# E POLICY COHERENCE AND INTERNATIONAL COOPERATION

This Section discusses some aspects of the international dimensions of policy coherence. The core question that will be considered is how far coherent policies at the national level require international cooperation. The examination of this question is not just limited to the policy areas discussed in the rest of the study, but is a more general exploration of the role of international cooperation in supporting coherent policy formulation, including in the field of trade policy. In identifying what appear to be the main explanations of how international cooperation helps support good policy domestically, the point will also be made that sometimes efforts to foster international cooperation may have negative consequences. In other words, effective international cooperation depends on such considerations as what governments are trying to coordinate, the degree of cooperation sought, the willingness of the parties involved to shape national policies around a common international approach, and the costs of seeking and maintaining cooperative arrangements in relation to the benefits so generated.

Another important consideration, not taken up in this study, is how different international agencies cooperate among themselves and whether they are sufficiently coherent to meet the needs of the governments they are intended to serve. Institutional and policy incoherence at the international level will weaken governments' contribution and may even undermine the primary rationale for international cooperation.

As noted in the introduction to Section II of this report, coherence is a complicated and multi-faceted term used, and arguably misused, in a range of contexts. This discussion is not repeated here. For the present purposes, however, coherence is not just a matter of whether policies that might conflict or cancel out one another are adequately aligned to meet set objectives – it is also about how international cooperation fosters efficiency and national welfare by allowing governments to meet policy objectives that might otherwise elude them. So far as the notion of international cooperation is concerned, this is also a term open to divergent interpretations. Cooperation can be more or less explicit and more or less binding, and this will be explored further below.

The first subsection below examines the circumstances in which one form or another of international cooperation can facilitate the attainment of national objectives, in the sense of securing efficient outcomes that maximize a country's welfare. If there is a case for such cooperation, a question that naturally follows is the form that cooperation should take, and this is examined in the next subsection. Finally, Section IIE is rounded off with a short discussion of the role of the WTO as an agent of international cooperation and of the conditions required for the effective fulfilment of that role.

## 1. INTERNATIONAL COOPERATION AND NATIONAL POLICY OBJECTIVES

What are the circumstances in which international cooperation can facilitate the attainment of national economic objectives? The potential role of international cooperation in assisting governments to attain their social, political and economic objectives is a vast subject. This discussion will only touch briefly on a subset of issues, focusing mainly on economic efficiency and welfare maximization gains from cooperation. It is important to remember, however, that international cooperation goes much wider and deeper than this, dealing with such fundamental issues as peace, security, the eradication of poverty, and human rights.[197] The conclusions drawn here about cooperation may be more or less relevant to these other aspects of how governments seek to support one another through joint international action.

The discussion that follows touches on 'beggar-thy-neighbour' or 'prisoners' dilemma' problems in policy formulation, the role of international cooperation from a political economy perspective, international policy spillovers, cooperation in curbing market power, transparency, regulatory coordination, and questions relating to institutional capacity.

[197] The United Nations Development Programme has undertaken some interesting recent work in this area, structuring a consideration of the challenges of international cooperation around the notion of global public goods and an analysis of where responsibilities lie for supplying these «goods». See Kaul et al. (1999) and Kaul et al. (2003). The adoption by the United Nations of the Millennium Development Goals is an important international initiative aimed at addressing a wide range of development challenges through international cooperation. For more detail, see World Trade Report (2003) pp.80-81.

