation option in return for money or some other trade benefit to another Contracting Party, retaliation could then be a totally effective remedy as a last resort.

5. Room for Improvement

As documented above, the WTO DSS is one of the major achievements of the rule based multilateral trade mechanism. However, it is extremely rare for anything to be flawless and perfect. The WTO DSS despite being considered as success need some attention on certain issues. The issues which create room for improvement within the WTO DSS are discussed below.

First, the cost of the WTO litigation is quite high. It requires lot expertise from international trade lawyers. Majority of the developing countries lack specialized lawyers to contest case at

⁹²⁶ Rufus Yerxa, 'The power of dispute settlement system' in Key Issues in the WTO Dispute Settlement: The First Ten Years. Rufus Yerxa, and Bruce Wilson. (eds). New York City: Cambridge University Press, 2005.

⁹²⁷ Joost Pauwelyn and Chad P. Bown (eds.) (2010), The Law, Economics and Politics of Retaliation in WTO Dispute Settlement, Cambridge University Press.

the WTO DSS. Thus, they need to high lawyers from developed countries which are quite costly.⁹²⁸ Moreover, if developing countries are unable to arrange the required legal resources, they do not have likelihood to get their rights. As Marc Busch and Eric Reinhardt summarise,

*“By adding 26,000 pages of new treaty text, not to mention a rapidly burgeoning case law; by imposing several new stages of legal activity per dispute, such as appeals, compliance reviews, and compensation arbitration; by judicializing proceedings and thus putting a premium on sophisticated legal argumentation as opposed to informal negotiation; and by adding a potential two years or more to defendants’ legally permissible delays in complying with adverse rulings, the WTO reforms have raised the hurdles facing [developing countries] contemplating litigation.”*⁹²⁹

Second, the developed countries use the DSS to shape the WTO law. As modification of the WTO rules is quite difficult, due to consensus requirement. The developed countries use the DSS to shape the formal interpretation of the WTO binding law. They invest significant legal resources in fighting for their right or contesting for a favorable interpretation of the WTO law. The EC and US use the DSS the most and thus are mainly in a better position to further their interests via the judicial process. The struggle for a favourable interpretation can be judged by the fact that the US was a party in 340 GATT/WTO disputes, constituting 52% of the total number of 654 disputes, while the EC was a party in 238 disputes, or 36% of that total.⁹³⁰ Moreover, the EC and US were third parties in most of the cases where they are not

⁹²⁸ Gregory Shaffer (2003), “How to Make the WTO Dispute Settlement System Work for Developing Countries: Some proactive *developing country* strategies”, in *ICTSD Resource Paper No.5* (ICTSD, Geneva).

⁹²⁹ See Marc Busch & Eric Reinhardt, *Testing International Trade Law: Empirical Studies of GATT/WTO Dispute Settlement*, in *The Political Economy of International Trade Law: Essays in Honor of Robert E. Hudec* 457, 467 (Daniel Kennedy & James Southwick eds., 2002).

⁹³⁰ See Busch & Reinhardt, *Testing International Trade Law*, supra note 15, at 462.

complainants or defendants. As parties and third parties, the United States and EC endeavor to protect their interests in shaping the interpretation of WTO rules over time.⁹³¹

On the other hand, the participation of the developing countries' has relatively decreased in the WTO DSS as compared to the less-legalized GATT. Only large developing countries are in a position to participate in the DSS, such as, India, Brazil and Mexico⁹³² who have participated as third parties in more than eight (of the first 273) WTO cases. The majority of developing country WTO members have never participated.⁹³³

In short, the WTO DSS is a successful rule based system, however. There are some issues which need to be improved. Such as, developing the legal capacity, related trade, of the developing countries or ensure legal aid to the developing countries. Moreover, the interest of the developing countries in the shaping the WTO law should also be watched. It could be done by allowing NGOs to become third parties in the DSS system on behalf of the developing countries. Furthermore, the WTO remedies⁹³⁴ also need attention in context for developing countries.

