Understanding Technical Barriers to Agricultural Trade

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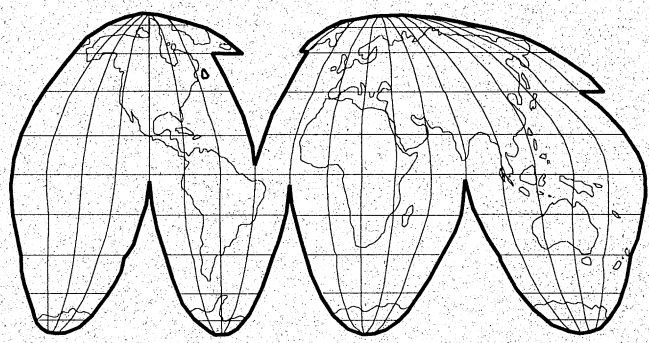

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The Intersection of Law and Trade in the WTO System: Economics and the Transition to a Hard Law System

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The entry into force of the World Trade Organization Agreement on January 1, 1995 culminated nearly a decade of negotiations aimed at restructuring the liberal international trading system. These negotiations were in many ways more successful than knowledgeable observers had expected. A single integrated rule system was adopted in place of the General Agreement on Tariffs and Trade [GATT] *a la carte*. Services, investment measures and intellectual property rights protection were the subject of new area agreements. Hard-fought inroads into agricultural protectionism were made. The dispute settlement system was revised in important ways.

Many of the changes brought about by the Uruguay Round [UR] negotiations were intended to address perceived defects in the legal structure of the GATT. The changes addressed perceptions that the GATT was insufficiently law based; that it operated on the basis of the effective economic and political power of its members, and dealt unfairly with the interests of members lacking effective bargaining power. The United States [US] had unilaterally adopted GATT-inconsistent measures with virtual impunity; redress against it other than by the European Union [EU] and Japan was politically impracticable.

Dissatisfaction with the legal character of the GATT was not limited to developing countries and NICs. The Japanese were anxious to strengthen GATT rule enforcement. Japan operates outside a formal regional integration mechanism like the European Community [EC] Treaty or North American Free Trade Agreement [NAFTA]. Regional structures will provide fallback trade environments if the global trading system becomes unglued. Japan does not have this fallback. It has become essential to Japan to assure that the multilateral trading system continues to function effectively. The Japanese government perceived that the GATT would best serve its interests as a more enforceable set of rules.[1]

The enhanced "legalization" of the GATT system as embodied in the World Trade Organization [WTO] may be described as a transition from a "soft law" to a "hard law" system. The term "soft law" has been used by international lawyers for a number of years to characterize legal norms that do not effectively compel compliance. Examples of soft law include various United Nations [UN] General Assembly Resolutions that urge states to behave in one way or another, but do not provide a concrete basis for enforcement through the International Court of Justice or UN Security Council. The term "soft law" has also been used to describe some of the results of the 1992 Rio Conference on Environment and Development. At that conference, governments adopted a number of non-binding

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[1]These views were conveyed to the author in interviews with government officials in Japan in 1993. Frederick M. Abbott, Law and Policy of Regional Integration: The NAFTA and Western Hemispheric Integration in the World Trade Organization System (1995), Ch. 8.

declarations, including the Rio Declaration on Environment and Development. The Rio Declaration is ascribed a soft law character because it does not impose the type of concrete legal obligations on its adherents that would be imposed by a treaty.[2] The GATT 1947 General Agreement is of course a treaty, and it does impose specific legal obligations on its members. A characterization of the GATT 1947 as soft law should not be understood to equate it to a UN General Assembly Resolution or the Rio Declaration. A soft law characterization of the GATT 1947, though perhaps imprecise, is intended to reflect the operational reality of the GATT from 1947 through the UR.[3]

The seminal description of the GATT as a soft-law system is in Olivier Long's Law and Its Limitations in the GATT Multilateral Trading System.[4] Long, a former GATT Director-General, suggested that the GATT functioned effectively as an international organization because its Members chose to operate through a flexible process of political bargaining as opposed to demanding attention to a fixed set of rules. If the demands of a block of Members were inconsistent with existing rules, new rules would be fashioned.[5] If the express mechanisms for amending the General Agreement appeared inconvenient, a new and less demanding amendment mechanism might be employed.[6] Disputes were resolved by consensus and not by the imposition of measures on a recalcitrant member.

"Hard law" refers to a system of norms to which a relatively high expectation of compliance exists. The changes brought about by the entry into force of the WTO Agreement may be characterized as part of a transition of the GATT/WTO from a soft law to a hard law system.[7] The principal evidence of this trend may be found in two areas. The first is in the

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[2]Ulrich Beyerlin, "The Concept of Sustainable Development," in Enforcing Environmental Standards (Rudiger Wolfrum ed. 1996 forthcoming). Beyerlin does not expressly adopt the "soft law" terminology, referring instead to the concept of sustainable development as "an overall political aim which all actors in the field of international environmental protection and development have to respect."

