BARGAINING IN THE SHADOW OF THE LAW: EARLY SETTLEMENT IN GATT/WTO DISPUTES

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INTRODUCTION

In the words of the Director General of the World Trade Organization ("WTO"), Mike Moore, dispute settlement "is the backbone of the multilateral trading system." As dispute settlement under the General Agreement on Tariffs and Trade ("GATT") and WTO grows progressively more rule-oriented, the literature on the institution’s jurisprudence is increasing markedly. And yet, as the text of the Dispute Settlement Understanding ("DSU") makes clear, and as the Appellate Body’s Wool Shirts and Blouses report reminds us, the basic aim of the institution is political, inasmuch as the goal is to settle disputes, with or without reports. Along these lines, one little-known fact about GATT/WTO is that fully three-fifths of all disputes end prior to a panel ruling, and most of these without a request for a

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6. See DSU art. 3.7 (stating that "the aim . . . is to secure a positive solution to a dispute."). Article 3.3 emphasizes that "prompt settlement . . . is essential to the effective functioning of the WTO." Id.
panel even being made. This lends weight to Mike Moore’s observation that “settlement . . . is the key principle,” without which, “it would be virtually impossible to maintain the delicate balance of international rights and obligations.”

That being said, WTO observers have invested little in trying to understand the role of consultations and early settlement in particular. Why do disputants disproportionately settle early despite the institution’s lack of enforcement power? How have procedural reforms over the years influenced these trends? This Essay examines consultations and early settlement in GATT/WTO dispute resolution.

Given that the WTO remains a “court with no bailiff,” its rulings at best can have only a modest direct influence on dispute outcomes. As Robert Hudec wisely observes, “No functioning legal system can wait until then to exert its primary impact.” Rather, the effectiveness of the regime disproportionately manifests itself in the form of settlement, either at the stage of consultations or during panel proceedings prior to a ruling. Further, what additional liberalization the system (as apart from the market power of the complainant) is able to elicit from defendants is attributable not to the WTO’s (supposedly) improved enforcement regime, but to the system’s ability to deliver a definitive, normative condemnation of defendants’ policies. Yet, cases in which the regime’s bluff has been called (i.e., those in which judgments are issued), are likely to be those in which the regime’s normative power holds little sway over the defendant. Hence, we expect that once a ruling has been issued a dispute is much less likely to end with full or partial satisfaction of the complainant’s initial demands.

This argument suggests as a corollary that the much-vaunted WTO reforms, as well as the more modest 1989 improvements, should have relatively little impact on the overall success of the dispute settlement regime or the pattern of early settlement in particular. These reforms, after all, invest little in the consultation stage. Rather, they speak to the procedures

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8. Moore, supra note 2.
governing the panel proceedings and to the aftermath of panel reports. If the institution’s ability to promulgate a clear judgment (outside of its ability to make that judgment legally or politically binding) has not been sharply improved, then the regime’s ability to induce early settlement should remain the same. Like dispute settlement under GATT, the success of the WTO system hangs on its ability to encourage bargaining in the shadow of weak law.

This Essay proceeds in four steps. Part I summarizes the quantitative evidence on the pattern of escalation and outcomes of more than 600 GATT/WTO disputes from 1948 through 1999. Part II elaborates on our theory of settlement bargaining within the context of an institution lacking enforcement power and shows how the hypotheses are consistent with the evidence introduced earlier. Part III discusses the theory’s expectations regarding the effect of the 1989 and 1995 dispute settlement reforms and likewise compares those predictions with the evidence. Part IV highlights the implications of our perspective for proposed future reforms dealing with transparency and developing country participation.

I. ‘A PUNCH THAT WILL NOT HIT ANYONE’

As was true under GATT, disputes occurring under the WTO begin with a complaint, consultations, and potentially proceed to a panel proceeding. At this stage, in the absence of settlement or withdrawal of the suit, the panel issues a legal judgment, a ruling that, for the most part, is the stuff of the literature on dispute settlement. Surprisingly, few observers have investigated what proportion of disputes reach each stage of the process. To find out, we turn to an exhaustive database of GATT/WTO complaints reported by Busch and Reinhardt. This database builds on the considerable nucleus compiled by Bob Hudec, supplemented with more recent records. Like Hudec, we count only those complaints that explicitly invoke

GATT/WTO laws regulating dispute proceedings, name defendants, and allege the infringement of specific legal rights, most often in the form of a "request for consultations." Also, since we are interested in characterizing patterns of settlement, and since settlement may occur bilaterally in disputes involving multiple complainants or defendants, we break multi-state complaints into each constituent pair of complainant and defendant. The results, listed by stage of escalation reached, are in Table 1.

