

# **Do we need an undertaker for the Single Undertaking? Considering the angles of variable geometry**

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## I. Introduction

Perhaps the most striking accomplishment of the Uruguay Round was the extent to which the vast bulk of the world's trading nations agreed on the vast bulk of rules governing world trade. Whereas the Tokyo Round had featured important agreements signed by only a limited group of participants, the "Single Undertaking" obliged signatories to the Final Act to accept or reject the whole agreement.<sup>1</sup>

This approach helped address a long-standing problem inherent in the General Agreement on Tariffs and Trade's (GATT) principle of Most Favored Nation treatment: the ability of countries to "free ride" on the liberalization of others. If two participants sign an agreement to reform their anti-dumping procedures, for example, the benefits may be extended to a third, non-signatory country without any reciprocal obligation.<sup>2</sup>

The Single Undertaking approach also allowed for tradeoffs across issues that would otherwise seem unrelated. According to the standard mercantilist calculus, developed countries made concessions on textiles and apparel while developing countries made concessions on trade-related aspect of intellectual property rights (TRIPS).<sup>3</sup> Liberalization in agriculture was balanced against liberalization of trade in services. To argue that the agreements in each of these areas would have worked as stand-alone negotiations would require that all major participants saw themselves as gaining from all of the agreements; that was clearly not the case. The linkages made possible by the Single Undertaking were central to the gains in world welfare that have and will continue to flow from the Uruguay Round.<sup>4</sup>

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<sup>1</sup> This is a slight exaggeration. In fact, there were four "plurilateral agreements" on trade in civil aircraft, government procurement, dairy, and bovine meat that only certain members joined. The relevance of this will be discussed below.

<sup>2</sup> To the extent that signatories are able to discriminate among trading partners (conditional MFN) the third country will neither incur the costs nor enjoy the benefits of the agreement. This is less troubling from the perspective of maintaining incentives to liberalize.

<sup>3</sup> While textiles and apparel liberalization will indisputably raise developed country welfare, it is not as clear that less developed countries will gain from the TRIPS accord.

<sup>4</sup> See (John Whalley and Colleen Hamilton, 1996, pp. 59-76) for computable general equilibrium estimates of those gains.

Despite this success, the idea of a large negotiating round came under attack almost as soon as the Uruguay Round ended. There was a built-in agenda that stemmed from the Round itself which called for negotiations on information technology, telecommunications, financial services, shipping, and the movement of natural persons. By 1999, new negotiations on agriculture were to commence. These negotiations were designed to be independent of one another (devoid of linkages). The apparent success of some of these negotiations (information technology, telecommunications and financial services) has emboldened critics of broader rounds.

The Clinton Administration in the United States was the most vigorous advocate of a sector-by-sector alternative to rounds. This stemmed in part from the belief that the Uruguay Round was too complex and time consuming.<sup>5</sup> There was also a concern that such delay imposed welfare costs by unnecessarily postponing viable liberalization. In his May 1998 address to ministers at the World Trade Organization (WTO), President Clinton said:<sup>6</sup>

“We should explore what new type of trade negotiating round is best suited to the new economy. We should explore whether there is a way to tear down barriers without waiting for every issue in every sector to be resolved before any issue in any sector is resolved. We should do this in a way that is fair and balanced, that takes into account the needs of nations large and small, rich and poor. But I am confident we can go about the task of negotiating trade agreements in a way that is faster and better than today.”

This idea entered into trade parlance as an “early harvest” — reaping the benefits of each negotiating area as they ripen. Implicit in this is the belief that it is possible to reach liberalization agreements in some sectors without agreement in others. At a trivial level,

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<sup>5</sup> It was 15 years from the end of the Tokyo Round in 1979 to the Marrakech conclusion of the Uruguay Round in 1994. The Uruguay Round began in 1986, but the United States suggested a new round as early as 1981 (Ernest H. Preeg, 1995, p. 30). Preeg also notes that the six year Tokyo Round led to “GATT fatigue... Officials wondered if a continuous process of single-issue negotiations within the GATT would be preferable.” (p. 27). He writes, “The most persistent criticism of the GATT round approach... is that it simply takes too long.” (p. 186).

<sup>6</sup> WTO document WT/FIFTY/H/ST/8, available at <http://www.wto.org/>.

this must be true, since liberalization agreements have been reached and there are still virgin sectors left untouched by GATT rounds. At a less trivial level, this raises several important questions. What is the appropriate scope of a negotiating round? Is it generally possible to reach agreements sector by sector? If it is possible, is it advisable?

The Doha round of trade negotiations were launched as a successor to the Uruguay Round in 2001. While areas of negotiation were identified, largely matching up with those of the Uruguay Round, the exact scope of the talks remains a matter of substantial controversy. The Cancun Ministerial meeting of September, 2003 failed in large part because of a dispute over whether or not negotiations should cover the “Singapore Issues” of investment, competition, government procurement, and trade facilitation.

This paper will attempt to bring existing economic theory to bear on these questions. In the next section, we will review the traditional case for package deals in trade rounds, bolster that case with some theory and then challenge it with the apparent success of sectoral negotiations. We will argue that track record of the sector-by-sector approach is less attractive than it seems and that its successes may well have had negative effects on future negotiations beyond the unfortunate procedural precedent.

If one accepts the argument that broad rounds are desirable, this begs the important question of just how broad a round should be. In lieu of a precise answer to that question, the third section will try to clarify the issues surrounding the scope of the round. These issues include the importance of limited negotiating resources in developing countries and the extent to which the agenda is linked to the eventual outcome. We will also consider whether there are “natural” demarcations by which one might include or exclude negotiating topics.