[3]In its seminal decision denying the GATT a self-executing character, the European Court of Justice emphasized the character of the GATT as a forum for reciprocal bargaining, as opposed to a fixed set of rules. International Fruit Company N.V. v. Produktschap voor Groenten en Fruit No. 3), Case 21-24/72, Court of Justice of the European Communities, Dec. 12, 1972.

[4]Olivier Long, Law and Its Limitations in the GATT Multilateral Trading System (1985).

[5]As in the case of special and differential treatment for developing countries.

[6]As in the case of the consensus framework agreements used to conclude part of the Tokyo Round negotiations.

[7]The movement of the GATT/WTO from a soft to a hard law system might be understood to manifest itself in a number of ways. The creation of the single integrated system, for example, might be understood to evidence the trend by eliminating the optional character of many sets of rules. Rules are now applicable to a greater number of parties. However, the mere extension of norms to a wider group of parties does not necessarily signal an enhancement in the expectation that norms will be complied with.

progressive refinement of rules from the general to the specific. The second is in the transformation of the dispute settlement system from consensus-based to quasi-judicial. These two manifestations have occurred to some extent independently of one another. The phenomenon of rule refinement has been underway since the founding of the GATT, and was a major theme of the Tokyo Round negotiations which culminated in 1979.[8] The transformation of the dispute settlement system in the conclusion of the UR, on the other hand, represented a sharp break with the consensus practice that had evolved since 1947.

The overarching goal of the WTO system is the progressive worldwide elimination of tariff and non-tariff barriers to trade in goods and services. Underlying the WTO system is the economic theory of comparative advantage holding that as individual nations allocate production to their comparatively most efficient sectors, and trade with other nations for efficiently produced goods, global wealth creation will be optimized. The question naturally arises whether a hard law multilateral trading system is more likely than a soft law system to optimize the free movement of goods and services, and reduce trade barriers. The intuitive answer to this question is "yes," since a hard law system should be assumed to enhance the prospects of compliance with specific rules. On the other hand, there are several variables that raise doubts. The establishment of a hard law framework may, at least in the short term, increase the frequency of disputes; it may reduce the likelihood that governments will accept new commitments; it may increase the likelihood that disputes will lead to a breakdown in inter-governmental relations, and; it may not in fact result in compliance (a result suggested by the US-Japan automobile dispute). Moreover, hard law is not necessarily good law -- specific and enforceable rules may not have been designed to reduce barriers to trade.

This paper examines the transition of the GATT/WTO from a soft law to a hard law system, and makes some tentative suggestions about the potential economic implications of this transition. It suggests that, on the whole, the transition should tend to enhance global economic efficiency by reducing the transactions costs associated with international trade. However, there are many uncertainties inherent in this conclusion. Moreover, the creation of a hard law system in the WTO is but one of a number of important developments that will influence the flow of trade.

Two contemporaneous trends outside the movement from a soft to a hard law system will significantly determine the capacity of the institution to reduce barriers to trade. The first is the simultaneous evolution of competing regional rules systems, such as the EU and NAFTA, which may threaten the integrity of the WTO rule system. The second, and perhaps more important, is the potential incorporation of new and powerful state actors such as the People's Republic of China [PRC] and Russia into the WTO system. The politics of the WTO system will be realigned as these new state actors add their voices to the system, and it is open to question whether these voices will be reading from the Organization for Economic

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[8]Rule refinement does not always result in a significant reduction of the level of discretion allowed to national governments, as evidenced to some extent by the Sanitary and Phytosanitary Measures Agreement. In the concluding stage of the UR this agreement was modified to facilitate deviations from internationally-agreed norms.

Cooperation and Development [OECD] book of verses. The combination of a new hard law approach, the ascendence of regionalism, and major state actors with economic perspectives decidedly different from that of the US and EU, may result in a substantial challenge to the functioning of the WTO system.

From Soft Law to Hard Law

The Refinement of Rules

The GATT General Agreement as adopted in 1947 contained a set of general principles drafted at a fairly high level of abstraction. The two most important general principles, the most favored nation [MFN][9] and national treatment principles,[10] in theory are capable of application in the most diverse circumstances. However, in neither case has the application of the general rule proven straightforward. In part this is because the General Agreement itself contains exceptions from the general principles, and the inter-action of the general principle and the exception gives rise to complications. In part this is because parties may in good faith differ as to the intent of the general principle in a specific case.

To illustrate with respect to exceptions, GATT Article XXIV establishes an exception from the MFN principle to permit the creation of customs union and free trade areas.[11] While the MFN principle itself is relatively straightforward, the customs union exception is not, and interpretation of the customs union exception has been problematic since the founding of the GATT. In order to resolve some of the ambiguities surrounding the customs union exception, the UR negotiations included an Understanding on Article XXIV which seeks to clarify the meaning of certain of its terms. The Understanding with respect to Article XXIV is quite a bit lengthier than Article XXIV itself, and would have been much longer except for the fact that it incorporates by reference certain tariff averaging procedures followed by the GATT Secretariat in the UR negotiations.[12]

Good faith differences of opinion with respect to the application of general principles, and the resulting need to reduce the scope of permissible interpretation, are a more prevalent basis

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[9]General Agreement on Tariffs and Trade 1994 [hereinafter GATT], art. I, in World Trade Organization, The Results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Texts (1995).