**Table 1. Patterns of GATT/WTO Dispute Escalation**

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<tr>
<td>Initiated</td>
<td>620</td>
<td>313</td>
<td>122</td>
<td>185</td>
</tr>
<tr>
<td>. . . of which</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Panel established</td>
<td>276</td>
<td>137</td>
<td>59</td>
<td>80</td>
</tr>
<tr>
<td>. . . of which</td>
<td>(44.5%)</td>
<td>(43.8%)</td>
<td>(48.4%)</td>
<td>(43.2%)</td>
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<tr>
<td>Panel ruling issued</td>
<td>233</td>
<td>120</td>
<td>51</td>
<td>62</td>
</tr>
<tr>
<td>. . . of which</td>
<td>(37.6%)</td>
<td>(38.3%)</td>
<td>(41.8%)</td>
<td>(33.5%)</td>
</tr>
<tr>
<td>Appellate ruling issued</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>44</td>
</tr>
<tr>
<td>. . . of which</td>
<td></td>
<td></td>
<td></td>
<td>(23.8%)</td>
</tr>
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*Note: Since adjudication in the first years of GATT relied less on formal panels than on other bodies (e.g., working parties or the entire Council) to issue judgments, the term "panel" above includes those alternative authorities as well. The figures in parentheses reflect the row’s percent of the total cases initiated in that period. Cases filed in 2000, as well as 17 earlier WTO disputes whose panels had not yet had a suitable chance to form or issue a ruling as of July 2000, are not included.*

Two facts stand out. First, in a substantial majority of disputes (roughly 55%), no panel is ever established. A further 8% or so end prior to the issuance of a panel report. Settlement and the withdrawal of cases are thus the norm, not the exception. This finding, of course, is in sharp contrast to the view one might

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distil from a casual read of the literature on the GATT/WTO. Second, and more surprising still, the proportion of disputes in which a panel has been established has not changed appreciably over time, even under the WTO. If anything, under the WTO, somewhat fewer disputes last long enough to have a ruling issued, despite the strict time limits concerning panel establishment and panel proceedings. These findings are borne out by other scholars who have reached qualitatively similar conclusions using different methods for delineating disputes.\textsuperscript{15}

The key question, of course, is how outcomes of disputes vary across these different stages of dispute settlement. By “outcome,” following Hudec,\textsuperscript{16} we mean the ultimate policy result of a dispute, rather than the nature of a ruling per se. In other words, the key is whether the defendant liberalized the disputed trade policy practices, conceding to some or all of the complainant’s demands, as opposed to whether a ruling (if there was one) favored one side or the other. Using a benchmark that has meaning at each stage of dispute settlement, from consultations to a panel ruling, Hudec coded the policy result of each dispute into one of three categories, depending on whether the objectionable practices were fully, partly, or not at all removed.\textsuperscript{17} Reinhardt and Busch extend Hudec’s data on dispute outcomes up through the end of 1994.\textsuperscript{18} Results of this work for 298 bilateral disputes in the GATT period, broken down by stage of dispute escalation, are displayed in Table 2.\textsuperscript{19}

The data paint a remarkable picture. Specifically, 67.1% of those disputes ending prior to a ruling (whether before or after the establishment of a panel) exhibited full or partial concessions by the defendant. Surprisingly, despite the fact that only 16.1% of rulings upheld the status quo, a lower proportion (only 62.2%) of the cases with rulings ended in comparable levels of concessions. To put it another way, most of the concessions made by defendants in these disputes (53.9%) took the form of pre-ruling settlements, even though the rulings issued were heavily biased against defendants. Settlement is clearly where the in

\begin{itemize}
\item \textsuperscript{15} See, e.g., C. Christopher Parkin, Operation of Consultations, Deterrence, and Mediation, 31 L. & Pol’y Rev. 565-72, 567-69 (2000).
\item \textsuperscript{16} Hudec, supra note 10.
\item \textsuperscript{17} Id.
\item \textsuperscript{18} Reinhardt 2001, supra note 14; Busch, supra note 14.
\item \textsuperscript{19} Reinhardt 2001, supra note 14, tbl. 1.
\end{itemize}
TABLE 2. THE PATTERN OF DISPUTE OUTCOMES, 1948-1994

