

The development of the multilateral trade regime

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Summary

This dissertation aims to explore the dynamics of institutional change in the multilateral trade regime. It focuses on those institutional structures that relate to the governance of the regime; i.e. the structures of the trading system's international organizations that determine policy output. These kind of structures are politically very sensitive, as they capture how much authority is transferred from the national to the international level and how decisions are taken on this level. The most recent episode of significant institutional change of this nature came about in 1995 as a result of the Uruguay Round, which led to the creation and design of the World Trade Organization (WTO), including reforms in the trade regime's dispute settlement system and the introduction of the Trade Policy Review Mechanism (TPRM). This episode of institutional change stands at the center of the investigation conducted in this dissertation. Exploring this episode is highly relevant as it sheds light on the origins of the current institutional problems that the trade regime is facing, and because it provides a rich narrative that is useful to inform the development of theories on institutional change of the governance structures of international organizations.

In doing so, the research relies on theory guided process tracing. Making use of literature on rational and historical institutionalism a theoretical framework is developed to guide empirical investigation of institutional change in the trade regime. Three cases are examined in the course of this investigation. The first addresses the establishment and institutional setup of the WTO, including its legislative decision-making structures. The second examines the reforms in dispute settlement that resulted from the Uruguay Round, and the third sheds light on the creation of the TPRM.

The theoretical framework is developed in chapter 2 of this dissertation. It takes the rational design framework developed by Koremenos et al. (2001)¹ as underlying basis for this. This framework is suitable because with centralization and control it provides two variables that capture the institutional structures that are of interest to this dissertation. Centralization indicates whether a focal entity conducts a particular institutional task. It thereby indicates *who*, i.e. which institutional bodies or actors, are in charge of a certain kind of policy output. Control in turn indicates *how* such output is derived. Together they can indicate the institutional architecture that governs an international organization. Furthermore, the rational design

¹ Koremenos, B., Lipson, C., & Snidal, D. (2001). The Rational Design of International Institutions. *International Organization*, 55(4), 761-799.

framework provides conjectures that specify under which conditions centralization and control are assumed to vary. It thereby offers a starting point to conceptualize institutional change.

However, the chapter argues that the rational design framework only constitutes a starting point to guide empirical investigations, because it depicts four weaknesses that need to be addressed. First, the framework's variables are only very broadly defined and need to be specified further before they can be applied to the empirical analyses of international organizations. Second, the framework does not elaborate on the possible interaction of its different variables. Yet, such interaction can be important to fully understand real-world instances of institutional design. Third, rational design has not been developed to explicitly capture the notion of change. It approaches institutional design as a static-equilibrium and takes a 'snapshot' of an organization's institutional structure at a particular point in time. Thereby the framework is prone to neglect long-term dynamics of institutional change. Fourth, the rational design framework takes a functional approach to the emergence of institutional structures. This can induce post-hoc research designs that explain the existence of such structures by the functions they fulfill. Such approaches are at risk to overlook alternative explanatory factors of institutional design.

To address these shortcomings the chapter adapts the framework for the purpose of this dissertation in two steps. In the first step, centralization and control as relevant variables are specified, and their interaction is explored. This results in finer conceptual distinctions of the variables and shows that the variables can take different forms. It is argued that such differentiation is important, because the different forms that the variables can take follow different logics of institutional design. Furthermore, the different conceptualizations are necessary to analyze the institutional architecture of an international organization in detail. In this respect, it is shown that different kinds of centralization and control necessarily occur together and form building blocks that constitute the complex, multilayered architecture of an international organization.

In the second step, the chapter elaborates on the notion of institutional change. Four sets of factors are identified that need to be taken into account to understand the underlying dynamics of institutional change. The first set is provided by the rational design framework itself. Resting on functional assumptions institutional change is regarded as a response to the variation in the characteristics of a collective action problem. Although this is a powerful theoretical starting point, change tends to be more complex than the suggested functional link between a collective action problem and institutional design. This is highlighted by the three other sets of factors. The second set points out that institutional change is affected by the desire to reduce the risks and costs of such change. The third set highlights that institutional change is often contested, which might lead to compromises in institutional design that are functionally suboptimal. The fourth set of factors points to the importance of the institutional and historical context in which an episode of change takes place. This shows that that change can be a long-term process, characterized by path dependencies that limit the options for change and that make it contingent on previous institutional developments. To understand how these different sets of

factors play out the chapter argues that empirical process tracing is a methodological necessity. The presences of factors that tend to interfere with functional approaches to institutional change also shows that such change should not be conceived as a fully rational, but rather as a bounded rational process.

