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The GATT and the WTO: An Overview

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SUMMARY

Under the auspices of the General Agreement on Tariffs and Trade (GATT), eight rounds of trade negotiations lowered tariffs of developed countries to an average 3.9 percent. New areas, such as services, intellectual property rights, agriculture, and textiles and apparel, were brought under the discipline of the GATT for the first time in the Uruguay Round. The World Trade Organization (WTO), a permanent entity agreed on during the Uruguay Round, went into effect January 1, 1995. Multilateral trade issues for the future include continuing services negotiations, the relationship of the environment and labor standards to trade, and investment and competition policy.

BACKGROUND

The General Agreement on Tariffs and Trade provides a framework of principles to govern international trade, a forum for negotiating trade issues, and procedures to settle disputes among nations. Twenty-three countries signed the original GATT agreement, which became effective in January 1948. As of December 8, 1994, the 125 member-countries[1] accounted for over 90 percent of the world's merchandise trade. About two-thirds of the members are developing countries.

An important motivation for the GATT in the immediate post-war period was to avoid a repetition of the trade restrictions of the early 1930s. The passage of the Tariff Act of 1930 (more widely known as the Smoot-Hawley Tariff) raised tariffs to an all-time high, amid strong protectionist pressures. Within two years, 25 nations retaliated by raising tariffs in an attempt to protect their own industries. Other measures, such as competitive currency depreciations and quotas, followed. Many believe that growing trade restrictions exacerbated the depth and duration of the 1930s depression, worsened political relations among countries, and contributed to the growing nationalism of the decade.

[1]Technically, participants in the GATT were "contracting parties," but the term "member" is often used, and will be used here.

Although GATT negotiations to reduce tariffs began in 1946, the GATT was not intended to be an organization. Rather, it was assumed that the GATT would operate under the umbrella of the proposed International Trade Organization (ITO), which was being negotiated at the same time. Although negotiations for the ITO were completed in 1948, the U.S. Congress never approved it.[2] The GATT operated as the only multilateral instrument governing international trade until the World Trade Organization went into effect January 1, 1995.

MAJOR GATT PRINCIPLES

Non-discrimination is the most important principle underlying the GATT. The most-favored nation (MFN) principle, in Article I of the GATT, requires each member country to grant each other member country treatment at least as favorable as it grants to its most favored trade partner. Thus, *a country cannot discriminate among countries* in applying tariffs or charges, unless an exemption is allowed. One of several exceptions to the MFN clause is Article XXIV, which permits regional trading arrangements as long as specified criteria are fulfilled.

The national treatment provision, in Article III, obligates *each country not to discriminate between domestic and foreign products*. Once an imported product has entered a country, the product must be treated no less favorably than a "like" product domestically produced.

Quotas are generally prohibited by the GATT since they totally keep out imports and can offset tariff reductions. Where protection is necessary, tariffs, which allow price changes to influence trade and are more transparent than quotas, are preferable. Some exceptions are allowed, however. For example, quotas are permitted under some circumstances to protect a country's balance of payments.

Other GATT rules help to provide a more stable and predictable basis for trade. Tariffs are "bound" at rates negotiated among the GATT members. This means that, unless bound tariffs are renegotiated, a country that raises tariffs above the bound rate will be required to provide compensation. Antidumping and countervailing duties are permitted if dumping or subsidies exist and can be shown to be injuring a domestic industry. A safeguard (or escape clause) provision allows the imposition of duties if imports can be found to be injuring a domestic industry. Rules are provided for customs valuation, marks of origin, and state trading, among others.

The GATT's dispute settlement procedures are aimed at reducing trade conflicts. If bilateral consultations, the first step in resolving disputes, are unsuccessful, a GATT panel, consisting of three experts from countries not involved in the dispute, can be formed. After evaluating the dispute in relation to the GATT principles, the panel issues a report. Prior to the Uruguay Round

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[2]The GATT was negotiated under authority granted to the President in the Reciprocal Trade Agreements Act of 1934 and thus did not require Congressional approval.

Agreement, the panel report could only be adopted by consensus, allowing one country to block it. If adopted, a country is required to implement its recommendations, or face possible retaliation.

