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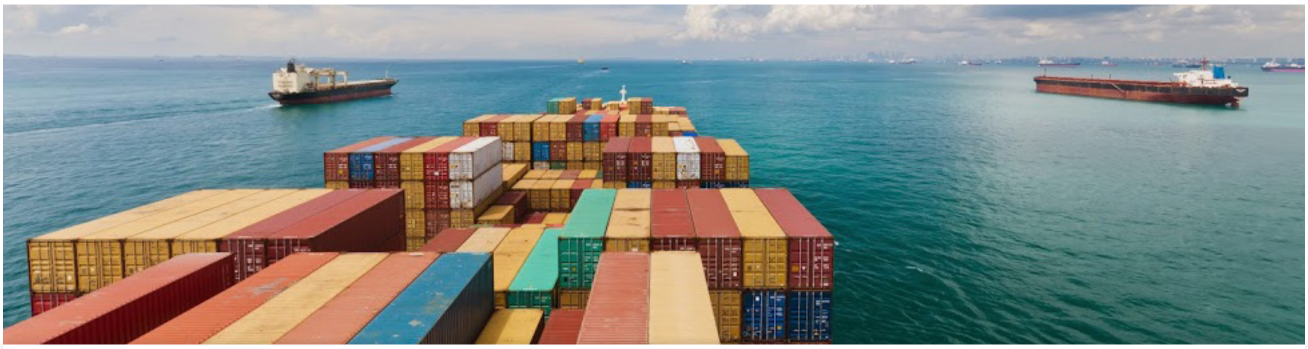

Trade Policy in a Global Age

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E15 Expert Group on Global Value Chains: Development Challenges and Policy Options

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ABSTRACT

More and more of the world's economic activity is now organized through global value chains (GVCs) and strategic networks. However, the World Trade Organization (WTO) and its Members remain preoccupied with the removal of barriers to trade introduced in the early 20th century. That focus inhibits the WTO's ability to turn to the challenges that a more networked global economy presents.

Globalization has fundamentally altered the way we trade, the way production is organized, and the basis of competition in the international economy. The rise of GVCs represents an integral part of that process. Accordingly, a trade policy that focuses exclusively on reducing tariffs, and implicitly defines market access in terms of lowering such barriers in a particular "export market," risks marginalizing itself and the WTO in the process. What matters more is improving the institutions and building the capacity, whether as a firm or as a nation, that facilitate participation in the more networked world economy of which GVCs are a part.

The nature of what is needed comes closer to the structural adjustment lending the World Bank did as its contribution to resolving the various debt and financial crises affecting the developing world in the 1980s and 1990s. But the structural adjustment in this instance would involve policy reforms aimed at enabling local firms and workers to engage successfully in the global economy. That agenda could embrace financing for hardware (physical infrastructure) and software (institutional change).

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LIST OF ABBREVIATIONS

DDA	Doha Development Agenda
GATT	General Agreement on Tariffs and Trade
GVCs	global value chains
ITA	Information Technology Agreement
WTO	World Trade Organization

INTRODUCTION

The following discussion has two aims—to assess the extent to which the rise of global value chains (GVCs) demands a new approach to trade policy, and to identify concrete trade policy options that would advance the objectives of the world trading system and its members.

More and more of the world's economic activity is now organized through GVCs and strategic networks, rather than through arm's length sales between vertically integrated buyers and sellers in different countries, as the textbook examples of international trade imply. The most obvious evidence of that trend lies in the percentage of world trade made up of intermediate goods—a nearly 60 percent share of world imports (Sturgeon and Memedovic 2011).[1]

But the impact of GVCs extends well beyond the higher volume of trade in intermediates. Global value chains draw "a broader range of establishments, firms, workers, and countries into increasingly complex and dynamic divisions of labour," which has driven a much deeper and more far-reaching change in the organization of production globally and the basis of competition (Sturgeon and Memedovic 2011).

To the extent that participation in GVCs represents the new gateway to global markets, firms "must find ways to participate, add value, and specialize" (Sturgeon and Memedovic 2011). Trade policy should be geared toward facilitating that process (Whittaker et al. 2008).

For now, however, the World Trade Organization (WTO) and its Members remain preoccupied with the removal of barriers to trade introduced in the early 20th century in between two world wars and in the midst of the Great Depression.[2] That focus, reflected in the enduring stalemate of the Doha Development Agenda (DDA), comes at a cost. It inhibits the WTO's ability to turn to the challenges that a more networked global economy presents.

For the WTO to remain relevant, much less to fulfil its function as one of the pillars of global economic governance, its rules and its capacity to encourage trade liberalization must address those challenges. Otherwise, governments and market participants will turn to alternative means for arranging their economic relations.