Equipped with these insights, the dissertation proceeds with the empirical investigation of the case studies. Chapter 3 explores the creation of the WTO and the design of its administrative institutional structures and legislative decision-making procedures. It first establishes why the creation of the WTO is to be regarded as a change of centralization and control in comparison to its predecessor, the GATT. This shows that the advent of the WTO clearly constitutes an increase in centralization in comparison to the GATT, due to its more formal status as a proper international organization, its stronger enforcement capacity, wider scope and larger membership. However, when examining the WTO's institutional architecture in detail differences to the GATT are less pronounced and it becomes clear that the degree of centralization is significantly limited by the tight control that the membership maintains over the organization's legislative and administrative functioning.

The chapter proceeds by exploring how the functional explanations offered by the rational design framework can account for the emergence and design of the organization. In doing so it is shown that on a high level of abstraction rational design can account reasonably well for the creation of the WTO. Generally speaking, the idea to create the WTO was motivated by the desire for having a proper organizational structure to support the implementation of the substantive agreements that resulted from the Uruguay Round, which was in turn initiated as a response to address the collective action problems that beset the multilateral trading system during the 1980s. However, rational design faces shortcomings in accounting for the WTO's specific institutional architecture and in answering the question why the organization emerged despite initially strong opposition by the US as the most powerful actor during negotiations.

To address these shortcomings the chapter examines the wider history of the trade regime's institutional development. This shows that the WTO's administrative and decision-making structure can largely be considered as a formalized continuation of (informal) practices that had developed incrementally in the GATT. In this respect the creation of the WTO is to be interpreted as a significant last step, a tipping point, of a long-term process of institutional development that shows strong traces of path dependency. This helps to understand the architecture of the WTO and the high degree of control that the membership has over the organization. However, it does not address how the opposition to the creation of the organization could be overcome.

Tracing the negotiation process that led to the creation of the WTO sheds light on this matter. Such process tracing points to power as an important factor influencing institutional change and shows that institutional questions can often not be separated from questions on substance. This section of the chapter argues that the US as an initially powerful veto player, eventually dropped its opposition to the establishment of the WTO after it had realized that the

creation of an organization could be used as a means to ensure substantively beneficial negotiation outcomes. Given the asymmetric distribution of power at the time, the US and other developed countries were able to use the creation of the WTO to overcome the opposition of many developing countries to a uniform application of the Uruguay Round's substantive agreements. In essence, the creation of the organization was used to resolve contested distributive questions on substance to the advantage of the trade regime's most influential members, which in turn provided sufficient incentive for the US to drop its opposition. This argument does not necessarily contradict functional explanations of institutional change, but highlights that it is often the most powerful who are able to define what is to be regarded as functional.

Finally, chapter 3 examines how concerns over costs and risks of institutional change influenced the WTO negotiations and how they are reflected in the WTO's design. Adding to the historical section, it is shown that the long-standing emphasis on individual control and sovereign equality that characterized the trade regime's history also shaped the Uruguay Round negotiations. Concerns over control, playing out in a path dependent institutional context limited the opportunities for formal institutional change and reinforced existing trajectories. Functional gains from further centralization were of secondary importance to considerations of individual control during the negotiations and had to be forgone. Thus, the WTO remained very similar to the GATT in terms of decision-making and regime administration. To compensate for this lack of formal centralization, the WTO continues the trade regime's practice to rely on informal procedures that are less inclusive and that account for power asymmetries. This mix of formal and informal procedures is a convenient way of maintaining the illusion of sovereign equality amongst states while taking political realities into account. In the current setup, informal approaches can facilitate decision-making; but when they fail, the large amount of formal individual control implies that decision-making can easily get paralyzed.

