MORPHOGENESIS OF THE GLOBAL TRADING SYSTEM IN AN EVOLVING INTERNATIONAL ECONOMIC ENVIRONMENT

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Abstract

In keeping with the evolving global economic environment, the global trading system needs to undergo a constant transformation. Without such a transformation it can neither efficiently and effectively respond to the needs of the global economy nor attain its fundamental objectives. Due to the existence of policy linkages at both national and global levels institutional policy and functional co-operation is essential. The global economic architecture should evolve in such a manner that policies related to trade, capital flows and finance are coherent and congenial.

In the process of reacting and responding to the new demands, institutional role of the global trading system went on expanding. Evolving nature of the global economy justifies further expansion of its scope to include strategic institutional co-operation in monetary, finance, exchange rate and capital flows areas so that coherence in global economic architecture can be achieved. Further deepening and broadening co-operation between the WTO and the two Bretton Woods institutions is indispensable. This paper also contends that the level of effectiveness and decision-making in the WTO and greater coherence in global economic policymaking can be improved with the help of negotiating groups like the FOGS.

Key Words

global trading system
institutional co-operation
policy coherence
financial issues
capital flows

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1. Introduction

The fundamental objectives of the global trading system, as spelled out in the Preamble to the General Agreement on Tariffs and Trade (GATT) and the Preamble of the Marrakesh Agreement, were similar. The two institutions were successful in bringing down trade barriers in industrial and developing economies. Global economy has undergone a great deal of transformation during the recent decades. One of the most important being the new distinctive wave of globalization that began around 1980. The dimension of private capital flows to developing economies has also increased substantially and by the mid-1990s they came to dwarf official flows. Given this background of recent global economic developments, the WTO needs to mull over and decide its future direction.

There has been a long-standing view that due to the existence of policy linkages at both national and global levels, policies related to trade, capital flows and finance should be globally congenial and coherent. On the global level, this objective can only be achieved by deepening and broadening co-operation and collaboration between the WTO on one side and the two Bretton Woods sisters on the other. Inter-institutional co-operation existed during the lifetime of the

GATT, intensified during Uruguay Round and continued during the brief life-span of the WTO. By the mid-1980s, particularly during the Uruguay Round, global trading system grew more responsive to the evolving global economic environment. The Marrakesh Declaration and subsequently the Doha Ministerial Declaration reiterated the pressing need for WTO co-operating with the international organization responsible for monetary and financial matters. One of the six functional objectives of the WTO is “co-operation with other international organizations”.[1]

In the process of reacting and responding to the new demands, institutional role of the global trading system went on expanding. This justifies further expansion of its scope to include strategic institutional co-operation in monetary, finance, exchange rate and capital flows (including FDI) areas so that much-needed coherence in global economic architecture can be achieved. This paper contends that strengthened institutional co-operation and coherence in monetary, finance, exchange rate and capital flows matters is an achievable target. The level of effectiveness and decision-making in the WTO and greater coherence in global economic policymaking can be improved with the help of negotiating groups like the FOGS or the negotiating group on the functioning of the GATT system (Section 6).

As for the structure of the paper, the second section focuses on the achievements of the global trading system and financial movements in the recent

[1] Refer to the WTO website http://www.wto.org/english/thewto_e/thewto_e.htm.

past. The third section delves into the evolving new role of the global trading system in the backdrop of the transformations that took place in the global economy. The focus of the fourth section is growing interaction and inter-linkages in the global policy structure. The fifth section deals with achieving policy coherence and the role of global trading system. Trade policy and its links with financial issues are discussed in the sixth section. A proposal of extending the global trading system has been taken up in the seventh section. The last, eighth section, provides a summary and conclusions.

2. Global Trade and Financial Movements

The contemporary global trading system, which can trace its origins to the proposal to found an International Trade Organization after World War II and the negotiation of the GATT, is five-and-a-half decades old. It underwent a great deal transformation in form and substance during this period. At the time of its genesis in 1947, the GATT agreement was signed by 23 nations. Historical events and philosophy of the thinkers creating a new global organization contribute to its objectives, which in turn go into designing its regulations. The basic objectives of the GATT were spelled out in the second and third paragraphs of the Preamble to the GATT. In order to achieve full employment, rising living standards and full utilization of global resources, the ultimate objective of the GATT was pursuit of "Substantial reduction of tariffs and other barriers to trade … the elimination of discriminatory treatment in international commerce." Decades later, the Preamble of the Marrakesh Agreement[2] emphasized the objective of "sustainable development" in lieu of the GATT's objective of "developing full use of the resources of the world" (Lloyd, 2001). In effect, these paragraphs committed the GATT and the WTO to trade liberalization and elimination of discrimination.

In 1995, the WTO took over functions of the GATT. As an institution, it is GATT plus a lot more, in that, its political and legal base is broader than that of the GATT. It has also been entrusted with implementing the many agreements that emerged from the Uruguay Round[3]. While the WTO inherited all the multilateral trade negotiations (MTNs) related knowledge and decisions of the GATT, its obligations are applicable to a much larger share of global trade. The WTO has consolidated various provisions of the dispute settlement mechanism (DSM) that existed under the GATT and made it more cohesive and efficient. In addition, as seen above, membership of the WTO is larger than that of the GATT, particularly the developing economies are much better represented in the new system. The WTO's Trade Policy Review Mechanism (TPRM) provides regular monitoring of trade policies of the member economies, while the biennial ministerial conferences provide political leaders an opportunity to review the work of the WTO and provide it with necessary redirection (Das, 2001a).

[2] The Marrakesh Agreement was formally adopted on 15 April 1994 and the WTO was born on the 1st of January 1995. At present, its annual budget is approximately SFr 143 million and total personnel strength close to 550.

[3] One such agreement is GATT 1994, which is an up-dated version of the original GATT 1947. Refer to footnote 13 also.

The two institutions--GATT and subsequently the WTO--pursued the objective of trade liberalization seriously. Consequently, the most-favored-nation (MFN) tariff reduction of industrial countries between 1947 and 1999 was substantial. During the first five GATT Rounds (1948-63), weighted average of tariff reduction was 36 percent. During the Kennedy Round (1968-72) they were further slashed by 37 percent. During the Tokyo Round (1980-87) they were again brought down by 33 percent and during the Uruguay Round (1995-99) by 38 percent[4] (GATT, 1994 and WTO calculations). The number of economies participating in the global trading system, as represented by these two institutions, went on increasing. In all, 62 countries participated in the Kennedy Round (1964-67), 102 in the Tokyo Round (1973-79) and 123 in the Uruguay Round (1968-94). As of March 2002, the WTO had 144 members, with additional 31 countries waiting in the wings as observers.

