While the World Trade Organization in current existence provides its membership with forums for three interrelated functions—negotiation, illumination, and litigation—it is probably best known for the first of these. This chapter provides a brief overview of the negotiating forum of the General Agreement on Tariffs and Trade and its WTO successor, as well as how each has been used by the world’s major trading nations since 1947.

Since the ultimate focus of this book is on developing countries and dispute settlement, it may appear strange to start with a topic that has little obvious relation to either. This chapter describes the relative success of the negotiating forum of the GATT—an agreement to which developing countries largely did not have a proactive contribution. A careful analysis of the origins of the GATT, as well as some of its later history, offers a tremendous number of lessons for developing countries and for the settlement of disputes. The underlying political and economic forces that create the incentives that shape trade relations between sovereign nations—be the countries developed or developing—remain relatively consistent over time. Thus the evidence from later chapters will substantiate that there is much to learn from the relative successes of the GATT and its negotiating history. These successes are particularly important to understand and appreciate given the extremely negative and pessimistic view that developing countries have of the current WTO bargain, which is described in chapter 2.
In the next section, I provide a brief introduction to the original GATT that was negotiated to conclusion in 1947, as well as the subsequent trade liberalization negotiations that took place over the next forty-five years. The third section presents the principles on which the GATT and the WTO are built—reciprocity, most-favored-nation treatment, and national treatment—and their practical relevance for shaping the outcomes of the negotiations. The final section describes some of the emerging evidence from more formal scholarship that finds that the GATT and the WTO (GATT/WTO), as well as these foundational principles, have an impact on government policies and subsequently on the trade flows and economic activity that such policies affect.

A Brief History of GATT Negotiations

The current WTO agreements are the legacy of commitments that countries have voluntarily negotiated with each other, on a repeat basis, in the decades since 1947. To understand the causes of the present patterns of import protection across WTO member countries as well as across products and industries within those countries, it is important to turn to the past.

The 1930s and 1940s era of the Great Depression and World War II provide important reminders of globalization’s last dark episode of protectionism. The U.S. imposition of the Smoot-Hawley tariffs and the international retaliatory response in the 1930s led to the virtual halting of international commerce. Table 1-1 illustrates the pattern of the new trade barriers that were implemented by the United States and a number of other European countries during the Great Depression. What is clear is that the level of tariffs during the Depression was much higher than what most developed economies impose today.

At the conclusion of World War II, twenty-three countries, led primarily by the United States, Canada, and the United Kingdom, negotiated the General Agreement on Tariffs and Trade. The goal was to create an agreement that would ensure postwar stability and avoid a repeat of the mistakes of the recent past, including the Smoot-Hawley tariffs and retaliatory responses, which had been a contributor to the devastating economic climate that culminated in the death and destruction of the Second World War. The 1947 GATT created a new basic template of rules and exceptions to regulate international trade between members (referred to as contracting parties) and locked in initial tariff

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1. The twenty-three countries engaging in the Geneva negotiations that led to the signing of the GATT in 1947 were Australia, Belgium, Brazil, Burma (Myanmar), Canada, Ceylon (Sri Lanka), Chile, China, Cuba, Czechoslovakia (Czech Republic and Slovakia), France, India, Lebanon, Luxembourg, Netherlands, New Zealand, Norway, Pakistan, South Africa, Southern Rhodesia (Zimbabwe), Syria, United Kingdom, and United States. For a discussion of the negotiating history leading up to the GATT, see Irwin, Mavroidis, and Sykes (2008).
reductions that these countries committed to establish. Even as early as 1952, the tariff cuts had reduced average tariffs substantially, as shown in table 1-1, for a number of these countries.