Overall, the chapter shows that functional approaches like the one of rational design are a useful starting point to understand the emergence of the WTO, its institutional architecture and decision-making principles. They provide reasonably adequate accounts of the underlying motives for change. However, they face weaknesses in explaining how these motives are translated into actual design. Some ideas get lost in translation, since historical context, negotiation dynamics, and concerns over individual control moderate and at times distort functional design. In the case of the WTO this moderation implied that institutional change was more conservative with respect to its administration and legislative function than the news of the creation of a new international organization would on the surface suggest.

Chapter 4 shows that this was significantly different concerning the WTO's judicial function. The changes in centralization and control that the Uruguay Round brought about in the field of dispute resolution constitute a remarkable increase of centralization in the trade regime. On a general level, centralization increased because the Uruguay Round brought about the unification of a previously fragmented dispute settlement system, with a compulsory and exclusive

jurisdiction under the auspices of the WTO as a proper international organization. More specifically, several institutional design features that characterize the setup of dispute settlement in the trade regime were changed, leading to more centralization and less control than it used to be the case before the Uruguay Round. The introduction of reverse-consensus as a decision making practice for key decisions in the dispute settlement process, the creation of the Appellate Body, and the streamlining of panel procedures are to be identified in this respect.

To understand this institutional change, the rational design framework is consulted first, showing that in theory the framework is highly suitable to account for the reform of the trade regime's dispute settlement mechanism. Also empirical investigations reveal that the underlying motives that motivated the reform correspond well to the assumptions of the framework. In essence, the trade regime's membership wanted to address functional deficiencies of the dispute settlement system that were thought to endanger the implementation of substantive agreements and the credibility of the GATT. However, such a purely functional account is unable to explain how the interest heterogeneity that characterized the negotiations on dispute settlement was overcome, and it would overlook the impact of historical legacies on institutional change.

To address this, the chapter proceeds by delineating the development of dispute settlement mechanisms throughout the trade regime's history. In doing so it becomes clear that path dependencies partially explain the dynamics of change and the resulting design of the WTO's dispute settlement system. They provide a seemingly paradoxical explanation of both, conservative but also revolutionary aspects of the institutional reforms that the Uruguay Round brought about. On the one side, institutional path dependencies show that large parts of the WTO's approach to dispute settlement, are a continuation of practices that had incrementally developed throughout the history of the GATT. In this regard the reform of dispute settlement can be interpreted as a significant tipping point in a long-term process of institutional development, rather than the result of a revolutionary moment of rational design. On the other side, some elements of the reform – like the introduction of reverse consensus and the Appellate Body – constitute a significant break with the past and changed the trade regime's culture of dispute settlement from a political, conciliatory one to a highly legalistic one. It is argued that cognitive path dependencies contribute to understand this revolutionary change: Designers underestimated the implications of the reform and did not expect a significant shift in legal culture, because their expectations of the results of change were biased by their experiences with the longstanding GATT system. Thus the break with the past was not fully intended and the degree of centralization that resulted from the reforms was higher than initially foreseen. It seems plausible that this facilitated the reforms, as it downplayed potential costs of the large increase in centralization. Overall, the historical review illuminates how past practices have informed the design of the WTO's dispute settlement system in a bounded (instead of fully) rational process. Yet it does not help to understand how coordination problems during the negotiations were overcome.

Such problems certainly existed. Despite the fact the trade regime's members shared the general view that the dispute settlement system needed to be reformed, they differed in opinion on how this reform should look like. To show how such problems were overcome, the chapter continues by tracing the negotiation process that led to the reforms. At the heart of the problems were different negotiation interests of the US and the EC regarding decision-making procedures in dispute settlement. Initially the EC was firmly opposed to US demands for a more automatic approach to dispute settlement, which included calls to reform the existing approach of decision-making by consensus. Only when the US made use of its powerful position in the international trading system and resorted to aggressive unilateral policies to open foreign markets, the EC (and others) were induced to change their negotiating position and agreed to the introduction of reverse consensus as a new decision-making practice. Power thus played a crucial role in the reform of the system. Furthermore, tracing the negotiation process also shows that several of the institutional changes in dispute settlement should be regarded as spin-off effects of larger discussions that took place during the Uruguay Round. The decision to establish the Appellate Body for example can be considered as a domino effect of the introduction of reverse-consensus. The unification of the dispute-settlement system in turn emerged in the slipstream of the wider negotiations that led to the establishment of the WTO.