The trend toward preferential trade arrangements suggests that process is well under way. That trend implies an answer to the first question above—a reassessment of the aims and means of trade policy in light of the changes in the global economy of which GVCs are a part is overdue.

The discussion in the succeeding section elaborates on why that is the case and what that reassessment means for trade policy and the trading system as a whole.

THE CHALLENGE GVCS POSE FOR TRADE POLICY

The Marrakesh Agreement establishing the WTO provides a useful starting point for thinking about the implications of GVCs for trade policy and for the multilateral trading system. In Marrakesh, the WTO Members agreed that "their relations in the field of trade and economic endeavour should be conducted with a view to "raising standards of living, ensuring full employment and a rising "real income and effective demand," and expanding the "production of and trade in goods and services," while, at the same time, "allowing for the optimal use of the world's resources in accordance with the objective of sustainable development" (Agreement Establishing the World Trade Organization 1994). To that list of aspirations, the Members added the commitment to "ensure that developing countries, and especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development" (Agreement Establishing the World Trade Organization 1994).

The challenge for trade policy was then, and remains now, how best to achieve those objectives. In Marrakesh, WTO Members also indicated the means by which they intended to achieve those goals. They declared their intent to enter into "reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international trade relations" as a means of achieving those objectives (Agreement Establishing the World Trade Organization 1994). The DDA fully reflects that approach.

1 "Mapping Global Value Chains: Intermediate Goods Trade and Structural Change in the World Economy," Figure 1. Interestingly, United Nations statistics showed trade in intermediate goods falling from the early 1960s to the late 1980s before once again rising over the past 25 years. That may be a function of the failure of U.N. statistics to capture the true value of intermediate goods trade, but the period in which intermediate goods trade fell also coincides with a number of other features of the global economy that may have driven greater consolidation and vertical integration, which would imply a lower volume of trade in intermediates.

2 The WTO and its predecessor, the General Agreement on Tariffs and Trade (GATT), succeeded in establishing a rules-based trading system. Actual progress toward liberalization, however, remains elusive—limited largely to the area of developed country industrial tariffs. Tariffs, quotas and developed country trade-distorting subsidies, rather than undistorted markets, continue to shape much of world agricultural trade. While some developing countries have undertaken significant trade reforms, virtually none have proved willing to bind those changes in the form of WTO commitments. Indeed, of late, the largest emerging markets have rolled back previous reforms or introduced new barriers to trade and investment on the theory that such barriers would improve the prospects for developing new industries in their markets. Deep commitments toward liberalization in new areas like services, investment and intellectual property remain limited to a handful of (largely developed) countries.

The question now is whether that approach to trade policy will suffice in light of the fundamental changes in the global economy since Marrakesh.

THE FORCES BEHIND THE RISE OF GVCS

Since the WTO Members met in Marrakesh, globalization (that is, the various forces driving the integration of world markets) has fundamentally altered the way we trade, the way production is organized, and the basis of competition in the international economy. The rise of GVCs represents an integral part of that process.

That process began with the Cold War's end. The resolution of that conflict erased political barriers that divided the world economy for the better part of the 20th century. Erasing those barriers had the effect of dramatically expanding the reach of global markets and creating new opportunities for trade and specialization.

At the same time, many countries in the developing world began to rely more heavily on markets as a means of organizing economic activity. The shift toward reliance on markets included a shift away from policies that isolated their markets from the world economy and a greater openness to trade and foreign investment, particularly in Asia. Like the Cold War's end, that shift had the effect of integrating those developing country economies with the world economy and expanding the reach of global markets.

Just as important, however, the shift toward greater reliance on markets implied the need to adopt their institutional underpinnings, from property rights to freedom of contract to greater regulatory certainty.

The reforms reduced the uncertainty, risk, and transaction costs associated with doing business in those markets.

The momentous changes in the world economy paralleled a revolution in computing, communications, transportation, logistics, and finance. That revolution's most obvious impact was a further sharp reduction in transaction costs associated with engaging in trade. But, the revolution's far deeper impact lies in its diffusion of technology.

One of the lessons that have emerged from the study of economic growth in the past three decades is the importance of technology in raising productivity and making higher standards of living possible. The foundation for the "new growth" theory has been the non-rival quality of ideas (that is, ideas are not consumed in the production process; they can be used simultaneously by any number of users) (Jones and Romer 2009).

Forces encouraging the diffusion of ideas create multiple opportunities to raise productivity and the prospects for growth (Jones and Romer 2009).

That, in the end, is what the revolution in technology has done. The end of the Cold War and the shift toward organizing economic activity through markets expanded the plane surface of the global economy; the technological revolution accelerated the diffusion of technology across that plane and reduced the cost of engaging in trade. In the process, the forces driving globalization created conditions that gave rise to GVCs.