The liberalization of international transactions has gone a long way in the course of past half century to transform the global economic landscape. Over 45 percent of global output is now exported, compared to only 7 percent in the 1950s and about 32 percent in the 1970s (See Table 1; Figure 1). Over the 1948-2000 period, merchandise trade grew *in real terms* by 6 percent annually or 22 fold. During the same period, global out up, grew *in real terms* by 4 percent annually or 7 fold. Over the recent decades, trade in goods and services grew twice as fast as global GDP. Measured in constant (1987) dollars, the ratio of trade in goods and services to global GDP rose from 8 percent in 1950 to 29.5 percent in

[4] Parentheses show the implementation periods.

2000.[5] As the rate of trade flows outpaced global GDP growth rate, global economy became more integrated. Trade as percentage of GDP showed steep rise (Table 1) in the 1990s, until the on set of the Asian crisis, reflecting the economic expansion of the global economy.

A growing number of developing economies recognized the value of economic liberalization and outward orientation and began liberalizing their economies during the 1980s. Some did so unilaterally, while others moved in this direction with impetus from the International Monetary Fund and the World Bank, which conditioned their financial assistance on reforms designed to liberalize transactions and open the economy to the rest of the world. Policy reforms and institutional developments--both domestic and global--enabled countries to take advantage of the static comparative advantage of the market conditions and expand trade. As a result, developing economies now participate in international trade very significantly. The WTO league tables for 1999, which list the 50 largest traders in the world, include twenty non-OPEC developing countries (WTO, 2000). Among the top 20 are China (number 9), Hong Kong SAR (11), South Korea (12), Mexico (13), Taiwan (14), Singapore(15), and Malaysia (18). Accounting for 3.5 percent of world trade in 1999, China is the single largest developing country exporter.

[5] Aggregate world trade in 2000 was $7.6 trillion, of which $6.2 trillion (81 percent) was merchandise and $1.4 trillion (19 percent) was commercial services.

What is true of trade in goods is also true of trade in services. Exports of commercial services quadrupled in the course of the 1980s and 1990s from $364 billion to $1350 billion.[6] (See Table 2; Figure 3). Several Asian economies were particularly successful in trade in services. Asia's exports in commercial services increased especially rapidly in the 1990s. As a proportion of the world total, they rose from 16.7 percent to 22.6 percent between 1990 and 1997 (before declining to 19.5 percent in 1999 due to the Asian crisis).

Rapid trade expansion of the 1990s had several reasons (deregulation and privatization of the 1980s, more enlightened political decision making, technological advances) but higher trans-border capital movements helped in sustaining it. Some analysts believe that rapid expansion in global financial movement was mirrored in the trade boom of the last decade (Schlesinger, 2000). Trans-border financial flows have come close to creating a seamlessly integrated global market. Financial firms headquartered in the advanced industrial countries increasingly exhibit global reach. In an early survey of international financial markets, Mussa and Goldstein (1993) found that global financial linkages among the advanced industrial countries had tightened significantly over the course of the 1980s. While developing economies, especially emerging market economies, were also integrating themselves into global financial markets, this part of the process was proceeding at a slower pace. In the 1990s, this process accelerated significantly. Whereas only some

[6] Commercial services include transportation and travel services and a third category called "other commercial services". The last named category includes financial services, banking,

$50 billion of private portfolio capital flowed into emerging markets in 1990, by 1996 this number had soared to $227 billion (before declining somewhat as a result of financial crises in Asia and elsewhere).

As for the dimension of private capital flows to developing economies, by the mid-1990s they came to dwarf official flows. Net private capital flows[7] to developing economies peaked at $358.7 billion in 1997, the year Asian crisis struck (WB, 2001). In 1990, this level was $100.8 billion. The 1997 level was almost four times higher than the peak reached during the 1978-82 commercial lending boom (Das, 1999; WB, 1997). After the financial crisis of 1997, developing countries were not able to access external capital to the same extent as they did in the recent past. Net capital flows declined to $246 billion in 1999. However, in the wake of a strong recovery that began in 1999, private capital flows strengthened in 2000 and reached $299.3 billion. For all appearances, this was the resumption of the march of financial globalization.

As regards financial globalization, its present level is high. Cross-border capital flows have reached $1.5 trillion a day. Also, investors now can instantaneously react to economic, financial and political developments around the globe. Markets offer a wide range of financial instruments, which includes both equity and debt instruments. Despite making a great deal of headway, global financial flows have not reached the level attained a century ago. During the Victorian

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insurance, construction, and computer and information services.

[7] Net resource flows imply capital inflows net of amortization payments.

period, outflows of capital from Great Britain, France, Germany and the Netherlands were close to 9 percent of their GDP. For the contemporary period, no major economy has come close to this figure. For most leading industrial economies this figure was slightly above 2 percent during the 1990s (IMF, 1997).

Foreign direct investment (FDI) was, and continues to be, an important instrument of global financial movements. Net FDI flows as a percentage of global GDP rose from 0.48 percent to 0.65 per cent in the 1970s, to 1.01 percent in 1990 and fully 2.25 percent in 1998.[8] Over the 1973-2000 period, global FDI flows grew 53 fold, or 16 percent annually, touching $1.3 trillion in 2000 (UNCTAD, 2001). The manufacturing and service sectors have been the main destinations of FDI, although newly privatized utilities have also been powerful attractors. Transnational corporations (TNCs) have become powerful agents of market integration and conduits for FDI. International production by TNCs, now numbering some 63,000 parent firms with roughly 700,000 foreign affiliates, span virtually all countries and economic activities.

The 1990s also saw considerable geographical broadening of FDI flows. While in the 1980s FDI was dominated by flows within the OECD, in the 1990s FDI flows to non-OECD countries increased both absolutely and as a portion of the total. A large part of these flows are accounted for by a small number of Asian and Latin

[8] Global FDI as a proportion of global investment rose to equally impressive levels. Between 1970 and 1980, the rate of increase was slow (from 2.40 percent to 2.75 percent) but after 1980 the rate of increase was steep. In 1990, it was 4.40 percent of the GDI, and it further rose to 7.13 percent in 1997 (See Table 1; Figure 2).