<table>
<thead>
<tr>
<th>Final Disposition of Case</th>
<th>Level of Concessions</th>
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<tr>
<td></td>
<td>None</td>
</tr>
<tr>
<td>Panel not established</td>
<td>47</td>
</tr>
<tr>
<td>Panel established, no ruling</td>
<td>4</td>
</tr>
<tr>
<td>Ruling for complainant</td>
<td>28</td>
</tr>
<tr>
<td>Mixed ruling</td>
<td>5</td>
</tr>
<tr>
<td>Ruling for defendant</td>
<td>21</td>
</tr>
<tr>
<td>Total</td>
<td>105</td>
</tr>
</tbody>
</table>

Note: As in Table 1, since adjudication in the first years of GATT relied less on formal panels than on other bodies (e.g., working parties or the entire Council) to issue judgments, the term “panel” above includes those alternative authorities as well. “Ruling” above refers to the issuance of reports and not their formal adoption by the Contracting Parties.

The institution achieves its greatest impact. The puzzle, of course, is that this early settlement is happening in the shadow of weak law.

Table 2 further indicates that the probability of settlement is not evenly distributed across the events leading up to a ruling. In particular, concessions by defendants appear significantly more likely to occur after a panel has been established, but before it has ruled (regardless of which way the verdict goes). Reinhardt conducts an analysis of the probability of concessions by defendants at each stage of dispute escalation, controlling for factors like the complainant’s relative market power and the nature of the disputed measures.20 The resulting predicted probability of concessions at each stage, showing the bubble in settlement rates after panel establishment, is depicted in Figure 1.

Besides simply highlighting the importance of pre-ruling settlement for the institution, these findings raise an intriguing question. Neither GATT nor the WTO possess centralized enforcement power, the upshot being that both have relied on the complainant itself to implement any retaliatory measures that may be authorized. In this spirit, Hudc e aptly characterizes an adverse ruling as a "punch that will not hit anyone."21 The evi-

20. Id.
dence here indicates, however, that defendants nonetheless seek to avoid an adverse ruling by settling early. This simply begs the question, “Why should defendants settle early if they can spurn adverse rulings with impunity?” The answer cannot simply be that it is the threat of retaliation by the complainant that prompts early settlement, since this threat is obviously insufficient to induce full compliance in the majority of cases (58.25%) in which there is a ruling against the defendant. Moreover, retaliation by the complainant is extraordinarily rare and legally-authorized retaliation is even more so.22 Hence, in order to explain early settlement in GATT/WTO disputes, we must look elsewhere.

II. BARGAINING IN THE SHADOW OF WEAK LAW

When adjudication lacks enforcement power, the shadow of the law, as apart from the complainant’s potential threat to retaliate unilaterally, at most can serve as a modest inducement to

22. Jackson, supra note 4, at 67, 95.
settle early. Yet, the threat of a “punch that will not hit anyone” can still make a country flinch. A panel ruling carries weight to the extent that it delivers a timely and coherent normative statement on the matter. Even without a credible threat by a complainant to seek authorization to retaliate, a definitive legal opinion from the institution may empower groups in the defendant state who oppose the disputed measure. Alternatively, a ruling may enable the defendant’s executive to “tie hands,” making concessions more politically palatable by citing the need to be a “good citizen” of GATT/WTO.23 A well-reasoned report may also set a de facto (if not formal) precedent that might put related protectionist policies by the defendant at risk for litigation or it may adversely affect the defendant’s positions in ongoing multilateral trade round talks. Still, for most states most of the time, these factors may have little importance compared to the domestic political benefits of maintaining a disputed protectionist practice. The challenge for the system is to use its only leverage—the clear normative statement embodied in a ruling—on even those states that, under certain circumstances, are likely to openly thumb their nose at this norm.