[10]GATT, art. III.

[11]Other examples are the tension between the MFN principle and the exception for less developed countries and the prohibition of export subsidies and the expectation for exports of primary products. The problem of interpreting exceptions in relation to rules has led to some of the most intense and long lasting GATT disputes.

[12]Regarding Article XXIV, the Understanding regarding Article XXIV, and new General Agreement on Trade in Services (GATS) Article V governing regional services agreements, Frederick M. Abbott, Law and Policy of Regional Integration: The NAFTA and Western Hemispheric Integration in the World Trade Organization System (1995), pp. 35-54.

for the addition of specifics to the GATT. The national treatment principle is frequently invoked in dispute settlement proceedings. A GATT Member is expected to treat imported products on the same basis as domestically-produced products for the purposes of internal sale. For good reason, formally identical treatment of domestic and imported products is not required. A government may require that certain agricultural procedures are followed domestically to protect the health of humans or animals, and the same government may require the border inspection of like imported products to assure equivalent safety. The goal of the regulations is the same, i.e., protection of health at an equivalent level. The application of different rules to imported like products is not contrary to the national treatment principle unless the aim and effect of the import regulations is to afford a competitive advantage to domestic production.[13] The desire to avoid the inherent uncertainties in determining whether import regulations are the equivalent of domestic regulations has caused governments to seek in the Sanitary and Phytosanitary Measures [SPS] Agreement to establish specific rules as to how import measures are adopted, to assure the transparency of rules, and to govern the way these rules are applied.[14]

Articles VI and XVI of the GATT established rules with respect to the application of antidumping and countervailing duty measures. By the time the Tokyo Round negotiations were initiated, it was apparent to many GATT Member governments that these rules allowed too much flexibility in the determination of dumping and subsidization, and so efforts were undertaken to add specificity, such as by clarifying the method by which material injury to domestic industries would be determined. The adoption of these more specific rules in the Tokyo Round did not accomplish a great deal in terms of minimizing inter-governmental friction in the context of dumping and subsidization, so efforts to further clarify rules were pursued in the UR. In the new Agreement on Application of GATT Article VI a higher level of detail is added, for example, with respect to the rates of exchange to be used in comparing export price and normal value.[15] Likewise, the Agreement on Subsidies added a substantially higher level of detail regarding what types of subsidies may be countervailed against.[16]

Economics is a largely quantitative science. If tariff A is reduced by x percent, and if the elasticities of supply and demand are y and z, and if exchange rates are held constant, then, all other things being equal, there will be an increase in imports of q. Quantitative analysis of course has its limits. Services barriers are difficult to quantify, elasticities are difficult to measure, and all other things are often not equal. Human behavior plays a central role in determining economic events. While economists attempt to quantify human propensities -- as, for example, with consumer sentiment surveys and indices -- difficulties in predicting

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[13]For an explanation of the National Treatment principle, see the GATT panel report in United States Taxes on Automobiles.

[14]Agreement on the Application of Sanitary and Phytosanitary Measures [hereinafter SPS's Agreement], at Annex C.

[15]Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994, at art. 2.4.1 [hereinafter Agreement on Dumping].

[16]Agreement on Subsidies and Countervailing Measures, arts. 3-8.

human behavior hinder the ability of economists to make accurate forecasts.[17] The same kinds of indeterminacies inherent in individual human behavior are inherent in governmental or state behavior. The reaction of one government to the trade measures of another government may principally depend on predictions regarding quantifiable economic effects. However there are more subjective factors that may also influence or determine reactions, including the political history of relations between the governments, perceived national security concerns, and domestic political variables.[18] For this reason, "political economics" may be the discipline that best suits an analysis of the potential impact of the new WTO agreements on administered barriers to trade.

The WTO Agreements on SPS, Dumping and Subsidies, as well as the agreements with respect to fields such as technical barriers to trade, valuation for customs purposes, rules of origin and import licensing procedures, establish specific rules with respect to the operation of "administered barriers to trade" as those terms are used in the context of this conference. The objective of the negotiators of these agreements was to clarify the application of GATT general principles (such as the national treatment principle) in the relevant subject matter areas, and to limit the discretion of national and regional administrators in the implementation of rules. The goal of limiting discretion was not, however, pursued without objection or qualification.