In Section 4 of the paper, we turn to the more particular question of the Single Undertaking. While it is closely related to issue linkage, it goes further to require that nothing is agreed until everything is agreed. The contrast here need not only be with

single sector negotiations; there is also the possibility of plurilateral agreements with a proper subset of the negotiating countries. There are serious obstacles to repeating the feat from the Uruguay Round.

## II. One sector or two?

This section first lays out the conventional wisdom in support of linking negotiating issues in trade rounds. Then it attempts to relate such views to theoretical economic models in the hope that those models will help answer questions about the appropriate scope of linkage. Next, we consider the post-Uruguay Round experience with single sector negotiations. The section concludes with a summation of the case for linkage across sectors.

### A. Conventional wisdom about packaging

Given the challenges to broad negotiating rounds, it is remarkable the extent to which distinguished analysts agree that such bundling has been vital to the success of post-war trade liberalization. In *After Hegemony*, the political scientist Robert Keohane wrote:<sup>7</sup>

“Clustering of issues under a regime facilitates side-payments among those issues: more potential *quids* are available for the *quo*. Without international regimes linking clusters of issues to one another, side-payments and linkages would be difficult to arrange in world politics;”

He goes on to discuss the GATT as a particular example where such linkage has worked well, allowing for tradeoffs across sectors.

Ernest Preeg discusses packaging in the Uruguay Round. He notes that while such packaging had been a persistent feature of GATT negotiations, the scale to which it was attempted in the last Round was much greater than in the previous. He concluded:<sup>8</sup>

“This unprecedentedly comprehensive round strategy did, in the end, work despite many misgivings throughout the negotiations that it was too ambitious and complicated. There was a weakening of the draft agreement for some issues, particularly in the final phase of negotiations, but this was

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<sup>7</sup> (Robert O. Keohane, 1984, p. 91)

<sup>8</sup> (Ernest H. Preeg, 1995, p. 185)

to be expected... In contrast, it is doubtful that such politically sensitive issues as agriculture, textiles and intellectual-property rights, to name only a few, could have been negotiated with comparable result on an individual basis.”

Since these are sectors in which some of the Round’s most trumpeted achievements took place, this statement is tantamount to saying that packaging was central to the multilateral liberalization achievements of the last 20 years.

Looking forward, Anne Krueger identifies the trend toward sector-by-sector negotiation as one of the key threats to the multilateral trading system (1998). The principal problem is the same one identified above — the inability to deal across sectors in overly focused negotiations. She also asserts that a sector-by-sector process would likely bias future liberalization toward the interests of developed countries:<sup>9</sup>

“The ability of developed countries to define the agenda and to support negotiations only for sectors in which they believe they have a comparative advantage (such as information technology) makes the likelihood that developed countries’ protection against imports from developing countries will be reduced considerably smaller.”

Similarly, (J. E. Stiglitz, 2000) espoused comprehensiveness as one of the two basic principles that should be pursued in any ensuing round (the other is fairness). He recounts the important role of export interests in pushing for passage of the North American Free Trade Agreement in the United States. By addressing issues separately, sectoral negotiations separate import-competing and exporting lobbies.

The qualms politicians have voiced about broad rounds are not without support from analysts, however. Keohane, who generally supported linking issues, is skeptical of the kind of package that crosses issue boundaries:<sup>10</sup>

“Suppose, for instance, that each issue were handled separately from all others, by a different governmental bureau in each country. Since a side-payment or linkage always means that a government must give up something on one dimension to get something on another, there would always be a bureaucratic loser within each government. Bureaus that

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<sup>9</sup> (Krueger, 1999, p. 930)

<sup>10</sup> (Robert O. Keohane, 1984, p. 91)

would lose from proposed side-payments, on issues that matter to them, would be unlikely to bear the costs of these linkages willingly on the basis of other agencies' claims that the national interest required it."

This is noteworthy because the Uruguay Round expansion of the trading agenda into new issues such as services, investment and intellectual property meant that new agencies would be brought into intragovernmental discussions.

Schott and Watal (2000) argue that the 1999 breakdown in talks in Seattle was attributable to the increased complexity of the task. Specifically, they identify the increased membership of the WTO as a complicating factor, along with the Single Undertaking requirement that all countries be involved on all issues.

"This requirement means that developing countries have to commit to substantially greater reforms of their trade barriers and trade practices than they did in the past. Consequently, they need to be better informed about issues under negotiation."

These added burdens prevent the kind of flexible agenda setting that was more common in previous rounds.<sup>11</sup>

## B. Theory behind the conventional wisdom

Thus, there is widespread agreement that linkages are useful, but also some concern that costs may mount as negotiations become overly broad (e.g., cutting across agencies in the case of Keohane). This hints at a happy medium. In an effort to find it, we next consider some of the theoretical foundations for the linkage arguments made above.

At the simplest level, one might suppose that all governments participating in a set of trade negotiations have preferences over domestic prices and that these prices are affected by trade policies. Many common trade instruments have the effect of helping the implementing country at the expense of trading partners. Frequently the expense exceeds the benefits to the implementing country. Thus, one might think of an agreement that all participants could sign that would raise the welfare of each of them. In fact, there are

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<sup>11</sup> Schott and Watal do *not* advocate sector-by-sector negotiation as a remedy. Instead, they recommend the creation of a WTO steering committee to set the agenda. That idea is beyond the scope of this paper.

likely to be many such agreements that would be mutually beneficial. How the gains are to be divided in such a situation has been the central issue of bargaining theory.<sup>12</sup> However the gains are split, the countries sign the resulting accord and the game is finished.