As it turns out, the small possibility that an adverse ruling might independently sway a defendant is enough to induce greater concessions through early settlement, even from defendants not inclined to comply in the event of an adverse ruling. This, as Reinhartt elaborates, is because of the way uncertainty about the defendant’s preferences plays into the bilateral bargaining process.24 For example, consider a complainant that can unilaterally retaliate without the blessing of GATT/WTO or file for dispute settlement. Whether the complainant is politically capable of implementing costly retaliation is uncertain, as is the extent to which the defendant would suffer politically if it fails to comply with an adverse ruling. Both states attempt to exploit this uncertainty to maximum advantage, leveraging concessions or upholding the status quo, as the case may be. The result is that even when the defendant has no inherent interest in complying with rulings, it will be compelled to offer early on a more generous settlement package than it otherwise might.


since the complainant’s resolve is boosted by its (in this case, erroneous) belief that the defendant is going to be compelled to concede in the event of an adverse ruling. Thus, “the basic force of the procedure [comes] from the normative force of the decisions themselves and from community [i.e., complainant] pressure to observe them.”\textsuperscript{25} And the normative power of a GATT/WTO ruling can constrain even the behavior of states that do not subscribe to the norm. Needless to say, this norm is in no way divorced from the underlying power contest; the defendant’s uncertainty about the complainant’s willingness to implement retaliatory measures (if called upon to do so) is absolutely necessary to give recalcitrant defendants some interest, however slight, in cutting a deal in the first place.

Of course, as Amy Porges put it nicely, sometimes “the soufflé does not rise,” i.e., settlement talks fail and the dispute goes to a ruling.\textsuperscript{26} In this event, since only the anticipation, and not the realization, of a ruling can boost the complainant’s bargaining power, the system has lost its best chance to influence the defendant’s policy. That is, the cases most likely to end without concessions by defendants are disproportionately those in which rulings are issued. Hence, what is surprising is not that the twin levers of the legal norm and the threat of sanctions combine to elicit cooperation from defendants, but that they do so disproportionately in the form of early settlement. True, an adverse ruling is likely to cause greater concessions from a defendant than would a ruling supporting the status quo (a point upheld by the evidence from GATT disputes in Table 2). Nevertheless, the number of concessions after rulings is expected to be lower than in cases ending prior to rulings, just as the evidence presented earlier indicates.

This argument, while perhaps sufficient to account for the broad pattern of concessions across successive stages of dispute settlement, does not tell us which states are more likely to settle than others. Busch takes up this question explicitly, again just for the GATT period.\textsuperscript{27} He finds that pairs of highly democratic countries (e.g., United States—Canada) are up to 21\% more

\textsuperscript{25} Hudec, supra note 21, at 214.


\textsuperscript{27} Busch, supra note 14.
likely to settle their disputes cooperatively in the consultation stage, as compared to pairs with one or more states that are not fully democratic (e.g., Mexico—Guatemala). But pairs of democratic states are no more likely than non-democratic pairs to resolve their disputes cooperatively after a panel has been formed. This finding has clear implications for the WTO’s increasingly heterogeneous membership. It suggests, moreover, that the greater transparency of a panel proceeding makes it difficult for those countries that are highly accountable at the ballot box to compromise in full public view. If so, then efforts to increase transparency at the consultation stage may well prove counterproductive—a point that we shall return to shortly.

It also appears that more “open” economies (i.e., those that are highly receptive to trade as a percentage of Gross Domestic Product) are less likely to make concessions at either the consultation or panel stages. More precisely, the most open economies are about 31% less likely than the least open economies to make concessions at the consultation stage, and about 13% less likely at the panel stage. This is surprising, given the view that more trade-dependent economies ought to be especially concerned with provoking foreign retaliation, and thus presumably more likely to make concessions than less trade-dependent countries. One explanation for this finding may be that more open economies have less slack to liberalize further, given their investment in “social insurance” measures, for example.

