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DEDICATION

The team responsible for producing the World Trade Report 2007 would like to dedicate the Report to the memory of Bijit Bora. Bijit, who joined the Economic Research Section in 2001, participated in the design of the present Report and had started some of the writing before his very sad and untimely passing. Our colleague is sorely missed.

DISCLAIMER

The World Trade Report and any opinions reflected therein are the sole responsibility of the WTO Secretariat. They do not purport to reflect the opinions or views of Members of the WTO. The main authors of the Report also wish to exonerate those who have commented upon it from responsibility for any outstanding errors or omissions.

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I RECENT TRADE DEVELOPMENTS AND SELECTED TRENDS IN TRADE

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ABBREVIATIONS AND SYMBOLS

| | |
|---------|--|
| AB | Appellate Body |
| ACP | Africa, Caribbean and Pacific |
| AD | Antidumping |
| AoA | Agreement on Agriculture |
| ASEAN | Association of South East Asian Nations |
| ASP | American Selling Price |
| ATC | Agreement on Textiles and Clothing |
| BIS | Bank for International Settlements |
| BISD | Basic Instruments and Selected Documents |
| BOP | Balance of Payment |
| BTN | Brussels Tariffs Nomenclature |
| c.i.f. | cost, insurance and freight |
| CAFTA | Central American Free Trade Agreement |
| CAP | Common Agriculture Policy |
| CARICOM | Caribbean Community and Common Market |
| CCCN | Customs Cooperation Council Nomenclature |
| CEEC | Central and Eastern European Country |
| CFF | Compensatory Financing Facility |
| CIS | Commonwealth of Independent States |
| CPEs | Centrally Planned Economies |
| CRTA | Committee on Regional Trade Agreements |
| CU | Customs Union |
| CvD | countervailing duty |
| DISC | Domestic International Sales Corporation |
| DSB | Dispute Settlement Body |
| DSM | Dispute Settlement Mechanism |
| DSU | Dispute Settlement Understanding |
| EC | European Community |
| ECSC | European Coal and Steel Community |
| EEC | European Economic Community |
| EFTA | European Free Trade Area |
| EPZs | Export processing zones |
| EU | European Union |
| f.o.b. | free on board |
| FACB | Freedom of Association and Collective Bargaining |
| FAO | Food and Agricultural Organization |
| FDI | Foreign Direct Investment |
| FSC | Foreign Sales Corporation |
| FTA | Free Trade Agreement |
| GATS | General Agreement on Trade in Services |
| GATT | General Agreement on Tariff and Trade |
| GDP | Gross Domestic Product |
| GSP | Generalized System of References |
| GSTP | Global System of Trade Preferences |
| HS | Harmonized System |
| ICITO | Interim Commission for the International Trade Organization |
| ICJ | International Court of Justice |
| ICSID | International Centre for the Settlement of Investment Disputes |
| IF | Integrated Framework |
| ILO | International Labour Organization |
| IMF | International Monetary Fund |

| | |
|----------|--|
| IOs | International Organizations |
| IP | Intellectual Property |
| IPC | Integrated Programme on Commodities |
| IPRs | Intellectual Property Rights |
| IR | International Relations |
| IT | Information technology |
| ITA | Information Technology Agreement |
| ITC | International Trade Centre |
| ITO | International Trade Organization |
| ITS | International Trade Statistics |
| ITU | International Telecommunications Union |
| L&E | Law and Economics |
| LAFTA | Latin American Free Trade Association |
| LDCs | Least-Developed Countries |
| LMG | Like-Minded Group |
| LTA | Long Term Agreement Regarding International Trade in Cotton Textiles |
| MEAs | Multilateral Environmental Agreements |
| MERCOSUR | Southern Common Market |
| MFA | Multi-fibre Arrangement |
| MFN | Most-Favoured-Nation |
| MOU | Memorandum of Understanding |
| NAFTA | North American Free Trade Agreement |
| NGO | Non-governmental organization |
| NTBs | Non-tariff barriers |
| NTM | Non-tariff measures |
| OECD | Organization for Economic Co-operation and Development |
| OEEC | Organization for European Economic Cooperation |
| OPEC | Organization of the Petroleum Exporting Countries |
| OTC | Organization for Trade Cooperation |
| PECS | Pan-European cumulation system |
| PPMs | Process and production methods |
| PTA | Preferential Trading Arrangement |
| QRs | Quantitative restrictions |
| R&D | Research & Development |
| RoO | Rules of Origin |
| RTA | Regional trade agreement |
| S&D | Special and differential treatment |
| SCM | Subsidies and Countervailing Measures |
| SME | Small and Medium Enterprises |
| SPS | Sanitary and Phytosanitary Measures |
| STA | Short Term Agreement on Cotton and Textiles |
| STDF | Standards and Trade Development Facility |
| STEs | State-trading enterprises |
| SVEs | Small and Vulnerable Economies |
| TBTs | Technical barriers to trade |
| TCBDB | Trade Capacity Building Database |
| TIM | Trade Integration Mechanism |
| TPR | Trade Policy Review |
| TPRM | Trade Policy Review Mechanism |
| TRIMs | Trade-Related Investment Measures |
| TRIPS | Trade-Related Intellectual Property Rights |
| UN | United Nations |
| UNCITRAL | United Nations Commission on International Trade Law |
| UNCTAD | United Nations Conference on Trade and Development |

| | |
|------|--|
| UNDP | United Nations Development Programme |
| UR | Uruguay Round |
| US | United States of America |
| USSR | Union of Socialist Soviet Republics |
| USTC | United States Tariff Commission |
| VCLT | Vienna Convention on the Law of Treaties |
| VER | Voluntary export restraint |
| WIPO | World Intellectual Property Organization |

The following symbols are used in this publication:

| | |
|-------------|--|
| ... | not available |
| 0 | figure is zero or became zero due to rounding |
| - | not applicable |
| \$ | United States dollars |
| € | euro |
| £ | United Kingdom pound |
| Q1,Q2,Q3,Q4 | 1st quarter, 2nd quarter, 3rd quarter, 4th quarter |

EXECUTIVE SUMMARY

On 1 January 2008 the multilateral trading system will celebrate its sixtieth anniversary. The World Trade Report 2007 marks the occasion with a retrospective look at what we have learned from those six decades of international trade cooperation. In asking this question, the report reviews a rich history of change and institutional adaptation. It attempts to identify both what lessons are to be drawn from past experience and the nature of challenges to come. This is an ambitious undertaking, and we have divided the Chapter into three main sections. The first major Section (Section B) begins with a very brief historical review of what the trade policy world looked like in the century and a half before the birth of the GATT. The rest of this Section takes a step back from events to consider what the theoretical literature might teach us about why nations choose to cooperate with one another in trade matters. This is an eclectic review that draws on perspectives from economics, political economy, political science and international relations literature, as well as legal analysis. We seek to show that despite differences in their methodological approach, these different conceptual frameworks display some interesting features in common. They also offer a variety of different insights about what might drive cooperation.

Building on the rationale for trade cooperation, Section C is concerned with the practical question of how the gains from such cooperation can be secured and safeguarded. The Section starts with an analysis of why governments appear willing to cede authority to international institutions like the GATT/WTO and what they expect to gain from such commitments. We then look more closely at the mechanics and architecture of arrangements designed to promote and protect trade liberalization. Different subsections deal with trade liberalization, how the gains from liberalization are secured, the role of contingency provisions in addressing unanticipated situations, the function of dispute settlement as an enforcement mechanism, and how transparency and surveillance can serve to strengthen the basis for international cooperation.

While the previous two Sections focus mainly on trade agreements in general, Section D examines the multilateral trading system of the GATT/WTO. The Section starts with a historical account of how the GATT emerged, developed and was eventually transformed into the WTO. We then examine the evolution of market access commitments over the years and the development of the dispute settlement system. This is followed by a discussion of the development of the institution in the context of the continuing need to accommodate an expanding and increasingly diverse membership. The emphasis here is on the challenges of addressing developing country needs and interests within the system. The next Section looks at regionalism, both as a complement to multilateral cooperation and as a systemic challenge. We then discuss decision-making in the GATT/WTO, both in relation to internal processes for doing business and the interest in involvement on the part of external non-state actors. The final Section in this Chapter seeks to explain how governments determine the content of the trade agenda under the WTO and considers the challenges of defining policy areas upon which governments choose to negotiate.

THE ECONOMICS AND POLITICAL ECONOMY OF INTERNATIONAL TRADE COOPERATION

The historical context

Many historians regard a part of the last half of the nineteenth century as a golden age of international cooperation in Europe, characterized by fast growing economies and a spontaneous emergence of multilateralism in trade ... but this period was short-lived.