## (a) The terms of trade, domestic political economy, and international cooperation

International trade is one area where extensive international cooperation is observed. The rationale for entering into international trade agreements and the ways such agreements are enforced have been subject to extensive research. The literature points to at least three reasons why countries may want to enter into international trade agreements: i) a terms-of-trade driven prisoners' dilemma; ii) political economy considerations and iii) commitment to policies.[198]

About fifty years ago, Harry Johnson (1954) showed how, in the face of terms-or-trade effects arising from tariffs, countries could cooperate to make themselves better off through the avoidance of mutually destructive episodes of trade policy retaliation. This is an application of the prisoners' dilemma in game theory, where a failure to cooperate reduces the welfare of parties to the game, and cooperation increases welfare. Johnson was looking at a situation where countries presided over a market that was big enough to affect the world price of a product following a change in demand in that market. Thus, if a government in a big country were to impose a tariff on an imported good, this would raise the price and reduce demand in the domestic market, affecting enough of the total market to lower the world price of the good concerned. The effect of the tariff would be to cheapen the price of imports relative to exports (the terms of trade) and thereby increase national income at the expense of another country. The same thing could happen if a large country taxed an export, thus raising the international price of the good concerned.

The effect on national income of the relationship between import and export prices has been well understood for a long time. Johnson's insight was to show that if countries pursue such beggar-thy-neighbour policies – retaliating against one another with sequential trade restrictions – they would end up reducing national income all round. An international agreement to restrain such behaviour makes all parties better off. Here, then, is a reason why government policy can be made more coherent through international cooperation. Furthermore, in the presence of power imbalances between countries, multinational bargaining enables countries to achieve deeper trade liberalization than a web of bilateral negotiations. Thus, Maggi (1999) argues that trade negotiations can be regarded as a market where countries exchange trade concessions and that bilateral bargaining is inefficient because the market is segmented.

Ethier (2004a; 2004b) addresses political economy reasons why governments might enter into international trade agreements. He questions whether the terms of trade effect is the main reason for the existence of GATT and the WTO. He argues that the GATT does not in fact prohibit export taxes and, therefore, does not prevent large countries from using trade policy to improve their terms of trade. Besides, if terms of trade were the main explanation for the existence of multilateral agreements, small countries would have little to gain from membership. The explanation offered by Ethier is a combination of terms of trade effects and what he calls political externalities. These externalities relate to the assumption that governments depend on political support from different interest groups and thus need to balance the interests of exporters and import-competing industries and workers employed in these industries. Two assumptions are made about the policy environment. First, it is assumed that political support is more affected by the direct impact of a trade agreement than the indirect effects. The direct effect refers to increased import penetration in sectors where the government has lowered protection, and to increased exports in sectors where the government has negotiated improved market access. The indirect effects are the economy-wide subsequent adjustments in prices and rewards to factors of production that take place in order to rebalance the overall trade balance. The second assumption is that while governments want to reap the gains from trade, they also want to avoid large reductions in the income of any interest group. When these assumptions are satisfied, a reciprocal, gradual approach to trade liberalization is the preferred policy. Ethier argues that the political support rationale best explains the actual trade agreements that we observe.[199]

[198] See Bagwell and Staiger (2002) for an extensive discussion.

[199] See also Mayer (1981), Grossman and Helpman (1995) and Bagwell and Staiger (2002) for discussions of the relative importance of terms of trade and political economy effects.

The third rationale for international trade agreements – commitment – has been analysed by Maggi and Rodríguez-Clare (1998) and Staiger and Tabellini (1999). They have provided a good theoretical basis for the idea that governments can use international commitments to signal policy intentions, or "tie in" policy commitments in a manner that makes them harder to challenge by interest groups. This can be done by governments regardless of country size. The analysis suggests that the balance between a government's bargaining position and that of lobbies will influence the willingness and ability of governments to use international commitments in this way. Finally, it should be noted that if there are no terms of trade effects and if the government's objective is to maximize total national income, then free trade is the optimal policy.

Turning to the issue of enforcing trade agreements, a potential problem with multilateral agreements is the incentive for, say, two countries to enter into separate agreements that would undermine the concessions that the two have given to all other countries. A most favoured nation (MFN) clause in the agreement prevents this from happening and makes reciprocal liberalization agreements implementable. Furthermore, Bagwell and Staiger (1999) show that in a multi-country setting tariffs that satisfy governments' objectives of maximizing welfare are efficient only if they conform to MFN. Efficiency is defined as a tariff structure where no country can improve its welfare by changing its tariffs without harming another country. Finally, Ethier (2004b) notes that MFN is important to the individual signatory to a multilateral agreement not because of the MFN status it receives, but because each of its competitors has conceded such status to each of its potential trading partners.