6. WTO/GATS Case Law relevant to Financial Services Sector

Before formation of the WTO, disputes were dealt with within the GATT framework which did not take into account the services sector (including financial services). Since 1995, disputes related to the services sector have been dealt with by the DSS of the WTO. So far, case law in relation to the financial services trade sector has not developed significantly. Nevertheless, three

⁹³¹Jay Smith (2003), *Inequality in International Trade? Developing Countries and WTO Dispute Settlement*, Rev. of Int'l Political Economy, p16.

⁹³² See Richard Steinberg, *In the Shadow of Law or Power? Consensus-Based Bargaining and Outcomes in the GATT/WTO*, 56 Int'l Org. 339 (Spring 2002).

⁹³³ Sometime a WTO DSS case is financed by an industry in a developing country whose stakes are involved. For example, the Venezuelan national petroleum company, *Petroleos de Venezuela*, financed a Washington DC law firm to support the government in fighting WTO case (*Venezuelan gas case against the US*). [Gregory Shaffer (2003), "How to Make the WTO Dispute Settlement System Work for Developing Countries: Some proactive *developing country strategies*", in *ICTSD Resource Paper No.5 (ICTSD, Geneva)*.]

⁹³⁴ Ch.VIII.C.4.c) on p 336

WTO cases are discussed briefly below to give an idea of how the DSS resolves issues and promotes certainty in the international economic legal regime.

a) United States of America — Measures Affecting the Cross-Border Supply of Gambling and Betting Services (Complainant: Antigua and Barbuda hereinafter “Antigua”)⁹³⁵

In 2003, Antigua applied to the DSB to form a Panel in relation to the US’s measures affecting the cross-border supply of gambling services by foreign providers.⁹³⁶ Antigua maintained that some of the US measures were in violation of GATS Article XVI:1, which deals with market access, by making the cross-border supply of gambling and betting services illegal, and that the US could not sustain such a ban on the basis of GATS mode 1 commitments. Additionally, it asserted that the US was discriminating between domestic and foreign services suppliers by allowing their domestic Internet operators to provide gambling services.⁹³⁷

However, the US asserted that they had not discriminated between foreign and domestic suppliers in their measures and had made unlawful all types of Internet gambling. Moreover, it responded that it had not made specific GATS commitments with respect to cross-border gambling services. Regarding market access commitments, the US stressed that Article XVI of GATS deals with circumventing specified quantitative limitations and it does not forbid eliminating the electronic supply of certain services. Lastly, the US claimed that the GATS exemptions under Article XIV would vindicate their derogation from existing specific GATS

⁹³⁵ Available at: http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds285_e.htm

⁹³⁶ WT/DS285/1 – S/L/110 (27 March 2003) and WT/DS285/2 (13 June 2003).

⁹³⁷ Antigua’s first oral statement, para. 94, its first written submission, para. 118 and its reply to Panel question No. 19, as cited in the Panel report, para. 6.585 in fn. 1037 (note that all oral statements and the written submissions of Antigua and the United States are cited here as referenced in the Panel and Appellate Body Reports). All related submissions of the US can be downloaded at www.ustr.gov/Trade_Agreements/Monitoring_Enforcement/Dispute_Settlement/Section_Index.html

obligations due to dominant public policy apprehensions such as public morals, fraud and security.⁹³⁸

The Appellate Body upheld the Panel's report that the US could not impose a ban on the cross-border supply of gambling services under its schedule of specific commitments under GATS Article XVI (market access commitments). The Appellate Body also upheld the Panel's decision that in the light of protection of 'public morals' and/or 'public order' under the general exception to the GATS, the ban on the cross-border supply of gambling services was acceptable. However, contrary to the findings of the Panel, the Appellate Body ruled that the US's measures were not adequate or 'necessary to protect public morals or maintain public order', which is necessary for the chapeau and paragraph (a) of GATS Article XIV. This is because one of the relevant laws (i.e. the Interstate Horseracing Act) allowed electronic gambling to domestic service providers.⁹³⁹ Thus, in order to protect public morals and order completely, the Appellate body ruled that the US should change the Interstate Horseracing Act.