Understanding why requires a brief excursion into the economics of industrial organization.

IMPLICATIONS FOR THE ORGANIZATION OF PRODUCTION AND THE BASIS OF COMPETITION

What the economics of industrial organization tells us is that firms offer a means of organizing economic activity that reduces or avoids a number of costs that would otherwise arise from trying to achieve the same result through a series of market-based exchanges (Coase 1937; Williamson 1985; Grossman and Hart 1986). An environment of high transaction costs favours vertical integration of production within a single firm. A low transaction cost environment, on the other hand, enhances the ability to engage in impersonal exchange and, therefore, reduces the need for vertical integration (Sturgeon 2000).[3] It favours de-verticalization, greater horizontal reach, and softer boundaries at the edges of an enterprise.

The forces driving globalization simply extend that logic to world markets. By erasing political divisions in the world economy, creating a much broader space within which the institutional underpinnings of markets applied, and introducing technologies that allowed for a radical reduction in the cost of doing business internationally and a broad diffusion of technology, those forces created the environment that gave rise to GVCs (Feenstra 1998).[4]

Linkages in a value chain consist of "more than just the purchase of raw materials and standardized intermediate goods" (Grossman and Helpman 2002).[5] It requires "finding a partner with which a firm can establish a bilateral

3 "Higher transaction costs lead firms to internalize functions, while lower transaction costs (or zero transaction costs as assumed by standard neoclassical theory) result in industry structures where amalgams of smaller firms interact through arm-length, price-based market transactions—the Marshallian norm."

4 "The rising integration of world markets has brought with it a disintegration of the production process, in which manufacturing or services activities done abroad are combined with those performed at home. Companies are now finding it profitable to outsource increasing amounts of the production process, a process which can happen either domestically or abroad. This represents a breakdown in the vertically integrated mode of production."

5 They went further, examining the determinants of the location of sub-contracted activity, that is, instances where the economics of the firm dictated that the activity would be outsourced, leaving only the question of where the work would be done.

relationship and having the partner undertake relationship-specific investments so that it becomes able to produce goods or services that fit the firm's particular needs" (Grossman and Helpman 2002). Establishing the required linkages to form a global value chain "depends inter alia on the thickness of the domestic and foreign market for input suppliers, the relative cost of searching in each market, the relative cost of customizing inputs, and the nature of the contracting environment in each country" (Grossman and Helpman 2002).

In that respect, participation in GVCs is fundamentally different from engaging in exchange in the textbook example of a completely undistorted market under conditions of perfect competition. In the case of arm's length sales, price is both the principal determinant of competition and the principal means of conveying information about the value that buyer and seller attach to the good or service exchanged (Gereffi et al. 2005).[6] Very little more needs to be shared between buyer and seller to effect a transaction, particularly if the exchange is an isolated, rather than a repeated, event.

In contrast to market-based transactions, participation in a firm's supply and value chain requires a good deal more in the way of sharing information, which underscores the importance of rules and other institutional arrangements that protect that information, whether in the form of patents, copyrights, trade secrets, or other institutional arrangements (Gereffi, et al. 2005).[7] Participation in value chains also requires the ability to communicate effectively up and down the chain, which requires an infrastructure that supports such communication, as well as rules that protect those communications (Sturgeon 2000).[8]

Increasingly, participation in value chains also requires the ability to innovate with other links in the chain, which requires a higher level of both technological sophistication and human capital and institutions that foster entrepreneurial innovation (Gereffi et al. 2005; Sturgeon and Florida 2000).[9]

As a consequence, competition in this networked world is not based on price alone but depends as well on the capacity of firms and of economies to integrate themselves into the value chains that serve global consumer markets. That, as it turns out, has significant implications for how we define "market access" in a more globalized world economy.

MARKET ACCESS IN A NETWORKED WORLD

The effect of the forces driving globalization on transaction costs and, ultimately, on the organization of production and the basis of competition helps explain why removing conventional barriers to trade has less traction in a networked world. A tariff, for example, affords protection by virtue of its impact on the delivered price of imports, whether inputs or finished goods. To the extent that price is less relevant to the decision to buy, a tariff necessarily has less impact, and a trade policy aimed solely at reducing tariffs in potential export markets has less to offer local firms confronted with the challenge of connecting to GVCs.

From the local firm's perspective, tariffs are only one of any number of transaction costs associated with engaging in the international exchange of goods and services. Indeed, while not insignificant, tariffs (particularly on industrial goods) are low in comparison to other costs that inhibit participation in GVCs (for example, the lack of communications and transport infrastructure; information barriers that make it difficult to receive price signals or find new customers, and so on).