Over the next forty-seven years, more countries signed on to the GATT, and further trade liberalization negotiations ensued. As table 1-2 documents, between 1947 and 1994, the GATT contracting parties began and concluded eight separate negotiating rounds of voluntary trade liberalization. The last of these completed rounds was the Uruguay Round, which ended the GATT era in 1994 by ushering in the World Trade Organization. By 1994, the GATT membership had simultaneously expanded from an initial 23 contracting parties to 128 participating countries. With a number of new members acceding to the WTO since its 1995 inception, more than 150 countries have signed the agreement.

**The Negotiating Rounds and Negotiating Approaches**

The first five rounds of GATT negotiations covering the initial 1947–61 period were typically dominated by major exporting countries, or those with a “principal supplying interest” in a particular product, getting together and negotiating reciprocal market access improvements. The initial negotiators under the

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### Table 1-1. Average Tariff Levels for the United States and Major European Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>1913</th>
<th>1925</th>
<th>1931</th>
<th>1952</th>
<th>2007*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belgium</td>
<td>6</td>
<td>7</td>
<td>17</td>
<td>n.a.</td>
<td>5.2</td>
</tr>
<tr>
<td>France</td>
<td>14</td>
<td>9</td>
<td>38</td>
<td>19</td>
<td>5.2</td>
</tr>
<tr>
<td>Germany</td>
<td>12</td>
<td>15</td>
<td>40</td>
<td>16</td>
<td>5.2</td>
</tr>
<tr>
<td>Italy</td>
<td>17</td>
<td>16</td>
<td>48</td>
<td>24</td>
<td>5.2</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>n.a.</td>
<td>4</td>
<td>17</td>
<td>17</td>
<td>5.2</td>
</tr>
<tr>
<td>United States</td>
<td>32</td>
<td>26</td>
<td>35</td>
<td>9</td>
<td>3.5</td>
</tr>
</tbody>
</table>


* n.a. = Not available.

1. A tariff level for each European Community member country represents the EC-wide import tariff rate.

2. Barton and others (2006) provide an economic, legal, and political assessment of the trade regime from the GATT through to the WTO.

3. For a discussion, see Dam (1970, chapter 5). Hoekman and Kostecki (2009, chapter 4) discuss not only the negotiating history but also the economic outcomes of different negotiating approaches of principal suppliers versus tariff formulas and exceptions. Ludema and Mayda (2009) provide an economic theory that rationalizes participation by the largest exporters in negotiations, and thus supports the principal supplier rule as a feature of the negotiations. Their theory justifies the principal supplier rule as a means to overcome the otherwise nontrivial concern of externalities that can lead to the failure of multilateral negotiations attributed to the free rider problem. Then,
GATT, especially those with a principal supplying interest, were developed economies. They focused their negotiation efforts on reducing import barriers in other countries that were of primary interest to their own exporters, and they used the political trade-off of expanded market access abroad for exporting industries against increased market access granted at home to foreign industries and thus the losses to industries competing against these imports.

Since the trade barriers targeted for elimination were typically those in the import markets of other developed countries, the primary result was that developed countries were asked to reduce their tariffs. Put differently, since most developing countries were neither principal suppliers nor major importing markets, little was asked of them in terms of their own trade liberalization, and little of what was of direct export interest to developing countries was liberalized by others. Such an outcome is consistent with the pattern of import tariff protection that persists today, which is explored in more depth in the next chapter, a remnant of the form of the negotiations begun in the 1940s.

using data on the United States, they also provide evidence for how the principal supplier rule affects the imposition of tariffs, finding that a higher concentration of exporters in a sector reduces free riding and thus results in a lower tariff.
Starting with the Kennedy Round of negotiations in 1964 through the Tokyo Round in the 1970s, countries participating in the trade negotiations used formulaic approaches to reduce further the remaining trade barriers across the board. Certain tariff-cutting formulas can be preferable to reciprocal negotiations between principal suppliers, in that they can serve to reduce average tariff levels as well as their dispersion. The dispersion of tariffs within a country, and even for products within an industry, is related to the difference between the average tariff and the country’s highest tariffs, or the phenomenon of “tariff peaks,” which is discussed in more detail in chapter 2.