TRADE NEGOTIATIONS

Negotiations to reduce tariffs are the heart of the GATT. Including the first series of negotiations ("rounds") in 1946-47, there have been a total of eight negotiating rounds. The first five rounds focused almost exclusively on tariff reductions. By the end of the Tokyo Round (1973-79), the seventh round, the average tariff of industrial countries was 6.4 percent.

As tariffs fell, nontariff barriers such as subsidies, import licensing, and government procurement assumed increasing importance. Although the Kennedy Round (1964-67) addressed rules for using antidumping duties, the Tokyo Round was more successful at rule-making for nontariff barriers. Codes of conduct covering dumping, countervailing duties, government procurement, technical barriers to trade (standards), import licensing procedures, and customs valuation were negotiated, but applied only to those countries who signed them.

The Uruguay Round began in 1986, and continued for seven years, unexpectedly long. Agreement was reached December 1993, and the Uruguay Round Final Act was signed in Marrakesh, Morocco, on April 15, 1994. Implementing legislation (P.L. 103-465) was signed into law December 8, 1994. The Agreement went into effect January 1, 1995.

Highlights of the Uruguay Round Agreement

As with all previous negotiations, tariff reductions played an important role. Tariffs of developed countries were reduced by an average of 38 percent to 3.9 percent. Most reductions would be effective after five years. Developed countries reduced tariffs to zero for a number of products. Importantly, the percentage of tariffs that are "bound" increased, especially for developing countries.

For the first time, agriculture, services, intellectual property rights, trade-related investment measures, and textiles and apparel trade are brought under the discipline of the GATT. The main achievements for these new areas were:

- *Agriculture.* Domestic and export subsidies are being reduced; quotas and other trade restraints are replaced by tariffs, which will be reduced over a period of years;

- *Textiles and Apparel.* Quotas under the existing Multifiber Arrangement are being phased out over 10 years;

- *Services.* Principles for services trade and investment, such as MFN and national treatment, are established; some specific market access commitments were achieved, but more are yet to be negotiated;

- *Trade-Related Investment Measures (TRIMS).* Measures, such as requiring foreign firms to achieve a specified level of domestic content in their production or requiring that imports be balanced by exports, are being phased out;

- *Intellectual Property Rights.* Minimum standards of protection are established for intellectual property, including copyright, trademarks and patents; the countries agree to adhere to the Berne Convention, the major copyright treaty.

Rules were clarified and expanded, and, in some cases tightened, for other issues which had already been part of the GATT. These include:

- *Subsidies and Countervailing Duties.* In an important result, subsidies are (for the first time) defined and categorized as prohibited, actionable, or non-actionable; the rules for imposing countervailing duties are clarified and expanded;

- *Antidumping.* Some antidumping procedures are changed, including improved rules for calculating dumping margins, and the imposition of a "sunset" provision on antidumping duties;

- *Safeguards.* The rules on safeguards are tightened and made more transparent; new voluntary restraint agreements (VRAs) are discouraged, and existing VRAs are being phased out.

The Uruguay Round Agreement included two important institutional changes that are designed to improve the way the multilateral trading system functions. It established the World Trade Organization (WTO), a permanent entity, which went into effect January 1, 1995. As an umbrella organization, the WTO oversees all the trade agreements negotiated under the GATT. It also administers the single dispute settlement procedure, (which applies to all the agreements) and periodically evaluates trade policies and practices of members.

The second institutional change is the strengthened dispute settlement procedure. A new Dispute Settlement Body (DSB) is established under the WTO and will administer all dispute proceedings. Unlike in the past, a panel must be set up on request. Importantly, a panel report is automatically adopted unless a consensus decides otherwise, a reversal of the previous procedure where panel adoption required a consensus. If a panel report is not implemented, the DSB will automatically authorize retaliation, if requested, unless a consensus decides otherwise. Stricter time limits are applied throughout the dispute settlement process.