Accordingly, a trade policy that focuses exclusively on reducing tariffs, and implicitly defines market access in terms of lowering such barriers in a particular "export market," risks marginalizing itself and the WTO in the process. What matters more is improving the institutions and building the capacity, whether as a firm or as a nation, that facilitate participation in the more networked world economy of which GVCs are a part.

In this networked world, steps aimed at increasing the quality and reliability of goods and services, decreasing time to market, and enhancing the ability to innovate matter more than lowering the price wedge that tariffs can create. Enabling local firms' participation in GVCs requires a focus

6 The nature of both the products and relationship involved in arm's length sales explains why price is the predominant determinant of competition in such markets. "Arm's-length market relations work well for standard products because they are easily described and valued. Coordination problems are reduced not only because their ease of description makes contracts simple to write, but also because standard products can be produced for stock and supplied as needed. At the same time, because standard products are made by a variety of suppliers and bought by a variety of customers, problems arising from asset specificity are low."

7 "Non-standard inputs and integrated product design architectures involve more complex transfers of design information and therefore intense interactions across enterprise boundaries."

8 He emphasizes the frequency of interaction and the volume of "codified information flowing across the inter-firm link" and drawing an explicit contrast between "the rich streams of data that flow across the inter-firm links in the modular network and the simple price information and specifications that form the basis of the traditional characterization of arms-length market transactions.").

9 Including suppliers in the process of innovation not only spreads the risk and required investment; it also flows from the nature of what the links in the value chain provide. "Integral product architectures are more likely to require non-standard inputs, and changes in the design of particular parts tend to precipitate design changes in other areas of the system." Sharing information with suppliers, and involving them in innovation and design, facilitates that process and reduces its cost. Studies of various industries, such as the automotive industry, reinforce that conclusion, indicating that suppliers are increasingly "selected and involved before components are designed," with suppliers assisting with prototype development long before the lead firm launches high volume production of a new car. Early involvement of suppliers in the design phase has the concomitant benefit of improving the value chain's ability to redesign products for new markets and other design and production changes.

on improving both an economy's "hardware" (for example, transportation and communications infrastructure) and its "software" (that is, its institutional arrangements, such as quality and safety standards; improvements in customs procedures, and so on).

All of which suggests the need for a broader focus for trade policy—one informed by the need to create an environment that facilitates participation in such value chains. The demand for progress within the DDA on trade facilitation, relative to the stasis on tariff liberalization, reflects that reality. But the policies needed to enable successful participation in GVCs and a more networked global economy go much further than trade facilitation alone.

Wholly apart from creating an environment that facilitates trade, participating in a more networked world economy depends on access to factors of production—capital, talent and ideas—that are essential for innovation and economic growth and for exploiting the opportunities for trade and specialization that a more globalized world economy creates. Success in the global economy, whether as a firm or as a nation, depends increasingly on the ability to develop or attract those factors of production. That implies a greater need to focus on liberalizing restraints on investment, adopting measures to facilitate access to finance, adopting rules that encourage innovation and the exchange of ideas, and institutions that foster the development of human capital.

Imposing disciplines on tariffs and non-tariff measures and ensuring non-discriminatory treatment in international trade, to which the WTO Members committed themselves in Marrakesh, can play a role in that process. But in a more networked global economy, such efforts are only likely to help facilitate a local firm's participation if the liberalization is reciprocal.

To understand why, it helps to think of what a firm must do to participate effectively in a global value chain. It must, first and foremost, be able to deliver a high quality product or input at a competitive price. That means the firm must have access to the highest quality and lowest cost inputs. From a trade policy perspective, that implies the need to lower tariffs and other barriers to trade in the firm's inputs, as well as to seek a reduction in such barriers in the markets for the firm's goods or services.

That logic applies with equal force in other areas, like building human capital. Ensuring one laptop or tablet per child to facilitate their acquisition of computing and communication skills at an early age, for example, means reducing trade barriers that raise the cost of putting the tools of the modern global economy in their hands.

Seen in that light, a mercantilist approach to trade policy—even in the name of helping the least developed countries—is self-defeating. It undermines a local firm's ability to participate in a more networked global economy by raising the firm's costs and by foreclosing one of the main channels through which technology is diffused. A broader liberalization of trade barriers would have the opposite effect, if accompanied by parallel approaches to improve an economy's ability to attract those factors of production critical to participating in a more networked global economy.