A useful illustration of the tendency to qualification is in a provision regarding dispute settlement in the Agreement on Dumping. If a Dispute Settlement Understanding [DSU] panel finds that there is "more than one permissible interpretation" of the Agreement on Dumping, and a complained-against Member's administrative measures are in conformity with one permissible interpretation, then those measures will be considered consistent with the Agreement.[19] The implication of this provision is that WTO Members did not in fact agree on a single set of rules governing the application of antidumping measures, but instead achieved an agreement with multiple meanings that may be adjusted to suit individual Members. There is some considerable concern among GATT legal scholars with respect to this provision. It seems to be inconsistent with general principles of treaty interpretation which assume that the meaning of terms can be definitively ascertained. A provision that

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[17]Brookings Report on External Balances.

[18]Law is a largely subjective science. Human behavior is often difficult to predict, and the outcome of legal measures is inherently uncertain. For example, it may be intuitively postulated that the degree to which a law will control behavior is directly dependent on the intensity of the sanctions and enforcement mechanisms that accompany the law. Nevertheless, even the most extreme sanctions do not assure compliance with law. Murder occurs even if capital punishment is certain and drug traffickers continue to ply their trade in countries where they face virtually certain execution if caught. Economists certainly recognize that a general analysis of the effect of the economic effects of the WTO agreements on administered barriers to trade will involve a great number of variables and must account for a great deal of uncertainty, including the uncertainties inherent in unpredictable human (and governmental) behavior.

[19]Agreement on Dumping, art. 17.6(ii); see Croley and Jackson, in Petersmann.

permits individual WTO Members to adopt different interpretations of the same text suggests some of the difficulties that may be inherent in attempting to ascribe or predict economic effects with respect to the WTO agreements governing administered barriers to trade. Predicting the effects of the agreements is hampered by uncertainties in the agreements themselves.

The most significant movement toward the creation of specific or hard rules in the GATT/WTO system occurred in connection with the Agreement on Trade-Related Aspects of Intellectual Property Rights [TRIPS Agreement]. In the TRIPS Agreement, WTO Members largely abandoned the historical practice of leaving to individual governments the choice of mechanisms used to fulfill their GATT obligations, and specified both strict minimum substantive standards of intellectual property rights [IPRs] protection and the legal mechanisms for enforcing those standards that Member governments must maintain.[20] The TRIPS Agreement reflects a significant degree of skepticism among OECD governments that a soft law system in the area of IPRs protection would be adequate to protect their perceived interests. The hard law of the specific TRIPS substantive standards, and the potential for imposition of trade sanctions against transgressors, would be more suited to their purposes.

The often-cited length of the final WTO Agreement as some 25,000 pages is deceptive since this includes the tariff schedules of the members. The basic texts, standing at approximately 500 pages, nevertheless represent a significantly more detailed set of rules for the governance of the multilateral trading system than the GATT 1947 and Tokyo Round agreements. Taken as a whole, these texts evidence a trend toward the application of harder law in the WTO.

From Consensus to Quasi-Judicial Dispute Settlement

The WTO Agreement has transformed the GATT dispute settlement system from a consensus-based system to a quasi-judicial system. Both the old and new systems derive from Article XXIII of the GATT which generally provided for a system of consultation, to be followed by recommendations from the Members as appropriate, to authorization of the withdrawal of trade concessions as required.[21] The basic Article XXIII provisions evolved over time into a panel dispute settlement system which was codified in a 1979 Understanding on Dispute Settlement. In this system, the GATT Council received complaints from Members, and could agree by consensus to establish a panel of experts, generally consisting of three individuals, who were charged with drafting a report with respect to a dispute. The report might make recommendations concerning measures to be taken by a complained-against Member in order to conform its rules to the GATT. In order for the report of the panel to be binding on a complained-against Member, the GATT Council was required to adopt the report by a consensus of its Members, including the complained-against Member.

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[20]Agreement on Trade-Related Aspects of Intellectual Property Rights.

[21]Robert Hudec, Enforcing International Trade Law (1993), and Pierre Pescatore, William Davey, and Andreas Lowenfeld, Handbook of GATT Dispute Settlement (1991, and updates).

Although this system of dispute settlement appears to have functioned effectively for much of recent GATT history,[22] there was a perception that the consensus-based system resulted in the the failure to establish panels and avoidance of panel rulings,[23] and that the system was therefore insufficiently law-based.

The DSU[24] adopted in connection with the conclusion of the UR substantially alters the prior GATT dispute settlement practice.[25] The DSU applies to the settlement of disputes under all of the multilateral trade agreements [MTAs]. Following a mandatory consultation period, a panel of experts will be appointed by the WTO Secretariat (or Director-General if necessary), unless the Dispute Settlement Body [DSB] votes by consensus against the establishment of a panel.[26] The report of the panel will be adopted by the DSB unless there is a consensus vote against adoption, or unless a disputing party appeals the decision to the newly created Appellate Body. If an appeal is undertaken, the ruling of the Appellate Body is adopted by the DSB, unless there is a consensus against adoption. Since there is little prospect that a consensus will exist against the adoption of a report,[27] for all intents and purposes the adoption of panel reports is now automatic.