Trade over long distances, contractual trade relations and tariffs can be documented from antiquity, but a new level of more intensive trade relations and cooperation emerged in Europe after the end of the Napoleonic wars. The Vienna Congress contributed to more political stability on the continent and the mercantilist system prevailing in the 18th century was further weakened by new economic thinking pioneered by Adam Smith. Technological advancement and industrialization underpinned economic development in Europe during the second half of the 19th century and spurred trade cooperation through a series of bilateral trade treaties that significantly lowered trade barriers and evolved into a *de facto* multilateral non-discriminatory network of agreements. Not all nations shared in this experience.

The United States and Latin America remained relatively protectionist in this period, while Asian, African and other countries were being forced into a form of cooperation driven in no small part by colonial relations or imperial design. In Europe, however, strong leadership and enthusiasm for free trade from the United Kingdom sustained a period of relative prosperity. But this began to falter towards the latter part of the 19th century, as depressed conditions in agriculture contributed to increased and generalized protectionism in continental Europe.

Crumbling international cooperation and deteriorating economic conditions towards the end of the 19th century provided the backdrop against which Europe was plunged into war in 1914.

By the time more than 50 European trade treaties came up for renewal in the early 1890s, most governments faced an increase in demand for protection from organized interest groups representing agricultural producers and a number of industrialists. Several countries resorted to high trade barriers across a range of sectors and European powers increasingly turned to their colonies and spheres of territorial influence for trade, building a series of preferential trading arrangements along the way. Nationalism was on the increase, German and Italian unification had been consolidated, the United States was growing in power and influence, and the United Kingdom was experiencing relative decline. European nations were competing more fiercely for colonial territory and influence. Territorial disputes within Europe, particularly between France and Germany, contributed to strained foreign relations. A lack of leadership, flagging cooperation, deteriorating economic conditions and escalating tensions created the conditions for war.

The inter-war years were marked by far-reaching government failure, limited international cooperation, acute economic hardship in many countries, and erratic trade policy punctuated by bouts of protectionism, discrimination and policy tension, both in the trade and monetary fields – in short, a set of conditions conducive once again to armed conflict.

The absence of international coordination to dismantle war-time controls and create the conditions for an orderly transition to a post-war economy simply fed uncertainty and mistrust. Although trade protection among some countries was reduced in the years following the war, it took nearly a decade after the cessation of hostilities for trade to attain its pre-World War I level. The period was characterized by instability and unpredictability with respect to trade policy, and as economic conditions deteriorated in the late 1920s, the trade war provoked by the Smoot-Hawley tariff (1930) aggravated the economic crisis that resulted in a shrinkage in trade flows of some 60 per cent between 1929 and 1932. The breakdown in trade further exacerbated deflation and unemployment in many economies. Monetary policy was also in crisis, with the collapse of the gold standard in the early 1930s and a rash of currency devaluations. The reversal of protectionism in the United States and some other countries in the mid-1930s, and efforts to squeeze some of the discrimination and instability out of trade policy came too late to stem the tide towards preferential trading arrangements.

Trade policy largely remained in disorderly limbo until the establishment of post-World War II institutional arrangements and the birth of the modern multilateral trading system. A lesson from the first half of the 20th century is surely that effective and sustainable international cooperation requires a predictable institutional framework that embodies a pre-commitment by governments to a defined policy stance.

The significant degree of international economic integration achieved in the latter part of the 19th and early 20th century might have been sustainable with better institutional foundations. The history of the first half of the 20th century demonstrates how easily the benefits of open trade and sound economic policy more generally can elude nations in the absence of a commitment to international cooperation.

If these are lessons that should be learned, what is their relevance today? Will governments show the necessary foresight and commitment to preserve, strengthen and, if necessary, reform the institutions they deemed necessary in the past to articulate and order international cooperation?

The multilateral trading system is confronted by considerable challenges, of a short-term nature in relation to incomplete negotiations, but more fundamentally in relation to its continuing role as an institution vested with the legitimacy necessary to mediate international trade relations. The balance of economic power and the focus of national interests is shifting among nations. Do governments see viable alternatives to the inclusiveness of the universalist perspective implicit in today's multilateral trading system? If not, careful reflection is needed on how to nurture and manage the multilateral trading system in the interests of shared benefits. The future of the WTO depends on how far governments value the contributions such an institution can make.

What economic theory has to say about motivations for international trade cooperation

Economists traditionally see trade cooperation as a means to escape trade wars that could arise when large countries unilaterally raise tariffs so as to reduce the price of their imports at the expense of their trading partners. A country seeking to improve its terms of trade (relative price of exports in terms of imports) in this way may provoke retaliatory behaviour from other trading partners, making all parties concerned worse off.

The terms-of-trade argument is the most formalized and elaborated of all economic rationales for trade cooperation. It is the only one that formally integrates an explanation of why countries cooperate with an explanation of how they can do this. In other words, it is the only available economic approach that can explain both the GATT/WTO and its architecture. Some of the other economic approaches discussed in the Report certainly lend themselves to more rigorous analysis and empirical investigation, but this work has yet to be undertaken.

The non-cooperative situation posited in the traditional approach is sometimes referred to as a prisoners' dilemma, where rational behaviour without cooperation will leave the parties concerned worse off than they would be if they were to cooperate. But this take on what motivates cooperation has two main weaknesses. First, many economists are sceptical about its practical relevance and the empirical evidence is mixed as to whether the exclusive focus on relative world prices is what really shapes behaviour. Second, the theory only provides a rationale for agreements between countries large enough to impose terms-of-trade costs on their partners. We do not have an explanation here for why countries that are too small to manipulate the world price of their imports would see a reason to cooperate with each other or why large countries would enter into trade negotiations with such countries.

Some political economy analysis has focused on two reasons governments have for imposing taxes on trade – to garner political support from beneficiaries of such taxes and, if large enough, to shift the terms of trade in their favour.

We have already seen how the latter motivation makes international cooperation worthwhile. Adding a political economy dimension to the analysis takes account of realities such as that private interest groups will try and sometimes succeed in changing government policy and that the interests of producers may prevail over those of more numerous consumers because the former are better organized politically than the latter. The interaction of private interest groups and political-support-seeking governments explains why governments would want to eliminate the incentive to manipulate the terms of trade. The reciprocity inherent in an inter-governmental agreement will convert each nation's exporters from bystanders in the tariff debate to opponents of protection within their own nation.

Since governments will factor in the political consequences of a trade policy decision and not look simply for an efficient outcome, as suggested in an economist's traditional view, we have an explanation for two important empirical observations about policy behaviour. First, the process of trade liberalization has been gradual – free trade would be the rational outcome if governments only cared about the terms of trade. Second, mixed motives for government behaviour can also help to account for the fact that most post-war liberalization has taken place in products characterized by two-way trade.

This political economy analysis still does not explain why small countries would be participants in international trade agreements – both from the point of view of their own interests and those of their large trading partners. Attempts have been made to explain small country involvement as a purely political motivation with no terms-of-trade effects, where exporters are induced to lobby for trade liberalization in a reciprocal negotiating framework simply by the prospect of additional market opportunities. The absence of a terms-of-trade dimension under this reasoning has troubled many theorists, some of whom have argued that terms of trade effects may be more common than is generally appreciated, even in supposedly small economies, on account of the myriad factors that may segment markets in practice.

Another approach to explaining why governments cooperate in trade rests on a policy credibility argument. This is the so-called commitment approach.

If governments lack credibility *vis-à-vis* domestic economic agents, they may wish to anchor future policy intentions in international commitments. If, for example, the decision of a government to liberalize trade in a particular sector at a certain future date is not deemed credible by the industry concerned, the latter may fail to undertake the required restructuring during the transition period. Then when the liberalization falls due it will not be an optimal policy because the sector will not be ready for international competition. So an international commitment can solve a time-inconsistency problem. International commitments are rendered more credible by the threat of retaliation in the face of non-compliance.

Reasons for questioning the practical validity of this argument include the observation that trade rules may not be designed to make them enforceable – especially on small and poor countries. Moreover, the commitment argument for cooperation may be undermined somewhat by the reality of existing international trade agreements. For example, the existence of contractual escape provisions such as safeguards in trade agreements cannot be explained by a commitment motivation for cooperating. We lack empirical evidence in regard both to the political economy and commitment approaches to the explanation for international cooperation

A number of other reasons suggest themselves as to why governments may wish to cooperate on trade policy. These include strategic reasons, such as increasing market size and insurance against unfavourable trade policy developments in partner countries. Yet other reasons are specific to preferential arrangements, such as increasing bargaining power and the pursuit of geographically limited market-opening for protectionist motives.