A dispute settlement procedure (DSP) is another feature of the multilateral trading system that is important for the enforcement of agreements. In addition to settling disputes between two or more Members, the procedure identifies violations of the agreements and brings them to the attention of third countries. This has a disciplining effect since it affects the offender's reputation as a trustworthy trading partner. Non-tariff barriers are much less transparent than tariffs and the "information conveying" function of the DSP is particularly relevant in these areas. Maggi (1999) shows that with a DSP in place, a multilateral agreement can be enforced without having to resort to severe sanctions. Third party sanctions can be small and are needed only for violations that are difficult to deter through bilateral sanctions, most importantly in cases involving a strong and a weak country. Thus, the DSP transfers enforcement power across bilateral relationships – another feature that distinguishes a multilateral from a bilateral trade agreement.

To sum up this subsection, governments may wish to secure greater policy coherence through international commitments in order to: i) avoid tit-for-tat trade restrictions that make all worse off; ii) affect the distribution of political influence that determines policy outcomes in the domestic economy; and iii) commit themselves to trade policy reforms. The results built on political economy arguments are not sensitive to country size. Moreover, even though the insights from this work have been couched largely in terms of trade policy, it would be interesting to consider whether they help in understanding other areas of international cooperation.

## (b) International policy spillovers

International policy spillovers are an example of an externality that may require international cooperation to deal with effectively (Section IIC). Frequently cited examples of international spillovers are the unsustainable use of the global commons (e.g. global climate, oceans, etc. ), and the "export" of pollution to other jurisdictions. The level of international cooperation on environmental problems has grown enormously since the 1972 Stockholm Conference (UN Conference on the Human Environment). There are now a multitude of international environmental agreements, covering such issues as climate change, the ozone layer, biodiversity, marine and coastal areas, endangered species, persistent organic pollutants, hazardous wastes, desertification, etc. A number of key processes have made this progress possible, including the growth in scientific understanding of environmental problems, greater global public awareness and concern about environmental issues and greater recognition by national governments of the need for environmental action (Conca and Dabelko, 1998). Effective inter-governmental cooperation would ensure that economic activities at the national level are not responsible for environmental degradation affecting other countries or the world at large.

The presence of technological spillovers with international dimensions is another example of where international policy coordination might help. If technological spillovers accrue through trade, for example, this would suggest that the market is producing too little trade, thereby supporting the notion that coordinated action to reduce obstacles to trade would increase economic well-being.

Another area of international spillovers is the transmission of macroeconomic shocks (Section IIA). Countries face some degree of fluctuations in aggregate economic activity arising from the business cycle. Each national authority will be required to employ fiscal and monetary policies to smooth out its business cycle. But the effects of the cycle as well as the policy response can be transmitted to one's partners through changes in trade flows which affects the partners' output, employment and prices.

In the two-country Mundell-Fleming model with flexible exchange rates, a country which adopts an expansionary monetary policy will worsen the current account and reduce the aggregate demand of its trade partner. This policy will not be welcome by its trading partner particularly if it is facing macroeconomic weakness of its own. The mechanisms for transmitting this beggar-thy-neighbour effect are the exchange rate and the induced changes in trade flows (switch in demand to the exportables of the first country). One way to alleviate such tensions is to coordinate a response to macroeconomic weakness (or strength) and to share in the benefits and costs through international cooperation. Cooperation can take various forms, from macroeconomic coordination (such as through the G-7) all the way to monetary union (such as in the formation of the euro zone). Still, one key shortcoming of this literature is that the policy analysis is not welfare-based and depends on ad-hoc assumptions about the objectives of policy makers.[200]

Over the last decade, a new modelling framework for open-economy macroeconomics has been developed (Obtsfeld and Rogoff, 1995b). The new framework moves away from the old Mundell-Fleming model with its Keynesian roots to one with stronger micro-foundations. The key features include differentiated products and hence imperfectly competitive markets, utility maximization by households through their choice of consumption, real balances and labour supply, and nominal price rigidity. One important consequence of this framework (particularly the utility maximizing behaviour of households) is that it allows for welfare evaluation of various types of policy choices, including the coordination of policies with other partners.

