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Abstract

This paper discusses options to manage spillovers of unilateral trade policies motivated by national security and other non-economic objectives on global trade and investment. Within the WTO framework, we argue a ‘specific trade concern’ mechanism is likely to be more effective than dispute settlement to address national security-motivated trade intervention. More broadly, we propose creation of a platform for governments, supported by relevant international organisations, to enhance transparency and assess the effectiveness and magnitude of the spillover effects of trade-related policies of systemic import. This would serve to help identify efficient instruments to achieve economic and non-economic goals and inform WTO reform discussions on subsidies and discriminatory trade policies. Plurilateral cooperation among like-minded nations offers a pragmatic pathway to address spillover effects of policies to achieve security and other non-economic objectives but requires a stronger governance framework to ensure consistency with an open multilateral trading system.

KEYWORDS

geopolitics, globalisation, national security, non-economic objectives, values, WTO

1 | INTRODUCTION

The four horsemen of the apocalypse seem to have galloped out of the pages of the Book of Revelation: war, in the form of Russia's invasion of Ukraine; pestilence, in the form of a global pandemic; famine (and more), in the form of man-made environmental catastrophe; all associated with the rider on the

pale horse, death. Increasing use of unilateral measures by the large trade powers to support domestic economic activity and defend national autonomy reflects a mix of geopolitical rivalry, national security concerns and a desire to condition trade and investment on labour rights and environmental standards. Many of these measures are related to what we will call ‘non-economic objectives’ (NEOs) (Bhagwati, 1967; Johnson, 1960) encompassing national security and societal values such as environmental sustainability and protection of workers and human rights.¹ Because of the complexity of reducing the trade and transaction costs created by differences in national regulatory regimes, the way they interact with each other and the spillovers they create across countries, cooperation on trade no longer works as well as it used to when the agenda mostly centred on border barriers. Instead, strategic autonomy, national security and other NEOs are motivating calls for collaboration among countries with similar values and political-economic systems (‘friend-shoring’).

In this paper, we consider the implications of these developments for the global trade regime. Our premise is that systemic rivalry need not preclude multilateral cooperation to manage policy spillovers, but that for the WTO to remain relevant, the membership must recognise the way that international trade is increasingly linked to system competition and contestation over issues for which trade is seen as instrumental to policy success. An implication is a need to prioritise cooperation to attenuate cross-border spillovers created by national economic policies such as subsidies, and to re-visit extant approaches towards managing spillovers from the use of trade policy for national security and pursuit of NEOs reflected in GATT Article XXI (Security Exceptions) and Article XX (General Exceptions). The underlying challenge is to balance the ability (need) for countries to protect themselves from policy spillovers while safeguarding the right of policy-active countries to adopt policies that produce spillovers, possibly significant ones.

Security considerations had already become more prominent in trade relations before Russia's launch of war against Ukraine in February 2022. The widespread perception of a reversal of market-oriented reforms in China – the world's largest exporter – its positioning vis-à-vis Taiwan, repeated recourse to economic coercion as an instrument of foreign policy (including both formal and informal sanctions on trading partners)² and the 2022 ‘no limits’ partnership with Russia led many to reassess views of China as a proponent of peaceful international relations and its continued willingness to participate in good faith as a member of the liberal trading system (Lardy, 2019; Mavroidis & Sapir, 2021). US measures to control exports of advanced technologies (e.g. semiconductor equipment) and to (re-)build domestic production in critical sectors (e.g. batteries) are aimed at China. Unilateral trade measures taken by the EU do not single out China as such but aim to protect the EU's autonomy and security by enhancing its ability to respond to attempts at coercion by foreign countries,³ bolster screening of foreign investment⁴ and act against foreign policies that distort competition or are inconsistent with EU values.⁵

¹Francois et al. (2022) discuss the economics literature on NEOs, which goes back to Pigou (1920) and Samuelson (1947). In this paper we regard national security as one type of NEO. Baldwin (1997) defines national security in an objective sense as comprising a policy environment that entails a low probability of damage to acquired values; in a subjective sense, the absence of fear that such values will be attacked. This definition captures both threats to national sovereignty and societal values.

²For example, against Korea (Lim & Ferguson, 2022); Australia (Ferguson et al., 2022) and Lithuania (Blockmans, 2021).

³https://ec.europa.eu/commission/presscorner/detail/en/ip_21_6642.

⁴<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02019R0452-20200919&from=EN>.

⁵Examples include measures to ban imports of goods produced with forced labour and new anti-subsidy regulation. See, for example, <https://www.euractiv.com/section/economy-jobs/news/meps-experts-ask-to-shift-burden-of-proof-in-forced-labour-products-ban/>; https://competition-policy.ec.europa.eu/foreign-subsidies-regulation_en.



WTO members are permitted to take unilateral actions if these apply equally to all products, national and foreign, and may invoke general exceptions provisions (such as Article XX) to justify that discrimination is necessary to achieve a NEO. Countries that decide trade restrictions are required for national security can invoke Article XXI. Adversely affected states can respond by invoking dispute settlement procedures if they believe that the adopted policy measures violate WTO rules. We argue in this paper that the ‘specific trade concern’ process developed by WTO members for other policy areas offers a better path for addressing concerns raised by national security-motivated measures through peer-to-peer engagement as opposed to delegation to adjudicators in a dispute settlement panel. More broadly, we suggest efforts to bolster the ‘guardrails’ safeguarding the rules-based trade order and globalisation should centre on frameworks to guide initiatives by governments to attain goals such as making supply chains more resilient, avoiding excessive dependence on one or a small number of suppliers of critical products and more broadly safeguarding policy autonomy. A central feature of such frameworks should be to provide platforms and processes for states to engage in deliberation and dialogue with a view to reducing negative spillovers of trade-related measures. Often measures motivated by national security and other non-economic goals (e.g. combatting climate change) will involve subsidies and give rise to competitiveness spillovers. A platform offering governments support to consider the aims and spillover effects of policies motivated by NEOs could help generate information on the goal of intervention, its effectiveness as well as the spillover effects and facilitate the quest for alternative, more efficient instruments. Such a mechanism would support domestic debate and accountability in states using measures and help WTO members determine whether new rules would be Pareto improving.

The effectiveness of unilateral action to attain NEOs generally will be enhanced if measures are also adopted by other nations that share similar goals. Insofar as multilateral agreement to update and clarify WTO provisions relating to security, subsidies and general exceptions is not feasible, there may be scope for cooperation on a plurilateral basis. This may encompass national security as well as other NEOs. We argue that WTO reform discussions should include a focus on developing a governance framework to guide the concerted use of trade policy motivated by NEOs by groups of like-minded economies. This would benefit members of potential clubs to design and implement efficient policies, and non-members by reducing potential negative spillovers and adverse effects on the trading system.

The paper proceeds as follows. Section 2 presents a simple framework for thinking about national security and trade. Section 3 discusses key elements of any effort to manage policy spillovers. Section 4 turns to specific suggestions for managing the trade–NEO interface, both national security and trade policies targeting other objectives, given that the latter are likely to become more common. Section 5 proposes the establishment of a platform for governments, supported by relevant international organisations, to discuss the objectives of policy interventions motivated by NEOs, their effects and potential alternatives that give rise to fewer negative spillovers. Section 6 discusses club-based approaches to cooperating on policies aimed at achieving NEOs. Section 7 concludes.