Although formulas can be preferable to simple negotiations between principal suppliers if the formulas are applied rigorously, inevitably the formulaic approaches applied during the Kennedy and Tokyo Rounds did not turn out to be sufficiently “pure” in practice to fully achieve this effect. In the rounds in which formulas were applied, negotiating countries sought and were granted exemptions for “sensitive products” that they could remove from the list of goods whose import tariffs would be subject to the formula. In this manner countries typically avoided having to reduce the highest tariffs in products that the formulaic approach was trying to attack in the first place. The result is a persistent pattern of protection across countries and industries that likely looks quite similar to the reciprocity-based, bid-offer approach between principal suppliers of different products.

**Important Commercial Sector Exemptions to the GATT**

In addition to the general problem of certain products effectively being excluded from multilateral trade liberalization rounds because of the principal supplying interest and formula-exemption approaches to the GATT negotiations, the contracting parties deepened the severity of the problem in certain sectors by essentially taking two industries off the negotiating table—agriculture and apparel and textiles.

First, most agricultural trade was exempted from GATT disciplines beginning in the 1950s. The United States initiated the trend by requesting a GATT waiver to that effect; the emerging European Economic Community subsequently supported this decision as it undertook substantial government intervention in agricultural markets through its Common Agricultural Policy (CAP). This lack of discipline concerning trade in agricultural products would ultimately result in a complicated web of domestic policies throughout the sector—excesses in import restrictions as well as substantial domestic support (subsidies) programs, which can have the effect of choking off imports and making suppliers artificially competitive in third country (export) markets.
Second, beginning with Japan’s accession to the GATT in 1955, special trading rules also were introduced to deal with potentially disruptive imports in clothing and textile products. What began as the Short-Term Arrangement covering cotton textiles (1961) turned into the Long-Term Arrangement (1962–73) and subsequently the Multifibre Arrangement (MFA) (1974–94). These agreements managed global textiles and apparel trade through a complex system of quantitative restrictions and voluntary export restraints. The products covered by these agreements thus fell outside of the GATT system of rules, disciplines, and ultimately enforcement.

As discussed in chapter 2, the creation of the WTO in 1995 has provided a framework to resolve these problems. Nevertheless, these particular two sectors are of fundamental interest to exporters in many developing countries. Thus the effects of the negotiating legacy of such sectors do contribute to complaints being made by developing countries about the WTO today, especially because countries continue to impose high import tariffs on these products.

The Fundamental Principles of the GATT and the WTO

The General Agreement on Tariffs and Trade established the forum for negotiations on cutting tariffs that subsequently would take place over the following decades through multilateral trade rounds. In addition, the initial negotiations resulted in an agreement that established a set of basic rules and disciplines that participating countries were to follow, as well as a forum for dispute resolution if countries deviated from them. Perhaps the most important and enduring of these basic rules embodied in the GATT 1947 are the fundamental principle of reciprocity and two nondiscrimination principles—most-favored-nation treatment and national treatment.

Reciprocity

The GATT fundamental principle of reciprocity enters into the agreement in a number of different ways, both formally and informally.

4. Japan’s entry into the GATT in 1955 as a major developing country exporter of clothing and textile products, and the associated fear of disruption of economic activity due to the integration of this country into the GATT system, has a number of marked similarities with China’s accession to the WTO in 2001. See the discussion in Bown and McCulloch (2007a).

5. For a more complete discussion, see Hoekman and Kostecki (2009, chapter 6).

6. Unlike the principles of nondiscrimination (most-favored-nation treatment and national treatment) described in the next two subsections, there is no article of the GATT 1947 that clearly identifies reciprocity as a foundational principle. Nevertheless, the articles in the GATT 1947 that govern how countries are to renegotiate concessions—in particular Articles XXVIII and XIX—if
First, as discussed above in the section about the process of GATT rounds of multilateral trade negotiations, these negotiations were typically undertaken on a reciprocal basis—frequently between countries with a principal supplying export interest in the other’s import market. While this particular approach to negotiations was successful, it was more of a rule of thumb in the negotiations phase. There is nothing in the GATT texts that requires countries to reciprocally negotiate market access liberalization.