The DSB adopted the Appellate Body report and the modified Panel report in April 2005. The 'reasonable period of time' for the US to implement the rulings of the DSB expired on 3 April 2006.⁹⁴⁰ The most important aspect of this case is that it adds *greater legal certainty* as to the applicability of WTO and GATS commitments to the electronic cross-border supply of services (which also includes financial services).

⁹³⁸Wunsch-Vincent, Sacha, 'Cross-border trade in services and the GATS: lessons from the WTO US—Internet Gambling case', *World Trade Review* (2006), 5: 3, 319–355.

⁹³⁹US—Gambling, Appellate Body Report, para. 374.

⁹⁴⁰DS, US—Gambling, Arbitration under Art. 21.3(c) of the Understanding on Rules and Procedures Governing the Settlement of Disputes, WT/DS285/13 (19 August 2005).

b) China — Measures Affecting Financial Information Services and Foreign Financial Information Suppliers (Complainant: United States of America)⁹⁴¹

In March 2008, the US requested consultations with China regarding measures related to financial information services and service suppliers.

The US asserted that China was not providing the same treatment to foreign financial services suppliers in the supply of financial information services to China. All the foreign financial information suppliers, in order to supply their services, need to supply their services through the China Economic Information Service, one of the commercial entities of the Xinhua News Agency which prohibits any foreign financial information suppliers from directly offering subscriptions for their services to the public. Additionally, at the time of renewing their licences, China made it a requirement for foreign financial information suppliers to provide the Foreign Information Administration Centre, (a regulatory body within the Xinhua framework), with comprehensive and confidential information concerning their services, their customers and their suppliers. The US claimed that these restrictions and prerequisites do not apply to domestic services providers.

The US also asserted that China does not allow foreign financial information service suppliers to have a commercial presence in China other than in a limited number of representative offices.

The US claimed that the actions at issue were contrary to the various provisions of GATS, such as Articles XVI, XVII, XVIII, and Part I, para. 1.2 of China's Protocol of Accession.

However, in December 2008, China and the US came to a mutual understanding in the form of a Memorandum of Understanding and the dispute was withdrawn from the DSS.

⁹⁴¹ Available at: http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds373_e.htm

The reason for highlighting this case was to show how all the measures of all the Contracting Parties can be brought to conformity with commitment and agreement under the WTO framework. The quest for their rights by Contracting Parties within the DSS brings certainty and clarity to the system.

c) China — Certain Measures Affecting Electronic Payment Services (Complainant: United States of America)⁹⁴²

In this dispute, the US claimed that China imposes restrictions and requirements on the foreign electronic payment services providers for payment card transactions. According to allegations, China only allows China UnionPay (a domestic entity) to provide electronic payment services denominated and paid in domestic currency (renminbi – the official currency of China) for payment card transactions, whilst the service providers of other Contracting Parties can provide these services but only in foreign currency. Moreover, in China, all card payment machines have to be compatible with China UnionPay's system. In addition, all foreign service providers have to bargain with sellers for access whereas, on the contrary, China UnionPay has a guaranteed access to card payment machines in China.

The US claimed that China's measures are restrictive and are in conflict with its commitments under GATS Articles XVI (Market Access) and XVII (National Treatment). The dispute is at the Panel stage and yet to be decided.

7. Conclusion

This subheading documented the adjudicative functioning of the WTO as part of its institutional role. The adjudicative functioning of the WTO adds certainty and predictability to the rules of

⁹⁴² Available at: http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds413_e.htm

the game within the global economy (in this case, the financial services sector) which in turn leads to the development of the financial services sector. As discussed in the theoretical framework, the development of the financial sector stimulates the Economic Cycle and increases international trade (Patrick's supply lead hypothesis) which eventually results in a more stable and balanced growth of the global economy.