At this level of abstraction, we have not yet dealt with issues such as whether countries are maximizing the unweighted sum of citizens' welfare or whether they are favoring politically powerful domestic actors. Even so, we encounter a difficulty. The bargaining story above is most plausible in a national setting, where the resulting agreement might be enforced by a judicial system. It is much less satisfactory in an international setting where no such system exists.

Of course, the Uruguay Round establishment of the WTO significantly strengthened the GATT's dispute settlement mechanism. Yet that system does not mete out its own punishments. Rather, the punishment for renegeing on an agreement is the reciprocal withdrawal of concessions by the aggrieved trading partner. Thus, whatever agreement is reached must be "self-enforcing" — the terms must be such that no signatory to the agreement has an incentive to deviate from the accord. Thus, one would expect that enforcement issues subsequent to an agreement have an important effect on the shape of the agreement.<sup>13</sup>

In the context of trade liberalization, (Avinash Dixit, 1987) introduced the idea of an infinitely repeated game between two countries. Whereas each would like to impose a relatively high tariff on the other, they are mutually worse off if they do so. Cooperation in the form of lower tariffs can be supported by the threat of future imposition of the high tariffs (a trade war) in response to any provocation.

(K. Bagwell and R. W. Staiger, 1990) extended this approach significantly with a description of the "most cooperative tariff" that two countries could sustain. For a given

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<sup>12</sup> For a good general reference on bargaining theory, see (Abhinay Muthoo, 1999).

<sup>13</sup> (J. D. Fearon, 1998) provides a thorough treatment of this proposition.



level of future trade volumes, the lowering of the cooperative tariff increases both the incentive to defect from the agreement (since the gap between cooperative tariff and optimal tariff is larger) and the incentive to cooperate (since the pain induced by a future trade war rises with the degree of cooperation). Bagwell and Staiger derive the lowest tariff at which the incentive to cooperate and the incentive to defect exactly offset. For later purposes, it is worth introducing here the terminology of “slack in the incentive constraint.” The incentive constraint is the restriction on the cooperative tariff level that a country is better off maintaining that cooperative level than it would be were it to defect and suffer the future consequences. At tariff levels above the lowest cooperative tariff, the benefits of cooperation more than offset the appeals of defection; thus, there is “slack” in the incentive constraint.

Each of these two papers provides an important role for issue linkage. Since they are emphasizing other points, they each describe world with only two sectors. Yet it is the threat of retaliation in the export sector that induces a country to liberalize in its import sector. It would be meaningless to think of a sector-by-sector approach here. In neither sector would the importing country have any incentive to alter its policy from the non-cooperative level. Aside from bargaining considerations, in a two-sector model the sectors are necessarily linked by general equilibrium considerations.

This infinitely-repeated game approach is put in a political-economy framework by (Levy, 1999). In that model, government preferences are shaped, in part, by lobbies. In each of two countries there are assumed to be two sectors that feature lobbying groups. The export lobby in one country thus is pitted against the import-competing lobby in the other. Governments are limited in their abilities to meet the lobbies’ requests. It is easy to help the import-competing industries — one can impose protection directly. It is more difficult to help the export industries (though the governments may be even more anxious to do so). The exporters can only be helped through reciprocal liberalization. This effectively pits the export lobby in a country against the import-competing lobby of the

*same* country. The model is also constructed in such a way that general equilibrium considerations play no role. This is, then, a theoretical basis for Stiglitz' concern that if the concerns of export interests are somehow addressed separately, there will be no force left that will push for lower protection in the import-competing sector.

Each of the preceding theoretical works provides an illustration of why one would wish to link different sectors in a trade negotiation. Because of their focus on an illustrative pair of sectors, they provide much less guidance on which sectors one should include in negotiations. To that end, we consider one final theoretical work on self-enforcing agreements: the paper of (B. Douglas Bernheim and Michael D. Whinston, 1990) on "multimarket contact." Though Bernheim and Whinston nominally consider the behavior of firms that compete in a range of different markets, their conclusions are readily applicable to self-enforcing trade agreements. They show that when players encounter each other across a range of sectors, the breadth of contact can only help, not hurt, the extent of cooperation they can achieve.

Their argument is that a broad agreement allows players to "pool" their incentive constraints across sectors. For example, if a country defects from a trade agreement in one sector, it could be punished across the various sectors in which it encounters the trading partner. When the country is deciding whether or not to defect, it takes this enhanced threat of punishment into account.

It is not immediately obvious that such linkage will allow for greater liberalization. If a country were to defect despite the prospect of punishment across a broad range of sectors, it would then wish to defect across the entire range of sectors, rather than in a single one (the punishment would be no worse).

Bernheim and Whinston show that the extent of additional liberalization that might be achieved depends on slack in the countries' incentive constraints. If the incentive to cooperate exactly offsets the incentive to defect in each linked sector, then the total incentive to cooperate across sectors should exactly offset the total incentive to

defect and nothing additional could be achieved. Suppose, though, that there was a sector in which free trade could easily be supported by the threat of future reversion to noncooperative play (“easily” here means that the incentive to cooperate is strictly greater than the incentive to defect). Next, imagine there is a second sector in which the lowest supportable cooperative tariff is greater than zero. The “slack” in the first sector’s incentive constraints can be put to use in the second sector to allow for a lowering of tariffs. The tariff can be lowered until the *total* incentive to cooperate just offsets the *total* incentive to defect. Thus, the linkage of sectors allows for greater overall liberalization.