While the possibility of international spillovers is acknowledged, there is less consensus about the value of international macroeconomic coordination. Obstfeld and Rogoff (2000) have argued that as central banks in the major industrialized countries move towards rules-based monetary policies and as international financial markets become more complete, international spillover effects become only a 'second-order' problem.[201] The gains from monetary cooperation are therefore small. Hence it is enough that central banks respond optimally to domestic macroeconomic conditions and shocks. However, their results regarding international transmission and the welfare effects may not be robust to changes in some of the specifications of the models, including price stickiness, preferences and the financial structure (Lane, 2001). Using the same basic model, Canzoneri, Cumby and Diba (2002) assumed a different pattern of productivity shocks and asymmetries in the formation of wages and prices to generate benefits from international monetary cooperation.

While recognizing the value of international cooperation, a recent paper by Conconi and Perroni (2003) explores the conditions under which coordination among governments can help deal with spillovers. The analysis deals with interaction among governments as well as with private agents. One conclusion of the paper is that if governments and private interests are continually reacting to each other and among themselves ("repeated interaction"), international agreements may be less necessary. The players can build up sufficient credibility regarding their willingness to accommodate one another's interests. On the other hand, if governments have difficulty in pre-committing to a desirable domestic policy response, an international agreement may help. One object lesson from this analysis, and a number of similar papers built on game theoretic analysis, is that the nature and degree of desirable international cooperation will vary with circumstance. It is not always true that more cooperation at the international level is better than less.

[200] More often than not, the analysis assumes that governments are seeking to avoid unemployment and inflation.

[201] In marked contrast for example to the Mundell-Fleming result, a monetary expansion by one country increases the output and welfare of its trade partner (a prosper-thy-neighbour outcome).

## (c) Curbing market power

Another important area for international cooperation to address is market power by firms that are domiciled in one jurisdiction but whose activities exact significant costs on consumers and firms in another jurisdiction. The sources of such market power and the form it takes can vary. Market power may be concentrated in just one firm or it could be shared among a group of firms acting in a coordinated fashion (e.g. a cartel) to manipulate prices and stifle competition. The source of market power may be monopoly over a resource, economies of scale, or access to a unique technology.

Some have questioned whether these negative spillovers are sufficiently large to warrant the need for international cooperation (Bilal and Olarreaga, 1998). But as noted in Section IIC, recent research suggests that the costs to consumers and other producers of international cartels can be quite high. Many governments are frequently more lenient about the behaviour of firms in export markets than in domestic markets. This is because national competition authorities may not have an incentive to curb monopolistic behaviour by firms based in their jurisdiction if such behaviour leads to increased domestic profits primarily at the expense of foreign consumers and competitors.

There is yet another argument which calls for international coordination on competition rules. With greater trade liberalization and multilateral disciplines on the use of traditional trade measures, there may be a temptation for governments to make strategic use of competition policy as a device to shift rents from foreign to domestic firms (Cadot, Grether and de Melo, 2000). The few studies that have looked at this issue in the context of mergers have suggested that there is no simple answer (Horn and Levinsohn, 2001). In fact, the model that was employed produced the contrary result – greater liberalization induced national welfare maximizing governments to tighten competition rules. But the results clearly depend on model and parameter assumptions so that the issue continues to stand as an empirical question.

Section IIC has also discussed the various forms of international cooperation such as strengthened comity-based agreements among national competition authorities, harmonization of national competition laws and the creation of a multilateral framework. Some have argued that multilateral rules and case law already provide scope for both the application and non-application of existing domestic competition laws of members to be challenged where de facto discrimination occurs between domestic and foreign products (Hoekman and Mavroidis, 1994). Hoekman and Mavroidis (2002) also argue that for developing countries, the presumed benefits of multilateral disciplines in competition policy can be more effectively secured from traditional liberalization commitments using existing WTO fora.