Countries may want to cooperate on trade issues to increase their market size. This is likely to be more true of small countries and would allow domestic firms to exploit economies of scale and reduce costs. Trade cooperation may be motivated by the need to insure countries against the erosion of their market access to other countries. This could be achieved by fostering further MFN liberalization or alternatively by entering into competing regional trade agreements. An interest in engaging in regional trade agreements may be provoked by a desire to secure preferential market access for producers that are not globally competitive but are competitive at the regional level. Such a motivation implies that some of the benefits of a discriminatory trade agreement may come at the expenses of non-participants. Alternatively, regional and bilateral trade alliances may be designed to increase the bargaining power of the countries concerned. The above range of propositions, while all plausible, have not been the subject of rigorous theoretical formulation nor a great deal of empirical verification.

Insights from the international relations literature

The international relations (IR) literature is rich in explanations of what motivates international cooperation, going beyond the proposition that interested parties cooperate simply to maximize collective economic benefits. While IR theories offer varied and interesting ways of looking at the motivations and behaviour underlying decisions to cooperate, as well as the nature of that cooperation, they do not always lend themselves readily to empirical validation. Just as with some economic analyses, this lack of precision is an invitation to continuing research.

A broad conclusion emerging from IR theories is that the rationale and historical evolution of international trade cooperation must also be understood in terms of the changing configuration of power capabilities, distributional conflict, the role of shared ideas and beliefs, and developments in the wider international political and security order. Two broad approaches in IR are referred to as rationalism and constructivism.

Rationalist theories assume that actors take decisions with the strict aim of maximising their utility subject to whatever constraints are present. They do so by weighing up the costs and benefits of cooperation in a world where national interests are already defined. Constructivist approaches see international cooperation as a means of interactive iteration towards mutually beneficial outcomes. Cooperating parties influence one another in shaping their commitments.

The study of international cooperation in IR theory was traditionally dominated by the assumption that the state was a unitary actor. More recently, theories have focused on the links between international cooperation and domestic politics.

Some theories build on the notion that agents – individuals, groups, or states – can actively and consciously shape the consequences of their interaction. The choices made by agents determine outcomes, or in other words, the system. Other theories are more “structuralist” in nature and contend that it is the system that shapes the actors and not vice-versa. The system is more than the sum of its constituent parts, and therefore assumes a life of its own. Systems influence how agents think and act.

Several strands of rationalist analysis explain cooperation in trade.

One strand of rationalist literature – “neoliberal institutionalism” – assumes that states are driven by mutual efficiency concerns. Each party bargains for the solution that maximises the “size of the pie” generated by cooperation. The core objective of cooperation is to increase mutual efficiency.

The school of “liberalism” parts with the notion that states are unitary actors with a steady and defined purpose in mind. In order to explain what motivates countries to cooperate internationally, liberalists base their research on domestic politics. Cooperative agreements are concluded if the decision to collaborate is the equilibrium outflow of some rational deliberation process among relevant domestic groups.

Another strand of rationalism – “neorealism” – assumes that parties try to maximize their relative power position in the international system. International cooperation is akin to a “zero-sum game”, where gains to one party come at a loss to another because the size of the pie is fixed. Cooperating parties seek to protect their power ranking within the international system. Cooperation among states occurs in the form of short-term alliances that can temporarily mitigate anarchy, but never overcome it.

A milder form of neorealism – “postclassical” or “defensive realism” – argues that while power is an important dimension of state interaction, it is not an end in itself. Rather it is a means of achieving security and increasing the resource-base of a country. Countries therefore choose cooperation so as to reduce the probability of conflict, help overcome international externalities or spillovers, and increase the welfare.

“Hegemonic stability theory” is another variant of neorealism. A hegemon seeks to fortify its predominant position in the international system through cooperation, while at the same time injecting its own norms and values into the international regime. The hegemon also has the power to address international collective action problems involving spillovers and to underwrite the supply of public goods from which all parties to cooperative arrangements can benefit.

“Constructivist” or non-rationalist approaches to decision-making reject the assumption that agents are driven only by cost-benefit considerations – the power of shared norms and inter-subjective beliefs prevails as a base for actors’ decision-making.

Constructivists consider that international cooperation is better explained by reference to fundamental norms, shared ideas, inter-subjective beliefs, traditions, habits, and perception. Norm-based decisions (the “logic of appropriateness”) replace rational, self-interested choice (the “logic of consequences”). The system and the agents acting within it are strongly interdependent – the structure shapes agents’ perceptions and therefore preferences and behaviour. Collective behaviour can in turn have a feedback impact on the system.

A variation of constructivism is the “English” school of IR, which is concerned with the diffusion of certain norms and values within “international society”. The construction of the post-war liberal international economic order is a good example of this thinking, where like-minded countries formed a coalition to inject their open market ideas into the international system. Finally, “weakly cognitivist” approaches examine how guiding norms and principles emerge, become prominent and consequently influence the cooperative choices of governments.

The contribution of legal analysis to understanding international cooperation

Legal theories of trade agreements are theories of constitutionalism.

Legal approaches to trade agreements are based on two central tenets. The first is that the individual citizen is the legitimate principal in all domestic and world affairs. The second is that “government failure” and rent-seeking behaviour on the part of public officials are rampant and need to be overcome by means of an adequate legal framework – namely a constitution.

Four main approaches to trade constitutionalism can be discerned from the legal literature.

The first of these has been referred to as the “internal” constitutional view, which treats trade agreements as the second line of constitutional defence against domestic policy failure. Secondly, the “external” or “transnational” constitutional view perceives trade agreements to be contracts aimed at reciprocally granting countries transnational representation and participation in each others’ trade policymaking processes. Third, what can be called the “internal-external” constitutional view claims that elected legislators deliberately delegate trade policy-making to the administrative branch of government in order to lessen the likelihood of political capture and the cooption of trade policy decisions by narrowly focused interest groups. Finally, the “global” constitutional view asserts that citizens in an interdependent world enact an international multilevel trade constitution, since national constitutional approaches and state-centric international law necessarily fail to curb global policy failures.

Legal approaches tend to focus on non-economic issues, such as legitimacy, participation, democracy, and sovereignty. Given the difficulties associated with according precise, consensual meanings to some of these concepts, legal approaches to trade agreements sometimes blur the line between prescription and description.

Diverse actors, diverse motives and diverse agreements: cooperation in a heterogeneous world

Diverse nations are likely to have different motives and priorities when they contemplate participation in trade agreements. The traditional terms-of-trade approach only provides a rationale for trade agreements among countries with market power. Political economy considerations, on the other hand, apply to both large and small countries. The desire to use international agreements as a commitment device, or to increase market size and bargaining power, are more likely to motivate smaller countries and in some case will favour regional over multilateral cooperation.

The four “grand theories” of IR – neorealism, neoliberal institutionalism, liberalism, and constructivism – offer a wide variety of motivations for participating in bilateral, plurilateral, or multilateral trade agreements for diverse countries. Neorealists stress issues of power (balancing, bloc-building, dependency-creation), institutionalists focus on efficiency, liberalists look at domestic political-economy reasons for contracting, and constructivists emphasize the pervasive role of social norms, values, and ideas in motivating behaviour. Similar observations apply in relation to the broad applicability of legal analyses to a diverse range of motivations for shaping different kinds of international cooperation.

Pulling together the strands of theoretical thought on international cooperation

Despite different analytical methods and traditions, commonalities are present among the theoretical approaches to understanding international cooperation that have been identified in this Report. Four distinct clusters of explanation can be identified.

The first cluster focuses on a domestic problem negatively affecting economic efficiency that an international contract can help to overcome. This is the essential focus of the political economy and commitment approaches originating in economics, the IR school of liberalism, and the legal internal constitutionalist approach.

The second cluster views international spillovers or externalities as the key problem that a contract can remedy. Trade agreements can constrain unilateralism, for example, where one country's actions can harm the economic well-being of others. This is the essence of the traditional approach in economics, neoliberalist institutionalism in IR theory, and the external and internal-external constitutionalist legal theories.