EXPANDING THE SCOPE OF TRADE POLICY

Exploring the reasons for the success of a number of Asian economies over the past five decades offers some helpful insights into what mix of policies might prove useful in attracting those factors of production and facilitating participation in the value chains serving global markets. The conventional debate over the "East Asian miracle" tends to break down into two groups—those that attribute the extraordinary growth among those countries to getting the "economic fundamentals" right (that is, macroeconomic stability; trade openness, and so on), and those that attribute their success to the implementation of heterodox approaches to economic policy, including a significant role for the state in "industrial policy" (Rodriguez and Rodrik 2001).[10]

In retrospect, the approach of Asia's success stories was heterodox, but not in the way that that term is generally used. The key to the Asian Tigers' success, much like the previous success of Japan and the more recent success of China, lay in their ability to create environments that allowed them to develop or attract the factors of production critical to exploiting new opportunities for trade in a globalizing world economy. Building the institutional underpinnings of markets, reducing transaction costs, and investing in human capital in their own economies had the effect of encouraging inbound investment and facilitating linkages between local firms and GVCs (Lall 2000). While each of the countries did engage in "selectively promoting capital and knowledge intensive industries," it is clear that their success flowed more from creating the environment that fostered profitable, internationally competitive firms (Page 1994).

Trade policy is, of course, an important part of creating an environment that fosters internationally competitive firms capable of participating in a world economy organized

10 It has been argued, citing the work of Dani Rodrik, that the Asian Tigers' success derives, in part, from their adoption of heterodox approaches to trade policy. Those arguments tend to misstate Rodrik's work, which provides a critique of a variety of measures used to demonstrate a causal link between trade openness and growth. The arguments tend to ignore the fact that Rodrik's argument has largely been about what the measures show or fail to show, rather than an argument in favour of isolating an economy, particularly a developing economy, from the global economy. Rodrik has consistently argued that there is "no credible evidence—at least for the post-1945 period—that suggests that trade restrictions are systematically associated with higher growth rates." Instead, his point was to question the view that "integration into the world economy is such a potent force for economic growth that it can effectively substitute for a development strategy." The argument outlined above for a new approach to trade policy as part of a country's development strategy is consistent with Rodrik's conclusion, rather than a departure from it.

around GVCs. Focusing on the pathologies of trade policy in Asia, however, has obscured the fact that the region has taken a very pragmatic approach that resulted in far more liberalization than is often recognized.

The countries of the region liberalized significantly through bilateral and regional arrangements in areas where it was politically feasible, and multilaterally where it otherwise served their economic objectives, as in the case of the region's participation in the Information Technology Agreement (ITA). More importantly, they focused on reducing barriers to trade in other potentially more tangible ways.

They were among the first countries to recognize that "openness" depended on lowering transaction costs and friction across the board, rather than convenient fictions, such as binding tariffs at levels well above the applied rates. Their policies focused, as a consequence, on eliminating friction in the channels of trade—reducing regulation and harmonizing customs entry procedures—in ways that facilitated the ability of their firms to occupy different niches in the value chains that serve global consumer markets, particularly in the area of electronics.

The success of the first movers in Asia demonstrates the benefits of a broader engagement in the global economy and fostering the economic environment that enables local firms to make those linkages as an integral part of a nation's trade policy and its development strategy. Their success also points toward a trade policy far more attuned to the reality of a more networked world.

THE DEVELOPING WORLD'S STAKE

Rethinking trade policy and market access in terms of facilitating participation in a networked global economy is particularly important for achieving the last of the goals set by WTO Members—ensuring that "developing countries, and especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development." The reason why thinking in terms of linkages to GVCs is critical for developing countries, particularly the least developed, is that they start farther away from the technological frontier, and the pace of technological change is accelerating.

In part for that reason, developing countries have a far smaller stake in the emerging trade in intermediate goods and possible diffusion of technology that participating in that trade might encourage (Antras 2003).[11] Participation in trade is an important means for acquiring technology and building the human capital that allows a country to interact with and reap greater benefits from the global economy and close the gap between its current state and the technological frontier in the process (Sturgeon and Memedovic 2011).[12] By the same token, because the pace of technological change is accelerating and the technological frontier is being pushed outward at a corresponding rate, the failure of a developing country to connect its firms and workers effectively to GVCs implies that it will fall behind at a faster rate, with all that implies for its citizens' standard of living and wellbeing (Sturgeon and Memedovic 2011).[13]

Given that fact, developing countries—the least developed most of all—have the most to gain from expanding the aims of trade policy and the most to lose if trade policy and the definition of market access remain that articulated in Marrakesh.

11 "Not only is intra-firm trade a large fraction of world trade, but it also shows some distinctive patterns. Relative to the total volume of trade, intra-firm trade (i) is heavily concentrated in capital-intensive industries and (ii) flows mostly between capital-abundant countries." [In other words,] "the well-known predominance of North-North trade in total world trade is even more pronounced within the intra-firm component of trade."

