

If Weak Is Good, Will Strong Be Better?
Reforming the WTO Enforcement Mechanism

– Very first draft, comments most welcome –

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A robot may not injure a human being or, through inaction, allow a human being to come to harm.

A robot must obey orders given to it by human beings, except where such orders would conflict with the First Law.

A robot must protect its own existence as long as such protection does not conflict with the First or Second Law.

Isaac Asimov's *Three Laws of Robotics*

Abstract: In a nutshell, I claim in this memo that only free trade is ethical and ethical trade is free as it improves the welfare of all trading countries. As a consequence, it has to be made sure that all reforms of the World Trade Organization (WTO) further advance the idea of a world without barriers – quantitative or qualitative, obvious or obfuscated, long- or short-term – to cross-border exchange, to the idea of a truly global economy, where goods and services are allowed to flow freely and unrestricted throughout the world. Focusing on the WTO's dispute settlement procedures, I acknowledge that they have worked reasonably well at bringing about compliance with the international rules of trade. However, I argue that doing so via the threat and use of countervailing measures¹ is not consistent with the WTO's primary objective of increasing economic efficiency through free trade. First of all, there is the potential for abuse, the risk that countervailing measures are used as nothing but another means to insulate domestic producers from foreign competition. More importantly, even if the use of countervailing measures is

¹ By countervailing measures, I mean in this memo all types of retaliatory measures sanctioned under the WTO dispute settlement procedures.

sanctioned by the WTO, even if countervailing measures are only recovering the losses that the complainant's producers incur at the hand of the defendant and due to its illegal trade practices, and even if countervailing measures succeed at deterring countries from committing violations of the international rules of trade in the future or the first place, countervailing measures do still create trade distortions and reduce global welfare. Therefore, I suggest that the WTO's dispute settlement procedures should be reformed and modeled on the European Union's infringement proceedings, which do not allow member states of the EU to use the threat of protection to get other member states to implement and comply with European legislation. Instead of allowing member states to retaliate and infringe on European law themselves, the European Commission prosecutes member states, which it suspects of violating European law. If found guilty and still refusing to comply, the European Commission has the right to ask the European Court of Justice to impose financial penalties – which might be painful, but are not trade distorting.

Free Trade Equals Ethical Trade

Being more used to interpreting and describing confidence intervals, marginal effects, and standard deviations, than to writing about ethics, I start off this memo by boldly claiming that only free trade is ethical trade. Therefore, any 'ethical' reform of the WTO has to advance the idea of a truly globalized economy where people are free to engage in exchange with any individual, group, or company from any country. Unrestricted trade

leads to lower prices for consumers, higher quality products, greater efficiency in the use of resources, and thus a higher standard of living for people around the globe.

While arguments against free trade are common, they are also very much misguided. Claims that free trade destroy domestic jobs, that the protection of certain industries is vital for national security, that temporary trade restrictions help infant industries to get off the ground, or that barriers to trade are necessary to create a 'fair' and level global playing field, as not all countries are having the same environmental and/or labor standards, have long been shown to be wrong, both theoretically and empirically. What remains is the argument about strategic trade theory and optimal tariffs. However, the fact that some countries can take advantage of their latent monopoly power to improve their own economic wellbeing at the expense of other countries does not make protectionism ethical. Furthermore, even those economists, who made their academic reputation by finding theoretical cases in which countries can improve their welfare via restrictions on free trade (e.g. Avinash Dixit, Gene Grossman, and Paul Krugman), admit that these cases are rare exceptions rather than the rule. Also, there is always the chance that other countries retaliate against such optimal tariffs, potentially triggering a downward spiral into rampant global protectionism.

The WTO Today

The GATT/WTO was created after the end of World War II to prevent such a downward spiral. In fact, it succeeded at dramatically reducing global levels of protection,

expanding the volume of trade, and – as a consequence – substantially improved the welfare of its member states. Why has it succeeded? The GATT/WTO has created an upward spiral towards ever freer trade by linking tariff reductions in one country to reductions in others, mobilizing exporters to counter-balance the rent-seeking activities of import-competing industries. The principle of reciprocity provides competitive and export-oriented industries with incentives to organize and lobby survival-maximizing governments so as not to leave the political turf to their protection-seeking counterparts. The GATT/WTO has helped countries to overcome the coordination problems of how and under which rules to liberalize. Last, but not least, the GATT/WTO has created standards of behavior that most of its member states seem to follow most of the time.