The third cluster has been referred to as the "ideational" route, which is the normative approach to understanding international cooperation. Values, age-old traditions, a collective sense of history and humanity, and other such factors inspire influential individuals, pivotal groups, and states as a whole to conclude trade agreements. Non-economic objectives for contracting play a crucial role here. Norms and ideas play some role in certain variants of neoliberal institutionalism and hegemonic stability theory. The power of ideas, however, is a central feature of the English school in IR, as well as the weakly and strongly cognitivist schools of constructivism. This thinking is also present in legal approaches characterized as external and global constitutionalism.

The final cluster can be termed the "realpolitik" argument. Countries conclude trade agreements – or refrain from doing so – for reasons of power (i.e. distributive efficiency). The focus is on power-related benefits and within this framework participation in international agreements could even be involuntary. Alternatively, the driving force could be to create dependency in others, to balance power, or to build power blocs. This concern for power and distribution is most notably at the core of neorealism, and may also be found in postclassical realism and hegemonic stability theory.

Scholarship has a long way to go in enhancing our understanding of the motivations for international cooperation in trade matters.

The fact that there are so many different analytical approaches explaining the same outcome, namely the conclusion of international trade agreements, raises reasonable doubts that there exists one single theory that is able to explain the phenomenon of trade cooperation. It is probably fair to say that most countries are motivated by an array of objectives they want to pursue by contracting to a trade agreement. Moreover, it may be difficult to find two countries with identical "baskets" of cooperative goals. Some states may wish, for example, to promote peace and stability in the region, advance their power-based position internationally, attract foreign investment, mitigate the influence of domestic special interest groups, and so forth. Some of a government's objectives may be partially in conflict with one another. Even when we take a broad multidisciplinary approach in trying to understand the motives for cooperative international arrangements, it is obvious that our current state of understanding of these complex issues is in need of more research.

Policy conclusions that follow from the theoretical analysis of trade cooperation

Notwithstanding the limited reach of our understanding of what drives international cooperation, we can draw some practical lessons from what we do know. These relate to the sheer heterogeneity of interests at stake and the fragile and incomplete nature of cooperative endeavours in a changing and uncertain world.

Three key points should be made. First, because of the varied nature of motivations, interests and priorities that seem to inform international cooperative endeavours, it will frequently prove difficult – and sometimes impossible – to strike the initial balance in an agreement, a balance that will offer something to all parties.

Second, once an agreement has been struck, it will invariably have to contend with at least three sources of uncertainty. One is the fact that not all eventualities could be foreseen when the contract was struck. This is because the world is too complex and our knowledge of it too imperfect. Another is that circumstances upon which an agreement was predicated can change, testing the willingness of parties to stick with the contract. A final factor that can change is the nature of the underlying interests of the parties to an agreement.

The third key point relating to the complexities of international agreements and the uncertainties surrounding them is that successful cooperation requires negotiating agendas to be encompassing enough to reflect adequately the heterogeneity of interests and priorities among the negotiating parties. Failing this, negotiations may be unending or results may contain a coercive element and therefore impart a destabilizing effect on an agreement.

All the above considerations remind us that successful international cooperation is a continuing, iterative process. Reaching compromise takes time and effort, and lengthy negotiations may be a sign of the system at work – not at fault. International cooperation and the underlying agreements are likely to fail if governments are inattentive to the need for inclusiveness and flexibility in the face of change.

THE DESIGN OF INTERNATIONAL TRADE AGREEMENTS

The role of institutions

Neither economics nor IR literature has invested a great deal of research on the role of institutions. Yet their significance in determining cooperative outcomes has become better understood in recent years. Legal scholarship usually thinks in terms of constitutions as the institutional setting for cooperation.

Much like when at the national level political constituencies entrust an independent central bank with the conduct of monetary policy, signatories to trade agreements may confer some authority to an independent agent (institution) in the belief that a neutral or internationalized body is more effective in governing trade relations than the signatories themselves. Such institutions differ from the kind of *ad hoc* or circumstance-specific cooperative arrangement that might be predicted as the preferred approach by the neorealist literature. In conferring certain authority upon an institution, governments are effectively pre-committing to a set of rules without certainty as to their implications in terms of future outcomes. This is one way of looking at how authority is ceded to the institution – as a constraint on present and future freedom of independent action. Why would governments do this?

Early economic approaches to cooperation built on assumptions that simply assumed away any of the reasons that governments might have for creating institutions – including uncertainty, lack of full information, costly transactions and changing circumstances – but more recent work identifies a series of efficiency-enhancing functions for institutions.

Economic research on the rationale for trade cooperation and on the rationale for trade institutions evolved independently. The latter body of work evolved once market “imperfections” in the form of transaction costs, asymmetrical information, contractual incompleteness and so on were allowed, thus accounting for the efficiency-enhancing nature of an impartial trade institution to underpin trading arrangements. Thus, formal economic models can show that institutions matter, among other reasons, because they can facilitate negotiations, disseminate information, settle disputes, administer agreements, monitor policies and act as an agent for surveillance.

Theories of international relations establish a number of additional roles for trade institutions.

Trade institutions can act as facilitators of cooperation, helping parties to achieve a cooperative equilibrium in the face of heterogeneous preferences. Furthermore, trade organizations like the WTO oversee the implementation and operation of negotiated outcomes. In an effort to centralize operations – that is to

reduce transaction costs and enhance efficiency – signatories create international institutions. Much of this is similar to what theorizing from economics would also conclude. In addition, however, constructivist takes on cooperation see trade institutions as fostering the generation and evolution of common norms and values that reflect the community interest. Issues of autonomy and oversight, such as agency capture by influential parties, and autonomous regime evolution are also addressed in some IR theories.

Trade liberalization as an outcome of international cooperation

The approach through which international trade cooperation allows countries to escape from the terms-of-trade prisoners' dilemma is reciprocal liberalization. Liberalization needs to be non-discriminatory to eliminate terms-of-trade effects. Reciprocity cannot always be precisely defined in practice, although it is possible to model its welfare effects. The binding of liberalization commitments is regarded as vital for contractual stability.

The theoretical literature defines reciprocal liberalization as a coordinated reduction of protection which leaves the terms of trade of the parties to the agreement unchanged. The mutual reduction of protection expands the division of labour and the volume of trade, which increases national income. Leaving the terms of trade unchanged implies that this trade expansion is not accompanied by world price changes that make one of the parties less well off.

If there are more than two parties involved in the negotiation, efficiency requires that liberalization be non-discriminatory. If a country discriminates among its trading partners by applying different tariffs, different terms of trade will apply to each. This creates the possibility of opportunistic gains for subsets of countries from reciprocal liberalization, which would be at the expense of non-participants whose terms of trade deteriorate.

While a number of prominent economists have sought to provide an economically rigorous interpretation of reciprocity in the GATT, long-time observers of the multilateral trading system tend to emphasize the political aspect of reciprocity. Reciprocity in the GATT/WTO involves an outcome that each Member considers advantageous by whatever standard the Member chooses to apply. Precise measurement is not of the essence.

As far as trade in goods are concerned, liberalization in the GATT/WTO context not only means a reduction in tariff rates, but the binding of those rates against future increases. Governments have attached as much importance to the legal commitment not to raise tariffs beyond a certain level and the security in market access that this implies, as they have towards the reduction of duties. In the case of services, commitments are also bound against future increases, although the manner in which this is done is somewhat different on account of the particularities of services transactions.

The most-favoured-nation (MFN) principle is at the centre of the GATT/WTO system of rules, but important exceptions exist and it is difficult to make a strong case for MFN from a pure efficiency perspective.

Some economists have argued that the MFN principle (combined with reciprocity) is necessary in order for governments to engage in mutually beneficial bargaining. On the other hand MFN is likely to lead to free-riding and empirical evidence appears to confirm the relevance of the free-riding problem. Free-riding is less of a problem, however, in situations where trade liberalization is undertaken unilaterally. But where there is free-riding, governments would engage in less trade liberalization with MFN than without it.

One of the strongest economic arguments in favour of MFN is probably an argument developed in the 1930s that emphasises the costs of administering discriminatory tariffs because of the need to keep track of product origin. Formula approaches would allow WTO Members to avoid free-riding problems in negotiations and to take advantage of the lower costs involved with MFN – as opposed to discriminatory – tariffs.

Regionalism as a departure from MFN

Two main arguments have been advanced for regional agreements as an exception to MFN – that they can expand trade and serve as building blocks for further multilateral liberalization, but there are contrary views.

It is the impact of regional trade agreements (RTAs) on economic welfare rather than trade expansion which should be the proper criterion for evaluating such agreements. Economic theory is ambiguous as to whether a country gains or loses from entering into a RTA. This will depend on the balance between the trade creating and trade diverting effects of the agreement. Furthermore, RTAs will come at the expense of non-members who lose out from trade diversion and from the deterioration in their terms of trade.