Evaluation of the Uruguay Round Agreement

Several studies have estimated the economic effects of the Uruguay Round Agreement on the United States. Most estimates suggest small, but positive effects. U.S. GDP is expected to increase by about one percent when the Agreement is fully implemented. Arguably, however, the economic benefits will be considerably greater, since the studies do not adequately measure the elimination of nontariff barriers and gains from economies of scale and enhanced investment and competition.

At the same time, the Uruguay Round Agreement, like any international trade agreement, involves adjustment costs. Some workers lose jobs, while other workers gain jobs. Although there is no overall increase in unemployment, the adjustment may be painful for those workers losing jobs. According to a study by Alan Deardorff, over the 10 years that the Uruguay Round will be implemented, approximately 180,000 U.S. workers (0.2 percent of the labor force) will be adversely affected in any year, a small amount relative to the size of the U.S. economy.[3]

The establishment of the WTO places an international trade organization on a par with the International Monetary Fund and the World Bank, as had been envisioned in the late 1940s. As economies become more integrated, trade and monetary issues also become more interrelated. The WTO might facilitate joint discussion and resolution of problems that encompass both trade and finance. It also may encourage future trade negotiations, and, along with the improved dispute settlement procedure, reduce the potential for trade conflicts.

MULTILATERAL TRADE ISSUES FOR THE FUTURE

The most immediate issue is the continuation of negotiations to liberalize services trade. Negotiations on specific market access commitments in financial services, basic telecommunications, and maritime transport services were not completed during the Uruguay Round, and are continuing. The dates for expected completion of the negotiations are: financial services by June 30, 1995, basic telecommunications by April 30, 1996, and maritime transportation by June 30, 1996. If, as expected, the financial services agreement being negotiated can be implemented without a change in law, no congressional action is necessary. If any agreement does require a change in U.S. law, however, the use of the fast-track procedure might be considered.

The Congress will likely consider legislation to establish a WTO Dispute Settlement Review Commission. At the end of the congressional debate over the WTO in 1994, the Clinton Administration agreed to support a proposal by Senator Dole to establish such a Commission. S. 16, introduced January 4, 1995, would establish a Commission to review dispute settlement panel reports

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[3]Alan V. Deardorff. Economic Effects of Quota and Tariff Reductions. In *The New GATT: Implications for the United States*. Susan M. Collins and Barry P. Bosworth, eds. Washington, D.C., The Brookings Institution. 1994. p. 19.

that were adverse to the United States. It establishes procedures for the United States to withdraw from the WTO if the Commission finds that three times within a five-year period the panel exceeded its authority or acted arbitrarily.

The interrelationship between trade and the environment was extensively debated during the latter part of the GATT negotiations. Although the Uruguay Round Agreement included no specific provisions on environment, the preamble to the WTO recognizes the importance of environmental issues. Moreover, a WTO Committee on Trade and the Environment has been established to study issues such as the use of trade measures to protect the environment or to enforce environmental agreements.

Labor standards and their relationship to international trade was an important issue for some during the GATT negotiations.[4] The Uruguay Round Agreement contained no provisions on labor standards, nor was a WTO committee to study labor issues established. P.L. 103-465 (the U.S. implementing legislation), however, requires the President to seek the establishment of a WTO working group to evaluate the relationship between labor rights and international trade.

Although agreement was reached on trade-related investment issues in the Uruguay Round, liberalization of broad investment principles such as the right of establishment and discriminatory treatment of foreigners remains to be achieved. One possibility is that the WTO, perhaps along with the Organization for Economic Cooperation and Development or the World Bank (both of which have rules for some types of investments), will negotiate these issues at a later date. The Uruguay Round's TRIMs agreement provides that, within five years, additional provisions regarding investment or competition policy will be considered.

In competition policy, one of the main issues relates to market access. Private business practices, such as control over distribution channels or close relationships among affiliated firms, may effectively block sales by foreign firms. While the GATT has made progress on negotiating *government* policies which affect market access (such as technical standards, or government procurement policies), *private* practices are not covered by the GATT. Although still in the early stages, it is likely that private business practices may be the subject of study and negotiation in the WTO in the future.

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[4]Basic labor standards include freedom of association, the right to organize and bargain collectively, and restrictions on child labor.