12 For developing countries, global value chains "can provide mechanisms for rapid learning, innovation and industrial upgrading." To the extent global value chains have "enabled increased specialization and larger scale production, driven more efficient geographical allocation of industrial activities, and increased the availability of a variety of intermediate goods," they "tend to 'compress' the development experience" and reduce the time it takes to catch up with more developed economies.

13 Indeed, in the absence of actions designed to help local firms connect, the rise of global value chains "can create barriers to learning and drive uneven development over time, even as they trigger rapid industrial development and upgrading."

RESPONDING TO THE CHALLENGE A NETWORKED GLOBAL ECONOMY PRESENTS

In a more networked world economy, a country's ability to engage in and benefit from trade depends on facilitating the participation of its firms in the GVCs that have become the new gateways to global commerce. The discussion below identifies a number of concrete options that would meet the challenge that a more networked global economy presents, while reinforcing the WTO as a core institution of global economic governance.

CONCLUDING THE DOHA DEVELOPMENT AGENDA

Recognizing the need to liberalize imports as well as exports as a means of facilitating local firms' participation in GVCs helps clarify the objective of tariff negotiations. The aim should be (1) to foster real liberalization by all WTO Members and (2) to reduce the friction that customs classification decisions introduces into the equation.

A formula for moving toward a tariff-free world

Achieving both goals points toward a formula approach that would result in no more than three bands of tariff levels after a staging period of five to ten years (for example, zero percent tariffs on goods where applied rates are currently below 5 percent; 5 percent tariffs on goods where applied rates are currently between 5–25 percent; 10 percent tariffs on goods where applied rates are currently above 25 percent). That would have the effect not only of sharply reducing tariffs, but also of eliminating virtually all classification decisions that customs services are now obliged to make, which slow down the process of trade, create uncertainty, and open opportunities for graft and corruption, which serve as trade barriers themselves in a more networked world.

The formula would leave plenty of room for acceleration where possible (for example, elimination of all tariffs within five years by developed countries). It would also leave plenty of scope for "policy space" for further reductions (for example, joining the ITA in order to facilitate one laptop or one tablet per child programs), as well as room for further negotiations along the lines outlined below. Lastly, it would allow developing countries to maintain a sufficient uniform tariff to the extent they still rely on tariffs as an important source of government revenue until tariffs could be replaced by a more economically efficient means of taxation.

Liberalizing value chains

Either as an adjunct or alternative to the formula outlined above, WTO Members should think in terms of liberalizing entire value chains (that is, removing all tariff and non-tariff barriers that impede the flow of goods from inputs to delivery of a finished product to a consumer). As an adjunct, liberalizing an entire value chain could take the form of negotiations over the staging or "pace" of liberalization toward the goals established by the formula. As an alternative, it could offer a means of accelerating liberalization beyond the commitments reflected in the formula used as an example above.

What would negotiations aimed at liberalizing an entire value chain look like? The DDA negotiations over agricultural trade offer a salient example. The current talks implicitly define "agriculture" in terms of producers of agricultural commodities and nothing more. But the reality of farming is quite different. Farmers need inputs from seeds to fertilizer to capital equipment and extension services. They also need storage and transportation. They may even want to extend their own operations further up the value chain into processing by joining a cooperative.

To accomplish that, farmers do not simply need a reduction in tariff barriers affecting their exports in particular markets. They also need to reduce the cost of their inputs and their storage, handling, and transport. They would also benefit from access to communications technology that would offer them greater access to technology (for example, agronomy, soil science, and so on) and up-to-date market information that would help them with planting and harvesting decisions. In short, what they need is the removal of all tariff and non-tariff measures that impede their ability to raise their productivity and connect to markets.

WTO negotiations could make those interests work in favour of trade liberalization if it expressly undertook to liberalize the entire agribusiness value chain. In so doing, they would create a broader range of opportunities for tradeoffs that would facilitate the conclusion of an agreement. The formula outlined above consciously draws no distinction between industrial or agricultural tariffs for that reason. A developed country agricultural producer, for example, might be induced to liberalize on agricultural supports more rapidly if there were reciprocal benefits for its firms operating in other parts of the agribusiness value chain.[14]

INCREASING THE WTO'S RELEVANCE

Increasing the WTO's relevance does not, in every instance, expand its purview. The WTO could add to its relevance simply by providing a more policy-oriented focus to trade negotiations that fall squarely within the WTO's purview.