2 | NON-ECONOMIC OBJECTIVES AND TRADE

The theory of economic policy developed by trade economists as an extension of basic Pigouvian welfare economics provides a convenient framework for characterising and evaluating trade policy (Francois et al., 2022). Although this literature is developed at the level of technical sophistication associated with mainstream welfare and trade theory, the core intuition can be represented as a sequence of three questions (Hoekman & Nelson, 2020):

- What is the problem?
- What instruments are available to deal with the problem?
- Of those instruments, which politically feasible one(s) achieves the goal at lowest cost?

The policy choice/evaluation problem is inherently an optimisation problem – that is, what is the best policy from the perspective of a given policymaker? Answering this question requires knowledge of the relevant parts of the national political economy that constitute the constraints of the problem and of the decision-maker's objective function. The objectives of governments with respect to trade policy are many and complex. Considering just the history of US trade policy as an example, in addition to being the main source of revenue (and thus being tied to the military and development goals of the early Republic), trade policy was directly used as an instrument of foreign policy (e.g. Jefferson's embargo), an instrument of nation building (Clay's American system), an instrument of industrial policy and an attempt to build closer international political relations (the early attempts at trade reciprocity) (Irwin, 2017). The key to trade liberalisation during the GATT era was the attachment of trade policy to national security policy as a tool of reconstruction, alliance building and containment (Nelson, 1989).⁶ In both the Trump and Biden administrations, trade policy was seen as a tool of foreign policy with respect to China.

The theory of economic policy makes a useful first distinction between economic objectives (EOs) and non-economic objectives (NEOs). EOs refer to goals related to increasing the efficiency of the economy by 'fixing' a 'distortion'.⁷ These goals are relatively easy to understand, relatively uncontroversial and have clear policy responses (Hoekman & Nelson, 2020).⁸ The difficulties will usually relate to spillovers across objectives. Particularly problematic will be spillovers to income distribution goals.⁹ The attempt to treat all spillovers as externalities in the EO sense is convenient for economic analysis, but the drivers for most policies are NEOs. The label 'non-economic' in NEO often leads to some confusion. EOs relate only to distortions, responding to NEOs often involves the *creation* of distortions. Part of the confusion stems from the fact that many NEOs are directly about economic magnitudes. Consider income distribution. Most governments have income distribution objectives (reflected in, among other things, tax structures and subsidies for education, health care, etc.). These goals have nothing to do with distortions. Of course, there are also NEOs that are not, proximately, about economic magnitudes. National security, public health and environmental goals are all first, and foremost, about social goals, but policies adopted to pursue such objectives will generally have economic effects and economic policies will affect the pursuit of those objectives.

⁶The same is true of European integration. The primary objective was political, again in the context of the Cold War but with the added concern of avoiding future wars between Germany and France. The transnational structure of the European Coal and Steel Community and the European Atomic Energy Community reveals this goal clearly in the specific context of "economic" policy. See, for example, Haas (1958) and Milward (2000).

⁷A 'distortion' in this context has a specific meaning. A perfectly competitive economy is characterised by the first-order conditions associated with a maximum policy choice problem. These are usually referred to as marginal conditions, and a 'distortion' refers to the failure of one or more of those marginal conditions.

⁸The ease with which they are represented in economic theory is the major reason policy research by economists tends to evaluate policies as EOs. Often this involves representing some objective in terms of externalities, as these are straightforward distortions. An example in trade research is to consider the WTO as an instrument to deal with a terms-of-trade externality (Bagwell & Staiger, 2002), the distortion underlying optimal tariff theory.

⁹Going back at least as far back as Robbins (1938), it has been understood that significant policies generally have distributional spillover effects that undermine application of the Pareto rule. Insofar as policymakers have distributional goals (a NEO), these spillovers will matter to the evaluation of the given policy.



Another important aspect of the ‘what is the problem’ question has to do with spillovers across issues. These are often ignored in analyses because, in stable policy environments, to a first order of approximation, different policy domains are independent of one another. As the world is complex, policy analysts would drown in the essentially infinite details of spillovers across policy domains. Furthermore, major policy domains tend to be institutionally organised independently of one another (distinct committees in the legislature, executive bureaus and even bodies of law). In an unstable environment such approximations become very poor. A good example is national security. Wolfers (1951) distinguishes between situations at ‘the pole of power’, when the sole concern of the state is self-preservation, and ‘the pole of indifference’, where the state has essentially no national security concern.¹⁰ At most points in time, and for most issues, states find themselves between these poles, with security traded off against other goals that claim resources from the state and private uses. Close to the pole of power, national survival concerns subordinate all other goals, including trade goals. As long as the geostrategic environment is relatively stable, and the overall environment is not too close to the pole of power, other issues, like trade, can be treated as relatively independent from national security.¹¹ However, given the centrality of sovereignty/national security to all calculations in international relations, a change in the geostrategic environment will make spillovers a central concern of policy and produce changes in equilibrium policies across many policy domains.

2.1 | Trade policy and national security

In the early GATT years, in the immediate aftermath of a world war and early years of the Cold War, national security was the objective of the US government to which trade policy was attached (Irwin et al., 2008; Pinchis-Paulsen, 2020). Economic interdependence was not pursued primarily for its generalised economic benefits, but as part of the Cold War strategies of alliance building and containment – which also included active promotion of European economic integration, the Marshall Plan and the creation of regional security organisations such as the North Atlantic Treaty Organisation. One benefit of the extended period of political protection accorded to trade policy was that the associated elites came to accept a common understanding of the issues involved and the modalities for dealing with them. That is, what Haas (1992) calls an ‘epistemic community’ developed around tariff policy and, because trade was seen in this political context as a technocratic issue, that epistemic community was dominated by specialists in trade, not national security specialists.¹² This community came to share a view of trade policy as a response to economic objectives and to view international

¹⁰The geostrategic environment is not the only source of potential existential threat confronting governments. Threats to the natural environment and to public health also fall in this category. For consistency with conventional usage, we refer to issues around the pole of power as ‘national security issues’. There will be equivalent ‘poles’ and associated continua of similar structures, for other issues.

¹¹Links between issues help explain both how equilibrium policy can change even when the domain-specific environment of a policy does not change, and how domain-specific variables will still be statistically significant even if they do not determine the state of policy in that domain in a first-order way. Trade policy is a good example. The general liberalising trend is hard to explain without reference to state of policy outside the politics and institutions around trade, while the political economy of trade literature has demonstrated that standard economic variables predict well the dispersion of tariff rates, if not the average level.

¹²Haas (1992, pg. 3) describes an epistemic community as ‘a network of professionals with recognised expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge within that domain or issue-area. ... they have (1) a shared set of normative and principled beliefs ...; (2) shared causal beliefs ...; (3) shared notions of validity ...; and (4) a common policy enterprise’.

law as a framework for pursuing that policy.¹³ With the passing of the Cold War and the slow and uneven movement away from the pole of power, the broader political community in most national capitols came to view trade policy in terms of economic objectives. Even though trade policy lost its association with national security, technocratic management of the trading system continued to be possible as long as trade did not become a major issue of domestic politics.