American economies. China is the largest developing country recipient. Other large FDI destinations include Argentina, Brazil, Chile, Indonesia, Malaysia, Mexico, and Thailand. Eastern Europe has also been attracting growing quantifies of FDI, especially with the progress of its accession negotiations with the European Union. Over the years, the group of FDI supplier countries has also expanded. Newly industrialized economies like Hong Kong SAR, Korea, Malaysia, Singapore, Thailand and Taiwan have become substantial FDI suppliers. Large multinational enterprises from these countries are globally recognized names. Examples include Daewoo, Hyundai, Samsung, Evergreen, LG, TSMC, Hutchison Whampoa, the Li Ka-Shing group, and Hopewell Holdings. These FDI flows and intra-trade among the TNCs have significantly affected both nature and dimension of global trade.

3. Evolving New Role of the Global Trading System

That global trading system was successful in its trade liberalization role, cannot be denied. Statistics presented in the preceding section vouch for that. To be sure, there were more successful and slack periods in following the objective of trade liberalization. Since the early 1980s, other non-trade issues attracted the attention of the contracting parties (CPs) in a significant manner. Important ones among these included competition laws, labor standards, trade and environment, intellectual property rights, and trade-related investment measures. During the First Ministerial Council Meeting in Singapore in 1996 it was decided to establish Working Groups to examine the relationship between trade and investment and interaction between trade and competition. This sparked a debate in the academic and policy-making fora. The questions that were justly being asked were: Should the global trading system be extended to these non-trade issues? Even before that, is it imperative to have a multilateral system of regulations in these areas? If the answer is in the affirmative, should there be new global organizations covering the new set of regulations or there should be a division of labor among the existing ones? This debate is of a fundamental nature and thus far unresolved.

Substantial new developments have taken place in the global economy in the recent past. One of the most important being the new distinctive wave of globalization that began around 1980. Some thirty large number of middle- and high-income developing economies began to harness their labor abundance, began producing labor-intensive manufactures and services, and entered the global market place. In 1980, only 25 percent of exports from developing economies were that of manufactured goods. By 1998, this proportion increased to 80 percent. Similarly, exports of commercial services from developing economies also soared during this period. It almost doubled from 9 percent of total exports to 17 percent (WB, 2002). As demonstrated in the preceding section, capital became much more globally mobile, particularly during the 1990s and exchange rates were relatively more flexible. Freer capital movements, like trade in goods and services, benefit from following sound macroeconomic policy as well as from having credible institutions. Important factors that contributed to this new wave of globalization included trade and financial liberalization in several large developing economies, declining tariffs and non-tariff barriers (NTBs) in the industrial and developing economies, improved investment climate, technological progress in transportation and developments in information and communications technology (ICT).

Another noteworthy set of economic events during this period was the debt and financial crises. The decade of the 1980s was marred by the debt crises. The 1990s saw recurring financial crises that led to financial and monetary instability. They had high national and global costs. As a rule, these crises were detrimental to sustainable growth endeavors and an anathema to global trade and financial flows. They successfully impeded the onward march of global economic and financial integration. These financial turmoils have been closely scrutinized by economists. A consensus has gradually emerged in the profession regarding their causes. Inflexible or pegged exchange rate arrangements, state directed credit policies, overly protected financial and banking system, poor and inadequately developed regulatory structure, serious flaws in corporate governance, incorrect timing in opening up of current account, moral hazard at national and international levels and lack of transparency were considered among the contributory factors to a financial turmoil (Das 2000; Das 2001b).

Given this background of recent global economic developments, the WTO needs to mull over and decide its future direction. It needs to refine its institutional infrastructure with this ground reality in mind. As a global institution, it is vitally important for the WTO to accommodate structural and other changes in the world economy. Its new role must evolve in such a manner that the WTO continues to be relevant to the global economy. The most opportune time to do that would be the current round of multilateral trade negotiations (MTNs), the first round under the aegis of the WTO. That the members of the WTO are aware of these issues is obvious from the communiqué of the Doha Ministerial conference[9]. In Paragraph 36, the members have stated that they have agreed to "an examination, in a Working Group under the auspices of the General Council, of the relationship between trade, debt and finance, and of any possible recommendations of steps that might be taken within the mandate and competence of the WTO to enhance the capacity of the multilateral trading system to contribute to a durable solution to the problem of external indebtedness of developing and least developed countries, and to strengthen the coherence of international trade and financial policies, with a view to safeguarding the multilateral trading system from the effects of financial and monetary instability." This Working Group is scheduled to be set up in April 2002.

4. Growing Interaction and Inter-linkages

Experiences, particularly those of the last half-century, show that debt and economic and financial crises and recessions not only disrupt trade in goods and services and financial flows (as stated above) but also increase protectionist pressures. Recessions of the 1974-75, 1980-81, 1989-90, the debt crises of the

[9] This was the Fourth Session of the Ministerial Conference of the WTO.

1980s, the financial crises of the 1990s, the near collapse of a large hedge-fund, and a steep drop in major stock markets vouch of these facts. Although correlation between recession and crises on the one hand and protectionist tendencies on the other has not been computed, it can certainly be empirically established. When economic and financial difficulties arise, demands for protection is first to come from oligopolistic industries. When difficult times came, in the name of market failure, governments often resorted to intervening both directly and indirectly in the economy. This they did in the hope of supporting domestic production and employment. The same objectives led governments to intervene in the area of trade policy. Although neo-classical economic opinion has remained opposed to it, neo-mercantilism was accepted by some academic groups[10] in situations where growth was constrained by balance of payments difficulties.

In the domestic economic setting, trade policies do not stand in isolation. trade policies affect and are affected by other areas of policymaking, like macroeconomic, structural, financial and developmental. If the problems occur in the trade area and their origin lie in areas other than trade policy, they cannot be redressed through policy measures in the trade policy alone. Exchange and capital controls[11] in the domestic economic setting have a fundamental link with international trade. This fact was well recognized by the Bretton Woods conference. No wonder that one of the principal objectives of the creation of the

[10] Like the Cambridge Economic Policy Group in the U.K.