In any case, the sheer variety of regimes suggest that any effort at harmonization would be a difficult task. A rough taxonomy of competition regimes internationally classify them into five major categories (Levinsohn, 1996). If harmonization is to be attempted at all, chances of success will be higher if it focused on core principles. Current work in the WTO on competition policy has focused on core principles, including transparency, non-discrimination and procedural fairness, and provisions on hard core cartels.

## (d) Information asymmetries, transparency and regulatory failure

The economics of information has been a dominant theme of theoretical analysis in economics in recent years. The focus on imperfections in markets for information to explain varying outcomes has proved a rich vein of analysis. The simple idea is that information concerning conditions in the market is often asymmetrically distributed among parties to a transaction, and in some cases, an appropriate policy intervention to lessen or eradicate the asymmetry may be beneficial. Many expressions that have found their way into every day parlance, such as moral hazard, adverse selection and the principal-agent problem are applications of information economics. Information asymmetry has proven useful in explaining various types of market behaviour including signalling (Spence, 1974), screening (Stiglitz, 1975) or credit rationing (Stiglitz and Weiss, 1981).

Some of these kinds of problems can occur in an international setting, and to the extent they do, may provide grounds for international cooperation. Once again, however, proper analysis is essential to determine the degree and nature of desirable international cooperation. Examples where each of these aspects of cooperation has appeal are to be found in earlier parts of the study.

Information asymmetry may exist between consumers who wish to purchase products of a specific quality and producers. One way in which producers of the quality product can overcome the asymmetry is to signal to consumers through the use of marks or geographical indications (Section IB.3). But legal protection for these marks only in national markets would not be sufficient to ensure that consumers are protected since commerce is increasingly globalized. Hence, international cooperation in intellectual property protection complements national protection of these marks and indications.

The amount of information asymmetry in financial markets also increases their susceptibility to contagion. The asymmetry exists between debtors and share-issuing enterprises on the one hand and creditors and shareholders on the other. Debtors and enterprises have greater knowledge about the riskiness of their investment projects than creditors and shareholders. While this asymmetry is certainly present within national financial markets, it can be more severe in the case of undeveloped and poorly regulated emerging markets.[202] The asymmetry means that international investors may treat all emerging markets as alike and it also creates a hair trigger sensitivity to financial or macroeconomic shocks.[203] Creditors' and shareholders' panicky reactions in the face of a shock cause an adverse chain reaction through several financial markets at once, producing contagion. International cooperation in increasing transparency in financial markets as well as coordinating appropriate responses to financial crises can help reduce the often huge economic losses that are incurred in these episodes.

Finally, action to improve policy transparency, including at the international level, offers a basis for more informed policy-making. The cost of doing business internationally – that is, transactions costs – can be reduced through regulatory coordination. In the field of standard-setting, harmonization in some areas can be a prior requirement for transactions even to take place. Similarly, a coordinated approach to standard-setting can reduce transactions costs. Examples where each of these aspects of cooperation has appeal are to be found in earlier parts of the study. In the financial field, coordination can reduce opportunities for regulatory arbitrage that undermines macroeconomic management at the national level.

### (e) Supporting institution and capacity-building

"Trade, not aid" has been a catchphrase in recent debate, indicating that the two are seen as substitutes. The two are indeed substitutes in the sense that exports and aid are alternative sources of foreign exchange earnings that in turn can be used for importing goods and services. Aid can also affect trade in other more distorting ways. There is, for example, the possibility that donors are explicitly or implicitly given preferential access to the recipient's market.[204] In addition, aid transfers may have an impact on the recipient's exchange rate, causing it to appreciate and may thus have a negative impact on exporters' competitiveness. Finally, aid may allow a recipient to sustain trade deficits for long periods of time and thus may strengthen the import competing lobby relative to the export lobby. As discussed above, this may create less incentives for the government to pursue mutual exchange of market access.