Second, once a contracting party had committed to opening up access to its market, reciprocity did become a formal rule for renegotiations if that country subsequently wanted to back off from its commitment. There are two broad ways that countries have backed off prior commitments, and the GATT/WTO response to both has typically been based on reciprocity.

The first instance is when a country seeks to follow GATT/WTO legal procedures when raising its import tariffs to levels higher than the “bound” commitments (or limits) it had promised to offer to the rest of the membership during an earlier negotiating round. Adversely affected trading partners are then permitted to negotiate a reciprocal market access change in another area of interest. Although it is possible that this might occur through additional trade liberalization in another sector of interest to the affected exporter, typically it is implemented through a new “market closing,” which, while retaliatory, is limited by this reciprocity principle so as to rebalance the deal.

The second instance is when a country backs off commitments to opening market access in a way that is not “GATT/WTO legal,” whereby adversely affected trading partners use the dispute settlement process to obtain a legal ruling that allows them to rebalance market access obligations. Case law that has emerged under the formal trade dispute settlement procedures adjudicated at the WTO has also resulted in use of the reciprocity rule for instances in which compensation needs to be allocated to adversely affected exporters after legal breaches of the GATT/WTO bargain. This second point indicates that reciprocity is thus an extremely important principle when it comes to the issue of disputes and is therefore a topic that is dealt with in greater detail in subsequent chapters.

**Most-Favored-Nation Treatment**

The second fundamental principle of the GATT is the most-favored-nation (MFN) treatment, that is, nondiscrimination by importers across different
foreign export sources. MFN in the GATT is a rule for both negotiations and renegotiations. In a negotiating round, when one GATT contracting party offers to lower its tariff to increase the market access available to foreign exporters in another GATT country, that same lower tariff and terms of market access must be then granted to all other GATT countries on a nondiscriminatory, MFN basis. This is clearly one of the most important reasons for desired membership in the agreement. Even if a country did not seek to utilize the GATT for its own tariff liberalization negotiations or as an external commitment device to facilitate internal reform (for reasons described in the next section), joining the GATT was useful because it provided some guarantee that the country’s exporters would receive the “best” treatment made available to any other country in the agreement. This helps to explain why developing countries would want to join the GATT/WTO and establishes that there was some theoretical benefit to them of doing so.

Nevertheless, while MFN is an important principle in all aspects of the GATT and the WTO—during formal trade liberalization negotiations as well as renegotiations, for example, that might occur during the settlement of a dispute—this treatment becomes increasingly diluted in the presence of GATT/WTO-permitted exceptions to MFN. In particular, the GATT/WTO does permit members to sign preferential trade agreements (PTAs) between one another and thus offer lower-than-MFN tariff rates to preferred partners provided that this covers “substantially all trade.” Furthermore, and as chapter 2 describes in more detail, the GATT/WTO also encourages members to offer lower-than-MFN tariff rates to developing country exporters through the Generalized System of Preferences (GSP).

National Treatment

The second fundamental principle of nondiscrimination embodied in the GATT/WTO is the rule of national treatment. The basic idea is simple—once a foreign-produced good has paid the price of entry into an import market (an import tariff), it has to be treated just like a nationally produced good. The good cannot then be subject to additional taxes or regulatory barriers that would otherwise differentiate it from a domestically produced good, once the import tariff has been paid. The national treatment rule is there to prevent policymakers from eliminating the market access promised by tariff cuts through subsequent recourse to other domestic policies, such as taxes or subsidies.

8. The principle of MFN treatment is found in Article I of the GATT 1947. For a legal and economic discussion of the MFN rule, see Horn and Mavroidis (2001).