However, what happens if member states decide to infringe on the rules of trade? Without going into detail, the current WTO dispute settlement procedures allow for the adjudication of alleged infringement cases. If an arbitration panel finds in favor of the complainant member state and the convicted defendant refuses to change its trade policies, the WTO can authorize retaliation via countervailing measures, a practice, which not only Adam Smith described as a promising strategy to pry open the markets of other countries, but the 1988 Omnibus Trade and Competitiveness Act also prescribes as a means for the U.S. government to coax other countries into reducing their protection against U.S. products.

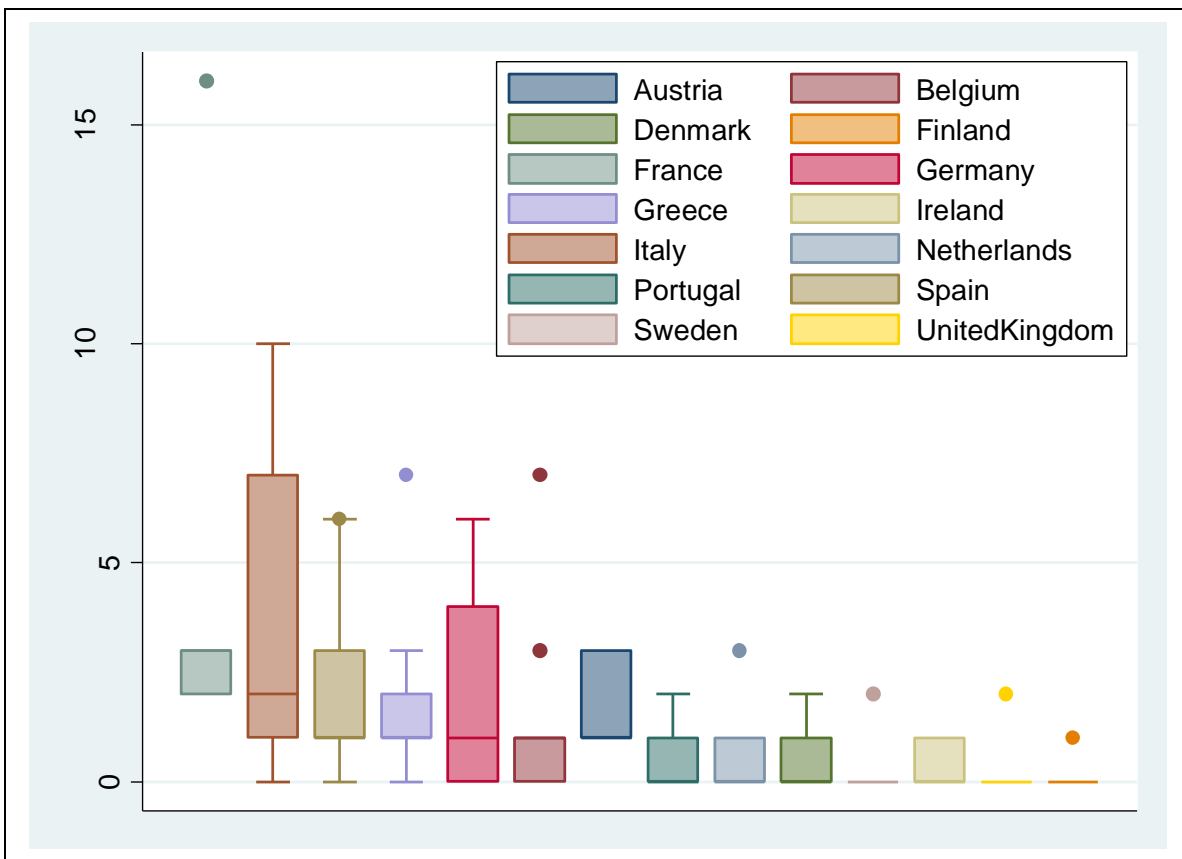
Being a weak international organization, the WTO lacks its own cavalry or trade police. By allowing complainants to retaliate against sensitive industries of the infringing member state with countervailing measures, the threat of protection can turn these industries into ‘agents of change’ for more WTO-consistent trade policies. In theory, if the targeted industries carry enough relative political weight in the eyes of opportunistic governments, they will take back protectionist trade policies in an effort to maximize their political support function. In practice, empirical evidence suggests that outsourcing enforcement is indeed an effective way to enforce the rules of trade. However, is effective good enough?