This implies that the sectors that one would most wish to include in a package deal are exactly those sectors that would be easiest to negotiate in stand-alone talks. We will return to this point after a brief discussion of recent experience with single sector negotiations.

### C. Challenge to conventional wisdom: single sector agreements<sup>14</sup>

In the wake of the Uruguay Round a number of single-sector negotiations were undertaken. Some of these were part of the “built-in agenda” of unresolved service talks. Others were undertaken separately. These negotiations have been the only real proving ground for sector-by-sector talks as an alternative format of multilateral negotiation. To the extent that they have been successful, it poses an important challenge to the theories described above. Thus, they merit some further examination.

With the close of the Uruguay Round, deadlines in 1995 and 1996 were adopted for further services talks on movement of natural persons, financial services, basic telecommunications, and maritime services.<sup>15</sup> Not a single one of these deadlines was met. The movement of natural persons negotiations were delayed and those on maritime services came to a complete halt.

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<sup>14</sup> This section draws heavily on (Rasheed Khalid et al., 1999)

<sup>15</sup> For a more detailed history, see (Wendy Dobson and Pierre Jacquet, 1998, pp. 80-85).

In financial services, the United States decided in June of 1995 that the offers other countries had made were inadequate and withdrew its offers. The European Union crafted an interim agreement to salvage the negotiations and a final agreement was reached by December 13, 1997. Various explanations are offered for the progress that was made. The most persuasive argument is that the Asian financial crisis commenced that summer.<sup>16</sup> At the heart of the crisis were concerns about the regulation and openness of Asian financial service sectors. By the fall, all participants were anxious to avoid further shocks, as the failure of the financial services negotiations surely would have been.

It must be remembered, as well, that the mere conclusion of an agreement does not mean that it was a success. The difficulties of assessing the extent of services liberalization described above apply to financial services as well. One expert conclusion was grim: “the (Financial Services Agreement), save for actual advances in the field of insurance services, barely goes beyond binding the status quo... Remarkable though it was in terms of the negotiating challenge, especially in light of the Asian financial crisis, the FSA does not appear to provide significant new momentum on market opening.”<sup>17</sup>

The negotiations on Basic Telecommunications had a similar history. In April 1996 the United States judged the package of offers inadequate and walked out of negotiations.<sup>18</sup> By February 15, 1997 an agreement was reached. Again, it is difficult to assess the extent of market opening and the extent to which the negotiations drove this liberalization.<sup>19</sup>

In both financial services and telecommunications, the United States’ and the European Union’s markets were reasonably open to competition and those of Japan and

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<sup>16</sup> (Dobson and Jacquet, 1998, pp. 84-85). They also cite better cooperation between the U.S. and the E.U. and more effective coordination between private lobbying interests.

<sup>17</sup> (Dobson and Jacquet, 1998, p. 90)

<sup>18</sup> See (Jonathan D. Aronson, 1998, p. 16).

<sup>19</sup> For a debate about the significance of the Basic Telecommunications agreement, see (William J. Drake and Eli M. Noam, 1998). Their skeptical view is that the agreement largely codified liberalization that was occurring anyway.

the developing nations were more protected. Further, the most competitive firms were based in the U.S. and the E.U.; the developing nations had relatively little interest in reciprocal market access. Thus, the difficulty in reaching agreements when these negotiations were carried on in isolation was entirely predictable. Under the General Agreement on Trade in Services (GATS), it was possible to sign an agreement without undertaking liberalization or without even locking in the status quo.

The Information Technology Agreement, which was concluded in March 1997, has been heralded as the prime example of successful negotiations outside of the standard round format. Although the negotiations were held under the auspices of the WTO, they were concentrated in a single sector and were not part of the Uruguay Round's built-in agenda. United States Trade Representative Charlene Barshefsky said of the ITA: "the significance of the agreement is without comparison. At no time in the history of the trading system have so many countries united to open up trade in a single sector by eliminating duties across the board."<sup>20</sup>

There is no doubt that a significant amount of trade liberalization occurred under the ITA and that it represents a major achievement for the WTO. On its face, the ease with which the ITA was reached seems to contradict the theoretical claims that broader rounds and linkages between sectors are necessary for significant multilateral liberalization. In fact, the history of the ITA reveals some reasons to doubt that the sectoral approach can provide a worthy substitute for a new round.

The ITA originated with an initiative pushed by U.S. information technology producers.<sup>21</sup> The United States requested a lowering of European barriers to goods such as semiconductors in 1993, at the conclusion of Uruguay Round negotiations. The issue was raised again in early 1995 in bilateral negotiations between the U.S. and the E.U. and was on the agenda of the spring 1996 meeting of the Quad countries. At this stage, the

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<sup>20</sup> Cited in (John Sullivan Wilson, 1998, p. 75). The statement was made on February 15, 1997.

<sup>21</sup> This history draws on (Wilson, 1998, pp. 72-76).

United States pushed for the agreement to be multilateral. Prospects were bolstered when the ITA was endorsed at the Asia Pacific Economic Cooperation (APEC) summit in November 1996.