D. Conclusion

This chapter documented that the WTO makes a reasonable contribution in the development of the global financial services sector through its institutional role. It addresses a common misconception that the WTO deals only with trade and has little to do with the development of the financial sector. This view is refuted by pointing out the WTO's involvement in the development of the global financial services sector.

All three components of the institutional role of an IEI (legislative and normative, executive and administrative, and, judicial and quasi-judicial) have been discussed in detail in the context of the WTO and financial services sector. By documenting the WTO's comprehensive institutional role, this chapter showed that the WTO has an effective role as an IEI in the IELR with specific reference to the financial services sector.

As part of the main argument presented in Section Three, the WTO should expand its functioning in the development of the financial services sector, especially in setting the rules of the game. Expansion is possible and practical because the WTO has the institutional capacity to do this. Moreover, by doing so, the WTO can substitute the role of the IMF (setting the rules of the game) by enhancing its role in financial sector development. This way, stable and balanced growth of the global economy can be achieved, by gathering all liberally institutionalised ideals (democratic values and cooperation with free will for collective gains) together.

This thesis calls for the expansion of the WTO's institutional role in context of the development of the global financial sector. However, there exists a view that questions the development of the WTO's financial services contributions. This view was mainly dominant at the Third Ministerial Conference at Seattle, US. The Third Ministerial Conference at Seattle, US brought a notable change in the stance of the developing countries towards any enhancement of commitments towards financial and investment related commitments. The post Seattle change in stance is discussed below.

Post Seattle changes are quite important and relatively in favour of the developing countries. The developing countries' government and the international civil society are fully aware of the developed countries approach and strategies towards the WTO negotiation process. The TRIMS which favours corporate rights and freedom to operate across state boundaries, in the mobility of products and, eventually, of capital. Free movement of the capital and investment under TRIMS made the Transnational Corporations (TNC) very strong. Not surprisingly majority of the TNC are owned by national of developed countries. The TRIMS is perceived by developing countries and civil society to be highly in favour of the developed countries.⁹⁴³ Agreement like TRIMS made the developing countries very conscious about the negotiation process and WTO commitment. This blunt/brave negotiation stand by the developed countries evolved and was known worldwide after the Third Ministerial Conference at Seattle, US.

During the Uruguay round the developing countries were not skilled or equipped at the negotiations and developed countries benefited from this weakness and brought the Uruguay Round balance in their favour. The developing countries realized this imbalance right after the

⁹⁴³ Philip McMichael (2000), Sleepless since Seattle: what is the WTO about? Review of International Political Economy 7:3 pp466–474.

Uruguay Round ended and when it was not implemented the way they have thought. However, after learning lesson from the Uruguay Round the developing countries performed slightly better in the Doha Round of multilateral negotiations. They can even negotiate better if they unite and are well prepared.

Some suggestions forwarded by Arvind Panagariya are quite realistic. By working on suggestion the developing countries can improve their relative bargaining position. The suggestions are as follows:⁹⁴⁴ Firstly, developing countries should focus on the composition of the negotiating. It should at least include lawyers and economists. Secondly, developing countries need to plan their policy before negotiations. Thirdly, developing countries must improve their research capacity. They should be in a position to understand and able to conduct cost-benefit analysis the agreements. Fourth, developing countries need bargain firmly and persistently. Fifth, promote development of civil society groups. Finally, and most importantly, developing countries need to cooperate with other developing and developed countries. For instance, developed countries cannot ignore if China and India together contest negotiations on any issue.