The most salient example involves agriculture and the challenge of food security. Although the WTO's founding document implicitly assumes that trade liberalization contributes to growth and is, therefore, a positive end in itself, that perspective is less widely shared in practice than the Marrakesh agreement suggests. The goal of achieving greater food security, on the other hand, is widely shared, as recent statements of the G-20 and various other groups suggest.[15]

Reorienting the current negotiations on agriculture in the DDA to focus on liberalization and reforms that would contribute to the goal of food security has the potential to change the nature of that game from zero sum to positive sum, both economically and politically. It would also build new constituencies in support of liberalization and reform.

Just as important, it would create a vehicle for negotiating liberalization and reform on the basis of value chains, given that the goal of food security would best be achieved by expanding farmers' access to technology and capital equipment that would boost their productivity, particularly in the developing world, and by reducing the transaction costs and market distortions that inhibit their ability to connect to markets, locally and globally.

BROADENING THE WTO'S REACH

As noted above, the failure to conclude the DDA has had the effect of limiting the WTO's agenda largely to the arena of conventional trade barriers, although the recent effort on services holds promise. WTO members have proved reluctant even to consider areas acknowledged to be directly related to trade, such as government procurement and investment.

But the changes in the global economy are forcing a reconsideration of what should be a part of future trade negotiations. The evidence for that lies in the various bilateral and regional arrangements that have proliferated while the DDA has been under negotiation. So the question is not whether they will be addressed as a part of trade negotiations. The only question is whether they will be addressed in the WTO or solely in bilateral and regional arrangements beyond the WTO's ambit.

Thinking in terms of enabling local firms to participate effectively in GVCs does imply a need for high quality rules on investment and intellectual property, which presuppose solid institutions like private property and the enforceability of contracts. What that suggests is the need for the WTO to expand its remit to include negotiation of rules that create the institutional underpinnings of a global market economy.

The idea is not as novel as it first seems. Before the rise of the General Agreement on Tariffs and Trade (GATT) and the WTO, there was a long tradition of addressing investment rules, contract law, and even the jurisdiction of courts in commercial matters in trade agreements (for example, treaties of "friendship, commerce and navigation") that remain a part of the fabric that is international trade law even today. In addition, wholly apart from the panoply of intellectual property conventions (for example, the Berne Convention on copyright; the Paris Convention on patents and trademarks), there are many examples in international law of treaties or agreements that create uniform rules of that sort. Two such are the United Nations Convention on the International Sale of Goods, which incorporates widely accepted principles of contract law shared by both common law and civil law traditions, and the International Chamber of Commerce's Uniform Customs and Practice for Documentary Credits, a set of privately developed rules on the issuance and use of letters of credit.

The WTO's role is not to supplant what exists, although that ad hoc architecture would benefit from greater oversight. Rather, the WTO's role should be to incorporate what exists, improve upon it, and build out the remaining institutional architecture in ways that reduce transaction costs, encourage innovation and the diffusion of technology, and, above all, reduce uncertainty in the legal environment, which will allow importers and exporters to allocate risk between themselves with certainty over the legal outcome.

14 An example helps explain how that might work. A number of West African countries have sought the elimination or sharp reduction of US support for cotton. But the current structure of the West African markets is such that there are a limited number of buyers. In that context, if the US lowered its support for cotton, the economic rents from that choice would likely flow to the buyers of West African cotton, rather than the producers. If, on the other hand, the West African producers had access to a wider range of buyers, their bargaining leverage would improve and they would benefit more from the US change than would otherwise be the case. One possible way to achieve that outcome would be to liberalize current barriers in West Africa that impede the farmers' access to communications technology and services. Equally, the West African countries could liberalize the markets for downstream services (for example, storage, handling, shipping, and processing) in ways that might attract additional buyers to their markets. Both steps would be entirely consistent with a trade policy aimed at facilitating links between their cotton farmers and global markets. From a US perspective, additional market access for telecommunications goods and services or services and investment liberalizations in areas like storage, handling, shipping, and processing might not be sufficient alone to induce the policy reforms the West African countries seek on cotton. But progress along those lines could add to a total package of liberalizations that did make such action workable for the US, as well as the West African cotton producers.

15 Ministerial Declaration, Action Plan on Food Price Volatility and Agriculture, Meeting of G-20 Agriculture Ministers (June 2011).

REINFORCING THE WTO'S ROLE AS A PILLAR OF GLOBAL ECONOMIC GOVERNANCE

As noted above, the success of the GATT and the WTO lies in establishing the foundation of a rules-based trading system. While often overlooked, its role in establishing trade rules and creating a mechanism for resolving disputes over the implementation and interpretation of those rules has a powerful liberalizing effect wholly apart from the WTO's contribution to reducing tariffs and other trade barriers. That liberalizing effect flows from the greater consistency it encourages in the application of the rules of the game, which has the effect of reducing uncertainty and risk associated with international trade, just as sound domestic legal institutions do in the area of contracts.