IMF was to assist in the elimination of foreign exchange restrictions which hamper the growth of world trade[12]. Using gravity equation framework, Tamirisa (1999) established that exchange and capital controls have a significant negative impact on exports. Results of this empirical exercise show that while controls on current payments and transfers are a minor barrier to trade, capital controls significantly reduce exports, particularly in the developing economies. This opens one large area for institutional co-operation.

There has been a long-standing view that due to the existence of policy linkages at both national and global levels, policies related to trade, capital flows and finance should be more congenial and coherent. On the global level, this objective can only be achieved by deepening and broadening co-operation and collaboration between the WTO on one side and the two Bretton Woods sisters on the other. As opposed to this, in the domestic economic setting policy coherence issues must be settled by the commerce or trade ministry of a country on the one hand and the finance ministry and central bank on the other.

While there was an awareness of these inter-linkages during the lifetime of the GATT, addressing them institutionally in a formal manner was not intensely debated until the Uruguay Round. Co-operation between the three multilateral institutions found a conspicuous place in the legal text of the Uruguay Round. Institutional co-operation was made to be one of the five fundamental objectives

[11] While capital controls encompass controls pertaining to capital account transactions, exchange controls refers to current international transactions.

of the WTO, without which much-needed coherence in the global economy and policymaking was considered difficult to achieve, if not completely unattainable (GATT, 1994). Although "coherence" in global economy and policymaking was internationally debated, the concept was not defined and remained vague for years to come. It was used as a portmanteau to describe any small or large policy initiative that seemed to contribute rationally to a congenial global economic architecture. It stood more for the political will of the participating governments than a concrete plan of action. That said, the concept of coherence was useful in its vagueness because it opened the door for new possibilities to construct new global economic architecture.

After avid debates during the Uruguay Round, significance of the twin factors, namely, (a) inter-linkages in the domestic economic policymaking and (b) the evolving global economic environment were not forgotten. The objective of institutional co-operation has been reiterated in the Doha Ministerial Declaration. In Paragraph 5 it stated that the WTO members are aware of the "rapidly changing international environment." They also reaffirmed their belief that under these circumstances "measures taken in the trade field alone" would be inadequate to deal squarely with several vitally important global economic issues. Instead of dealing in an inadequate manner with significant global issue through trade policy alone, trade ministers of the WTO member countries unequivocally expressed their determination to "continue to work with the Bretton Woods institutions for *greater coherence in global economic policymaking*" (Author's

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[12] Article I of the Articles of Agreement of the International Monetary Fund.

italics). Thus, the mandate of achieving strategic coherence between the WTO with the two global developmental and financial institutions has continued to receive its just attention from the member governments.

5. Policy Coherence and the Global Trading System

Sampson (1998) was among the first to address the issue of coherence in global economic policy making and the global trading system in an analytical manner. The objective of broadening and deepening of institutional co-operation and achieving "greater coherence in global economic policymaking", as set out above, can be implemented and is achievable but will naturally have limits. The first limit will arise from the fact that this objective was essentially accepted by the trade ministers of the member countries. If we take the seriousness of the trade ministers for granted, the enthusiasm of the finance ministers to collaborate with the trade minister will largely determine the level of institutional co-operation and coherence in global policymaking. Second, the objectives, mandates, institutional personalities and the capabilities of the professionals in the WTO and the two Bretton Woods institutions differ considerably. Unlike the other two institutions, the WTO deals with legally binding contracts between the members and establishes their rights and obligations. The WTO secretariat essentially provides services in the implementation of these contracts. Therefore, its role in policy related matters is small. Third, size of the WTO (professional strength and budget) is puny as compared to the two Bretton Woods institutions, severely limiting the possibilities of collaborative activities like joint country surveillance, joint research and seminars, exchange of professionals, even participation in meetings.

The Articles of Agreement of the three institutions reveal that they follow the same fundamental philosophy and are dedicated to common objectives of expansion of global trade, promotion of high or full employment, economic growth to raise the standards of living, and full utilization of other productive resources. Therefore, the notion of broadening and deepening of institutional co-operation and coherence in global economic policymaking was not an entirely novel idea to the three institutions. Beyond these common generalities, the International Monetary Fund (IMF) and the World Bank had specific institutional commitment to global trade expansion, without having any regularity authority over it. While focusing on coherence in global economic policymaking, GATT (1989) meticulously documented it. One of the institutional objectives of the IMF is to "facilitate the expansion and balanced growth of international trade" because the basic objective of the "international monetary system is to provide a framework that facilitates the exchange of goods, services and capital among countries". Likewise, an important objective of the World Bank is to "promote the long range balanced growth of international trade … by encouraging internal investment". That is, its role is indirect, namely, promotion of global trade by encouraging investment.

6. Trade Policy and Financial Issues

International trade benefits a great deal from a well-functioning financial environment, and vice versa. International trade cannot flourish without supportive services of financial institutions. Financial services work as a lubricant for international trade. When they are missing, the transaction costs of trade are likely to grow. In addition, international trading activities are essentially a part of the investment process. As set out earlier, domestically it is the central bank and the ministry of finance that hold sway over the financial institutions and markets, while globally it is essentially the IMF and the World Bank that influence the financial decisions and investment levels. Unless they are in an autarkic economy, domestic financial institutions are susceptible to global financial architecture.

Sampson (1998) pointed out that in the process of regulating the use of exchange restrictions and keeping surveillance over a member country's monetary and financial policies[13], the IMF exerts a great deal of influence, both direct and indirect, over trade policy framework. The same kind of influence is exerted over a member country while negotiating conditionality for the use of IMF resources. Furthermore, Article IV surveillance of the IMF covers a wide range of trade issues like "trade distorting subsidies, anti-dumping measures, sectoral policies (such as textile and clothing protection in the United States, the Common Agricultural Policy of the European Union), and restrictive distribution system such as *Keiretsu* in Japan." Similarly, growth of world trade and levels of trade barriers and NTBs are an important input in the area of project finance for the World Bank. Additionally, trade policy reforms are a vital part in structural adjustment programs devised by the World Bank. These reforms have to be in cohesion with the Fund-supported macroeconomic programs. It holds as a generalization that the structural reform programs of the Bank underpin the Fund-initiated trade liberalization programs.