Thus, overall the WTO system is beneficial to all the WTO members provided they fight for their rights. Moreover, the DSS which can shape the WTO law is very important. Developing countries should cooperate with each other to collectively fight for their rights. Cooperation is necessary to achieve desired results. As, discussed earlier, that WTO provides an opportunity to the developing countries to fight/negotiate for their rights. The WTO system is itself good and gives a chance to the developing countries to balance the dominance of the developed countries in the WTO system through their cooperation.

⁹⁴⁴ Panagariya, Arvind (2002), *Developing Countries at Doha: A Political Economy Analysis*The World Economy. Volume 25, Issue 9, pages 1205–1233.

If the developing countries opt proper negotiation strategies (as discussed above) and invest some resources towards research they can benefit more from the rule based WTO multilateral trade system. This thesis does not argue in favour of TRIMS but calls for the expansion of WTO's role in the development of the financial sector i.e., global financial regulations. Currently, the soft laws with hard law effect (if attached with IMF conditions) are transplanted into the domestic economies of the developing countries. If the developing countries collectively research, and negotiate with collective resources then they might be able to negotiate better terms than those imposed by the IMF while extending financial assistance.

In other words, the collectively negotiating opportunities are better at WTO platform than with the IMF. Moreover, the WTO DSS which is also rule based is in a position to solve disputes related to global financial regulations which currently are not dealt anywhere.

IX. Conclusion

Looking at our recent history, membership of the IEs has increased considerably and this is mostly due to the fact that the sovereign states are convinced that being a member of these organisations would benefit them more than non-membership. There may be many reasons for sovereign states becoming part of a global regime and compromising on their independent decision-making. States join IEs of their own free will and only join because they think that it is overall advantageous to be part of the organisation.

The purpose of this study, as set out in the introductory chapter of this thesis, has been to conduct an analysis of the institutional role of the IEs, as part of the IELR, in achieving a more stable and balanced growth of the global economy in which both the real and financial side of the economy grows. The objective of conducting this analysis was to develop an understanding of the link between the certainty and predictability of the rules of the game through the IELR and the Economic Cycle.

To limit the scope of the research, this thesis has taken two IEs as a case study; namely, the IMF and the WTO. The reason for choosing these IEs is very simple and is also discussed in the introductory chapter. The institutional role of these IEs is relatively significant in stimulating the Economic Cycle. The IMF has a leading role in the process of setting the rules of the game for the global financial sector whereas the WTO is the most effective in dealing with international trade matters.

The concept presented in this dissertation and the evolution of the IELR has been discussed in the first section of the thesis. The remaining two sections have demonstrated the application of the concept, presented in the theory chapter, in relation to the IMF and the WTO.

The concept of the IELR is based on liberally institutionalised rational cooperation among the sovereign states for collective gain in the form of IEIs. These IEIs, being the most important non-State actors, operate within the international economic framework through an international legal framework or international institutional framework or both to achieve an end result; that is, the more stable and balanced growth of the global economy.

The institutional role of the IEIs is defined in the theory chapter, as their role in their legislative and normative capacity, executive and administrative authority, and judicial and quasi-judicial functioning. The chapter two also stress on the principle of legal certainty that how institutional role can develop a set of rules and principles that are certain and predictable, which can better achieve overall stable and balanced growth. Moreover, thesis discusses of legal pluralism, legal transplant and legal harmonisation and relates the theories to the analysis of economic growth in the literature and how these theories explain the rise of institutions.

This thesis also discusses classical sociology, law and development, economic sociology, and institutional economics. The thesis then relies on Weber's theory of legal certainty and maintains that the legal certainty in any system ensures the calculability of economic activities within that system, including legal certainty of the rules of the game that control international trade and finance.

This thesis then explores the relationship of the institutional role of the IEIs in context of the Economic Cycle. The Economic Cycle as discussed in the theory chapter is based on the possible causal relationship between financial sector development and the international trade through the economic growth. According to it, economic growth is achieved through development of global financial sector (Patrick's supply lead hypothesis), which in turn stimulates international trade,

which then reinforces economic growth and leads to the development of the financial sector (Patrick's demand followed hypothesis).