That raises the question of whether there is a contribution that the WTO could make along those lines even in a world in which bilateral and regional trade agreements are proliferating. The answer is that the WTO can make a significant contribution by extending the reach of its dispute settlement mechanism to the application and interpretation of such bilateral and regional agreements.

There are sound legal and economic reasons for suggesting that bilateral and regional arrangements make use of the WTO's dispute settlement mechanism. As a matter of law, such arrangements coexist with the WTO only by virtue of their compliance with Article XXIV of GATT 1994. But both bilateral and regional arrangements frequently use WTO agreements as their baseline—a starting point from which they liberalize further. To the extent that interpretations of the underpinnings of those agreements imply interpretations of the WTO rules, they should be subject to the WTO disputes process. To do otherwise militates against the uniformity of interpretation that the WTO disputes procedure was expressly designed to foster.

The economic rationale is just as strong. As in every other area of law, experience is the best teacher. Legal systems succeed by virtue of aggregating the lessons of individual cases into legal doctrines that reflect an evolving set of best practices. The product of those legal systems is a certainty that reduces uncertainty and risk and fosters the flow of goods and services in a market economy.

That logic applies with equal force in the area of international law. The trading system as a whole would benefit from the WTO's service as an aggregator of legal best practices in the areas under its jurisdiction. Incorporating the WTO dispute settlement process into bilateral and regional arrangements would contribute to the organization's ability to fill in the architecture of trade law in ways that fostered, rather than undercut, the legal certainty needed for goods and services to flow through the global economy.

EXPANDING THE PARTICIPATION OF THE DEVELOPING WORLD

What the discussion above underscores is that the conventional means for encouraging greater developing-country participation in international trade and in the trading systems have become counterproductive. Expanding preferential access to developed-country markets or creating new allowances for special and differential treatment will not help developing-country firms participate in a more networked global economy. As noted above, firms in the developing world need access to imports not only as inputs but also as a channel for the diffusion of technology. One-sided liberalization in the form of preferential access to developed-country export markets does nothing to foster that access.

The key to broadening developing-country participation in a more networked world lies in policy instruments outside of trade policy as conventionally defined. The recent focus on "aid for trade" comes closer, but is still not sufficient to address the underlying problem that countries face when they are far from the technology frontier. What is needed, instead, is an approach to bargaining that fully integrates trade negotiations and development assistance in support of a strategy aimed at closing the gap between a developing country's current position and the technology frontier.

The nature of what is needed comes closer to the structural adjustment lending the World Bank did as its contribution to resolving the various debt and financial crises affecting the developing world in the 1980s and 1990s. But the structural adjustment in this instance would involve policy reforms aimed at enabling local firms and workers to engage successfully in the global economy. That agenda could embrace financing for hardware (physical infrastructure) and software (institutional change).

Whether thought of as "structural adjustment" or simply an expanded aid for trade agenda, the object of the effort must also take into account that creating an enabling environment that allows local firms to connect to GVCs can generate its own challenges. The risk of "policy stretch" for governments faced with the need to establish sound macroeconomic fundamentals and foster structural change, all the while providing world class customs services that reduce time to market and a system of education that provides everything from basic literacy and access to world class tertiary education is self-evident, as is the need for development assistance focused on those tasks.

BALI AND THE WTO WORK PROGRAM

The upcoming Bali ministerial represents an opportunity in two respects. The first is to reap what can be harvested from the past decade's work under the Doha Development Agenda and to put the talks on a path to a successful conclusion.

From the perspective of what would contribute most in a more networked global economy, the obvious answer is an agreement on trade facilitation. But, that should be coupled with an agreement on the negotiating modalities that will lead to the conclusion of the round within a year's time. Those modalities should incorporate the sort of formula discussed above, in the case of tariff negotiations, and the idea of fully liberalizing the agribusiness valuation chain, both as a means to eliminate the market distortions that afflict agriculture and as a means to achieve the goal of food security.

The second opportunity flows from the first. Success in Bali would allow the WTO and its members to turn their attention to the challenges the new patterns of trade present. WTO ministers should use Bali as an opportunity for a serious discussion of a work program within the WTO expressly designed to illuminate the challenges of connecting to world markets in an era in which global value chains and strategic networks have become a permanent, if not dominant, feature of world trade.

The objective should be to establish a forward- looking agenda – one that assumes success in the DDA and, therefore, looks past the current round to the real challenges that WTO members face in ensuring the ability of their firms and workers to participate effectively in the global economy and benefit from the contribution it can make to rising productivity and higher standards of living.

That forward looking agenda should start from the perspective of reinforcing the WTO's role as a pillar of global economic governance, which implies the need to broaden the focus of trade policy along the lines discussed above.

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