Negotiations took place at the Singapore Ministerial of the WTO in December 1996 and the agreement that was reached there was one of the centerpieces of the ministerial. The Singapore agreement was conditional. As a means of addressing the free-rider problem that had plagued the contemporaneous negotiations in telecommunications and financial services, it had been agreed that the ITA would only be concluded if a sufficient number of countries agreed to participate. Eventually, 43 WTO member countries joined the agreement accounting for approximately 93 percent of world trade in the sector.<sup>22</sup>

To assess the implications of the ITA for the shape of future negotiations, it is important to understand why it succeeded. Two major reasons suggest that the case for broad negotiations remains intact. First, the IT sector itself is sufficiently broad and production is sufficiently dispersed that most nations were both buyers and sellers of IT products. Thus, it was possible to agree to reciprocal market access even within the sector.<sup>23</sup> Second, it turns out that the agreement was not confined to the IT sector at all. Final agreement on the ITA came about only when the United States agreed to lower its barriers to European liquor exports. During the negotiations, the European negotiator insisted on a phase-out of tariffs on brown and white distilled spirits and liqueurs over a time period similar to that for IT products and the United States agreed. This concession was apparently necessary to overcome French resistance to the ITA.<sup>24</sup>

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<sup>22</sup> (WTO, 1997, p. 3).

<sup>23</sup> (Christopher B. Johnstone, 1997). Even where nations were not IT producers, these goods are often intermediate products rather than consumer goods, so producers that use IT could press their governments for liberalization. Evidence for this last point comes from the exclusion of music CDs and consumer electronics, both within the IT sector but not very useful in production.

<sup>24</sup> (European Report 1996). A European spokesman was quoted to say, "We're not trying to pretend that whisky and cognac are IT products. We're saying, merely, the more the merrier."

Thus, the success of sectoral negotiations has been more apparent than real. Movement of natural persons and maritime services talks failed completely. Telecommunications and financial services talks were very difficult and the extent of liberalization has been questioned. The ITA looks like the best case, but it featured substantial intra-industry trade and even so required an inter-sectoral deal for completion.

For the sake of argument, suppose that the spirits component of the ITA accord was trivial. Intra-industry trade has grown increasingly important in the last several decades; why shouldn't it allow for new bargaining patterns? Is there anything wrong with reaping gains in an important sector without waiting for other negotiations to conclude? If an event such as the Asian financial crisis creates a surge of interest in liberalization, why not seize the moment?

Taking these questions in turn, there is nothing inherently wrong in using tradeoffs within a sector to reach an agreement. In fact, the practice bolsters the theoretical arguments advanced earlier. To have a serious discussion of whether talks should include one or more sectors, it is necessary to define "a sector". The theoretical arguments would suggest a homogeneous product, such that one country would be an exporter and another would be an importer. This might take one to a single line in a tariff schedule. By this reasoning, an area such as financial services that includes banking, insurance, and investment services is really a bundle of sectors linked under a single rubric. This is more than mere pedantry; it shows that the true argument concerns not whether there should be one or two sectors, but rather how many different sectors one wants to conclude. Section III of this paper will address that explicitly.

First, though, we return to the question of whether there is any harm in settling one sector before the others. In fact, there is. If we consider the example of a sector such as IT in which there is broad willingness to liberalize, this is exactly where we expect to find slack in countries' incentive constraints. That slack could be put to good use by allowing other more difficult sectors (e.g. agriculture) to achieve greater liberalization.

This has been demonstrated generally in recent work by Roman Inderst (2000). In a bargaining game, he gives an example with two areas of negotiation. In one, both participants can gain, but there is a tradeoff between one participant's gain and the other's (it is over this division of the spoils that they are bargaining). In the other sector, both participants will gain but the division is pre-ordained. Thus, the first sector is the controversial one, while the second is the easy one. Inderst shows that except for a rare symmetric case, there will be different outcomes to the bargaining for separate versus simultaneous negotiations. The intuition is that the participant who gains more from the easy sector deal will suffer more if it is delayed. This gives leverage to the other participant in the more difficult negotiation when the two sectors are simultaneous (i.e., linked). Only when the participants are equally anxious to reach the easy accord will simultaneous and separate negotiations reach the same result. That hardly seems like an apt description of the single sector negotiations of the late 1990s.<sup>25</sup>

In less abstract terms, the problem with the financial services agreement or the ITA is that they removed strong advocates of liberalization from future negotiations. Financial lobbyists in the United States who might have pushed for a package that bundled financial services with reform of anti-dumping law will no longer have much incentive to be involved. Thus, an early harvest can damage other crops.

Of course, one can hardly argue that no agreement should ever be reached before all potential agreements are settled. Such an extreme stance would have denied the benefits of the post-war liberalization that took place under the GATT (since there are still, quite clearly, recalcitrant protected sectors). It will be the task of Section III to look for a middle ground.

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<sup>25</sup> This mechanism may also address the concern that developing countries made excessive concessions in the Uruguay Round. If those countries placed a higher weight on membership in the WTO as an important foreign policy measure (a non-controversial part of negotiations), then linkage of membership with the broad range of agreements would allow the less-interested developed countries to exploit the slack in the incentive constraint and achieve greater concessions in areas of concern to them, such as TRIPS. This is an inescapable concomitant of linked negotiations.



#### D. Do we see cross-sectoral tradeoffs?

While the previous subsection tested the theory of cross-sectoral linkages with a purported counterexample, this subsection will look more directly and more briefly at whether there is evidence that such linkages occur. Again, at first glance it might seem that the theory falters. The Punta del Este declaration that launched the Uruguay Round stated that, “Balanced concessions should be sought within broad trading areas and subjects to be negotiated in order to avoid unwarranted cross-sectoral demands.”<sup>26</sup> Further, in an analysis based on interviews with Uruguay Round negotiators, Finger et. al. (1999) found that those negotiators did not carefully tally gains and losses in the way the theory suggests.