Turning the other way around, GATT had a long-abiding institutional interest in financial issues. When the Tokyo Round was being launched (during the early 1970s), co-operation and co-ordination with the IMF in the global economic adjustment process became a part of the GATT agenda. In 1975, the Consultative Group of Eighteen was established by the GATT Council with a mandate to facilitate and assist the CPs in carrying out global economic adjustments as well as facilitate co-operation between the GATT and the IMF. The GATT-IMF linkage directly resulted in trade-finance linkage, which in turn worked through trade measures taken for the balance of payments purposes. This implied that exchange restrictions and trade measures were taken to be substitutes for each other. The IMF was represented on the GATT Committee on Balance of Payments Restrictions, which was established under Article XV of the GATT. This also led to closer institutional relationship between the two institutions. A comparable relationship with the World Bank was not established.

[13] The International Monetary Fund is obliged to do this under its Article IV obligations.

Although an informal relationship was maintained, the World Bank it did not find any specific mention in any of the Articles of Agreement of the GATT 1947[14].

By the mid-1980s, global trading system grew more responsive to the evolving economic environment. The Uruguay Round was launched in September 1986. Establishing a strong linkage between trade policy and financial issues was one of the four of its basic objectives. This objective was included with the specific goal of increasing the "responsiveness of the GATT system to the evolving international economic environment" (GATT, 1986). Another objective of the Uruguay Round was "to strengthen the inter-relationship between trade and other economic policies and efforts to improve the functioning of the international monetary system, and …" (GATT, 1986). Furthermore, a negotiating group on the functioning of the GATT system (FOGS) was created by the Punta del Este Ministerial Declaration establishing the Uruguay Round. Its express objective increasing "the contribution of the GATT to achieving greater coherence in global economic policy making through strengthening its relationship with other international organizations responsible for monetary and financial matters" (GATT, 1986). Although they were not explicitly named, these international organizations were implied to be the IMF and the World Bank. The three regional development banks were not expected to be a part of this global strategic collaboration because of their relatively lower professional capabilities in the area of global trade and finance. Their interest in these issues was even lower than

[14] The old text of the GATT agreement is called "GATT 1947", while the updated version which is covered by the WTO is called "GATT1994".

their professional capabilities. The FOGS negotiations focused on global trade, money and financial issues. They identified inconsistencies and contradictions in them and attempted to recommend solutions. Negotiations continued, although without any regularity. During the early 1990s, they were conducted in a sporadic manner, which was widely considered inadequate.

At the end of the Uruguay Round trade ministers met with the heads of the two Bretton Woods institutions, with an objective to decide on the form of institutional collaboration and to impart specificity to initiatives. The Marrakesh Declaration of April 1994 reiterated the pressing need for co-operating with the international organization responsible for monetary and financial matters. There was a long-standing realization that exchange rate volatility and misaligned currencies seriously disrupt trade flows. Therefore, it further recognized that greater exchange rate stability and more efforts towards resolution of debt problems would contribute to the expansion of trade (GATT, 1994). The Marrakesh Declaration emphasized that the WTO and two Bretton Woods institutions should follow mutually supportive policy in these areas. “Cooperation with other international organizations”

7. Extending the Global Trading System

In the process of reacting and responding to the new demands, institutional role of the global trading system went on expanding during the lifetime of the GATT. For instance, addition of the anti-dumping code during the Kennedy Round was conspicuous. The expansion was particularly rapid during the Tokyo Round, when several sectoral agreements on dairy, bovine meat and civil aircraft were added. Numerous codes (on technical barriers, government procurement and subsidies) were also added during and after the Tokyo Round. Expansion in the institutional role was further accelerated after the Uruguay Round when more than a dozen agreements were added to the global trading system. Two new areas of trade in trade were also appended, namely services and intellectual property rights. Lloyd (2001) contended that as new agreements were added to the global trading system, "substantial incoherence in the internal and external architecture" resulted. Lloyd (2001) has also argued that that constant expansion of the scope of the global trading system was undertaken because of a "perceived need for further rules in (some) areas". Does it not justify expansion of the scope of the global trading system to include strategic institutional co-operation in monetary, finance, exchange rate and capital flows (including FDI) areas so that coherence in global economic architecture can be achieved? Such institutional collaboration is sure to contribute to efficient global production, consumption and trade. It will *prima facie* appear expansion of the global trading system in a non-traditional field. But a deeper scrutiny would show that it basically contributes to global trade expansion.

Strengthened institutional co-operation and coherence in monetary, finance, exchange rate and capital flows (including FDI) matters can be achieved with or without the involvement of the member governments (Sampson, 1998). The three institutions can collaborate and co-operate at the level of their respective secretariats. They can chalk out formal linkage agreements between them. In fact, such agreements between the WTO and the two Bretton Woods institutions were made in 1996. Although they are similar, WTO's agreement with the IMF is more comprehensive and far-reaching than the one with the World Bank. The reason is that balance of payments restrictions is one area which is of primary common interest to both the IMF and the WTO. These agreements stipulated that attention needs to be paid to co-operation in specific policy measures of each of the three institutions. It was considered essential to dispel the conceptual vagueness that prevailed in the past in this area. These agreements provided for exchange of information between the three organizations. They also provided for the WTO staff to attend the Executive Board meetings of the IMF and the World Bank. Common higher-level staff meeting and consultations among professionals would certainly deepen the co-operation and contribute to coherence.

In view of the WTO, these formal agreements will lay down the foundation of achieving greater institutional coherence in monetary, finance, exchange rate and capital flows (including FDI) matters. Sampson (1998) believed that they would provide "a framework within which the institutions can explore the precise mechanisms for intensifying institutional co-operation". Experiences of the recent past suggest that deliberations and recommendations of groups like FOGS can be helpful in providing new functional ideas to the formal agreements. Effectiveness and decision-making in the GATT and achieving greater coherence in global economic policymaking were two of principal areas of focus of FOGS. FOGS deliberations and recommendations had a discernable favorable impact over the Uruguay Round. In particular, it was in FOGS that the suggestion of creating a new trade organization was first mooted in 1986. Lloyd (2001) proposed that the WTO now has many new areas of rule making and the scope of concern is much greater. Therefore, its role needs to be re-visualized to respond to the new circumstances. FOGS may be recreated under a new nomenclature, that is, negotiating group on the Function of the Multilateral System (FOMS). The forthcoming Round of MTNs could potentially benefit from the FOMS in the same manner as the Uruguay Round benefited from the FOGS.