The re-emergence of trade as a national security issue reopens the place of trade and trade policy in the political calculus of state decision-makers. In the current domestic and international political context, this place is fundamentally different from the early years of the Cold War. A major consequence of China's growth to become a major economic and nascent geopolitical power and Russia's war against Ukraine has been a reassessment of maintaining liberal trade and investment relations with potential adversaries and measures to safeguard national sovereignty.¹⁴ While these geostrategic events produce a lurch towards the pole of power, it does not take us into the range of the early Cold War, let alone that of the Second World War. States have increased their concern about national security, but there has not been an increased assertion of policy control by national security (i.e. military and intelligence) elites over cross-issue spillovers of anything like the magnitude of public political discourse around national security. Nonetheless, because national security functions like a trump card in potentially allowing whoever can successfully establish a definition of an issue in terms of national security to dominate that issue, there has been an increase in attempts to link trade policy, in general, sector-specific measures (telecommunications equipment, semiconductors, steel and aluminium), global value chain-related policies ('friend shoring' and 'reshoring') and support for trade-related international organisations to national security. These attempts often involve (proposals for) measures that increase trade barriers or change incentives to influence the location of production and sourcing of associated goods and services through subsidies of one kind or another. This sort of public posturing, and the policies that signal attachment to national security, spill over directly into WTO politics.

3 | NATIONAL SECURITY AND OTHER NEOS IN THE WTO

Given the geopolitical situation of the time, it is not surprising that national security concerns were explicitly incorporated into the GATT. Close to the pole of power, national security considerations dominate and trade policy becomes an instrument to safeguard state sovereignty. While the GATT includes many protections of sovereignty, it explicitly incorporated national security protection and GATT94 continued this protection. Article XXI reads as follows:

Nothing in this Agreement shall be construed

- a) to require any contracting party to furnish any information the disclosure of which it considers contrary to its essential security interests; or
- b) to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests

¹³The degree of 'community' between lawyers and economists in the trade domain is not nearly as strong as in, for example, the area of antitrust. Strengthening this aspect of the epistemic community around trade is one goal of the proposals in this paper.

¹⁴This predates Russia's war against Ukraine, as reflected in certain types of international relations scholars and domestic politicians to worry about 'Thucydides trap' (Allison, 2017) and 'power transition' (Mearsheimer, 2021).



- i. relating to fissionable materials or the materials from which they are derived;
 - ii. relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment;
 - iii. taken in time of war or other emergency in international relations; or
- c) to prevent any contracting party from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.

Under the WTO, the recognition of the implications of sovereign concerns for national security for trade and trade policy is not an unconstrained right of protection. Fundamental questions confronting WTO members concern the circumstances under which a state is free to assert its right to national self-preservation over its commitments to liberal trade and the rights of the other members faced with such claims. Institutionally, these questions manifest in terms of the role of the WTO's dispute settlement mechanism in evaluating applications of Article XXI. How this balancing act is supposed to work has played out in the WTO dispute settlement process as a contest between panels and leading WTO members, especially the United States.

There is a fundamental problem with Article XXI insofar as the only way to open a dialogue about national security actions by a member of the WTO is to file a dispute, as it is unlikely that the outcome will be implemented in situations near the pole of power. The use of a quasi-judicial procedure for dealing with national security is an even bigger problem as we move away from the pole of power into the range between the pole of power and the pole of indifference. Article XXI:b(iii) specifies that proximity to the pole of power as a condition for general application of trade to national security concerns, but states will have legitimate interests in trade in goods other than 'fissionable materials' and 'arms, ammunition and implements of war'. It is possible that the clause 'for the purpose of supplying a military establishment' can be interpreted sufficiently broadly to cover these general applications (e.g. restrictions on trade in advanced semiconductor technology), but that would seem to open the door to disputes that are not self-judging. In war, or a situation of heightened security concern (like the high Cold War), allies are likely to have very common interests, and trade with actual enemies will fall easily into the self-judging category. Thus, spillovers across allied countries are unlikely to be a problem. Further away from the pole of power that degree of unanimity on trade policy is unlikely to exist.¹⁵ As national security and cognate concerns about the environment remain major issues of public concern, it will be difficult for governments to avoid adopting policies that affect trade under the umbrella of national security. Article XXI does not provide a useful framework for dealing with these issues. In this context, spillovers across partners, as well as across issues, are likely to be a particularly difficult problem.

There have not been many disputes under Article XXI.¹⁶ They include some obviously awkward cases, like the Swedish shoes dispute in 1975, and more clear-cut instances such as import restrictions in Argentina associated with the Falklands war and US embargos on Nicaragua and Cuba.¹⁷ Only one

¹⁵An interesting earlier case is Congress' passage of the Helms–Burton act, which incorporated secondary boycotts as part of its implementation (Lowenfeld, 1996).

¹⁶Early in the GATT, the inclusion of Czechoslovakia by the United States in a list of countries subject to onerous conditions regarding the exportation of sensitive material led Czechoslovakia to accuse the United States of violating MFN. An overwhelming majority of GATT contracting parties supported the US national security defence. See GATT Press Release no 42, June 8, 1949. This dispute was discussed by the CONTRACTING PARTIES, the highest GATT organ, and consequently is part of the GATT acquis, as per GATT 1994 Article 1(b)(iv). It therefore binds the WTO membership.

¹⁷For details, see Pinchis-Paulsen (2020) and Mavroidis (2016, pp. 481–487).

of these, the US embargo on Nicaragua was (ineffectively) challenged before a GATT panel.¹⁸ Things changed in recent years, with submission of several disputes before panels. Most salient is the 2019 dispute brought by Ukraine against Russia concerning barriers to transit of goods, which occurred following the illegal annexation of Crimea by Russia and the launch of armed conflict between Russia-supported separatists and Ukraine in the Donbass region and took place in the shadow of the US Section 232 cases on steel and aluminium.¹⁹ After determining that it had legal jurisdiction to evaluate Article XXI claims and was tasked with determining the meaning of a WTO member's essential security interests and the necessity of measures taken to ensure these interests, the *Russia-Traffic in Transit* panel argued that 'essential security interests' and 'time of war or other emergency in international relations' should be objective states of the world and thus be subject to review. It held that essential security interests refer to 'the quintessential functions of the state, namely, the protection of its territory and its population from external threats, and the maintenance of law and public order domestically' (quoted in Crivelli & Pinchis-Paulsen, 2021, pp. 9–10). The panel also argued that Article XXI:b(iii) needed to be applied in good faith. In its report on *Russia-Traffic in Transit*, the panel ultimately concluded that Russia met these burdens.²⁰

Unlike Article XX GATT, Article XXI does not include introductory text requiring members to be even-handed. It also leaves open what constitutes 'essential security interests'. Although the panel in *Russia – Traffic in Transit* made clear its view that states invoking Article XXI do not have the sole authority to interpret the security exception, that is, that it is not self-judging,²¹ the presumption is that states are (must be) permitted to use trade policy for national security purposes and that the latter is determined by the state that acts. The panel adopted a two-tier standard of review: first scrutinising whether an emergency existed (by looking, for example, into discussions before the United Nations) and second limiting itself to a very deferential standard if an emergency was deemed to exist. Three subsequent WTO panels adopted this standard of review.²²

3.1 | Spillovers from invocation of general exceptions and subsidies

While national security issues have become more prominent, so have climate change and pandemics, and using trade to achieve sustainable development. These are also existential threats. As the Copenhagen school of peace research (Buzan et al., 1998) suggests, there is no particular difference between these and geopolitical conflict as threats. As with power, there will be a pole of existential dread in each of the other cases, increased proximity to which will increase the salience of the issue. Given the current instability caused by changes in salience in all these domains, it is essential

¹⁸The challenge was to no effect because its terms of reference precluded the panel from examining the consistency of its practices with Article XXI. See GATT Doc. L/6053, of October 13, 1986, at §§5.1 et seq.

¹⁹The United States participated in the Russia–Ukraine dispute as a third party, arguing that Article XXI was non-justiciable. The EU, China, Brazil, Australia, Japan and other third parties disagreed with Russia and the United States on the justiciability of national security disputes.