This last point is reminiscent of a standard and more central challenge to economic theory in which individuals are observed not to go around maximizing their utility subject to a budget constraint. It is a critique that was addressed by Milton Friedman decades ago when he argued that the theory was still useful so long as individuals behaved *as if* they doing the calculations (1953). In fact, Finger et. al. conclude that: “there were obvious trade-offs from one part of the (Uruguay Round) negotiations to another” (p. 10).

How could such tradeoffs occur if the negotiating groups are explicitly separate and instructed to strive for balance within? They occur because ultimately a minister or chief negotiator considers the package as a whole. No matter how hard negotiators on textiles and apparel might have worked to achieve internal balance, there was not much by way of market access that developing countries could have given to the developed countries to compensate for the political costs of ending the Multi-Fibre Arrangement. Similarly, it is hard to imagine what the developed countries might have offered the developing within the arena of intellectual property. Whether or not negotiators are quantifying their gains and losses precisely, the United States Trade Representative must

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<sup>26</sup> The declaration is reproduced in (John Croome and World Trade Organization., 1995). See p. 384.

have looked at those two agreements and seen textiles as a net loss and TRIPS as a net gain. To the extent that the two agreements packaged together are seen as acceptable, an implicit cross-sectoral tradeoff has been made.<sup>27</sup>

### **III. How many sectors?**

#### **A. Infinitely broad and complex rounds**

The central theme of the previous section was that cross-sectoral linkage is absolutely essential to successful multilateral negotiations. This begs the important question of just how broad such negotiations need to be. We start from an extreme position and then consider reasons for retreat.

The reasoning of Bernheim and Whinston would suggest that the broader the negotiations, the better. Suppose we have a proposed agenda with a given number of sectors and we ask what costs and benefits there might be from adding another sector. If the existing level of liberalization is only just supported in the additional sector (i.e., there is no slack in the incentive constraint), then there will be no gain from its inclusion in broad talks. Nor will there be any cost. Thus, we are no worse off for including it. If there is slack in the incentive constraint, we will be strictly better off for including it, since it will allow for greater liberalization in the sectors of our initial agenda. Thus, in the abstract, there is an appeal to negotiations of unlimited breadth.

The first objection to an overly broad round is that it would put an excessive burden on developing countries. Numerous commentators have described the strain that the Uruguay Round agreements caused.<sup>28</sup> Schott (2000) attributes this to the Single Undertaking requirement that countries participate in all of the negotiations. For poorer countries it was difficult to maintain representation at the multiple negotiating groups of the Uruguay Round, much less at an even broader round.

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<sup>27</sup> It is exactly this capacity of higher ranking ministers to take a broader view and see these tradeoffs that leads Wolfe to call for their greater involvement in talks (1996).

<sup>28</sup> As one example that cites others, see (R. Chadha et al., 2000).

While this concern is a very real one, it is worth noting its limits. It is certainly true that developing nations have also found it difficult to implement agreements, such as the one on customs procedures. However, this should not serve as an argument against broad negotiations. Rather, it concerns the amount of time allocated for developing countries to phase in reforms. The relevant constraint for determining the scope of talks is the limit on participants' negotiating ability, including the analytical apparatus that supports the negotiators. To the extent that there are limits on countries' capacity to implement agreements, one would expect that a broader round would require longer phase-in allowances for those countries that are constrained.

This capacity argument for limiting a round's scope is also quite different from the complexity complaint frequently heard from the United States. The contention is that the increased complexity of rounds has led to their increased length. In the context of the major developed countries, this is implausible. The Uruguay Round was to conclude at the 1990 ministerial meeting in Brussels. Had it done so, the Round would have been a more modest four years long. The delay was not caused by an inability of the United States or Europe to master the complexities of the issues involved nor by a shortage of Quad country negotiators who might attend talks. Instead, it was attributable to impasses on key issues, particularly agriculture. Preeg notes that with many sensitive issues on the table, "Recalcitrant negotiators, under constituent pressure not to be forthcoming, tend to hold back unless faced with some form of threat or ultimatum." (1995, p. 188). The spacing of those deadlines, which most frequently came from the expiration of U.S. fast-track negotiating authority, cannot be ascribed to the breadth of the talks.

### **B. Impasse, the Single Undertaking, and Pandora's Box**

There is one sense in which the breadth of the negotiations could be directly linked to the length of the talks. Suppose one includes a sector in which a major participant feels it absolutely cannot adopt any policy more liberal than the status quo. Further, suppose one

couples this with a Single Undertaking requirement that nothing is agreed until everything is agreed. This would seem to offer the potential of a never-ending round.

The question hinges on a more precise definition of the Single Undertaking requirement. What does it mean that everything must be agreed? Surely those countries that managed to put the controversial issue on the agenda would not be pleased to leave the round with the status quo intact. Yet the obstinate country, by assumption, will not back down. If our interpretation of the Single Undertaking is that it requires measurable liberalization from the status quo, then an impasse will occur. If, instead, it allows for empty agreements, then it should not delay the conclusion of the round. On the other hand, the possibility of empty agreements casts serious doubt on the importance of the Single Undertaking as a concept.