202 The recent accounting scandals across both sides of the Atlantic show that even the most developed, transparent and regulated financial markets are not free from quite severe cases of information asymmetry.

203 See Calvo and Mendoza (2000).

204 Aid can be tied to purchasing project inputs from the donor country, or aid may generate preferences for the donor country's goods and services through goodwill, or tie-ins with suppliers that might extend to purchases beyond the donor-funded part of a project (see Djajić et al. (2004), for a recent discussion).

The discussion in this Report, however, has focused on areas where aid and trade are complementary. The discussion in Section IIB on the role of infrastructure in trade clearly points to the disadvantages poor infrastructure imposes on exporters. Furthermore, the increased relative importance of timeliness as a competitive factor has rendered poor infrastructure a more serious obstacle to participation in international exchange of goods and services than it was in the past. Many LDCs will need significant transfers from abroad in order to raise the quality of infrastructure to an adequate standard, and hence aid in this area would help in improving the recipient's supply response to trade liberalization. This might in turn strengthen the export lobby and create incentives for negotiating reciprocal concessions.

The insight that better economic and physical infrastructure enhances the supply response of trade reforms and economic incentives in general is not new and infrastructure has been a priority area for aid recipients and donors alike for decades. Yet, in many cases there is much left to be desired as far as the quality of infrastructure is concerned. The fact that development aid has not always had the intended impact has provoked a growing body of research. It has been pointed out that aid is often motivated by the donors' political considerations rather than the need of the recipient (Alesina and Dollar, 2000). Incentive problems have also been suggested as an explanation for poor results (e.g. Svensson, 2003). Another explanation that has received a lot of attention and which has arguably induced a shift in focus is the empirical finding that aid is effective when combined with good governance, but has no positive effect on economic growth in a setting of weak governance (Burnside and Dollar, 2000).[205] The shift in focus of development aid has therefore been in the direction of institution and capacity building, which has also been a priority in the DDA under the auspices of the WTO.

Section IID in this Report highlights the role of institutions in creating a conducive environment of security and trust which, in turn, lowers the cost of doing business in general and international trade in particular. Institution building has been an area of increased emphasis in the donor community and both sticks and carrots have been employed in order to promote good governance – rewarding countries with good governance or significant improvements in governance and withholding aid from governments that have shown little progress.

The WTO has worked with the World Bank, IMF, UNCTAD, UNDP and ITC within an integrated framework for trade-related technical assistance with the objective of building capacity in the policy area of trade. The Integrated Framework was introduced following the Ministerial Meeting in Singapore. Coherence was one of the main objectives in this initiative as it sought to "mainstream trade into national development plans," as for example in the Poverty Reduction Strategy Plans. These plans, in turn, may serve as a vehicle for coordination of domestic policies as well as donor support for various projects and programmes.

## 2. WHAT KIND OF INTERNATIONAL COOPERATION NURTURES POLICY COHERENCE?

### (a) Differing degrees of cooperation

The previous subsection identified a range of circumstances that may give rise to a need for international cooperation in order to ensure policy coherence at the global and national level. But cooperation can be of varying degrees, with significant implications as to how far governments "tie their hands" through international agreements. At its lightest, cooperation might amount to little more than information exchange. Such exchanges may be more or less obligatory and may lead to additional layers of international commitment, often of a more binding nature.

[205] A recent paper (Easterly et al. 2003) casts doubt also on this result. It applies the same methodology as Burnside and Dollar but for a larger sample of aid recipients and for a longer timer period, and the result that aid was positively related to growth when interacted with the quality of institutions was not replicated in this study.