The data on dispute outcomes allow us to answer another question: exactly how frequent is compliance with GATT/WTO rulings? Speaking just of the GATT period, most scholars have adopted the sanguine view that noncompliance is quite rare. The figures in Table 4, however, tell a different story. Namely, only two-fifths of rulings for the complainant result in full compliance by the defendant. In nearly a third, defendants fail to

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comply at all, effectively spurning panel rulings (as a result, some of these rulings were not invested with formal legal authority by virtue of the defendant's veto). The WTO track record may well be better, although there are plenty of negative results here as well (e.g., Bananas & Hormones). The point here is not that the institution is ineffective, but rather that, as highlighted above, whatever positive effect it has on a defendant's willingness to liberalize occurs prior to rulings, in the form of early settlement. To put it another way, we cannot judge the institution's effectiveness by looking at compliance alone.

Which states are more likely to comply with adverse rulings? Counter to conventional wisdom, democracies, even controlling for their (typically) greater market power, are less likely to comply.\textsuperscript{32} As noted above, once GATT has thrown down the gauntlet, it will be harder for a government that is highly sensitive to public opinion to cave in. Otherwise, the evidence fits intuition. For example, a defendant that is highly dependent on the complainant's export market, or whose GDP is a small fraction of the complainant's (speaking to terms-of-trade considerations), is more likely to liberalize in the wake of an adverse ruling. And Less Developed Countries ("LDCs") are more likely to comply with adverse rulings than their comparably-sized, but more developed, counterparts.\textsuperscript{33} Since the later 1980s, many LDCs have embarked upon unilateral trade liberalization programs, and adverse GATT rulings help reinforce leaders facing opposition to the reforms, tying their hands. Ironically, given GATT/WTO's lack of autonomous enforcement power, only when the national public is incompletely informed about the (lack of) consequences of noncompliance (as is more often the case with LDCs, which participate in GATT/WTO disputes less frequently) can a leader credibly tie his hands with an adverse ruling.

The shadow of the law elicits greater concessions from even those defendants that would not suffer politically from noncompliance with an adverse ruling. Moreover, if the institution did not affect the bargaining between the disputants, then the direction of a ruling would not condition the probability of concessions by the defendant. As we see in Table 4, however, liberalization of the disputed measures is more than 4 times as likely after

\textsuperscript{32} Reinhardt 2000, supra note 14, at 19, 33.

\textsuperscript{33} Id., at 33, 36.
a ruling for the complainant than after a ruling for the defendant. Third, coming as close to a "smoking gun" as one could wish, Busch demonstrates that, even controlling for factors like bilateral trade dependence and market size, the target of a US Section 301 action is up to 38% more likely to concede when the 301 action is accompanied by a GATT/WTO complaint than when it is not. Hudec was right: the threat of a "punch that will not hit anyone" can nevertheless make a state flinch.

III. THE EFFECT OF PAST REFORMS IN THE DISPUTE SETTLEMENT REGIME

Since GATT/WTO is an evolving system, it is worth reflecting on the implications of the formal and informal reforms that have characterized dispute settlement.

One salient hypothesis in the literature concerns the effect of the 1989 Dispute Settlement Improvements Procedures ("Improvements"), which extended the "right" to a panel. Before the Improvements, a defendant's threat to delay or block the formation of a panel would likely deter many complainants from even trying to panel their disputes. One suspicion is thus that the Improvements may have encouraged more paneling by clearing away this obstacle. Indeed, in support of this argument, many scholars insist that the Improvements revitalize dispute settlement, giving GATT its "teeth," and that this would embolden complainants to request panels, looking to escape the power politics of the consultation stage. In much the same spirit, the right to a panel is among the more celebrated innovations firmed-up by the WTO's DSU. But has the right to a panel changed the way cases brought before the GATT/WTO are prosecuted? The evidence to date is a resounding no.

To begin, the expectation that the Improvements might

34. Busch, supra note 28, 13.
38. Judith Hippler Bello & Alan F. Holmer, GATT Dispute Settlement Agreement: Internationalization V. Elimination of Section 301, 26 INT'L. LAW. 795-803; Jackson, supra note 4, at 72.
lead to more escalation is simply not borne out by the data. In particular, Busch found that cases filed for consultations were no more likely to go to a panel after the Improvements than before.\footnote{Busch, \textit{supra} note 28.} On one hand, this is rather surprising, given the expectation that complainants would presumably favor the greater "legalism" of a panel to consultations. On the other hand, this finding may not be surprising at all, since the Improvements may have inspired earlier settlement, rather than more escalation, since by formally extending the right to a panel. In other words, under the shadow of the law, defendants would likely plead stronger cases and complainants would presumably withdraw weaker ones. If this was correct, then rather than look to see if more cases were paneled as a result of the Improvements, the data would be expected to reveal a pattern of more early settlement. They do not. Rather, concessions at the consultation stage turn out to be no more likely after, than before the Improvements, controlling for a host of attributes of the dispute itself.