The automatic adoption of panel reports is coupled with other important features of the new DSU. The DSU makes clear that Members are expected to resolve disputes involving interpretation and application of WTO rules, or "impediment[s] to the attainment of any objective of the covered agreements," under the rules and procedures of the DSU.[28] Moreover, a Member is not to impose trade sanctions on another Member for an alleged violation of WTO rules without the authorization of the DSB.[29] The DSU thus generally prohibits the unilateral imposition of trade sanctions. The adoption of rules prohibiting the unilateral imposition of trade sanctions was directed towards the US and its Section 301

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[22]Hudec, *id.*

[23]In fact, the adoption of a number of important panel reports rendered during the Uruguay Round negotiations, including the two Tuna panel reports, the Cafe Standards and Banana reports, was blocked. However, the reports may, in part, have been blocked on the grounds that the subject matter would be addressed as part of the bargaining at the completion of the Round. So that, in a sense, the claimed ineffectiveness of the panel procedure was a self-fulfilling prophecy.

[24]Understanding on Rules and Procedures Governing the Settlement of Disputes.

[25]Ernst-Ulrich Petersmann, The Dispute Settlement System of the World Trade Organization and the Evolution of the GATT Dispute Settlement System Since 1948, 31 CMLR 1157 (1994).

[26]The DSB is the General Council of the WTO sitting under a different name.

[27]The only foreseeable basis for a consensus against adoption is that the prevailing party will choose not to pursue its remedies. However, since that party is entitled to withdraw its complaint at any time, there is no foreseeable reason why it would permit the report to be brought before the DSB, only to vote against it.

[28]DSU, art. 23:1.

[29]*Id.* art. 23:2(c).

legislation which sets up the US Trade Representative's Office as prosecutor, judge, and executioner with respect to the trade-related practices of foreign governments.[30]

The dispute settlement procedure of the GATT 1947 involved a political negotiation directed at achieving a consensus among the disputing Members. Although this procedure may have been largely successful in resolving disputes, it lacked the legal character of a judicial procedure. A judicial procedure requires that the decision-making function be performed by a neutral decision-maker, i.e., one without a direct interest in the outcome of the dispute. The assumption underlying the judicial procedure is that the law applicable to the parties will govern the outcome of the dispute, and not the self-interest of the parties. Under the GATT 1947 system, the interests of the Members and the willingness of the Members to make concessions with respect to those interests were central to the outcome of a dispute.

The WTO DSU removes WTO Members from the center of the decision-making function by making the establishment of panels and the adoption of panel reports automatic. The panels and Appellate Body assume the role of primary decision-makers. Since panels are appointed on a case by case basis, the panelists act in the capacity of arbitrators rather than judges. Members of the Appellate Body serve for extended terms and have the independent character of appellate judges. On the whole, it seems fitting to refer to the new DSU procedure as "quasi-judicial." The underlying assumption of the new WTO system is that the law is the master of the Members. The outcome of a dispute settlement procedure should not, at least nominally, be based on a political negotiation.

Soft Law to Hard Law

It may be that a flexible soft-law character of the GATT was suitable from 1947 to the mid-1980s, when the global trading system was dominated by the US and the EU. Effective power in the multilateral trading system of the 1990s is more diffuse, and disputes may not be as easily settled as they were in the past. For this and other reasons, the soft-law system may have outlived its usefulness. The trend from a flexible to a fixed law system in the GATT/WTO is clear in the progression from GATT 1947 to the Tokyo Round to the UR. It is nevertheless not clear yet whether the new hard law system will be effective. There exist alternatives to the widely inclusive WTO system in the form of increasingly large and powerful regional trading systems in which states may share more complementary interests, and in which states may be more amenable to complying with hard legal rules.

The Economics of the Hard Law System

Since this is a distinguished audience of professional economists, I will not attempt to impress you with my mastery of the economic sciences. I will confine myself to some

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[30]Robert E. Hudec, "Thinking About the New Section 301: Beyond Good and Evil," in Aggressive Unilateralism (Jagdesh Bhagwati and Hugh T. Patrick, eds. 1990).

tentative suggestions or observations regarding the economic implications of the transition of the WTO to a hard law system, and hope that these observations may stimulate some useful reflections.

Transactions Costs and the Multilateral Trading System

The economic goal of trade liberalization is the enhancement of global efficiencies in the production and distribution of goods and services, i.e., the promotion of wealth creation (and, with appropriate social welfare planning, an equitable distribution of the wealth created). I will for the time being put aside the vital question of social welfare protection and enhancement that may interfere with pure economic efficiency, recognizing that efficiency without welfare is not a desirable goal. Thus, I will invoke the preamble of the economist -- I will assume a world in which maximizing economic efficiency in the production of goods and services is the desired goal.

It appears well accepted in economics literature that transactions costs are a drag on efficiency. I believe that one of the principal observations of Coase was that under free bargaining conditions legal rules are largely unimportant in determining the level of production in an economy since rational economic actors will bargain around legal rules that allocate production inefficiently. Coase suggested that transactions costs associated with the bargaining process may have a significant impact on economic efficiency.[31] He recognized that legal rules may substantially affect the distribution of wealth created by productive activities, even if not the level of production itself. If Coase is correct about the importance of transactions costs, which I believe he is, then one important economic goal of any legal system -- including a multilateral trading system -- will be to reduce the transactions costs associated with bargaining around rules.