The idea that preferential trade liberalization ultimately builds support for liberalization at the multilateral level faces significant objections. Once RTA members establish preferential footholds in their partners' markets, incentives are created to try and maintain the preferential advantage. Multilateral liberalization could be seen as a threat to that privileged access. The harmonization of rules and policies, which sometimes accompany regional integration, may lock in members to agreements that are later difficult to generalize. Finally, negotiating regional trade agreements absorb resources and political capital that could be devoted to multilateral negotiations.

Special provisions for developing countries as a departure from MFN

Guided by the idea that economic development requires the (temporary) use of trade-distorting policies, a number of exceptions have been included in GATT/WTO disciplines that allow for departures from key obligations, notably the MFN principle.

Special and differential (S&D) treatment provisions allow countries (often on a best-endeavour basis) to provide more favourable treatment to developing countries than to the remainder of the membership. Other provisions grant beneficiary developing countries rights that are not available to others. S&D is based on the assumption that developing countries are different from advanced economies and that temporary exemptions from the general rules (otherwise considered economically beneficial) constitute an appropriate response to particular development challenges. Developing countries may suffer from market imperfections and distortions not found in more advanced economies that obstruct their diversification into non-traditional activities. Resource constraints make it harder to adjust to the impact of trade liberalization, to take advantage of new trading opportunities and to shoulder the costs associated with reform. While trade measures rarely present a first-best policy response, their use may be appropriate under certain circumstances and for a limited amount of time.

A core challenge for the system is to distinguish between legitimate public policy and protectionism in the design and use of domestic policies

Most disputes concerning the effect of domestic policies on market access have been based on GATT Article III (national treatment) and/or Article XX (general exceptions), or on WTO Agreements concerning specific domestic measures like the Agreement on Subsidies and Countervailing Measures, the Agreement on Technical Barriers to Trade or the Agreement on Sanitary and Phytosanitary Measures. The relevant legal provisions give guidelines on how to distinguish a legitimate domestic policy from one that is not legitimate. In economic terms, first best policies – that is, policies that are the best remedy to correct a domestic market failures and imperfections, are considered legitimate. The question whether existing legal texts allow for an interpretation that corresponds to economic thinking has been debated in the relevant literature and different answers have been given to this question. Another difficulty is to know in practice which policy can be considered to be a first-best-policy in a given situation. It has been pointed out in the literature that this approach can lead to a "war between public orders", given that optimal policies depend on characteristics that may be country-specific, like consumer preferences, moral values or cultural heritage.

Contingency measures and trade liberalization

Contingency measures deal with political demands for protection, not the costs of adjustment. The introduction of contingency measures in a trade agreement may be thought of as anticipating the possibility of difficult adjustments and the political pressure for protection to which they give rise. Contingency measures provide a means to counter this pressure with a temporary reversal of liberalization. The existence of such escape clauses may allow deeper liberalization to be achieved.

How deep the liberalization that can be achieved by a trade agreement *ex-ante* may depend on whether built-in escape clauses exist that recognize uncertainty in the economic environment. While the use of contingent measures may result in *ex-post* welfare losses during periods when the level of protection is temporarily increased, the deeper liberalization that is allowed *ex-ante* means that these costs are outweighed by the long-term welfare gains.

The GATT/WTO contains a number of contingency provisions. These include those relating to safeguards, antidumping and countervailing duties, restrictions to safeguard the balance of payments, and Article XXVIII on the modification of schedules. Some WTO Members may also use the margin between bound and applied tariff rates as a trade-contingent device.

The enforcement of trade agreements

Trade agreements are contracts and require enforcement. Enforcement gives credibility to mutual commitments made. It may deepen those commitments and deter defection. Parties to a trade agreement may perceive an interest in vesting certain authority in an independent adjudicatory body.

The extent to which parties are willing to cooperate crucially depends on the quality of the enforcement mechanism. In the absence of a supra-national authority, most trade agreements must rely on self-enforcement. Codified rules of enforcement reduce the risk of a breakdown of cooperation by providing agreed mechanisms for the detection, examination and quantification of possible infringements. Rules may also help to improve the enforcement capacity of individual parties and provide for a range of options to settle disputes amicably. This, in turn, may increase mutual trust within the system and stimulate deeper *ex ante* trade liberalization commitments.

The existence of transaction costs, information asymmetries, uncertainty and other contractual imperfections may induce parties to a trade agreement to vest some authority in a neutral dispute settlement body. Such a body can fulfil multiple functions, including those of an honest broker, an arbitrator, an adjudicator and an information disseminator. However, under an international agreement, a dispute settlement body may not have the means to give effect to a verdict. Successful dispute resolution remains in the hands of the parties, depending either on the willingness of the offending party to cooperate or the capacity of the membership to punish the offender.

The transparency and surveillance roles of a trade agreement

Transparency provisions are fundamental to a viable international agreement. The transparency function fills information gaps, facilitates compliance and helps parties to uphold their rights. Surveillance is more than transparency. It involves monitoring and provides a forum for non-litigious exchange.

Transparency features in trade agreements because there are reasons for believing that the problem of imperfect information is acute in the case of trade agreements. Provisions on transparency are spread across the whole range of WTO Agreements. While the transparency provisions in a particular WTO Agreement may be concerned only with the narrow range of measures covered under that agreement, the cumulative effect of these provisions is to diminish the opacity of Members' trade regimes and trade policymaking processes.

Transparency helps achieve two basic objectives. The first is improved compliance by the parties to the commitments they have made under the trade agreement. Second, transparency should help private economic agents better understand the environment in which they operate and enable them to make better decisions.

Surveillance goes beyond transparency. It implies monitoring the compliance of Members with their obligations, but outside a litigation framework. It provides a forum for dialogue to enhance understanding among parties and is almost always an activity vested in an institution (and its bodies) rather than being left to the parties. An appropriate combination of transparency and surveillance can provide incentives for parties to validate their commitments under an agreement and to comply with their obligations.

What are the policy implications of design issues relating to international agreements?

Much depends on the underlying rationale for cooperating in the first place. It is clear that basic contractual ground rules and institutionalization can mitigate the inevitable incompleteness of agreements. However, treaty design is unlikely fully to overcome the pitfalls implied by contractual incompleteness.

The reasons why signatory countries engage in trade cooperation largely determine their preferred choice of treaty design. Intuitively, a trade agreement concluded with the objective of tying the hands of policymakers, for example, requires a substantially different set of rules, and will pose different demands on the institution administering them, than an agreement concluded with the sole aim of promoting global peace. To understand, explain, and reform contractual rules and institutional procedures, a better understanding of the determinants of trade cooperation is therefore helpful.

Contracting parties to a trade agreement can neither foresee every future contingency, nor can they write down in every detail even the foreseeable details. Every trade agreement is necessarily incomplete. Institutions and contractual provisions can mitigate the uncertainties connected with contractual incompleteness, but they can hardly eradicate them. This brings with it two implications. One is that disputes are a natural outflow of contractual incompleteness. The other is that dealing with incompleteness is a delicate balance between flexibility and adaptation on one hand and the preservation of predictability and stability on the other.

SIXTY YEARS OF THE MULTILATERAL TRADING SYSTEM: ACHIEVEMENTS AND CHALLENGES

From the GATT to the WTO: the building of an institution

The multilateral trading system had a rocky beginning, but its focus of purpose proved to be its early strength. The system expanded inexorably over the years, both in terms of membership, issue coverage and institutional purpose, culminating in the establishment of the WTO in 1995.

International trade cooperation had a difficult start. The efforts to establish an International Trade Organization failed, but a by-product was a temporary contract to govern trade relations among 23 nations. In eight successive rounds of multilateral trade negotiations, substantial trade liberalization was achieved and important trade rules were established. These developments culminated in the creation of the WTO in 1995. The WTO has a more comprehensive mandate, a more solid institutional base, and covers additional areas including trade in services and intellectual property rights.

From its inception the GATT brought together a diverse group of countries. The common goal of multilateral trade liberalization in the context of a rules-based system resulted in the continuous accession of new countries to the agreements, adding to the heterogeneity of the membership. Whereas the first five rounds of multilateral trade negotiations took place under the leadership of the United States and several European countries, developing countries assumed an increasingly prominent role in subsequent

rounds of negotiations. The ability of the GATT/WTO system to accommodate the different needs of its Members has been an important factor in its success.

The same range of issues has tended to dominate the multilateral trading agenda over the life of the institution and have become no easier to solve.