8. Summary and Conclusions

The fundamental objectives of the global trading system, as spelled out in the Preamble to the GATT as well as the Preamble of the Marrakesh Agreement, were similar. In effect, they committed the GATT and the WTO to trade liberalization and elimination of discrimination. The two institutions pursued the objective of trade liberalization seriously. Consequently, the most-favored-nation (MFN) tariff reduction of industrial and developing economies between 1947 and 1999 was substantial. During the past half century global economic landscape transformed considerably. As the rate of trade flows outpaced global GDP growth rate, global economy became more integrated. Trade as percentage of GDP showed steep rise in the 1990s, until the on set of the Asian crisis, reflecting the economic expansion of the global economy. A growing number of developing economies recognized the value of economic liberalization and outward orientation and began liberalizing their economies during the 1980s. Some did so unilaterally, while others moved in this direction with impetus from the IMF and the World Bank. Consequently, several developing economies are now in the WTO league table of largest-thirty exporters.

As for the dimension of private capital flows to developing economies, by the mid-1990s they came to dwarf official flows. Net private capital flows peaked in 1997; at this point their level was almost four times higher than the peak reached during the 1978-82 commercial lending boom. After the financial crisis of 1997, developing countries were not able to access external capital to the same extent as they did in the recent past. However, in the wake of a strong recovery that began in 1999, private capital flows strengthened in 2000. For all appearances, this was the resumption of the march of financial globalization.

That global trading system was successful in its trade liberalization role, cannot be denied. There were more successful and slack periods in following the objective of trade liberalization. Since the early 1980s, other non-trade issues attracted the attention of the CPs in a significant manner. Substantial new developments have taken place in the global economy in the recent past. One of the most important being the new distinctive wave of globalization that began around 1980. Some thirty developing consciously countries began globalizing their economies. Freer capital movements, like trade in goods and services, benefit from following sound macroeconomic policy as well as from having credible institutions. Important factors that contributed to this new wave of globalization during the 1980s and 1990s included trade and financial liberalization in several large developing economies, declining tariffs and non-tariff barriers (NTBs) in the industrial and developing economies, improved investment climate, technological progress in transportation and developments in information and communications technology (ICT). Another noteworthy set of economic events during this period was the debt and financial crises of the 1980s and 1990s that led to financial and monetary instability. These crises had high national and global costs.

Given this background of recent global economic developments, the WTO needs to mull over and decide its future direction. It needs to refine its institutional infrastructure with this ground reality in mind. As a global institution, it is vitally important for the WTO to accommodate structural and other changes in the world economy. Its new role must evolve in such a manner that the WTO continues to be relevant to the global economy. The most opportune time to do that would be the current round of MTNs, the first round under the aegis of the WTO. The WTO's decision to go beyond its trade objective and collaborate with the Bretton Woods institutions in coherently resolving monetary, finance, exchange rate and capital flows (including FDI) matters of global importance is reflected in the Ministerial Declaration following the Doha Ministerial Conference.

There has been a long-standing view that due to the existence of policy linkages at both national and global levels, policies related to trade, capital flows and finance should be more congenial and coherent. On the global level, this objective can only be achieved by deepening and broadening co-operation and collaboration between the WTO on one side and the two Bretton Woods sisters on the other. As opposed to this, in the domestic economic setting policy coherence issues must be settled by the commerce or trade ministry of a country on the one hand and the finance ministry and central bank on the other. Inter-institutional co-operation existed during the lifetime of the GATT; it was intensified during Uruguay Round. The Doha Ministerial Declaration emphasized the same in the background of "rapidly changing international environment." The objective of broadening and deepening of institutional co-operation and achieving greater coherence in global economic policymaking can be implemented and is achievable because the three institutions have the same fundamental philosophy and are dedicated to common objectives. However, this will naturally have limits.

In the process of regulating the use of exchange restrictions and keeping surveillance over a member country's monetary and financial policies, the IMF exerts a great deal of influence, both direct and indirect, over trade policy framework. Similarly, growth of world trade and levels of trade barriers and NTBs are an important input in the area of project finance for the World Bank. Trade policy reforms are also a vital part in structural adjustment programs devised by the World Bank. Similarly, GATT has had a long-abiding institutional interest in financial issues. By the mid-1980s, particularly during the Uruguay Round, global trading system grew more responsive to the evolving economic environment. The Marrakesh Declaration and subsequently the Doha Ministerial Declaration reiterated the pressing need for WTO co-operating with the international organization responsible for monetary and financial matters.

In the process of reacting and responding to the new demands, institutional role of the global trading system went on expanding during the lifetime of the GATT. This trend accelerated during the short life span of the WTO. This justifies expansion of the scope of the global trading system to include strategic institutional co-operation in monetary, finance, exchange rate and capital flows (including FDI) areas so that coherence in global economic architecture can be achieved? Strengthened institutional co-operation and coherence in monetary, finance, exchange rate and capital flows (including FDI) matters can be achieved with or without the involvement of the member governments. The level of effectiveness and decision-making in the GATT and achieving greater coherence in global economic policymaking can be improved with the help of negotiating groups like the FOGS.