It would be a tremendously interesting exercise to construct and test an international trading system model based on Coase's hypothesis that reduction of transactions costs is the prerequisite of efficiency -- and perhaps someone in this audience will know if this has already been done -- but it would not be easy. Coase highlights that wealth transfers between economic actors must be used as bargaining tools to permit the efficient allocation of production. The international economic system can be highly resistant to wealth transfers, and bargaining around inefficient legal rules may be exceedingly difficult. Thus the international economic system has certain inherent obstacles to optimum allocation of productive resources that may not be overcome by foreseeable bargaining. Regrettably, I will not be able to lay out a detailed Coasian model of multilateral trading behavior in this paper.

However, I wish to expand on one simple idea: that legal rules which can be applied with lower transactions costs are more economically efficient than legal rules which impose higher transactions costs. Assume that two countries would trade x volume of goods in period 1. The exchange of goods would reduce production costs in both countries by y amount. Delays in transaction processing imposed by bargaining over the terms of trade during period 1

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[31]Ronald Coase, "The Problem of Social Cost," 3 *J. Law & Econ.* 1 (1960).

would reduce the amount of efficiency gains in production by some amount z (thereby reducing y).

If the bargaining in period 1 results in a reduction in trade barriers that enhances future economic efficiencies, then production cost savings in future periods (e.g., period 2) will result. A future cost of y^1 will be saved in time period 2, but z will nevertheless have been lost in period 1.

The intuitive assumption is, I believe, that hard legal rules will, all other things being equal, reduce the amount z. The operation of a hard legal system should reduce delays in transaction processing by reducing the number of disputes concerning the application of rules, or by reducing the time spent in resolving disputes, that is, reducing bargaining or transactions costs.[32] The straightforward hypothesis is that the transition of the WTO to a hard legal system will reduce the frequency and duration of trade disputes, and thereby improve the efficiency characteristics of the multilateral trading system. The reality, of course, is not so simple.

First, the parties that argue trade disputes in the WTO are governments, while the parties that engage in trade are largely private enterprises. Therefore, there may not be a strong correlation between the frequency and duration of trade disputes settled within the WTO and the economic activity of private enterprises. If government A and government B dispute whether a particular agricultural inspection method violates the SPSs Agreement, this may not have an impact, or may have only a modest impact, on agricultural imports and exports during the prosecution of the dispute. Thus, reducing the frequency or duration of disputes within the WTO may have little or no direct effect on the activities of producers of goods and services, and therefore little or no effect on the efficient allocation of productive resources.

On the other hand, private enterprises may be affected during the prosecution of disputes, and such parties may refrain (by choice or necessity) from engaging in trade transactions pending the resolution of disputes. Take the cattle growth hormone dispute between the US and the EU as an example. This inter-governmental dispute has had a significant impact on exporters and importers, and has affected the volume of transactions during the dispute. Similarly, the dispute concerning the EU banana regulations has significantly affected the volume and direction of trade in bananas during the dispute. An expeditious resolution of the dispute presumably would restore some or all of the lost volume of trade. Since the EU has blocked two banana panel decisions under the old "soft" GATT system that would have caused it to reduce its barriers, and since the new "hard" system would not tolerate the blocking of panel decisions, this is a case in which the hypothetical capacity of the new system to reduce transactions costs is perhaps illustrated.

Second, in the short term at least, the new hard law system of trade regulation and dispute settlement may well result in increased recourse to WTO dispute settlement as compared with

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[32]While these observations could be framed in the form of a mathematical formula, I doubt that such an exercise would serve any useful purpose.

the prior GATT system. The new dispute settlement system does not require the consent of the complained-against party in order to proceed. With this obstacle to dispute settlement (at both the initiation and conclusion phase) removed, WTO Members may be more inclined to pursue dispute settlement. The political negotiation previously involving the complained-against party is no longer an obstacle. Japan, for example, has signaled its intention to more actively pursue trade dispute settlements in the WTO.

Nevertheless, it may be that more frequent recourse to WTO dispute settlement will result in the more expeditious settlement of trade disputes (which may not previously have been brought into the GATT), and thereby result in a reduction in overall inter-governmental transactions costs. With only a soft law system of dispute settlement, the parties to a dispute might have spent years in political negotiations whereas now they will be able to avoid this long period of negotiation through an expeditious proceeding at the WTO. It may therefore be that an increased frequency of recourse to the GATT/WTO dispute settlement mechanism will be combined with a shorter typical duration of dispute, perhaps leading to a net reduction in transactions costs, even over the short term. With respect to the longer term, a demonstration that trade rules will be enforced by the WTO Members might result in a decline in the frequency of disputes, as well as their duration. That is, at the moment, rather speculative.