A second level entails consultation. Consultation will have features of comity, such that cooperating jurisdictions may agree on a good-faith basis to assist one another. This could be by fashioning policy responses in a particular manner in order to convenience a partner. Such arrangements can be found, for example, among certain countries that cooperate in the field of competition or anti-trust policy. These kinds of undertakings are unlikely to have legal force, but will nevertheless be adhered to if there is a shared perception of mutual benefit.

A third level of cooperation is coordination. In this case authorities agree at the international level to adopt particular policy stances considered to be mutually beneficial. Again, strong enforcement mechanisms are likely to be lacking. Finance ministers from large countries have sought to coordinate exchange rate policy from time to time, with varying degrees of success. Sustained coordination in this field requires that agreed targets or ranges for currency values are seen to be in the common interest, and that central banks are strong enough to carry out their objectives if the markets hold a contrary view as to the exchange rates that reflect underlying economic fundamentals.

Fourthly, international cooperation may entail legally binding obligations which are backed up by more or less effective enforcement mechanisms. The World Trade Organization is a good example of an expression of international cooperation that relies on strong enforcement mechanisms. As with the softer varieties of international obligation described above, commitments of this kind may deal either with rules about what governments cannot do, or they may be more positive in the sense of defining what governments must do. In the latter case, the rules are more likely to embody requirements that lead to harmonized policy.

## (b) What degree of international cooperation is desirable for coherence?

This question cannot be answered simply, since situations will differ among countries and through time. Moreover, views as to what is desirable will vary across the political spectrum. The argument here, however, is that there can be too much as well as too little international cooperation on policy matters. Because the idea of cooperation carries intrinsic appeal, and the alternative might be thought of as uncooperative and therefore anti-social behaviour, it can be tempting to work from the implicit assumption that more international cooperation is always better than less. But coherence requires the right balance – international cooperation that is neither excessive nor excessively scarce.

We have already mentioned a number of considerations that make a case for international cooperation. Other factors may also be relevant to decisions about the optimal level of international cooperation to achieve policy coherence. One of these relates to the ability of intergovernmental institutions to manage policy at the international level. This was alluded to above. At least two requirements are indispensable. First, effective cooperation requires that adequate information is available to decision-makers. If information essential to well-informed decision-making does not filter up from the national context in the countries concerned, outcomes will be deficient. Secondly, international institutions need to have appropriate measures at their disposal and adequate enforcement means in order to act effectively.

A second factor influencing the desired level of international cooperation relates to the feasibility of seeking uniform solutions to shared problems when agreement is elusive and compromises suboptimal. Circumstances exist in which attempting to attain particular objectives against a background of dissension about the appropriate distribution of responsibility or burden-sharing will result in less effective action than would be the case under independent decision-making arrangements, even in the presence of international spillovers. This is a delicate issue because the optimal solution may well be constructive cooperation, but if this is unattainable, disengagement from efforts to establish international arrangements may be better than fruitless perseverance, at least in the short or medium term. Moreover, if a shared perception of the desirable terms of cooperation is lacking, persistent efforts to reach agreement may lead to coercive relationships or half-hearted acceptance, and ultimately to instability. Coherence that builds on international cooperation requires that the cooperation is voluntary and seen as being in the national interest.

A third consideration concerns transactions costs, but in a slightly different sense from that referred to above. While it is not difficult to see how cooperation across frontiers could facilitate mutually beneficial exchange in all sorts of ways, it may also be that the transactions costs implicit in the mechanics of international cooperation become sufficiently burdensome as to outweigh benefits from the activity. One hears anecdotally of occasional cooperative efforts among international agencies that are dismissed as time-wasting talk-shops. A more tempered analysis of this kind of problem would balance transactions costs with identifiable benefits. Where the balance is unfavourable, this is presumably because the activity is intrinsically not very helpful or because governments are simply unwilling to cooperate despite the advantages of doing so.

A final general observation concerns the idea that governments may sometimes seek to avoid responsibility and blame by transferring what should be a national policy discourse onto the international scene. Some policy challenges have their origins firmly rooted in a domestic setting and their solution can only be found in the same context. Blame- and responsibility-shifting behaviour in these circumstances will typically lead to a mis-specification of the true nature of a difficulty, and is unlikely to lead to beneficial international cooperation or a solution to an underlying problem.