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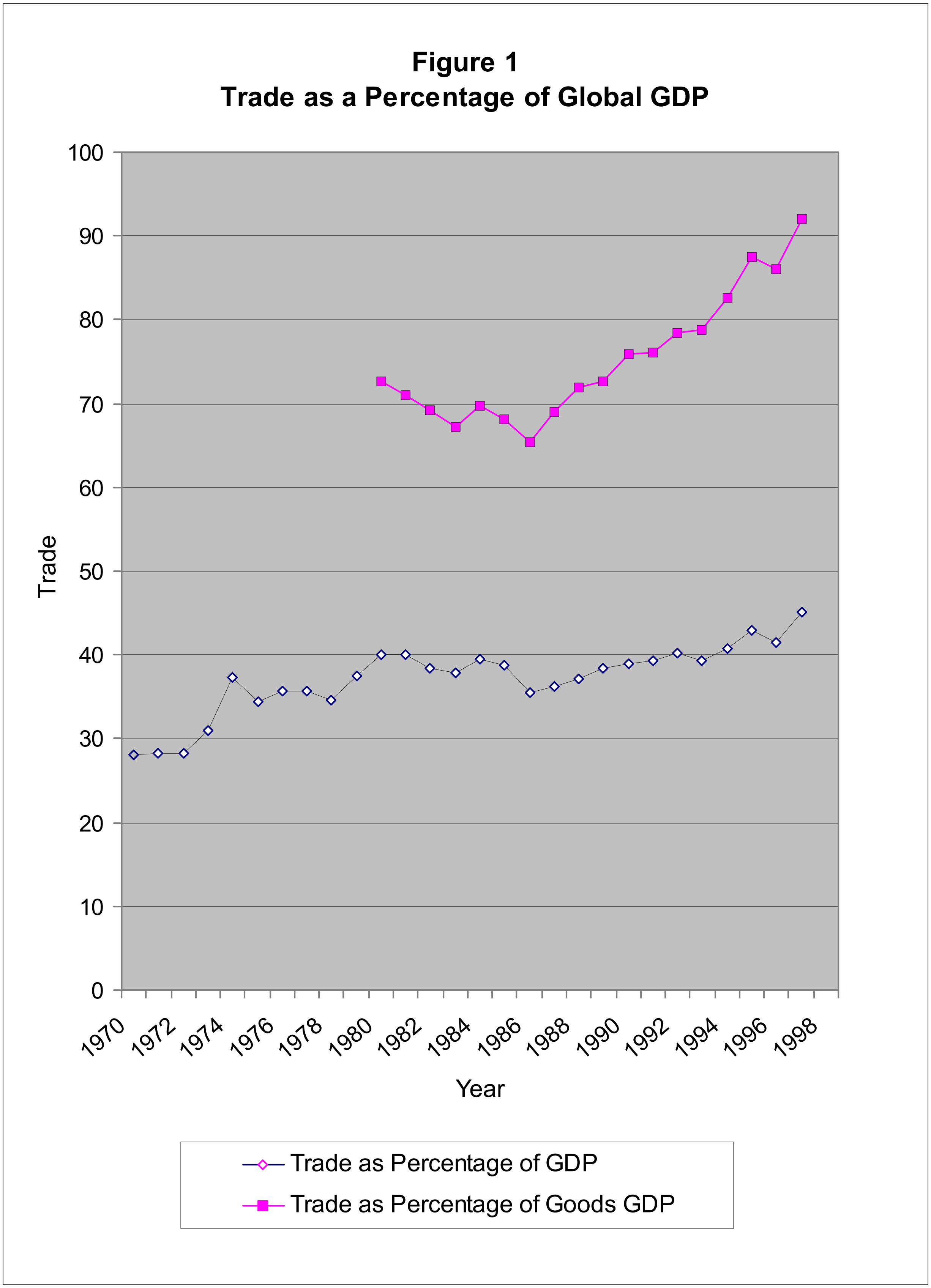
Table 1

Trends in Global Trade and Investment
Relative to Global Output

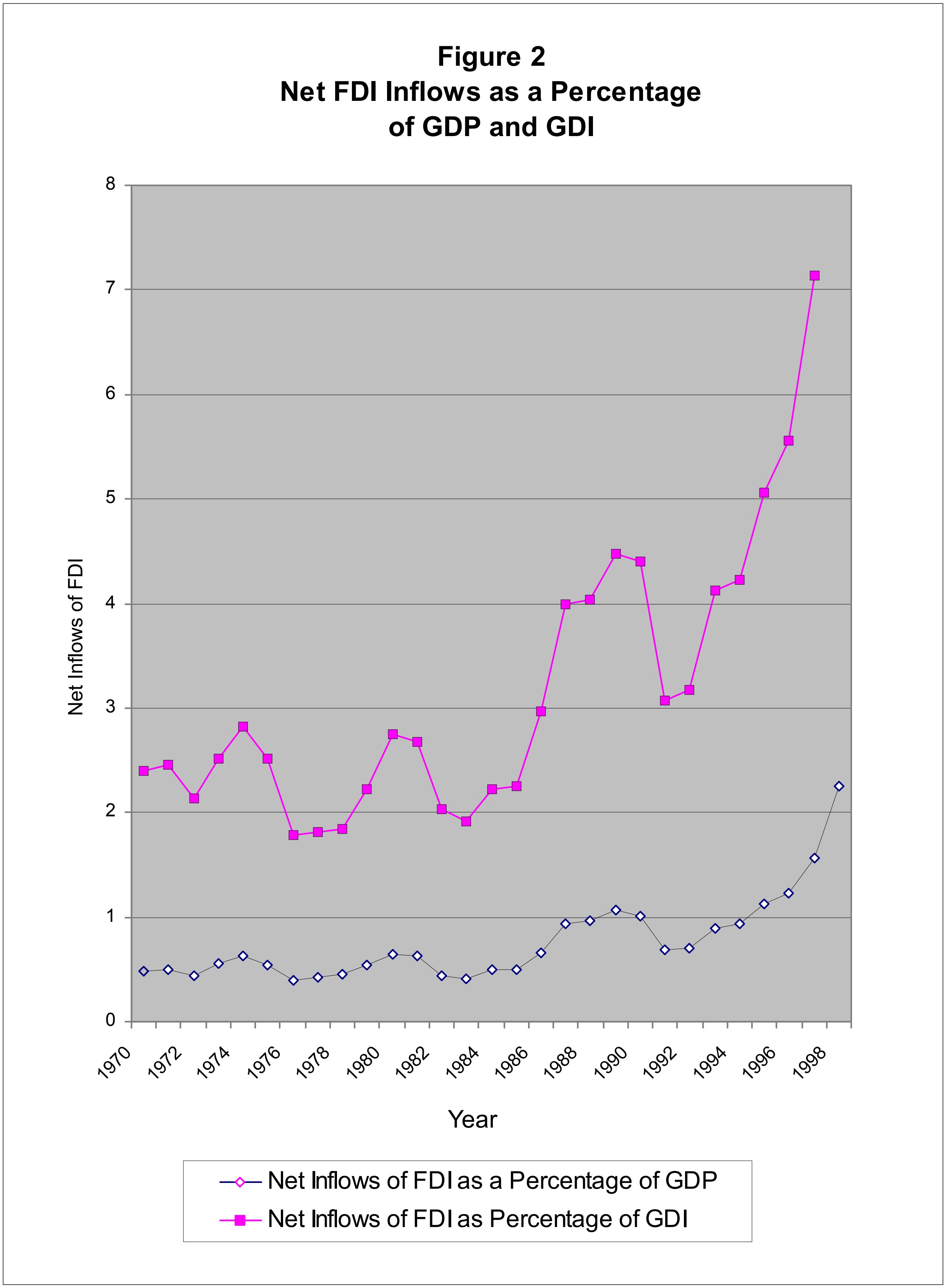
Year	Trade as Percentage of GDP	Trade as Percentage of Goods GDP	Net Inflows of FDI as a Percentage of GDP	Net Inflows of FDI as Percentage of GDI
1970	28.05	..	0.48	2.40
1971	28.18	..	0.50	2.46
1972	28.28	..	0.44	2.13
1973	30.97	..	0.55	2.51
1974	37.26	..	0.63	2.82
1975	34.45	..	0.54	2.51
1976	35.62	..	0.40	1.78
1977	35.63	..	0.43	1.81
1978	34.67	..	0.45	1.85
1979	37.44	..	0.54	2.22
1980	39.96	72.67	0.65	2.75
1981	40.11	71.08	0.63	2.68
1982	38.44	69.24	0.44	2.03
1983	37.82	67.21	0.41	1.91
1984	39.58	69.69	0.49	2.22
1985	38.81	68.11	0.50	2.25
1986	35.56	65.35	0.66	2.97
1987	36.16	69.10	0.93	4.00
1988	37.22	71.93	0.97	4.03
1989	38.42	72.60	1.07	4.47
1990	38.88	75.99	1.01	4.40
1991	39.34	76.01	0.69	3.07
1992	40.21	78.50	0.70	3.18
1993	39.33	78.73	0.89	4.12
1994	40.79	82.53	0.93	4.22
1995	42.90	87.55	1.13	5.06
1996	43.23	86.14	1.23	5.56
1997	45.18	92.11	1.57	7.13
1998	..	..	2.25	..