²⁰While this panel could be argued to have confounded "war or other emergency" (since it requested a single evidentiary requirement for either), it was interpreting XXI(b) and not XXI(a), which does not link discretion to relinquish information to a particular situation.

²¹As noted previously, this view is shared by China, the EU and many other WTO members. Pinchis-Paulsen (2020) documents that during the Havana Charter negotiations, the United States was the main demandeur for a security exception and did not envisage it as self-judging.

²²DS550: United States – Certain Measures on Steel and Aluminum Products; DS567: Saudi Arabia – Measures concerning the Protection of Intellectual Property Rights; and DS597: United States – Origin Marking Requirement.



to think about spillovers across domains and how the WTO handles these other non-geostrategic, but still deeply threatening, issues. The key legal structure here is Article XX (General Exceptions) (Mavroidis, 2016, Ch. 9).

Article XX contains chapeau language stating that application of trade policy tools under the listed exceptions should be '[s]ubject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade'. Thus, Article XX imposes more constraints on WTO members, notably that measures be the least trade restrictive means necessary to achieve the domestic goal and that they apply on a non-discriminatory basis (i.e. apply equally to all foreign and domestic suppliers of the products concerned).²³ On the other hand, Article XX mentions only a limited list of NEOs that reflects concerns prevailing in the 1940s.²⁴ Pressures to use trade policy instruments to attain a broader range of NEOs in the intervening years – for example, combat climate change, protect the environment and human rights – suggest WTO reform deliberations should consider Article XX, especially if agreement cannot be obtained to facilitate issue-specific cooperation that establishes criteria for the use of trade policy to pursue NEOs. As is, Article XX is unlikely to provide a general framework for managing spillovers associated with broadly legitimate interests of states in national security and related NEOs.

The same is true for WTO provisions dealing with subsidies, an instrument that often will be used to pursue national security and other NEOs in addition to (or instead of) trade barriers. From the very beginning of the trade regime, negotiators of the International Trade Organisation foresaw states playing an active role in economies. This is precisely the logic underlying Ruggie's (Ruggie, 1982) well-known analysis of embedded liberalism. A standard result of the theory of economic policy is that there is a strong presumption in favour of subsidies for the pursuit of many EOs and NEOs (Hoekman & Nelson, 2020). The difficulty, especially for NEOs, is that the way subsidies emerge from domestic politics and thus the justifications for and modalities of subsidisation will differ in fundamental ways between countries. Since these policies are often central to the domestic policy goals of the state, those differences must be recognised in any stable international system of rules about subsidies. This makes reform of WTO subsidy disciplines an important part of any effort to manage policy spillovers associated with the national pursuit of EOs and NEOs.

The WTO Agreement on Subsidies and Countervailing Measures (ASCM) does not recognise that in many situations subsidies may be a first best policy. Under the ASCM, all subsidies are in principle either prohibited or actionable – it does not consider what the theory of economic policy suggests should be the focus of disciplines: the extent of spillovers created by subsidy measures. The agreement is also based on the erroneous assumption that national and corporate frontiers coincide and that subsidies are allocated by governments. Several Appellate Body decisions regarding these features of the agreement, of doubtful consistency with the letter of WTO law, exacerbated perceptions in some quarters that the extant rules were not fit for purpose.²⁵ The ASCM is not constructed to

²³While the latter cannot apply in Article XXI situations, least trade restrictiveness is, at least in principle, a means to both reduce adverse spillover effects and potential efficiency costs of using trade policy. In a 2020 dispute, US – Tariff Measures (DS543), the US invoked the public morals exceptions to defend duties imposed on China further to a Section 301 investigation.

²⁴Case law has expanded the scope of Article XX. In EC-Seal Products, the Appellate Body interpreted the term "public morals" to cover standards of right and wrong. While Appellate Body rulings do not constitute precedent, this appears to be all encompassing.

²⁵Ahn (2021) and Mavroidis and Sapir (2021) discuss the reports regarding the understanding of 'public body', incoherence across Appellate Body reports and how the jurisprudence alienated the United States.

address cross-national subsidies, for example, a subsidised parent company – private or state-owned – in country A supporting a subsidiary in B to export finished goods in C. This has motivated recourse to unilateral measures. An example is an EU action to countervail subsidies granted by China to a firm that established production facilities in Egypt.²⁶ Because of the territorial scope of Article 1 ASCM, only subsidies granted by a host country to an investor can be countervailed. The EU has unilaterally bridged this gap to address distorting subsidies paid by foreign countries to economic agents in its market.²⁷

Much of the recent public discussion of subsidies has emphasised the role of state-owned enterprises in China. It is, however, important to recall that two of the longest-running subsidy disputes in the WTO relate to support for Boeing and Airbus, that is, between the transatlantic partners, and not between China and anyone else.²⁸ More recently, the EU has expressed serious concerns regarding US consumer subsidies for purchases of electric vehicles in the US Inflation Reduction Act of 2022, which are limited to vehicles assembled in North America and include sourcing requirements for batteries intended to reduce reliance on China and other ‘foreign entities of concern’.²⁹ The complex mix of industrial policy, national security and public good motivations (greening the economy) embodied in this law illustrates the need for new disciplines on subsidies that recognises they may be used for multiple purposes and that differences of modalities in and justifications for subsidies vary across members. The key will be managing international spillovers from such policies, some (many?) of which will be carried by trade without the implication that the trade effects are a hidden object of the policy.

4 | MANAGING POLICY SPILLOVERS

Providing a forum to resolve trade conflicts related to the pursuit of both EOs and NEOs would seem to be a fundamental task for the WTO. However, as argued in the previous section, the law of the WTO seems unfit to deal with that environment. The challenge posed for trade cooperation – and thus WTO reform – is twofold.³⁰ First, to determine which types of policy spillovers can be addressed through negotiation of new rules of the game by the major trade powers. Second, what to do when no agreement can be obtained, and states are left with the choice of taking unilateral action – under cover of Articles XX or XXI, as appropriate, if necessary – and cooperating with like-minded countries through preferential trade agreements (PTAs) or clubs that coordinate national action pursuant to shared NEOs.

There is no *prima facie* reason that large economies cannot agree on disciplines on policies in a range of areas that give rise to large spillovers. The scope for such cooperation, even among states with very different governance and economic systems, is substantial. China's acceptance of many conditions and requirements associated with WTO membership including dispute settlement rulings illustrates the point. The fact that China has applied to accede to the CPTPP (Comprehensive and

²⁶Jushi China, a SOE, provided Jushi Egypt, a subsidiary headquartered in the Suez Special Economic Zone, with funds at preferential rates. Jushi Egypt exported glass fibre products that had benefitted from Chinese subsidies to the EU and were subjected to countervailing duties under the new Commission regulation 2020/870.

²⁷https://ec.europa.eu/competition-policy/international/foreign-subsidies_en.

²⁸The 17-year old disputes were finally resolved by the Biden Administration (Wittig, 2021).

²⁹<https://www.congress.gov/117/plaws/publ169/PLAW-117publ169.pdf>.

³⁰There is a growing literature on desirable WTO reforms and the need for updating and expanding extant rules to make the organisation a more efficient and effective platform for cooperation. See, for example, the contributions in Global Policy (2021) and the references cited there.



Progressive Agreement for Trans-Pacific Partnership) and concluded the CAI (Comprehensive Agreement on Investment) talks with the EU, which included disciplines on state-owned enterprises (SOEs), suggests that negotiations on new disciplines are feasible.³¹ At the same time, the fact that such engagement has occurred in small group settings and not the WTO illustrates that cooperation to address spillovers may be facilitated if it is plurilateral in nature.