Looking back over six decades of multilateral trade negotiations, one observes the recurrence of certain key issues. Already in the 1950s, agriculture, regionalism, and development issues occupied trade negotiators in Geneva. On several occasions, the multilateral trade negotiations were on the brink of collapse because views, particularly on these topics, were far apart. Each time the GATT/WTO Members were able to bridge their differences.

Agriculture, the terms of participation of developing countries in the trading system, and the relationship between regionalism and multilateralism continue to dominate or at least overshadow the agenda, and prevent easy closure of the current Doha Round of negotiations.

Market access negotiations: liberalization and consolidation

Tariffs have been progressively reduced through eight rounds of trade negotiations since the establishment of the GATT in 1948. More progress has been made in the manufacturing sector than in agriculture. Industrial country tariffs on industrial products have come down sharply since the inception of the GATT, from an average of some 20 to 30 per cent to less than 4 per cent.

Tariffs in industrial countries today can only be considered a significant trade barrier in a few product categories. Reductions in tariffs over the years have differed by sector, with less progress in labour-intensive industrial products and agricultural products. Textiles and clothing, leather and footwear, fish and fish products and agriculture typically face higher tariffs and more tariff peaks than other product categories. While much of the observed reduction in developed country tariff levels has occurred through multilateral bargaining, one should not lose sight of the reductions resulting from regional integration and preferential schemes in favour of developing countries.

For several decades, developing countries did not make much use of the multilateral system to reduce or bind their tariffs even though tariffs have come down significantly as a result of unilateral policy reform and regional agreements. In the multilateral context, the situation changed significantly in the Uruguay Round.

Prior to the 1980s, developing countries made limited tariff commitments in accession negotiations. Binding coverage was relatively low and in most cases remained so until the Uruguay Round. A number of developing countries that negotiated their accession during the Uruguay Round consolidated all their tariffs at a ceiling level, which introduced a gap between bound and applied rates. Many developing countries significantly extended their binding coverage in the Uruguay Round. All of them bound the entirety of their agricultural tariff lines and a number of them, in particular in Latin America, extended the coverage of bindings on non-agricultural products. In most cases, however, the bindings were set at a ceiling level well above applied rates. In other words, applied tariffs have continued to be set independently of bound tariffs. The trend towards stronger multilateral commitments continued after the Uruguay Round. A number of Asian developing countries used the Information Technology Agreement (ITA) negotiations to eliminate their tariffs on IT products. Evidence also suggests that accession negotiations under Article XII of the Marrakesh Agreement have been instrumental in reducing the tariffs of new members.

Non-tariff barriers (NTBs) have played an important role in trade policy, but some progress has been made in reducing and eliminating these obstacles to trade. The fact that they remain an issue is testified to by the retention of the NTB issue on the Doha negotiating agenda.

The multilateral trading system has been instrumental in reducing and disciplining non-tariff barriers to trade, such as quantitative restrictions. While developed countries kept quantitative restrictions in place

in agriculture and textiles for many years, some developing countries maintained balance-of-payments related restrictions for several decades. The Uruguay Round made significant inroads on remaining non-tariff barriers. The elimination of voluntary export restraints was a notable achievement in this context.

World trade has grown twenty-seven fold in volume terms since 1950, three times faster than world output growth. The contribution of trade barrier reductions via the multilateral trading system to this impressive record has been significant although uneven. Moreover, the greater stability and certainty imparted by the rules of the system are also likely to have influenced trade growth over the years.

The contribution of the GATT/WTO to world trade growth via reduced tariffs has been uneven, with much stronger impacts on the trade of industrial countries and on a wide range of non-agricultural goods. This unevenness is a reflection of how the multilateral trading system managed to achieve more significant reductions in barriers to trade in industrial products and did not require much liberalization from developing countries. The GATT/WTO may also have been instrumental in the creation of new trade links between countries who had not previously traded before.

The evolution of the multilateral dispute settlement system

The last six decades have witnessed remarkable developments in the GATT/WTO dispute settlement system. Contracting Parties/Members have managed to strengthen the rule of law while preserving the system's intergovernmental character.

The demand for dispute settlement has existed since the early days of the GATT. Over time, somewhat informal "diplomatic" proceedings have given way to more "judicial" approaches. Basic disagreements in certain policy areas have sometimes overshadowed the system, whose limitations have been made evident from time to time by the failure to establish panels or by the non-adoption of rulings dealing with sensitive issues. During the Uruguay Round, dispute settlement procedures were strengthened in an unprecedented manner, notably with the introduction of the quasi-automatic adoption of reports and the establishment of the Appellate Body as a standing organ for legal review. Enforcement procedures have also been streamlined and isolated from possible blockage by the defendant.

Utilization of the dispute settlement mechanism has grown significantly since the establishment of the WTO, not least due to increased activity on the part of developing countries.

Developing countries have brought more than 40 per cent of WTO disputes. Forty-two per cent of developing country complaints under the WTO were directed against other developing countries, compared to merely 5 per cent under the GATT. Non-tariff barriers are the most frequent targets of complaint, followed closely by a large number of cases dealing with "unfair" trade practices or the measures taken to offset them (subsidies, antidumping/countervailing duties). Under the WTO, by far the largest number of disputes have been in agriculture. Most cases are settled successfully, predominantly in favour of the complaining party. In a majority of cases, compliance is forthcoming. However, a number of high-profile cases have been characterized by implementation problems and protracted proceedings. In a few instances, retaliatory measures were ultimately imposed.

A large measure of agreement exists in the literature that the WTO Dispute Settlement Mechanism has served Members well. Nevertheless, there is a lively discussion on how certain aspects of the new system could be further clarified and improved.

Additional improvements to the WTO Dispute Settlement Mechanism could possibly be made in facilitating its use, in clarifying its procedures, and perhaps even in further strengthening its capacity to resolve disputes in a more timely and effective manner. Overall, these discussions are not about drastic or fundamental changes to existing rules and do not seek to detract from the substantial results already achieved under the current system.

The ability of smaller and poorer countries to bring cases might be strengthened further. Besides the provision of legal aid, the role of improved "surveillance" has been stressed. A number of proposals have been made on procedural and adjudicative issues. These range from questions of transparency – notably to accommodate the increased interest of non-governmental actors in dispute settlement proceedings – to suggestions of a remand procedure by the Appellate Body to allow for further analysis. Some of this discussion touches on the more fundamental question of whether the system has become too "judicialized". In addition, a number of ideas have been put forward to deal with the limited availability and practicality of countermeasures, especially where developing countries are concerned. Economic thinking permeates many of the proposals made, especially those dealing with alternatives to mutually harmful trade sanctions. Some deeper concerns have been raised on the appropriate response to persistent non-compliance and the calculation of equivalent damages.

Developing countries in the multilateral trading system

For many years developing country participation in the multilateral trading system was confined to obtaining exceptions from the rules and more favourable treatment from industrialized nations.

Most of the trade and development-related provisions foreseen in the ITO draft charter did not become part of the GATT. However, with decolonization and increasing numbers of developing countries in GATT, these countries began to revive some of the proposals originally made at the ITO conference. They also gradually extended their interests from securing exceptions for their own policies towards extracting broad market access concessions from developed countries. Among the rule changes secured by developing countries were a revision of GATT Article XVIII to protect infant industries, the inclusion of Part IV on "Trade and Development", which codified the notion of "non-reciprocity", as well as a waiver for non-reciprocal preferences (later made permanent under the 1979 "Enabling Clause"). During the Tokyo Round, developing countries only made limited market access commitments and few signed up to the new "Codes" dealing with a variety of non-tariff barriers. Since they were hardly bound by the outcomes, developing countries did not participate much in GATT activities. The negotiating agenda was largely controlled by the industrialized countries.

Developing countries pursued their offensive interests more actively in the Uruguay Round.

Among the factors that contributed to increasing participation by developing countries were widespread perceptions concerning the limitations of import substitution policies and the success of East Asian countries in international markets. Moreover, a number of developing countries faced the threat of unilateral action against their exports in certain markets. Others, especially smaller developing countries, feared exclusion from emerging regional trading blocs. These and other developments contributed to deeper engagement by developing countries in the multilateral trading system.

At the same time, the Uruguay Round Single Undertaking implied a range of new obligations for developing countries.