In the context of this conference, the question arises whether administered barriers to trade are a substantial enough component of GATT dispute settlements such that reducing the frequency or duration of their disputes would have a significant effect on transactions costs within the GATT/WTO.

Bob Hudec has compiled a statistical profile of all GATT dispute settlement cases between 1948 and 1989.[33] There were a total of 207 complaints filed during this period. Of these, 20 involved antidumping and countervailing duties, 33 involved subsidies, 108 involved non-tariff barriers (of which 26 involved discriminatory measures), and 44 involved tariffs (of which 17 involved discriminatory measures). Though certainly it will be useful to pursue a more detailed inquiry into the individual cases underlying these statistics (which Hudec's book will allow us to do), it seems clear as a general observation that a substantial proportion of GATT dispute settlement cases involved administered barriers to trade. If hard law rules are successful in reducing the frequency or duration of such disputes, these rules should have a significant impact on the transaction cost associated with WTO dispute settlement.

Of course, it may be that transactions costs imposed by a single dispute involving a non-administered barrier -- for example, a dispute involving a complaint challenging the formation of a customs union or free trade area -- would be substantially higher than the transaction costs of many disputes involving administered barriers. It is exceedingly difficult to compare apples and oranges in this context; that is, to offer a prediction as to whether hard law rules will have a greater dollar volume effect on trade disputes involving administered or non-administered barriers. Such a determination would require us to be able to predict with some

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[33]Robert Hudec, Enforcing International Trade Law (1993), pp. 273-366.

degree of accuracy the type and intensity of disputes that will arise in the WTO, and we do not have an adequate basis for offering any predictions in this regard.

In the final analysis, the intuitive assumption that a hard law dispute settlement system is more likely than not to reduce transactions costs in the international trading system is probably correct, though not without its difficulties.

The Economics of Certainty

A second question raised by the transition of the WTO from a soft to a hard law system is whether the more specific rules of the new system will improve productivity within the international trading system by reducing uncertainties about what constitutes compliance with the rules. Intuitively, we would expect that reducing governmental and private costs associated with ascertaining compliance and reducing the frequency of inter-governmental disputes (as well as government vs. private enterprise disputes) concerning compliance would increase production efficiencies.

However, the situation may occur in which an economy is over-regulated through clear and certain rules. If business enterprises spend too much time assuring regulatory compliance as compared with engaging in productive activity, then productivity will suffer. It does not appear that the WTO is at the present time in danger of imposing a volume of rules that might constitute a drag on international economic productivity. However, it is becoming increasingly likely that claims by Members that the WTO is "over-regulating" will become more vocal as the WTO moves more forcefully into the areas of environmental, labor, and competition regulation.

In addition, while in some circumstances economists may be satisfied to ignore the content of rules, e.g., in relation to calculating transaction costs, this is not true for all circumstances. For example, the new WTO Agreement on Subsidies is considerably more specific than the prior Tokyo Round Subsidies Code, but the new Agreement permits subsidies in some cases that the old Code did not.[34] If trade economists are in general agreement that subsidies distort efficiencies, then more specific subsidies rules that expand the level of permissible subsidies will not have a positive impact on global wealth creation. It is therefore not possible to postulate that more specific rules necessarily lead to greater economic efficiencies (consider, for example, a specific rule that quotas are permitted).

An economic hypothesis with respect to specificity must be more narrowly defined. We might hypothesize: if trade rules are designed to result in the reduction of obstacles to trade and if such rules are properly drafted, then more specific rules will in general be preferable to less specific rules because this will facilitate governmental and private party compliance, resulting in a reduction in disputes and a lowering of transactions costs.

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[34]For example, research and development subsidies for specific industries.

This hypothesis suggests that the content of rules makes a difference from the standpoint of economic productivity. This is certainly the real world case in which conditions of free bargaining do not prevail.

Compliance with rules governing administered barriers should be enhanced by specificity. However, the caveat previously mentioned will apply. Specific rules may not be designed to promote a reduction in administered barriers to trade. The rule permitting multiple interpretations of the Agreement on Dumping may, for example, facilitate the inappropriate application of antidumping laws.

To some extent, the SPS Agreement provides an example of hardening rules that may increase (or at least not decrease) barriers to trade. The new SPS Agreement is rather specific in permitting Members to individually determine the level of health risk they are willing to tolerate (e.g., in establishing their "appropriate level of protection").[35] This specific rule, as well as a rule allowing measures that are "not more trade restrictive than required,"[36] in place of an old rule requiring that measures be the "least restrictive to trade," are designed to permit Members to flexibly deal with social concerns. As a statement of values, these rules are laudable. As an economic proposition, they may be inefficient.

A More Cautious World

Even if a hard legal system in the WTO enhances Member compliance with rules, thereby reducing disputes and increasing productive efficiencies, there may yet be a reaction that over the long term impacts adversely on the system. As Members become more convinced that new rules will be enforced, they may become more hesitant to make new commitments towards eliminating barriers. The enforcement of rules may, in fact, have negative political consequences for Member governments in their own territories.