We can define an “empty agreement” as one that requires no liberalization on the part of some or all of the participants in the talks. For world welfare it matters whether one country or all countries are exempted from obligation, so we can distinguish between “partially empty” and “completely empty” agreements. For the analysis of the Single Undertaking requirement, though, it makes no difference. Sadly, there are abundant examples of such empty agreements. The maritime services sector was under the domain of the Uruguay Round GATS negotiations, but no liberalization was undertaken by the end of the Round.<sup>29</sup> The Uruguay Round also featured four plurilateral agreements in which not all countries participated; these could be considered examples of “partially empty” agreements since nothing was required of non-signatories. It has been argued that the agreement on agriculture achieved little in the way of liberalization, though it may have set the stage for future liberalization through measures such as tariffication.<sup>30</sup>

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<sup>29</sup> Nor was any undertaken later, as described above.

<sup>30</sup> For a thorough discussion of the agreement on agriculture, see (Timothy E. Josling, 1998). He writes that the level of protection was not significantly reduced (p. 28).

How was the Uruguay Round agreed upon since there were clearly sectors in which no liberalization had taken place and others in which not all countries participated? A strict interpretation of the Single Undertaking requirement would say it should not have been. In practice, though, the Round was settled when there was a sufficient balance of concessions to satisfy all of the participants. This is not to argue that the Single Undertaking requirement had no effect at all. Finger writes, “the all-or-nothing character of the WTO proposal required that a country accept the disciplines of all the agreements if it became a WTO member. ... Accepting all of these disciplines could reasonably be interpreted by trading partners as worth as much as another percentage point coverage of tariff reduction.” (1999, p. 10). While this is true, it is important to remember that the content of those agreements was endogenously determined. Had the agreements required the repeal of the Jones Act, it is unlikely that the United States would have pursued membership.<sup>31</sup>

A closely related question is whether the presence of a topic on the negotiating agenda makes movement on that issue significantly more likely. In the case of maritime services, it did not. One might ask whether the same immunity would work for environmental or labor standards. Krueger asserts that such negotiations might have a life of their own: “It is all too easy to strengthen labour standards once they are accepted as a part of the WTO.” (1999, p. 915). This seems to be one major rationale for the strong developing country opposition to allowing these new issues on the agenda. Yet Krueger also argues that “developing countries have a strong interest in preventing developed countries from perceiving that they will not negotiate regarding the environment at all; such a stand could induce environmentalists to push even harder for trade-enforced environmental measures.” (p. 926). Thus, a critical question that is left unanswered here

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<sup>31</sup> The Jones Act governs maritime services in the United States and is very politically sensitive. Recall that the U.S. Congress failed to ratify the original International Trade Organization over complaints about its coverage.

is whether a country's ability to stand firm on an issue is altered by the inclusion of that issue on a negotiating agenda. The exclusion of an issue from an agenda necessarily precludes any movement on it, but that is quite different from saying that inclusion leads to movement.<sup>32</sup> Of course, developing countries might find it in their interest to make concessions on environmental measures, depending on the liberalization they were offered in return. That would be an argument for a broader agenda.

### C. Natural demarcations

An alternative rationale for excluding labor and environmental issues would be that harmonization of such policies is unnecessary to achieve gains from trade and may well harm global welfare. One might look for a natural demarcation between issues that are central to achieving gains from trade (e.g. the removal of explicit barriers to goods and services exchange) and those that are not (e.g. the harmonization of minimum wages across countries). There are a number of difficulties in drawing such a line.

One could try to distinguish between rules that concern products and those that concern the process by which those products were made (the former being worthy of negotiation, the latter excluded). However, this line has already been crossed with negotiations on countervailing duties and TRIPS. Nor can one easily separate domestic matters from trade flows. Any policy that alters domestic consumption or production levels will affect trade. Paul Krugman (1997) acknowledges this and points out that the search for a logical separation of negotiating issues is fundamentally flawed. Even when countries reciprocally lower tariff barriers, the mercantilist principle behind the exchange — that market opening is bad, but that one is compensated through access to other

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<sup>32</sup> There is a substantial literature on agenda setting and the effects it can have on outcomes. Most frequently, those effects come through the structure of the decision-making process (e.g., a committee chairman's decision to present Proposal A and then Proposal B, without any possibility of return to Proposal A or introduction of a Proposal C). In the less structured setting of WTO negotiations, it is less clear how these arguments apply.

countries' markets — is misguided. Thus, to say that harmonization of labor laws is also misguided does not set it apart.<sup>33</sup>

The exchange of tariff concessions can be distinguished from labor law harmonization in their ultimate effect on world welfare. The former will likely raise all participants' welfare and thereby raise world welfare. The latter may harm all participants' welfare and thereby lower world welfare. We could also consider scenarios, such as with the emission of transboundary pollution, where limits would harm one country's welfare while helping other countries and raising world welfare.

Keith Maskus (2000) assesses TRIPS, competition policy, labor standards and environmental standard on a number of related criteria: trade impacts, international externalities, policy coordination failures, and meaningful dispute resolution. He finds that "Overall, the "grand rank" ... provides an advantage to competition policy over environmental regulation. The criteria adopted here reject core labor rights as an appropriate area for the WTO." (p. 16). His arguments, while persuasive, also illustrate the extent to which suitability for inclusion is a matter of degree, rather than a binary property.