4.1 | National security: A specific trade concerns approach

The language of Article XXI reflects the period it was negotiated. Since then, changes have occurred in what is understood by national security and the type and potential sources of threats to such security. It is evident that states today (and the public) understand ‘national security’ to include issues like cybersecurity to protect critical infrastructure such as telecom networks, pipelines or data networks (Shaffer, 2021). As the term ‘essential interests’ is broad, an amendment to Article XXI is not needed to clarify that such concerns can fall under Article XXI. An interpretation of the term (Article IX.2 of the Agreement Establishing the WTO) may suffice. One could imagine, for example, the addition of an indicative list (including cybersecurity, environmental security, etc.), helping those tasked with interpreting this provision when confronted with trade measures taken to achieve cybersecurity or other goals included in the list. Unfortunately, there are two problems. First, the probability of getting consensus on such a list is low. Second, as the theory of economic policy suggests, a list approach is insufficiently sensitive to the emergence of new issues or cross-issue spillovers.³²

The justiciability (self-judging nature) of Article XXI is a matter of fundamental disagreement among the major powers in the WTO. As argued above, in situations close to the pole of power, the conclusions of a panel are not likely to be accepted by (all) protagonists, while in situations far from the pole of power, invoking dispute settlement is also fraught. Instead of using dispute settlement to determine whether invocation of Article XXI is justified, or seeking to revise Article XXI to update its coverage, which requires consensus that will undoubtedly be lacking, it may be easier to persuade the membership to build on approaches that have been used to address specific trade concerns (STCs) arising from the use of regulatory policies. Such an approach leaves it to WTO members to determine both what constitutes a matter of national security import justifying trade measures and to express concerns with the use of such measures.³³

The Technical Barriers to Trade (TBT) Committee and the Sanitary and Phytosanitary (SPS) Measures Committee regularly discuss ‘specific trade concerns’ (STCs) with proposed or already adopted product regulations.³⁴ STCs in the broad sense go well beyond SPS and TBT. Horn et al. (2013) and Karttunen (2020) have reviewed and evaluated the record of STCs. Only a very small

³¹The CAI was frozen by the European Parliament because of Chinese sanctions against several of its members and other EU persons. While moribund, the CAI illustrates the EU and China can agree on disciplines that go beyond the WTO. See Kurtz and Baihua (2021).

³²The same reasoning applies to recognising a major change in the environment relative to the 1950: today, threats to national security may originate in activities of non-state actors. As the relationship between states and such non-state actors often will be obscure, attributing behaviour of non-state actors to a state may be difficult to prove.

³³See also Lester and Manak (2020). Shaffer (2021) and Pinchis-Paulsen (2022) offer complementary arguments in favour of greater deliberation using extant WTO processes.

³⁴Discussion of trade concerns is increasing in other WTO bodies. Wolfe (2020) notes that since 1995, some 6000 questions (much like an STC) have been raised in the Committee on Agriculture (CoA) review process. Between mid-October 2014 and mid-October 2019, 1158 issues and concerns were raised in 129 formal meetings of 17 WTO committees and councils, other than SPS, TBT and CoA.

percentage of STCs become formal disputes (brought before a WTO panel), as most concerns are resolved as the result of interactions between officials with expertise on both the technical as well as legal/economic aspects of a given policy.³⁵ Practice shows that this instrument increases awareness about behind-the-border policies while reducing the overall number of disputes. The success of the STC process in defusing potential disputes in the TBT/SPS context provides the membership with experience that may support a willingness to experiment with STCs in other contexts as well. In our view, national security should top the list of candidates.³⁶

The exercise of the right to protect essential interests may have adverse consequences for third parties. It is left to the affected WTO members to raise concerns about such consequences. Article XXI does not encourage a state to consider the interests of third parties – the former has discretion to act, whereas the latter do not – unless they argue in turn that policies put in place by belligerents affect their essential interests. The only recourse a WTO member has presently to challenge trade measures justified under Art. XXI is to launch a dispute. In times of war, the standard that applies will be very deferential. In situations not involving military conflict, adjudicators may be less deferential but do not have much in the way of guidance from Art. XXI. They also may not have the expertise needed to make an informed judgement.³⁷ In practice, experience suggests panels will be deferential, even if a claim is weak, but these arguably are situations that should not be brought to dispute settlement in the first place, but rather be the subject of scrutiny and discussion, and agreed good practices as regards due process.

To move in this direction, WTO members could build on the experience with STCs associated with technical product regulations. This would comprise discussion about the underlying policy objectives motivating trade policy measures, both in times of war and other situations where essential security interests are claimed to be at stake. This is a feature of both the TBT and SPS agreements. Art. 2.2 TBT, for example, requires technical regulations not to be more trade restrictive than necessary to fulfil a legitimate objective, noting that national security is one possible objective of product regulation. This provides a rationale for posing questions regarding the objective motivating a proposed or adopted regulatory measure, and in the case of a national security-based motivation, how a regulation furthers realisation of that goal.³⁸ An important benefit of the process that has developed in the SPS and TBT Committees is to foster policy dialogue rather than a presumption that dispute settlement is the appropriate response to a trade concern. Such a presumption is particularly unconstructive in assessing national security arguments, as formal disputes are highly unlikely to induce a WTO member to change course.

³⁵Even if no formal settlement is notified, one can judge the success of STCs by comparing the content of a draft measure notified to the TBT Committee that triggers an STC, with the final measure eventually adopted.

³⁶STCs have already been used to address national security and cybersecurity concerns. Some 70 notifications on cybersecurity-related matters have been made, of which 70% in the last 2 years and 253 notifications regarding national security measures under TBT. There were 21 STCs on cybersecurity and another 42 STCs on national security issues. For an example, see WTO, G/TBT/N/EU/823, July 23, 2021.

³⁷Article 13 DSU permits panellists to resort to expert opinions, which offers a partial fix to this problem, but in our view emulating the Annex on Financial Services is a better approach. This requires that disputes on prudential measures be addressed by panellists with relevant expertise.

³⁸Various STCs have been raised to address cybersecurity-related measures. National security has been invoked to ban imports of caviar and/or lobsters. See, for example, WTO Doc. G/TBT/N/SAU/1214, of October 6, 2021, where the Kingdom of Saudi Arabia notified the WTO of its import restrictions on sturgeon caviar, invoking national security to this effect. In a similar vein, Hong Kong, China, banned imports of lobster from Australia, equally invoking national security as justification (<https://www.reuters.com/world/asia-pacific/australia-asks-why-hong-kong-considers-lobsters-national-security-risk-2021-10-22/>). Neither incident was notified as a STC.



An STC approach is less adversarial than recourse to dispute settlement panels, offers the potential to promote greater mutual understanding and will be a more legitimate process to assess whether ‘the emperor is naked’ (i.e. whether the measures relate to national security in a compelling manner) because it involves interaction between peers and not a small number of panellists who lack the legitimacy to judge on what invariably will be sensitive matters. An advantage of providing for deliberation-cum-STC-type processes in lieu of formal dispute settlement to address concerns regarding the justification of trade measures on national security grounds is that it would provide an opportunity to apply elements of the theory of economic policy. A process that centres on a WTO member clarifying to trade partners the objective function to be realised can guide a discussion on the effectiveness and (opportunity) cost of alternative instruments that may be used to realise it. In domestic policymaking settings, little attention to the consequences of policy choices on third parties may be given, potentially leading to decisions that are unnecessarily costly for countries not involved in a conflict. Domestic decision-making may also be captured by interest groups or simply not consider whether trade measures are appropriate. An STC process that involves participation of security and industry experts may have better prospects of doing so, potentially inducing adoption of less trade-restrictive measures.³⁹ The prospects for this are enhanced if the outcome of WTO deliberations feeds into the domestic policy-making process, as arguably this is a critical channel to influence policy choices, with greater prospects of being internalised than a ruling by a dispute settlement panel. As noted, the record of STCs is positive in terms of resolving potential disputes, suggesting that a forum that supports a similar process to discuss trade measures justified on national security grounds is worth considering.