9. The principle of national treatment is found in Article III of the GATT 1947. Horn (2006) provides a recent theoretical treatment of the national treatment principle on which the GATT/WTO are modeled as an incomplete contract.
Evidence that the coverage of the national treatment principle is broad and powerful is that it is the core issue in a large number of the formal WTO disputes, many of which are examined in later chapters. In fact, in almost any dispute in which a WTO member is alleged to have differentiated unfairly between domestic and foreign-produced goods—whether it be because of a discriminatory tax code, an explicit or implicit subsidy, or a regulatory barrier motivated by concerns over environmental or consumer safety—the heart of the issue is the applicability of and the potential limits to the national treatment principle.

The Theories and Empirical Evidence that the GATT and the WTO Are Relevant

For years, even serious scholars had difficulty reconciling the apparent successes of the GATT/WTO—and what appeared to be relatively mercantilist approaches taken by negotiators under its auspices—with basic economic theory. Nevertheless, the last decade in particular has seen much research progress made in understanding the relevance of the GATT/WTO as an important and necessary component of international economic relations.

In this section I make a brief detour to highlight some of the insights provided by this increasingly sophisticated political and economic scholarship on the GATT and the WTO. In particular, I describe a substantial literature in economic theory that ascribes two potential complementary benefits to a trade agreement such as the GATT or the WTO. I refer to these as the market access theory and the commitment theory.

The market access theory is based on the well-established fact that large importing countries, whose tariff policies can affect world market prices because of the country’s size, require an external motivation to agree to reduce and bind their import tariffs. The GATT and the WTO, and the principle of reciprocity in particular, provide this inducement by allowing any one country’s change in trade policy—either a lowering of trade barriers under a negotiating round or a raising of trade barriers subsequently bound by the agreement—to be accompanied by an equivalent, reciprocal change in market access by trading partners. The theory suggests that without the reciprocal inducement during negotiations of increased access to foreign markets, a large

10. More typically, the market access theory is referred to in the academic economic literature as the terms of trade theory and dates to the seminal work of Johnson (1953–54). A more recent treatment that now dominates the scholarly literature on international trade agreements is based on Bagwell and Staiger (1999, 2002). In particular, Bagwell and Staiger (2002, chapter 11) documented how the terms of trade theory and the market access theory are equivalent, largely addressing one issue of critics who previously found the terms of trade theory unconvincing because trade negotiators discuss import volumes (market access) rather than world prices (the terms of trade).
importing country would not unilaterally offer its own market access to foreign exporters through tariff liberalization. Furthermore, without the threat that this foreign market access will be taken away if one country deviates from the agreement by imposing new trade barriers, market access openings could not be sustained through renegotiations either.

Supporting the dominant market access theory of why the world trading system needs an institution like the GATT/WTO is increasing empirical evidence. A first study by Broda, Limão, and Weinstein uses new empirical techniques and data to provide two pieces of evidence broadly consistent with the theory.11 They estimated disaggregated foreign export supply elasticities, which are one component in answering the important economic question of whether the importing country is “large” in its ability to affect world prices. They found that countries that are not WTO members systematically set higher tariffs on goods that are supplied inelastically. Thus WTO nonmembers—countries that have not agreed to limit their policies toward imports—tend to impose higher import tariffs on goods for which they are large and need a trade agreement inducement to get these tariffs lowered. Second, for the United States, the authors found that trade barriers are significantly higher on products not covered by the WTO agreement for which the United States has more market power.

A second recent study by Bagwell and Staiger focuses on a set of countries newly acceding to the WTO between 1995 and 2005.12 They examined whether the motive of gaining access to markets affects these countries’ tariff cut commitments and found evidence consistent with the importance of this effect. Specifically, the farther the tariff to which a country negotiates is below its original (pre-WTO) tariff level, the larger is its original, pre-WTO import volume. This result is also consistent with negotiating behavior predicted by the market access theory.