This thesis asserts and shows that the IELRs (through the case studies of IMF and the WTO) through their institutional role support a stable and balanced growth of the global economy by stimulating the components of the Economic Cycle.

The analysis, of the relationship of institutional role of the IELRs and the Economic Cycle, conducted in this thesis is based on the regime theory which considers the web of global regulation as an international regime. This regime is mainly based on political, legal and economic factors, therefore it is referred to as the International Economic and Legal Regime. The main concept, as discussed in the introduction and also the conceptual framework, is examined from the liberal institutionalist viewpoint.

The above viewpoint maintains that the IELR is cooperation between the sovereign states of their own free will for collective gain. The most common and effective way to cooperate is through the IELRs which have their own will and reflects the collective will of its Members. Moreover, the only driving force for cooperation is mutual benefit and no other force; by other force, I mean the active participation of the hegemon in the regime. In other words, on the basis of the current cooperative mechanism (with liberal institutionalist insight), the IELR should be free from the dominance of the hegemon.

However, despite absence of hegemon in this current regime the collective dominance of the US and EU cannot be ignored absolutely. In practice it is observed that the US and the EU are to some extent dominant in the current economic scenario. In IMF and World Bank their dominance is constitutionally embedded in the weighted voting system. Whereas, it has been noticed by some scholars in the WTO, which is constitutionally liberally institutionalised, the

dominance of these two economic powers can also be noticed. In the WTO multilateral trade negotiation rounds the practice of agenda setting in Green Room meeting and then using economic and diplomatic coercion to bring other countries (especially developing countries) on board.

Two of the main IEIs which contribute significantly to the IELR have a strong realist insight; they are the IMF and the World Bank. These IEIs-created rules of the game have the taste of a realist approach in which the hegemon imposes rules of the game for its own benefit. The existence of the realist insight in these IEIs is evidenced by their decision-making and voting systems which very clearly tilt in favour of the US and its allies (especially EU). This aspect is also discussed in the evolution part of the chapter III which give a better understanding of the IELR and documents the historical background of the current regime and the way in which it evolved to its current stage.

The IMF is a substantial contributor to the IELR and it does not explicitly acknowledge its institutional role; it only defines its goals. The motive for highlighting its objectives and not its institutional role is to avoid any discussion which could lead to the explicit unveiling of its realist insight to the liberally institutionalized IELR. This is a possibility because structural and operational modification would require all the Members to contribute and this could cause the collective liberal institutionalist will to converge, based on the current patterns of the IELR, and question the hegemonic voting rights within the IMF.

Section two of this thesis demonstrates that the institutional role of the IMF does exist and could be better improved if it is explicitly acknowledged. The institutional role of the IMF is quite significant in the context of the Economic cycle. Both the elements of the Economic Cycle, financial sector and the international trade, are adequately addressed by the IMF. Moreover a

common perception about the IMF has nothing to do with international trade is also removed by showing the notable contribution by the IMF in enhancement of international trade.

However, even if the IMF acknowledge its institutional role, the structural deficiencies such as the absence of an adjudicating system and absence of democratic values within the IMF are significant enough to hold the IMF to contribute optimally towards the IELR. Moreover, this thesis has asserts that the structural deficiencies and absence of democratic values in the IMF are realistically not possible to modify.

The main reason for the IMF not openly recognising its institutional role is that it does not want to make officially public its realist characteristic within the liberally institutionalised dominated IELR. Regardless of deficit of democratic values within the IMF's, its membership widely follows the IMF; this is because there is not any other organisation to support in condition of desperate monetary need.

A suggestion is put forward in section two that the IMF can split its institutional role (which result in global financial regulations) and financing role in order to function more effectively to achieve its objectives. The weighted voting system could be retained on the financing role of the IMF and liberally institutionalised values could be incorporated in the global financial regulation role.