Note: FDI stands for foreign direct investment,
GDP for gross domestic product, and
GDI for gross domestic investment

Source: World Bank, *World Development Indicators 2000,* CD Rom.



Source: World Bank, *World Development Indicators 2000,* CD Rom.



Source: World Bank, *World Development Indicators 2000,* CD Rom.

Table 2

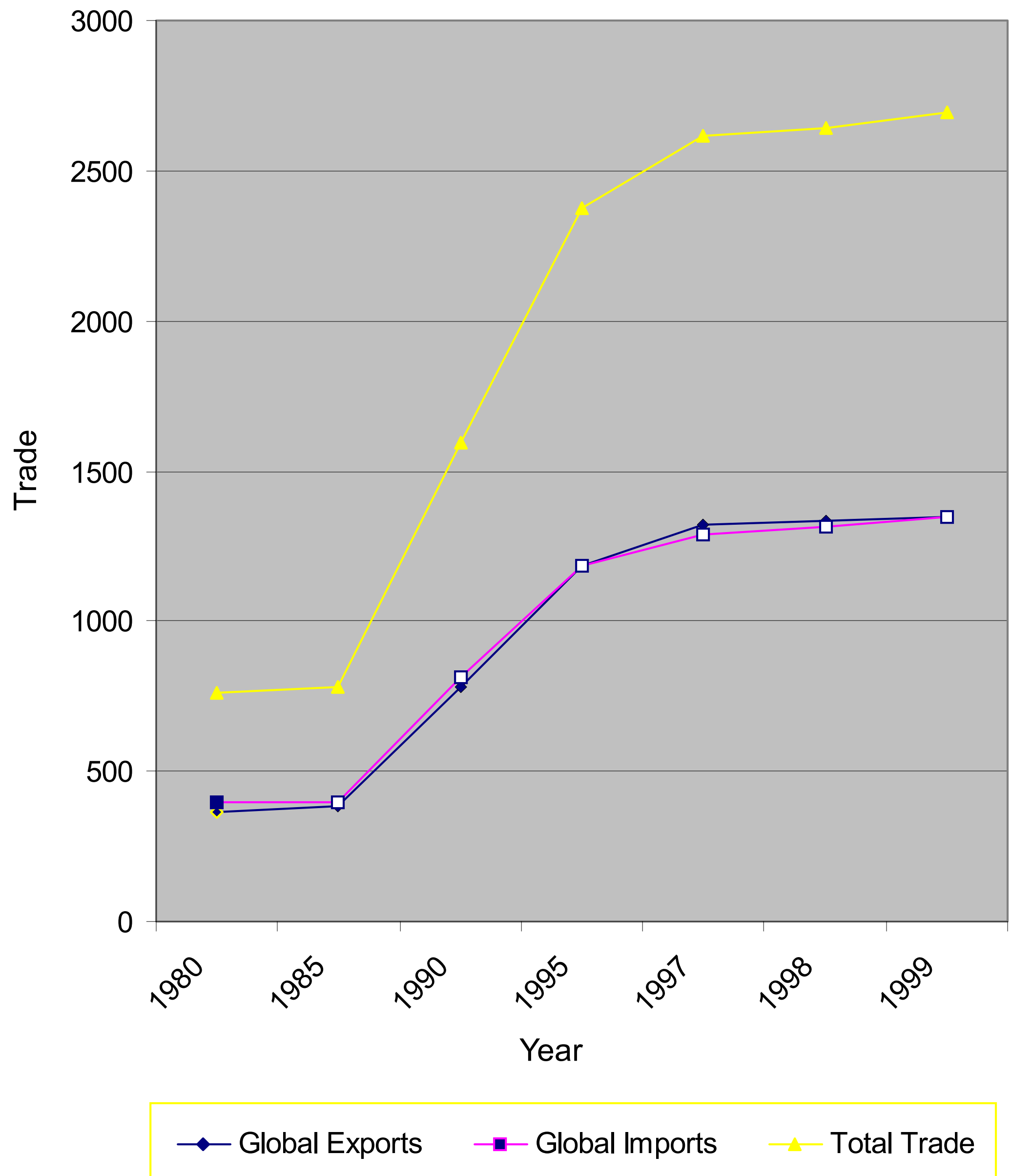
Global Exports and Imports of Commercial Services

(in Billions of US$)

Year	Global Exports	Global Imports	Total Trade
1980	364	397	761
1985	382	396	778
1990	783	812	1595
1995	1188	1188	2375
1997	1322	1291	2613
1998	1332	1314	2645
1999	1350	1345	2695

Source: World Trade Organization, 2001. *Trade Statistics: Historical Series.* Geneva.

Figure 3
Global Trade in Commercial Services



Source: World Trade Organization, 2001. *Trade Statistics: Historical Series.* Geneva.