The last section of the chapter takes a closer look at the design interaction of centralization and control, and highlights how the trade regime's membership sought to find an adequate balance between the benefits, the costs and the risks of creating a more independent dispute settlement system by devising adequate control elements. Since impartiality and independence are important features of the dispute settlement system, and since the enforcement of existing obligations is politically less sensitive than the negotiation of new obligations, it is not surprising that control is less stringent for dispute settlement than for the WTO's legislative procedures. This is best exemplified by the introduction of reverse consensus for major decisions in the dispute settlement process. However, several other design features were supposed to counterbalance this revolutionary reduction of control, indicating that controlling the WTO's autonomy in dispute settlement was a relevant factor that influenced the design of the system. The chapter also shows that the same holds true for control mechanisms that determine the relative influence of different members on the system – albeit to a lesser extent.

In sum, the chapter finds that the explanations of rational design account well for the core motivation of the change in the dispute settlement system, but historical process tracing and attention considerations of control is necessary to get a better understanding of its particular design features. Furthermore power is highly significant to account for the large degree of centralization that the Uruguay Round brought about in the trade regime's dispute settlement domain.

Chapter 5 introduces the last case study and examines the emergence of the Trade Policy Review Mechanism (TPRM) – a design feature that can be easily overlooked in comparison to the establishment of the WTO and the reforms in dispute settlement, but which is nonetheless

important. The TPRM clearly constitutes a change in the degree of centralization regarding the trade regime's information gathering and transparency facilitation function. For the first time in its history the regime's institutions were explicitly mandated to systematically and comprehensively review the policies of individual regime members. This included a significant increase in centralization as delegation, since the Secretariat was entrusted with an unprecedented role in the production of comprehensive review reports of individual members.

The chapter shows that the functional explanations of rational design are highly adequate to understand how this increase in the degree of centralization came about. Theoretical assumptions of rational design fit extremely well to the centralization of information gathering and transparency facilitation in the trade regime and are confirmed when tracing the actual motivations that led to the introduction of the TPRM. In contrast to the other case studies, it is shown that the impact of the regime's previous historical development and of coordination problems during the negotiation process was relatively limited.

This is not to say that the historical context in which the emergence of the TPRM was embedded is completely irrelevant. Of course, the TPRM was not created in isolation of this context. After all, the long-term incremental development of the GATT provided a suitable basis of institutional structures to build upon. However the impact of path dependence on the TPRM was moderate. While the TPRM might have been facilitated and inspired by existing GATT practices, external influences – such as a policy proposal by an independent expert group that informed the Uruguay Round negotiations and existing surveillance mechanisms in other international organizations – were at least as, if not more influential in its creation and design. In this light the TPRM can be described as a tipping point that builds upon existing structures, but that was at most moderately influenced by these structures.

Turning to the negotiation process of the TPRM it is evident that its design process was relatively uncontroversial. The TPRM did not touch upon major distributional questions and interests were mainly homogenous. Tracing the TPRM's negotiation process does therefore not disclose significant explanatory factors that cannot be accounted for by the rational design framework. However, it shows once more that the trade regime's membership aimed to devise institutional structures that balance centralization and control carefully. In the eventual agreement that resulted from the negotiations the concern over control is primarily expressed by the TPRM's limited mandate, which explicitly sets it apart from dispute settlement and which stresses that the TPRM is not a means to enforce substantive obligations. This limits the impact of the TPRM and makes it a relatively soft tool to facilitate compliance with the substantive rules of the multilateral trade regime, keeping sovereignty costs low.

Overall, these low costs in combination with the fact that the TPRM did not touch upon major distributional questions probably explains why the rational design approach is so suitable to explain its emergence. These conditions seem to provide fertile soil for functional design to flourish in a given institutional context without major disturbances.

The conclusion of this dissertation summarizes the main findings of this research. It ultimately argues that institutional change should be thought of as a bounded rational process that is motivated by the desire to find functional solutions to collective action problems, but that devising such solutions is compromised by intervening factors such as risk aversion, coordination problems, and historically developed path dependencies. Reflecting on the current institutional problems of the trade regime in light of the findings of this dissertation, it is posited that the likelihood of thorough institutional reform towards further centralization is low and that the most feasible way of addressing these problems is to make use of existing institutional structures differently than it is currently done.