### E. Ripe for negotiation and a vehicle for transfers

This section began with everything on the hypothetical negotiating table and then attempted to whittle down the agenda through consideration of negotiating costs, bargaining impasses, runaway talks, and welfare considerations. In the end, we are left with the basic idea of linked negotiations to allow welfare-enhancing exchanges. Given the substantial costs of negotiation to some participants, negotiations should be kept as small as possible without undercutting the prospects for a deal. To illustrate the point, suppose we consider an agenda with 12 potential topics. If it turns out that this agenda could be divided in half and the same outcome could be supported in each of the halves,

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<sup>33</sup> Krugman's article is a review of a very useful collection of articles that carefully consider the need for harmonization: (Jagdish N. Bhagwati et al., 1996).

then undertaking a six topic round would be harmless. One can assess the likelihood that the outcome will be preserved by examining the nature of concessions. If all of the necessary tradeoffs occur within the smaller groupings of topics, the division will be harmless. If, instead, one country's concessions made on the first six topics were justified by concessions won on the seventh topic, then the split would not preserve the outcome.

This criterion would rule out single-sector negotiations such as the ITA. As argued above, it's very likely that other countries could have won further liberalization from strong ITA proponents like the United States had the negotiations been bundled together with other issues. The criterion would also mean it is costless to exclude issues on which an impasse was highly likely; the outcome of the Uruguay Round would have been the same whether or not maritime services were ever discussed. This consideration might well exclude labor standards from talks. Finally, the criterion could allow the inclusion of transboundary environmental concerns. One of the central problems in reaching global agreements on environmental policy is the uneven incidence of the measures under consideration. This could be addressed through proper allocation of tradable permits, but the same result might also be achieved by allowing compensation to take place through trade concessions.

#### **IV. Single Undertaking**

The previous section prescribed a broad negotiating agenda. That leaves open the question of whether such a broad round would have a Single Undertaking requirement or whether countries would sign on only to those parts that they liked (variable geometry). Even if we ignore the arguments presented above on the limited impact of the Uruguay Round Single Undertaking requirement, it is difficult to see how it could be repeated.

Though the institution of the WTO was not proposed until relatively late in the Uruguay Round, it provided a ready vehicle for enforcing the Single Undertaking. A



country may have been a Contracting Party to the GATT, but it could not become a member of the WTO unless it assented to all of the requisite agreements. In all future rounds, one could request that all WTO members sign all parts of the ensuing accord, but what means of enforcement would there be? Would recalcitrant countries be expelled from the WTO? That would certainly alter the bargaining dynamics, but it seems unlikely. One might achieve the same effect by declaring a new organization, WTO-2, to replace the WTO and only allowing in those who undertook all the new agreements. That, too, is implausible and would lead to odd dynamics (a country might choose to wait until WTO-5 to join; or it might make different concessions in the knowledge that it might exit at the next incarnation).

The Cancun Ministerial of September 2003 illustrated the importance of this issue. Disagreements over the scope of the round were not notably between the major trading nations such as the United States, Europe and Japan. Instead, coalitions of developing nations (the Group of 20, prominently) were at the heart of fights to narrow the scope of the round in some areas (Singapore Issues) and expand it in others (specific measures on cotton). The effect was to halt multilateral progress for months. It remains to be seen whether the round can be revived.

Without any ready means of enforcing a Single Undertaking constraint, one is left with variable geometry. This is not as bad as it might seem. As argued above, even in the Uruguay Round certain issues were addressed with plurilateral agreements and certain negotiations resulted in empty agreements. The most common concern about variable geometry is the potential for free riders — countries who enjoy the benefits of an agreement without undertaking the accompanying obligations. We can consider two scenarios: one in which non-signatories cannot be effectively excluded (unconditional MFN prevails) and one in which exclusion is possible (conditional MFN).

If countries cannot be excluded from enjoying the benefits of an agreement, then participation can be enforced as it was in some of the post-Uruguay Round sectoral

negotiations. The United States declared that unless a critical mass of countries participated, it would not sign the agreement. If the agreements are truly welfare-enhancing, then countries should eventually find it in their own interests to join.<sup>34</sup>

If countries can be excluded through conditional MFN, this raises the concern that new distortions will be introduced into the world trading system. The problem is akin to the one raised by preferential trade agreements (PTA): consumers may buy goods from a high-cost producer because of trade preferences. A key difference, though, between a conditional MFN agreement under the WTO and a preferential trade agreement is the ease with which excluded countries could gain inclusion. Ideally, the conditional MFN agreement would require signatories to automatically extend MFN treatment to any country that subsequently wishes to sign. In contrast, gaining admission to a PTA can be exceedingly difficult.

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<sup>34</sup> An example of this latter point was the unilateral trade reform undertaken by developing countries in the 1980s and 1990s, despite their exemption from reciprocal obligation under special and differential treatment.

## V. Conclusions

This paper has argued that linkages across issues are a central component of international trade negotiations. This is true whether one considers governments as unified entities promoting national welfare or whether one takes into account the role of the interest groups in shaping government preferences. The landscape of negotiations has changed over the lifespan of the GATT, as issues that were once considered domestic have made their way onto the agenda and as talks have shifted from readily quantifiable tariffs toward more procedural questions such as government procurement or anti-dumping policy. None of this diminishes the possibility of cross-sectoral tradeoffs, however. The WTO can still play a vital role in facilitating the exchange of “concessions” across these issues in such a way as to raise world welfare.

While the added complexity of the prospective negotiating topics does put a burden on negotiating countries, a broad round is preferable to a narrow one in that it may allow otherwise unattainable deals. Countries’ own efforts to ensure that their concessions are offset by gains should be sufficient to ensure the breadth of participation. An attempt to impose a Single Undertaking requirement would likely fail.

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