Of course, it could still be argued that the codification of dispute settlement norms, as opposed to the right to a panel per se, may have changed the way cases were prosecuted at the GATT. If so, it might be more useful to look at the effects of the 1979 Understanding on Dispute Settlement ("Understanding"), and its annex on customary practices in particular.\footnote{WTO 1995, \textit{supra} note 13, at 632-36.} Here too, however, the data belie this expectation. More to the point, the Understanding did not encourage more escalation, nor did it lead to more early settlement. In sum, it appears that the norms codified by the Understanding were as robust before 1979 as after.

This is not to suggest that the greater legalism of the WTO's DSU is inconsequential. Our point is simply that the experience of GATT should alert us to the fact that the real "action" is still likely to be found in pre-trial negotiations.

\textbf{IV. IMPLICATIONS FOR PROPOSED REFORMS}

In recent years, demands for greater "transparency" in dispute settlement became very much in vogue. Particularly in the wake of the Seattle Ministerial, few analyses of the WTO fail to
raise the issue of giving non-governmental and other groups more access to panel proceedings, for example.41 And while, at first blush, it seems hard to argue against greater transparency, our argument suggests that opening up consultations, in particular, may be a mistake. "Privacy," as an experienced dispute negotiator reminds us, "is usually more conducive to settlement."42 As a case in point, the unintended side effects of the WTO's innovation of the interim report are revealing. Designed to maximize the potential for early settlement, distributing draft panel opinions to disputants has instead, by all accounts, been misused by litigants for political grandstanding, entrenching instead of softening their positions. Consequently, "the public often becomes aware of a dispute's outcome at the interim stage . . . [and] the chances of settlement at this stage, already low to begin with, decrease even further."43

The need for privacy is especially acute for resolution of disputes between democracies, which disproportionately settle early in consultations, suggesting that they find it easier to compromise in a setting that is relatively less transparent.44 Indeed, it is here that the terms of any arrangement, in sharp contrast to what occurs after panel rulings, are not subject to 21.5, or "compliance" reviews. This should not be surprising, since after rulings, pressure from legislators and industries at home will invariably be greater, if for no other reason than that post-ruling proceedings leave a clear paper trail and policy changes at that point are more likely to require implementing legislation. Consultations, by way of contrast, are sometimes not even reported to the GATT/WTO until after they are concluded. This gives the disputants more latitude to strike a deal, latitude that may be

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42. Davey & Porges, supra note 26, at 699.
44. Busch, supra note 14.
especially important for democracies, given their greater accountability to domestic constituents.

Another policy prescription concerns proposals for increased assistance for LDCs in using the WTO dispute settlement system. To date, GATT reform has focused on streamlining the access that LDCs have to a panel, most notably the 1966 Decision on Procedures Under Article XXIII.45 While this is certainly a laudable goal, it may not have the desired effect, since LDCs are still at a disadvantage when it comes to bargaining under the shadow of the law.46 Indeed, LDCs are often not in a position to recognize and take advantage of potential meritorious complaints because they have few, if any, in-house experts and are "less sophisticated buyers of legal advice."47 Hence, they are frequently unable to make the most of consultations, where developed state complainants wielding advance legal briefs are more readily able to demonstrate the credibility of their positions and hence induce more settlement by defendants. This suggests that the WTO would do well to put more emphasis on helping LDCs in general and at the consultation stage in particular. The goal is not to make consultations more formal, but rather to put a country where "the prime minister answers the switchboard," to quote Mike Moore, on a more equal footing.48 The recent establishment of the Advisory Centre on WTO Law, based in Geneva,49 goes a long way toward supplementing the WTO's insufficient existing regular technical assistance budget. Still, as LDC advocates have argued, the next round of multilateral trade negotiations should focus on reforms that might increase developing countries' capabilities to bargain more aggressively in the shadow of the law.50

45. WTO 1995, supra note 13, at 641-42.
49. Trade and Development Centre, supra note 47.