It may be replied, of course, that if governments are only willing to adopt rules that will not be enforced, this is no great economic benefit. Therefore, if Members elect to approach rule-making more cautiously, but genuinely intend to comply with the rules, this may be a positive result. Nevertheless, the forward momentum of the GATT was sustained by the willingness of its Members to compromise on soft commitments. That momentum could be lost in the transition to a hard law system.

The potential for resistance to commitments in respect to administered barriers to trade must be evaluated in light of domestic political pressures that often underlay the adoption and implementation of these measures. Antidumping laws are the archetypal administered barriers that exist largely to satisfy domestic political constituencies. They lack a satisfactory basis

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[35]SPS Agreement, art. 3:3, and note 2.
[36]*Id.*, e.g., art. 5:6.

in liberal trade theory.[37] If politically powerful domestic constituencies believed that a hard law reform of the WTO Agreement on Dumping might accomplish the purpose of reducing the frequency of Antidumping/Countervailing duty [AD/CVD] disputes, the resistance to such reforms might be intensified.

Hard Law and Heightened Conflict

Another variable in the transition from soft law to hard law is the potential that the hard law system will escalate tensions among Members. Under the soft law system, a Member could elect not to participate in a dispute settlement proceeding, or not to accept the result. The new system has been designed without these safety valves. The political consequences of this restructuring are indeterminate. I do not doubt the capacity of the WTO to fashion new face-saving devices to avoid the appearance of coercing Members. Olivier Long was of the view that the old system functioned well because of the spirit of compromise and consensus. The new hard law system has yet to be tested.

WTO Member governments do not act in an ideal world of disembodied spirit. Each operates at the interface of a domestic political arena and the international political arena. The domestic pressures to reject an objectively reasonable dispute settlement decision may be great. Pronouncing the end of the soft law system and achieving that reality may be two different matters.

Economics and Public Policy

The world does not live by economic efficiencies alone. In the US, economic policies designed to enhance business efficiencies may be taking a substantial toll on the social fabric of the nation. As this paper is drafted during the first week of December 1995, the French government faces a serious crisis resulting from its attempt to create efficiencies in its public works sector.[38] Whether hard legal rules increase the efficiency of the multilateral trading system is but a small component of the broader questions that the system must address. Efficient rules may enhance production, but they will not automatically result in a reasonably proportionate distribution of wealth in a world facing numerous distortions affecting the free movement of resources and persons. The WTO and its Members face important social welfare choices in the areas of labor protection, environmental protection, and others. It would be unwise to base these choices on economic efficiencies alone.

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[37]Hudec, Enforcing International Trade Law, p. 355, noting "the typical arbitrariness of AD/CVD criteria" may lead to the frequent failure of GATT settlement procedures in AD/CVD disputes.

[38]*N.Y. Times* of Dec. 5 regarding public workers' strike.

Extraneous Variables

There are two significant developments which will, in my view, impact the near to medium term future of the WTO in a more significant way than the success or failure of hard rules. The first, which has been much discussed, is the evolution of competing regional rule systems that threaten the integrity and supremacy of the WTO rule system. The second is the forthcoming entrance of powerful new Members into the system.

The EU, the NAFTA, Asian-Pacific Economic Cooperation [APEC] and the Mercosur are growing increasingly powerful. The number of countries participating in these arrangements has grown substantially, and membership in these arrangements has become a virtual matter of necessity for many countries. The EU has shown a recent tendency to ignore GATT rules and rulings in favor of regional rules and rulings. The potential for the regional systems to precipitate the disintegration of the WTO has been sufficiently analyzed that I need not belabor this matter here. I note only that this is a problem that deserves continued close attention.

Perhaps even more important, the WTO will in the near to medium term incorporate the PRC and Russia into its membership. These countries lack the history of market economics that has characterized the OECD, and yet they are great economic and political powers. The WTO is facing the prospect of no longer constituting an OECD-plus club. The prospects for consensus on important issues may soon be greatly diminished, and the WTO may become an organization ruled by majority, or super-majority, rather than by consensus. The potential consequences of this shift should not be underestimated. There are few, if any, examples of international organizations that have functioned as effectively as the GATT. The GATT may have functioned effectively because of its unique place in history. We might hope that the GATT functioned effectively because it was necessary to the economic well-being of modern civilization, and that Members will perceive the WTO as equally necessary to survival and prosperity.

Conclusions

The WTO is an exceptionally complex arrangement, from the economic, political, social and legal perspectives, and it is becoming more complicated. The isolation of specific rules and results, and quantitative analysis in particular cases, is problematic. UR negotiators have fashioned a new system of WTO legal rules more specific than prior GATT rules, and have coupled these rules with seemingly more certain enforcement. "All other things being equal," this new system should enhance productivity in the international economy and stimulate wealth creation. Caution should be exercised in assuming the flow of human events as a constant.