Article XXI differs from other WTO provisions and agreements in that there is no institutional body that is competent to engage in informed deliberation on whether a given situation reasonably can justify the use of trade measures or to consider potential adverse impacts on third parties that could in principle be attenuated or avoided. Article XXI-related issues currently fall under the ambit of the WTO Committee on Market Access. The mandate of this committee spans market access issues not covered by any other WTO body. In addition to supervising the implementation of commitments on tariffs and non-tariff measures and application of procedures for modification or withdrawal of concessions, it provides a forum for consultation on market access-related matters.⁴⁰ Although this Committee increasingly discusses trade concerns, the focus on market access implies that member country representatives participating in meetings are often customs officials, who are unlikely to be able to engage in the type of dialogue suggested above.

National security-motivated measures are often highly technical in nature, centring on specific technologies or features of products. Deliberation and discussion of such measures require participation by those with the requisite technical expertise as well as those in government responsible for the design and implementation of security-motivated trade measures. That said, there is no constraint on the ability of WTO members to send representatives with the requisite expertise to WTO Committees if national security issues are tabled for discussion. Alternatively, consideration could be given to creating a new forum that can be mobilised to consider instances when WTO members use trade policies motivated by security – or other non-economic – objectives. We make a proposal to this effect below.

The STC process used in the SPS and TBT committees is premised on notifications by WTO members of new (or changes to) technical product requirements. Notification performance in other committees is, as Wolfe (2020) has established, generally weaker. While new notifications facilitate the process, they are not a necessary condition to raise STCs. There is no constraint on addressing

³⁹See also Lester and Manak (2020).

⁴⁰https://www.wto.org/english/tratop_e/markacc_e/markacc_e.htm.

questions to a member of a WTO committee on measures that have not been notified and/or that are already in force. More important is the recognition by WTO members that the process is useful and benefits all members, including those of which questions are asked, not just in defusing potential concerns and disputes but as a means of learning and enhancing knowledge and common understanding of regulatory goals and good practices.

The suggested STC-type approach would not preclude members from bringing disputes. In our view, this should centre on determining appropriate remedies following the imposition of trade restrictions for national security purposes (Lester & Zhu, 2018). This differs from suggestions that national security disputes should take the form of a non-violation complaint (NVC) under GATT Article XXIII:1(b), which permits members to argue a measure that does not violate the WTO nullifies or impairs a benefit (Lamp, 2019). For an NVC to succeed it is necessary that (1) an initial concession (binding policy commitment) made by a WTO member is (2) impaired by a subsequent action on national security grounds that (3) could not have been reasonably anticipated. Given that states can be expected to protect their national security at the pole of power, for an NVC to work, parties must accept that invocation of Art. XXI could not have been reasonably anticipated because that invocation is a sham – and thus the panel would have to judge this to be the case. As any such determination is very unlikely to be accepted by the WTO member taking action, the NVC route as conceived in the DSU will be ineffective in serving as a basis for obtaining multilateral guidance on the appropriate level of rebalancing (because this requires a determination that the measure at hand was unexpected).

Affected states can nonetheless be expected to take action to address the negative spillovers from a WTO member's national security actions. From the perspective of sustaining a rules-based trade order, unilaterally determined 'retaliation' or rebalancing by affected members is undesirable. It would be preferable to have recourse to mechanisms that help to assess the appropriate level of countermeasures. Rather than invoking the DSU to contest a national security measure, WTO members should consider putting in place mechanisms to guide what constitutes appropriate rebalancing. This could be part of the proposed STC discussion. Potential remedies can range from withdrawal of the STC request (when affected parties are persuaded by the explanation provided) to voluntary (non-discriminatory) compensation if the peer-to-peer discussion makes clear that the invocation of measures reflects industrial policy concerns as well as national security. Absent such outcomes, there is the choice to engage in countermeasures as a remedy. This should not be dictated by a panel, but should instead be informed by the outcome of a deliberative process.

4.2 | Other NEOs: Article XX

Conditioning or linking market access (trade) to NEOs through imposition of e.g. production requirements is compatible with the WTO if trade measures are necessary to protect a societal value mentioned in Article XX and apply in a non-discriminatory fashion. If production requirements are based on commitments in international agreements (e.g. ILO Conventions; the Paris Agreement; etc.), they will may benefit from a presumption of nondiscrimination if they are regarded to be 'international standards'. WTO case law has not yet addressed this. Clarifying this through redrafting Article XX would enhance clarity regarding the legality of using trade measures motivated by NEOs, but is likely to be precluded by the consensus constraint. A lot can be achieved without amending Article XX, however, as the question of what needs updating depends on how 'discrimination' in GATT Article III (national treatment) is understood and whether one is comfortable with a broad interpretation of what constitutes 'public morals'. Article XX is an exception to obligations assumed, including Article III. But both Article III as well as Article XX require WTO members to observe non-discrimination (Art.



III, paragraphs 1, 2, and 4; Article XX in its chapeau). For Article XX to be an exception to Article III, non-discrimination must be understood in different ways in the two provisions.

An important question in this regard is whether regulatory standards should be considered when defining the term 'like products', the key concept in the WTO to decide whether discrimination has been afforded by a contested policy measure. GATT/WTO case law has engaged with this question (Grossman et al., 2013; Hudec, 1998), favouring an understanding of 'discrimination' that is not informed by regulatory concerns. Hence, Article XX (where regulatory intent matters) is the only place to advance non-trade justifications for trade measures. In other words, Article III understands non-discrimination from the perspective of a consumer assumed to be uninformed and/or uninterested as to how a good has been produced, whereas Article XX takes the perspective of a state actor interested in pursuing a NEO. If 'nondiscrimination' were to have one meaning across all WTO agreements in which it was informed by regulatory concerns, Article XX would no longer have a place as an exception to Article III.⁴¹

Even if the current understanding of the term 'nondiscrimination' persists, the need to redraft Article XX also depends on the understanding of the term 'public morals'.⁴² The Appellate Body (e.g. *EC-Seal and Seal Products*) argued this encompasses 'standards of right and wrong'. As noted previously, this is tantamount to covering all domestic legislation, in principle implying that WTO members can pursue any NEO they deem worth pursuing to the extent if they observe the even-handedness requirement discussed above and the test of legal consistency embedded in each sub-paragraph of Article XX. This leaves the question of whether there should be a presumption of consistency for measures enacted to implement multilateral obligations beyond the trade policy domain, for example, climate change conventions, for example, that do not qualify as standards in the TBT/SPS sense of the term.

Given that the content of Article XX as understood in case law is quasi-all-encompassing, depending on the understanding of 'nondiscrimination', NEOs might be pursued through Article III, rather than through Article XX. The more two WTO members share a NEO, the less likely they will have recourse to WTO provisions. Of course, unilateral action motivated by NEOs, even if likely to prevail in a WTO dispute, may have international competitiveness spillovers and lead to conflicts if trading partners do not apply similar trade-NEO conditionality policies. Unilateral action is unlikely to be very effective in attaining international policy objectives unless the importing jurisdiction is (very) large. If the problem is global in nature – for example, combating climate change by lowering carbon intensity of economic activity – cooperation is needed. States with similar values have incentives to cooperate to reduce the costs of unilateral measures and increase the prospects of realising the shared policy objectives.