These studies seek to explain why the world needs the GATT/WTO, because the fundamental problems that these agreements are designed to tackle would not be addressed if market forces were left unfettered and government policies were not coordinated internationally. These pieces of evidence indicate that the GATT/WTO has had important real effects on countries’ trade policies and the resulting trade flows.13 The evidence is consistent with what economists predict for government behavior, especially for large, developed countries. The GATT/WTO system has created incentives for such countries to restrict their import tariff barriers compared to the tariffs they would levy in the absence of a

13. In chapter 2 a number of other studies are described that present related results that the GATT/WTO has affected country-level trade flows, including Subramanian and Wei (2007); Goldstein, Rivers, and Tomz (2007); Tomz, Goldstein, and Rivers (2007).
GATT/WTO-like agreement. Simply compare current policies with what these large developed economies were doing in the 1930s (see again table 1-1): unilaterally imposing mutually destructive import barriers toward one another because they could not coordinate reciprocal market access opening. This underscores one fundamental benefit that the GATT/WTO provides to the world trading system.

According to the second major theory of trade agreements, the commitment theory, even for countries that are not large (in the sense of market access described above), the GATT/WTO may help struggling governments take on efficiency-enhancing, national welfare–improving economic reforms, including trade liberalization. This potential role for the GATT/WTO comes into play when a government faces entrenched political interest groups demanding special policies that make it difficult for the government to act unilaterally. In this case, the GATT/WTO might also help the government convince its domestic sectors that it is serious about reform and a long-term policy of more liberal trade.

Although there has been little empirical research formally testing the practical relevance of the commitment theory, one particular element should be noted with regard to the issue of GATT/WTO enforcement. As highlighted repeatedly throughout this book, the GATT/WTO institution does virtually no enforcement on its own. Rather, the GATT/WTO is a set of self-enforcing agreements: member countries enforce trading partners’ commitments embodied in the agreements by challenging each other’s missteps through formal dispute settlement. Thus, as described in substantial detail in later chapters, for a country to take advantage of the potential commitment-device role that the GATT/WTO might offer to government policymakers, some other trading partner must be willing to enforce the commitments that a country takes on. If there is no external enforcement—and this is especially relevant to the case of the poorest WTO member countries whose commitments are almost never enforced through dispute settlement—the WTO essentially provides the country seeking the external commitment with nothing.

14. See the work of Tumlir (1985). More recent theoretical treatments of focus in the academic literature include the work of Maggi and Rodríguez-Clare (1998, 2007) as well as Staiger and Tabellini (1987).

15. A related problem discussed by Staiger and Tabellini (1987) is the concern over time consistency. Although a government may have an incentive to announce trade reforms, it may find it difficult to follow through with them without an external commitment device. Because firms and workers recognize that the government will eventually face this time inconsistency problem (in the absence of external enforcement via a trade agreement), they undertake too little efficiency-enhancing change—whether it be investment in or adjustment to a new and growing sector.
Conclusion

This brief introduction to the General Agreement on Tariffs and Trade and the World Trade Organization identifies a number of important lessons for the remainder of this book. First, the results from the history of the GATT and the WTO negotiations—tariff barriers in developed economies that are massively lower today when compared with those during the Great Depression era of the 1930s—is an unprecedented multilateral outcome for international economic relations. Second, the underlying principle of reciprocity that served to influence these early negotiations turns out to have been an important international force allowing governments to coordinate and simultaneously lower trade barriers. Furthermore, this reciprocal balance of trade obligations across countries is what has allowed them to keep the trade barriers low toward one another, for the most part, over the next 60 years.

Although ultimately a more detailed analysis of this latter point is of interest—how WTO members use the dispute settlement process to self-enforce the agreement and maintain this reciprocal balance in the face of relatively challenging political and economic circumstances—first, in the next chapter, the history of the GATT/WTO negotiations are retold from the perspective of developing countries.