Reforming the WTO

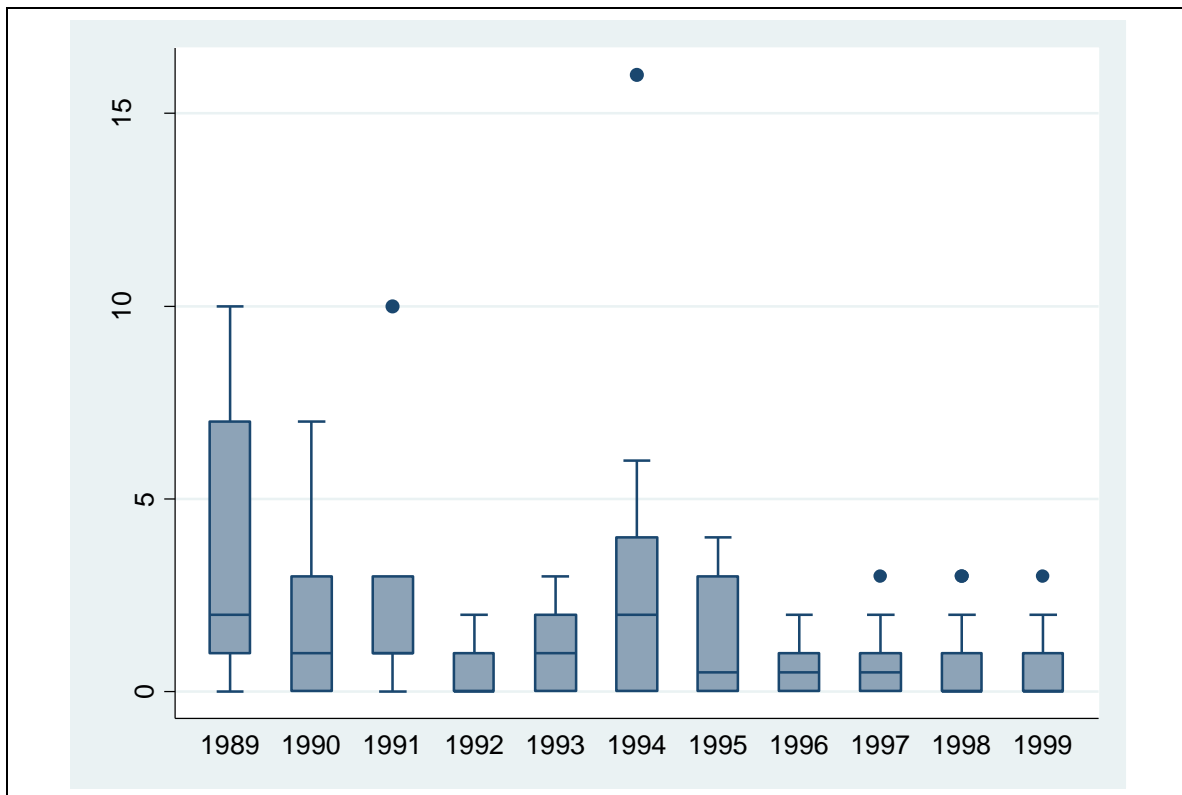
Even if the current the enforcement mechanism of the current WTO dispute procedures is effective at bringing about compliance with the rules of trade and even if we might perceive the use of countervailing measures as fair in one way or another, it cannot be disputed that countervailing measures distort trade, reducing economic efficiency and global welfare. While effective might be good, advancing the idea of free trade by allowing WTO member states to restrict free trade and injuring the welfare of human beings or, through not taking action itself, but outsourcing enforcement, allowing human beings to come to harm is certainly not good enough. This becomes particularly evident when one compares the WTO to other international organizations, which are also successful at bringing about compliance with their rules and regulations without betraying their very own principles in the process of doing so.

Opinion and ends with a ruling of the European Court of Justice. If the member states still refuse to comply, the Commission can open new proceedings. Article 228 ECT-proceedings consist of the same stages as Article 226 ECT proceedings, but the ECJ has the right to impose financial penalties.

Graph 2: Annual Infringements across Member States, 1989-99



Graph 3: Annual infringements across Time, 1989-99



While this enforcement mechanism does not prevent EU member states from infringing on European law² all together (cf. graphs 2 and 3³), there is not a single case in the EU's history where compliance was not (re)established via the EU infringement proceedings.

² Out of the approx. 10,000 European legal acts in force, member states infringe on 0.1 to 1 percent each year.

³ Both graphs look only at infringements on Articles 28 ECT ("Quantitative restrictions on imports and all measures having equivalent effect shall be prohibited between Member States") and 30 ("The provisions of Articles 28 and 29 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States") ECT, which come closest to the WTO provisions. The data come from the European Commission's Annual Reports on Monitoring the Application of Community Law.

Some countries might infringe more often on EU law than others and some infringement cases might take longer to get settled than others, but, in the end, the strong EU infringement proceedings are extremely effective without threatening the very principles the EU is based on. If the EU infringement proceedings were used in the WTO context, free trade could be achieved without distorting trade on the way.