5 | FOSTERING DELIBERATION ON NEO-POLICY SPILLOVERS

An important part of the WTO reform task is to bolster the institutional framework to support constructive deliberation among members by providing evidence-based analysis of the magnitude and incidence

⁴¹Even more so considering the WTO covers trade in services as well as goods. Services often are experience- or credence goods, calling for regulation to address ensuing asymmetric information problems. The relevance of regulatory intent when addressing claims that a services regulation measure is discriminatory was discussed in the *Argentina-Financial Services* dispute. The panel concluded that regulatory standards that apply to both domestic and foreign providers did not constitute discrimination. The Appellate Body did not address the matter. See Mavroidis (2020, pp. 349ff).

⁴²Mavroidis (2016, vol. 1, pp. 425ff). The Article III/XX divide does not arise in agreements dealing with behind-the-border policies, like the TBT/SPS Agreements.

of specific policy spillovers and potential ways of reducing them. Agreement on guardrails, let alone binding rules on contested policies, requires the major players to have a common understanding of the sources and magnitude of policy-induced spillovers. This calls for collecting and sharing information, policy dialogue and peer review. Managing the politics and political economy of defining acceptable trade-offs across values – military security, national autonomy, human rights and greening the economy – not only calls for clarity in the objective function of states but may imply discrimination against countries that are not in the club and continue to be required to satisfy the applicable market access conditionality.

Elements of reforms that could be considered in this regard have been proposed by WTO members and external observers. A common feature is that WTO committees and councils be used more to discuss trade concerns in their respective area (e.g. Hoekman, 2014; Pinchis-Paulsen, 2022; Shaffer, 2021). Some WTO bodies do much more of this than others. The WTO has held over 100 thematic sessions from 2017 through 2019, but as noted by Wolfe (2021) there is substantial variance across WTO bodies, with some not engaging at all with stakeholders. Regular thematic sessions that bring in outside expertise, practitioners, and industry representatives to discuss emerging issues are a regular feature of the activities of the SPS and TBT committees. Such sessions do not focus on implementation of the agreements as such but on sharing experiences and learning about new developments and opportunities for potential cooperation. This purely deliberative activity complements the regular work of committees. Thematic sessions provide a valuable window for officials to hear from groups directly affected by specific policies and their implementation, and to be made aware of policy areas that would benefit from international cooperation. This is a pathway for WTO members to leverage extant epistemic communities and to build such communities in instances where stakeholders do not have a platform through which to engage with each other and with responsible government officials.

Given the challenge of finding agreement on fundamental reform of the WTO structure or working practices and the obvious need for some way to manage policy spillovers from national security and other NEO-related interventions, consideration should be given to establishing a platform for policy dialogue on use of measures that increase the risk of geo-economic fragmentation. The aim would be to help trade partners understand both underlying concerns and intended objectives of (planned) interventions by a major state and to generate information on the likely effectiveness and spillover effects of (proposed) policy measures. A platform would have several functions:

- i. enhance knowledge on measures being considered and adopted by states in response to national security concerns and to safeguard autonomy to pursue NEOs;
- ii. generate and discuss the economic consequences of (proposed) measures, both for the state(s) taking action and the potential magnitude and incidence of cross-border spillovers and repercussions for trade and investment in affected products and global value chains;
- iii. support dialogue on alternative policy measures to address the underlying concerns motivating intervention and ways to reduce negative cross-border spillovers;
- iv. identify areas where international cooperation should be strengthened and foster discussion on possible institutional frameworks to do so, whether through WTO reform and/or formation of a club.⁴³

The platform would bring together policymakers (officials) spanning security, finance and trade to support coordination at the national level among agencies responsible for given policy areas. It should be designed to collect information from the actors that are directly involved in trade and the

⁴³A platform could serve as the basis for an eventual agreement between the major protagonists along similar lines as has occurred with export control regimes, which started as arrangements among allied nations but now include a more heterogeneous set of countries.



operation of international supply chains, that is, representatives of the businesses that produce or source essential goods or services that are the focus of policy concerns. Doing so is important to understand the structure of supply chains, the location of production facilities and extant capacity, sources of supply of critical inputs, etc. Depending on the issue this will involve different industries and stakeholders. Such processes exist at the national level but not at the international level (Findlay & Hoekman, 2021).

A necessary condition for a policy dialogue platform to enhance the prospects of cooperation is that participants are willing to share the concerns motivating the use of trade-related measures and the objectives they seek to attain, including underlying analyses that have informed policy decisions. An important contribution a platform can make to support deliberations is to provide independent objective empirical analyses of the likely economic impacts and incentive effects created by the policies pursued by a major state. This cannot be provided by the protagonists but can be supplied by staff of multilateral organisations with subject matter expertise and the analytical capacity needed to produce rigorous quantitative as well as qualitative assessments of a given situation, and feasible alternatives that may be more effective in addressing concerns with fewer negative spillovers. Such policy analysis must be provided through a process that generates the trust of the major players. Organisations such as the IMF, OECD and World Bank have the analytical capacity and necessary knowledge and could be tasked to provide the requisite background material to inform discussion, working with the appropriate technical sectoral or regional bodies with expertise in given issue areas as well as international business organisations with knowledge of the organisation of pertinent value chains, technologies and distribution and interdependence of global production capacity and use of products salient to a given national security concern or other NEO.

Such a policy dialogue platform should be hosted by an international organisation in which all parties involved are members. Given the centrality of trade in national security and other NEO debates, the WTO would appear an obvious host organisation, but for the process to be effective it will be important that all participants accept that this is not a forum for negotiation. Given that negotiation is deeply embedded in the 'DNA' of the WTO, this may constrain the ability of states to engage in an open substantive policy dialogue in a WTO setting. Organising a platform as a partnership with other salient international organisations with subject matter mandates and capacity should attenuate this constraint.

For a platform to be effective, it must include the key protagonists; to be representative, it should include a range of other countries. Balancing effectiveness and representativeness are a non-trivial challenge given the need for a group to be small enough for participants to be able to engage with each other. Participation should span the largest trading nations⁴⁴ plus a small number of low- and middle-income developing countries that are representative of nations affected by national security-motivated policies and that do not intend to align with either the United States or China in a more confrontational world.⁴⁵ While a G7+ dialogue, as is implicit in proposals that cooperation be based on 'friendshoring' reduces political complexity and may facilitate engagement, excluding China will have a significant opportunity cost both in terms of addressing spillover effects of trade and investment policies and in terms of perceived legitimacy.

⁴⁴The three largest trading powers (China, EU and US) account for 45% of world trade. Together with Japan, UK, Singapore and South Korea, the top seven traders account for 60% of world trade.

⁴⁵Tasking international organisations with providing analysis of the economic dimensions and spillover effects of policy measures taken (or being considered) by the major trade powers will ensure a focus on the implications for their member countries that are not part of the platform.

The subjects for discussions should be limited to economic instruments (subsidies, trade and investment restrictions) motivated by national security and other NEOs, recognising that the latter may be linked to or motivated by national security. For example, a useful focus of the platform would be on determining the products and technologies that can give rise to national security concerns. In the export control context (Wassenaar), this has expanded over time to cover threats from non-state actors (terrorist organisations), cybersecurity and technologies that may be used to violate human rights – for example, trade in cyber-surveillance technologies.⁴⁶ Initially, to build confidence and establish trust, meetings could prioritise areas that are relatively less sensitive and where mutual gains can be more immediately apparent to members – for example, the use of green subsidies, where cooperation clearly is needed to achieve shared climate change goals.