Section three is a response to the section two which asserts that practically major changes in the IMF is not possible because the dominant powers would not let go their dominance easily. On the other hand, the liberally institutionalised WTO has the tendency to modify its functioning for collective gains.

Section three discussed in detail the current contribution made by the WTO towards the IELR in the context of the global financial sector. The contributions are made by the WTO are relatively

less as compared to some of other IEIs. However, if the WTO's institutional role is expanded, which is possible, it could solve the problem by substituting the IMF's realist rules of the game with the WTO's liberally institutionalised rules of the game. Thus section three showed how the IMF fails to be an effective and legitimate part of the IELR and how the WTO has the potential to fill in the legitimacy and accountability gaps, and effectively substitutes the IMF's global financial rule setting role.

Section three also address the concern some scholars about the dominance of the EU and the US in the WTO multilateral negotiations. It has been observed and argued by some scholars that despite the WTO being a constitutionally liberally institutionalised and mainly every matter dealt by it is through consensus. But it is alleged that behind the veil of consensus the developed countries lead by EU and US puts economic and diplomatic coercion on the developing countries to achieve favourable deal for them.

The presence of this dominance cannot be absolutely ruled out. However, WTO gives option to the small economies to cooperate and unite together for collective gains. For example, if India and China together take a stance on an issue in the WTO negotiations; it cannot be ruled out by the developed nations. This is because China and India are considered as emerging economic powers. Thus, in the WTO system there is a hope that one day a weak economy might have an equal say as that of the developed countries.

Moreover, it was notices by some scholars that in the Uruguay Round developed countries tilted the Uruguay round negotiation results in their favour. This aspect of the developed countries was quite visible by the time of the Third Ministerial Conference at Seattle, US. The developing countries have learnt their lesson and now they try to cooperate with other countries both developed and developing countries to negotiate in a more coherent way. It has been noted by

some scholars that in Doha Round the imbalance of Uruguay Round was not restored but the developing countries negotiated relatively in a better way.

The section three also highlights the WTO's institutional role in the promotion of innovation through TRIPS. The link between innovation (creating comparative advantage) and international trade is very strong within the international economic framework. Highlighting this very aspect of TRIPS avoids repeating the content of other chapters. The institutional role of the WTO in the promotion of the international trade is discussed, and this, in turn, completes the Economic Cycle.

Overall, this thesis uses legal certainty created by the institutional role of the IEIs in achievement of a more stable and balanced growth of the global economy through Economic Cycle. As, a case study the IMF and the WTO are selected for the analysis. Both the institutions create legal certainty through their institutional role and support a more stable and balanced growth of the global economy. In analysing the institutional role of these IEIs, thesis finds that the WTO is in a better position to perform its institutional role than the IMF. On this bases thesis argues that the WTO should enhance its role in the global financial sector development. Although, the WTO negotiations suffer some informal dominance element from the US and the EU, but it provides opportunity to the developing countries to formally cooperate and reduce this informal dominance.

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Useful Web Sites

BIS visit: <http://www.bis.org/>

Bretton woods project <http://www.brettonwoodsproject.org>

ICSID visit: <http://icsid.worldbank.org/ICSID/Index.jsp>

IDA visit: <http://www.worldbank.org/ida/>

IFC visit: <http://www.ifc.org/>

International Accounting and Auditing Standards:

http://www.worldbank.org/ifa/LessonsLearned_ROSC_AA.pdf

International Association of Insurance Supervisors' Insurance Supervisory Principles visit:

<http://www.iaisweb.org/index.cfm?pageID=41>

International Organization of Securities Commission's Objectives for Securities Regulation visit:

<http://www.iosco.org/>

MIGA visit: <http://www.miga.org/>

NATO: <http://www.nato.int>

OECD visit: <http://www.oecd.org>

The Council of Europe <http://www.coe.int/>

UN visit: <http://www.un.org>

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