## 3. THE CASE OF THE WTO: INTERNATIONAL COOPERATION AND POLICY COHERENCE

This subsection briefly considers the place of the WTO in international governance. The WTO has five core functions.[206] Essentially, these are to provide a set of rules for the conduct of international trade, a forum for negotiating trade liberalization, a dispute settlement system, transparency and greater coherence in global economic policy-making. In all these functions, the WTO can be regarded as an international public good. Governments share an interest in having created and now preserving the system. Staiger (2004) argues that the WTO manifests the characteristics of an international public good[207] in terms of governments' willingness to establish and maintain the institution. According to Staiger, the public good aspect of the WTO resides largely in its contribution to the elimination of a terms of trade prisoners' dilemma, as discussed above. Without a forum to negotiate mutually advantageous tariff reductions and related trade agreements, the argument goes, terms-of-trade considerations would lead to lesser levels of mutually beneficial trade liberalization.

Although it seems clear that the WTO possesses many international public good characteristics, this does not mean that governments agree on such fundamental issues as the appropriate mix of reciprocal tariff reductions in a market access negotiation or the precise content of rules to which governments should submit. Nor do they necessarily agree that the working methods of the institution are sufficiently developed to allow full participation and an effective voice for all parties. These differences have to be ironed out in negotiations.

It is interesting that while Staiger sees the establishment and maintenance of the system as an investment by governments in a public good, he suggests that when governments utilize the system, they are exercising private rights – for example, when Members get together bilaterally and agree on tariff reductions which they later extend to their trading partners through the most-favoured-nation (MFN) principle. A similar argument might be made when governments are negotiating around their differences with respect to the content of rules under the system or the working procedures of the institution. This pursuit of private interests within an institution that supplies public goods is viable as long as outcomes are not such as to negate the value of the institution as a public good in the eyes of Member governments. If this does happen, the system is likely to fail over time as a shared commitment to its maintenance falls away. In simpler parlance, the system only works if all members believe there is something in it for them, and consider the absence of a multilateral agreement an inferior state of affairs.

206 Article III of the Marrakesh Agreement Establishing the World Trade Organization.

207 In other words, the WTO in this context is supported because it commits governments jointly to provide the institutional machinery for mutually beneficial multilateral trading arrangements.

An additional dimension of this distinction between the defence of an international public good and the pursuit of private (national) interests relates to negotiations on the coverage of the system and the use of trade measures for what are essentially non-trade objectives. These are two separate but related questions. Recent experience has amply demonstrated that WTO Members have different views about the desirability of international rule-making in the WTO in areas such as investment, competition policy and transparency in government procurement. Thus for some, international cooperation has not gone far enough. For others, it would go too far if these issues were included in further rule-making activities. It is not the intention here to venture a view on the merits of these positions, but rather to point to this debate as an illustration of important differences of perception as to the degree to which policy coherence requires international cooperation. Solving these differences over time would appear to be a pre-requisite for the effective functioning of the trading system.

Secondly, trade measures carry a particular attraction in international economic relations as an instrument of enforcement of international obligations and, perhaps, of persuasion in situations where views differ as to the nature of appropriate international obligations. Again, without venturing into an analysis that would attempt to determine whether particular international agreements are desirable, or whether the WTO would be the right place for such agreements, a point should be made about the systemic implications of how cooperation is defined. If the WTO were to become a place where trade measures could be taken by members on the basis of unshared definitions of permissible policy behaviour, the system would be destabilized. International cooperation can only lead to coherent policy outcomes in the WTO and elsewhere, including in terms of enforcement, if it is based on a pre-commitment to rules by all the parties involved. Once that pre-commitment to a shared policy standard and obligation has been secured, the question whether trade measures are used as an instrument of enforcement, or whether agreements are struck in the WTO or elsewhere, become much less important and less system-threatening.