While many developing countries had substantial interests in further multilateral trade liberalization and the strengthening of trade rules in a number of areas, for some of them the implementation of certain obligations stretched their resources and was not seen as a development priority. Transition periods were the primary means employed to ease the adjustment process to new obligations, and many developing countries considered the provisions inadequate. Calls intensified for further differentiation in WTO rules to take account of the special needs and capacity limitations of developing countries. These concerns first found concrete expression in the "implementation" debate. Subsequently, all S&D treatment provisions were made subject to review in the Doha negotiations. In parallel, the WTO has stepped up its technical assistance and capacity-building efforts and has increasingly assumed a coordinating role, most notably in the context of the Aid for Trade initiative, to ensure that other relevant agencies understand the trade needs of WTO Members and work together more coherently and effectively to address these needs.

The current negotiations provide an opportunity to reconsider how the special interests of developing countries might be accommodated within the WTO.

Existing approaches to S&D largely reflect early development thinking. It is questionable whether "policy space" in the sense simply of greater policy freedom is a promising approach. Nevertheless, in recent years there has been renewed recognition in many quarters that government interventions may be justified to address particular development challenges. It is also increasingly accepted that the cost-benefit ratio of certain obligations is a function of a country's level of development.

New approaches that seek to make WTO rules more responsive to development needs often involve a more or less explicit recognition of the fact that not all developing countries face the same problems. Despite the difficulties involved, a strong case can be made for an issue-by-issue analysis of needs in relation to the rationale for S&D, the form it takes, the conditions attached to it, and its compatibility with the rules-based character of the organization. More technical and incremental approaches to S&D stand the best chance of meeting the development needs of poorer countries within the multilateral trading system without undermining the integrity of the system. At the same time, it must be recognized that effective assistance and technical support constitute an indispensable complement to better rules.

Regionalism and the multilateral trading system

A major challenge facing the multilateral trading system is the proliferation of regional and bilateral trade agreements over the last decade and half.

As of 15 September 2006, there were 211 notified regional trade agreements (RTAs) in force, some involving several parties and others purely bilateral in nature. With the only exception of Mongolia, all WTO Members are a party to at least one preferential trade agreement. This poses clear risks for the transparency, efficiency and the progress of the multilateral trading system.

It was already apparent in the post-war negotiations of the 1940s to establish the International Trade Organization that while the nations involved favoured multilateral rules that would open up trade, they also had a keen interest in pursuing preferential trade arrangements. Article XXIV of the GATT was the legal expression of this reality. But the weakness of the GATT rules became apparent with the notification of the EEC-Association of Overseas Countries and Territories and the emergence of a second wave of regionalism.

The Uruguay Round sought to clarify the criteria and procedures for the assessment of regional agreements and to improve transparency by requiring that all notified RTAs be examined by a WTO working group. Interpretative questions relating to this decision combined with a certain lack of enthusiasm among Members meant that this initiative bore no fruit.

The recent decision on transparency is a step toward reducing the risk that the proliferation of RTAs will undermine the multilateral trading system.

The new transparency measures announced in July 2006 will increase the level of transparency of RTAs by mandating the WTO Secretariat to prepare reports on notified RTAs. While this report has to be "factual", it may provide a powerful tool to raise awareness and alert the WTO membership to some of the actual or potential negative implications of regional arrangements for third parties.

However, a number of non-procedural issues remain to be settled. Most importantly, this includes the re-examination of the requirements of Article XXIV for RTAs with a view to ensuring that any adverse effects of RTAs are minimized.

The main debate surrounding RTAs in the WTO has focused on the interpretation of the conditions that Article XXIV requires RTAs to satisfy. These concern the depth and the extent of product coverage of preferential liberalization, the transition period for the full establishment of a RTA, and the policy instruments in respect of which preferential rules should apply. These issues remain a challenge for further negotiations.

Article XXIV establishes that barriers to trade should be eliminated on "substantially all trade". The discussions aimed at clarifying this wording have focused on whether a more precise definition should be established in terms of trade volume, tariffs or sectoral coverage. But no consensus has been reached so far. As economic theory shows, whether or not a RTA is complementary to the multilateral trading system is likely to depend on the definition of the required product coverage of RTAs. Similar issues have emerged in trade in services with the establishment of the General Agreement on Trade in Services, GATS (Article V).

Article XXIV also requires that besides duties, RTAs eliminate "other restrictive regulations of commerce". The range of policies covered by RTAs may determine the depth and extent of trade liberalization under an agreement, as well as its impact on third countries. Such policy instruments may include tariff rate quotas, safeguards, anti-dumping measure and rules of origin. Yet there is no clear consensus on the interpretation of rules in these areas.

Finally, Article XXIV requires that RTAs should not result in higher barriers against third parties. However, economic theory suggests that this requirement will not guarantee the absence of negative welfare effects on third parties upon the formation of a RTA.

Arguments go both ways as to whether RTAs are "building blocks" or "stumbling blocks" in relation to the multilateral trading system. An issue related to this is whether provisions in some bilateral trade agreements, particularly involving developed and developing countries, that go beyond the WTO rules will facilitate or complicate progress in a multilateral setting. Recent work suggests that scope exists for multilateralizing the current multiplicity of overlapping regional and bilateral agreements.

The debate over whether RTAs are building blocks or stumbling blocks is characterized by two schools of thought. One provides a pessimistic prognosis of the effects of regionalism on multilateral liberalization, while the other predicts benign effects. Systematic and anecdotal evidence can be found to support both views.

A number of more recent bilateral agreements between developed and developing countries contain provisions in certain policy areas that are either excluded from the purview of the WTO or go beyond WTO provisions. While this tendency has been subject to some criticism in terms of its implications for the trade and development benefits of the developing country party to such an arrangement, another issue is what the implications of this pattern of differentiated content will be for the multilateral trading system.

Recent work has stressed that the network of overlapping RTAs, including trade-diverting RTAs, may act as a positive force for the multilateral trading system by generating a need to rationalize the system. This can be explained by the increasing costs generated by the system of overlapping RTAs and complex and intertwining rules of origin, especially with the increasing importance of production sharing and geographical fragmentation of production. In particular, it has been argued that the WTO could facilitate this process of multilateralization in three ways: (i) undertaking analytical research to provide a deeper understanding of the attractions of multilateralizing regionalism; (ii) providing a forum for the coordination/standardization/harmonization of preferential rules of origin; and (iii) providing a forum for the weak countries in hub-and-spoke regional arrangements to identify ways of dealing with the hegemonic power of the hub.

Doing business in the WTO: decision-making and relations with the outside world

Despite explicit voting provisions in the GATT, the decision-making practice generally has been characterized by consensus. This practice has been carried over into the WTO, but the issue of participation in decision-making processes has come to the fore.

GATT decisions relied on consensus, but in practice this was the product of deliberations among a minority of the membership. Despite growing disquiet with the traditional arrangements, many of the GATT decision-making practices were institutionalized in the WTO, including the consensus principle.

The WTO decision-making process, like the GATT before it, consists of formal and informal processes. The formal WTO meeting track is open to all Members of the organization and the minutes of meetings provide automatic transparency. Yet it is the informal meeting track where such decisions are negotiated and prepared. Because so many more countries are involved in the multilateral trading system than before, there have been growing demands to ensure adequate representation and participation. This issue is covered in WTO parlance under the rubric of "internal transparency". Over the past decade, issues relating to internal transparency and the decision-making processes of the WTO have emerged as a major institutional challenge facing the multilateral trading system. In response to these pressures, promising decision-making arrangements and ways of enhancing wider participation have evolved.

As far as decision-making processes are concerned, the principal challenge will always be to find the right balance between efficiency and inclusiveness.

The legitimacy of the decision-making process requires that there is an adequate degree of open-ended and inclusive activity to balance other more restrictive consultative processes. At the same time, informal and exclusive consultations for practical reasons will continue to play important roles in the overall WTO process. Although there is general recognition of this among the WTO membership, the legitimacy of such consultations hinges on the ability to ensure an adequate degree of transparency and inclusiveness, as well as a guarantee that such mechanisms are understood as coalition-building and not decision-making exercises.

Not all problems related to transparency and inclusiveness have been resolved. Indeed, the informal and non-legal nature of the principles and practices that underpin the current consultative process at the WTO provides no guarantee against the re-emergence of practices considered excluding by some parties.

Congressional coalitions have become more important in WTO decision-making processes, as well as in the formulation of substantive negotiating positions.

One of the most significant developments within the WTO decision-making process over the past few years is the growing role played by different country groups, particularly among developing countries. WTO Ministerial Conferences have played a particularly important part in the emergence and evolution of country groups as well as the wider cooperation that has developed among such groups.

It is difficult to generalize when it comes to the multitude of groups and coalitions which have emerged since the launch of the Doha Round. Most issues on the WTO agenda do not break along the sort of North-South fault line which in the past pre-empted the flexibility that characterizes coalition-building in the WTO today. The Doha Round negotiations have added a new dimension and a certain fluidity to the creation and destruction of coalitions and groups within the WTO.

The past decade has seen important changes in the way in which the WTO deals with non-governmental organizations (NGOs) and other representatives of civil society. Issues surrounding this relationship are referred to as "external transparency".

Although the WTO remains an intergovernmental organization where decisions are taken by consensus among Members, many NGOs have successfully established a role in which they influence the agenda and the negotiating positions of many parties. The original hesitation and suspicion among a majority of Members with respect to the role of NGOs has been replaced by an often symbiotic relationship which is manifested through increased substantive cooperation.

However, the institutional rules that guide WTO interaction with NGOs remain unchanged and largely informal, and as such do not provide these organizations with new rights in the context of the multilateral trading system. But it is probably fair to say that the current practices are now sufficiently well established to render a roll-back improbable. The challenge from an organizational perspective is to ensure that this relationship continues to evolve in a positive direction.

It is also important to recognize that the WTO system is only one part of a much broader set of international rights and obligations that bind WTO Members and that issues related to global economic policymaking go much beyond the WTO's formal and specific cooperation with the Bretton Woods institutions. The WTO maintains extensive institutional relations with several other international organizations, such as UN, FAO, UNEP and UNCTAD, and there are some 140 international organisations that have observer status in WTO bodies. Their close substantive involvement with the WTO and its Members provide an important transparency element to the overall international economic coherence discussion.

Deepening the multilateral agenda

A core issue confronting the multilateral trading system down the years is the extent of its competence. How is the WTO's mandate shaped? The shape of the multilateral trade agenda matters because it affects perceptions about the legitimacy of the system, and therefore its efficiency and viability.

Questions concerning the appropriate reach of the multilateral system and whether particular subjects should be covered – and if so in what institutional context – have been the subject of lively debate among governments. Differences of views on this matter have often influenced the pace of progress in rounds of multilateral trade negotiations. The debate in the late 1970s and 1980s about whether trade in services had a place in GATT has been followed by similar discussions on TRIPS, labour rights, environment, investment, and competition. Additionally, in some areas, the issue has not been so much about introducing new topics, but rather about how far to go in defining international obligations in established areas of GATT/WTO work, such as product standards and sanitary and phytosanitary measures. A distinction between border and internal measures is often made in these discussions, although in reality both border and internal measures will in some degree affect the conditions of competition between domestic and foreign supplies and suppliers, and therefore affect trade.

The scope of the multilateral trading system emerges from a political process. No adequately defined conceptual or theoretical framework exists for analysing the advantages or disadvantages of a given agenda.

The absence of an appropriate analytical frame of reference for identifying the optimal reach of international cooperation rules out normative prescription. We have no means for asserting *ex ante* what should be on or off the multilateral trade agenda. Nor do we have a blueprint for future agenda formation. This agnosticism about the feasibility of prediction or prescription is consistent with much of the relevant literature in this area.

A distinction can be made between internal measures aimed at preserving the value of pre-existing commitments and internal measures that seek to promote additional market opportunities through their impact on the conditions of competition. But internal measures do not always fit neatly into one or other of these categories.

Trade negotiations in the early GATT days were about the reduction of barriers to trade in the form of border measures like tariffs. Internal measures initially figured on the GATT agenda because of concerns that such measures may be used to circumvent concessions made in market access negotiations. Article III (national treatment) and Article XX (general exceptions) were the main provisions in the original GATT text that served this purpose, but as time went on these provisions were considered insufficient to control the circumvention of market access commitments. The Agreement on Technical Barriers to Trade, the Agreement on Sanitary and Phytosanitary Measures and certain elements of the Agreement on Subsidies and Countervailing Measures are examples of Agreements that in part aim to preserve the *acquis* of market access.

Internal measures aimed at preserving acquired market access rights may focus on avoiding explicit discrimination, as would be the case with subsidy or government procurement provisions. Alternatively, they may concern measures that embody elements of *de facto* discrimination, where the underlying putative objective of a measure is not directly to discriminate, but rather to secure a particular public

policy objective. Examples of internal measures falling into this category include standards and the range of objectives covered by Article XX of GATT or Article XIV of GATS.

A second factor explaining a broader and deeper agenda on internal measures relates to the notion that market access is inherently linked to the conditions of competition prevailing in the relevant markets. A focus on measures whose effect is to modify the conditions of competition has increasingly played a role in shaping the multilateral trading system. The motivation here is not to protect existing levels of market access, but rather to promote further market opportunities. Aspects of the General Agreement on Trade in Services are clearly an example of such a focus. The same may be said of the TRIPS Agreement, and would apply, for example, to rules on competition. But this distinction between protecting acquired rights in a market and seeking to advance those rights does not clearly categorize particular sets of rules on internal measures. There can be significant overlap. The reason for this is that any internal measure, whatever its motivation, will affect to some degree the conditions of competition in a market. It will affect the kinds of access and/or operating environment encountered by suppliers and supplies of goods and services.

Some have suggested that notions of "trade-relatedness" or "specificity" may be useful in identifying which internal measures should be subject to negotiation within the WTO. But trade-relatedness is not an efficiency postulate. Nor does the notion of specificity offer clear guidance on this question.

The more an internal measure is able to affect the relative competitive positions of foreign and domestic suppliers and supplies of goods and services, the argument goes, the stronger the case for subjecting that measure to WTO discipline. A problem with this proposition is that it does not indicate in a precise manner what the impact of internal measures might be on the conditions of competition or on welfare. The direct link to trade is but one element that might be considered. It would be for governments to determine that this was a key element in choosing among internal measures that might be negotiated in the WTO.

As far as specificity is concerned, measures that target a particular group of suppliers or consumers may be considered more distorting than measures of general application and therefore more deserving of attention in the WTO. The WTO Agreement on Subsidies and Countervailing Measures, for example, develops subsidy disciplines that rely on a specificity criterion. The idea that specificity should be a criterion for determining an ordering of internal measures as more or less desirable for inclusion on the WTO agenda has not been subject to systematic empirical or theoretical investigation. Nor does economic analysis yield clear guidance.

Governments may seek linkages between issues that are entirely unrelated to market access or competitive considerations. Such linkages can give rise to beneficial bargains, but they do render negotiations more complex and the negotiated results for individual parties harder to assess.

By exchanging concessions across different policy dimensions, two countries may be able to achieve cooperation in situations where scope would not otherwise exist for the attainment of mutual gains. The possibility of cross-issue linkage has, for instance, been raised with respect to global environmental problems and trade. A possible drawback of combining negotiations on border and (unrelated) internal measures is that the calculus of costs and benefits from international cooperation for individual parties becomes more multi-dimensional and less certain. This is the case in part because negotiations on internal measures often go in the direction of harmonizing relevant rules at the international level. Harmonization may facilitate international transactions and understandings, but may also have disadvantages when policy objectives and appropriate measures to pursue them differ across countries. Country-specific factors such as cultural heritage, climate, ideology, regulatory traditions and the level of development will become more relevant in more multi-dimensional exchanges.

International cooperation in some policy areas may involve distributional consequences, such that some countries loose and others gain. This does not provide a reason for eschewing such negotiations if the overall welfare benefits are positive, but it does argue for a need to develop compensatory mechanisms in such circumstances.

If commitments involved in rule-setting carry negative inter-jurisdictional implications for some parties in distributional terms, something else is required in order to ensure the viability of cooperation. Win-win outcomes at the global level that entail win-loss relationships at the level of individual parties may be rendered realizable when the losers are compensated in some fashion. Such compensation could comprise a transfer, elements not related directly to trade, or a balance might be found directly within a package emerging from trade negotiations.

The question whether or not to embrace international negotiations on internal measures is separate from the choice of forum. If international negotiations on related subjects take place in different fora, coherence needs to be guaranteed in order to avoid ambiguities and inefficiencies.

Numerous internal measures are negotiated in different international fora, often – but not always – within a specialized international organization. Food safety standards are negotiated at the Codex Alimentarius Commission, labour standards at the International Labour Organization and environmental standards in the context of multilateral environmental agreements (MEAs). Bringing internal measures into the multilateral trading system therefore also calls for a definition of the relationship between the WTO Agreement and other relevant standard-setting bodies or agreements. Once again, no conceptual framework exists for determining an optimal international architecture or desirable distribution of subject matter among institutions.