To reiterate, the role of the type of processes suggested above – use of STCs and policy dialogue platforms – is not to question the right of WTO members to invoke national security or pursue NEOs but to scrutinise such invocations through policy dialogue that clarifies goals and assesses the efficacy and potential spillovers of chosen instruments. The aim is to provide alternatives to recourse to dispute settlement and rulings by the associated adjudicators that are unlikely to be effective.

6 | CLUBS

Variable geometry is a core aspect of the world trading system, reflected most prominently in the extensive network of PTAs among WTO members. PTAs will continue to be an important part of the trade landscape, offering a mechanism for like-minded countries to deepen cooperation on realising NEOs as well as economic policies beyond what is desired or feasible in the multilateral setting. The Biden Administration has made clear that it is not interested in negotiating traditional PTAs that centre on reciprocal reduction of tariffs and non-tariff barriers to trade.⁴⁷ Instead, the United States currently favours issue-specific cooperation and frameworks to coordinate policies – for example, agreeing on good regulatory practices towards the digital economy, export controls, foreign direct investment and global value chains. Recent examples include the EU-US Trade and Technology Council,⁴⁸ the US-led Indo-Pacific Economic Framework (IPEF) for Prosperity⁴⁹ and calls for ‘friend shoring’ value chains and associated trade and investment (Yellen, 2022). Such arrangements have implications for the trading system insofar as they act as frameworks that jointly condition trade and investment on shared values through, for example, production requirements relating to labour, human rights and/or environmental sustainability. If associated (regulatory) cooperation arrangements are explicitly open to any country interested in participating, with the extension of benefits conditional on implementing agreed regulatory standards or principles, independent of national political systems and governance, they may support a process of gradual multilateralisation.

⁴⁶The suggested platform would be consistent with and should draw on extant international (plurilateral) export control regimes, which are non-binding and informal, establishing norms in the form of guidelines and lists of dual-use products that should be subject to regulation, and aimed at facilitating information exchange and coordination.

⁴⁷Illustrated in the 2022 US Trade Policy Agenda not mentioning negotiation of new trade agreements as an objective. See <https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2022/march/fact-sheet-ustr-releases-2022-trade-policy-agenda-and-2021-annual-report>.

⁴⁸<https://www.state.gov/u-s-eu-trade-and-technology-council-ttc/>.

⁴⁹<https://ustr.gov/about-us/policy-offices/press-office/press-releases/2022/september/indo-pacific-economic-framework-prosperity-biden-harris-administrations-negotiating-goals-connected>.



6.1 | Article XXI clubs

If the WTO membership cannot agree to introducing deliberation mechanisms and STC-type policy dialogue on the use of trade for national security objectives,⁵⁰ there is no reason why those interested cannot engage in such a process by forming ‘XXI clubs’. Clubs are likely to figure more generally in the future as vehicles to support regulatory cooperation and deeper economic integration of like-minded states, including to achieve security goals.⁵¹ Clubs are being pursued actively in- and outside the WTO. Military alliances have long been a central feature of national security-motivated cooperation. So have clubs addressing national security-related policy measures. An example during the Cold War was the initiative by Western countries to block exports of sensitive material to the Communist world through COCOM (Coordinating Committee for Multilateral Export Controls). An example of soft law (voluntary commitments) with broader membership is the Wassenaar Arrangement addressing export controls for dual use technologies.⁵²

Arguably, the WTO should become more accommodating of clubs, given the high likelihood that WTO members will otherwise continue to cooperate outside the WTO through PTAs and issue-specific plurilateral agreements. WTO members that use trade policy to pursue NEOs – for example, conditioning access to the market on satisfying specific production requirements⁵³ – can also do so in a coordinated manner, that is, engage in concerted unilateralism. This could be, in principle, consistent with WTO rules. Putting in place a framework that encourages WTO members to use WTO-sanctioned clubs instead of PTAs or to engage in concerted unilateral action to address to use of trade policy to support NEOs is in all members’ interests. Greater scrutiny, transparency and discussion of the rationale and analysis of the effects of trade–non-trade issue linkages pursued by groups of countries would benefit the jurisdictions pursuing such policies as well as those that do not but may be affected.

In related work, we argue WTO reform discussions should include a focus on creating a governance framework that accommodates clubs to which a subset of members subscribes but that are applied on a non-discriminatory basis.⁵⁴ Such agreements (commitments) on non-tariff policies can be added to GATT schedules if details of the covered products and the type of concessions are included (Hoekman & Mavroidis, 2017), even though this may involve some contortions if the subject matter of an open plurilateral agreement (OPA) does not easily ‘fit’ under an existing WTO agreement.⁵⁵ Accommodating OPAs in the WTO would be facilitated by a stronger governance framework and criteria to ensure they are consistent with the rules-based trading system.⁵⁶ This would not only enhance the relevance

⁵⁰A 2021 proposal by a group of WTO members (WTO, 2021) to expand the use of STCs and provide a common framework for raising concerns was not supported by many other WTO members.

⁵¹For example, the G7 Trade Ministers (2022) call ‘to enhance cooperation and explore coordinated approaches to address economic coercion both within and beyond the G7...’ (p.4)

⁵²In 2022, signatories included (original signatories of CoCom in boldface): Argentina, Australia, Austria, **Belgium**, Bulgaria, **Canada**, Croatia, Czech Republic, **Denmark**, Estonia, Finland, **France**, **Germany**, **Greece**, Hungary, India, Ireland, **Italy**, **Japan**, Latvia, Lithuania, **Luxembourg**, Malta, Mexico, **Netherlands**, New Zealand, **Norway**, Poland, **Portugal**, Republic of Korea, Romania, Russian Federation, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland, **Türkiye**, Ukraine, **United Kingdom** and **United States**.

⁵³The 2022 G7 Trade Ministers’ statement makes clear all G7 members support such measures. <https://www.meti.go.jp/press/2022/09/20220915003/20220915003-1.pdf>.

⁵⁴Hoekman and Mavroidis (2015) and Hoekman and Sabel (2019).

⁵⁵OPAs on services-related policies are facilitated by the fact that the GATS provides for additional commitments to be added to national schedules if a WTO member desires to do so (Hoekman & Mavroidis, 2017).

⁵⁶Possible criteria include being open to any WTO member, provisions to provide technical and financial assistance to countries seeking to accede, transparency and regular reporting to the WTO membership on the implementation of the agreement.

of the WTO as a platform to support the negotiation of new rules by large trade powers on commercial policies that have economic objectives – the traditional bread and butter of the organisation and the PTAs that have increasingly come to complement it – but bolster rules pertaining to the use of trade policy for NEO purposes given the increasing likelihood that countries will pursue alliances and clubs to defend national values and security.

In thinking about security clubs, it is useful to distinguish between situations where states find themselves close to the pole of power and those where this is not the case. Because in the former situation, much greater weight is placed on security objectives, the relative importance accorded to other objectives will be lower, and trade policy will tend to be dominated by those concerns rather than treated as a relatively autonomous issue. An implication is that if states form a club that has national security as a central objective, the weight placed on non-security dimensions will vary. This variation will arise both over time (i.e. be situational) and across members. A security club may have heterogeneous membership, spanning both high-income and developing nations. The latter may be less concerned with a given conflict that involves only some club members. Many developing countries have preferred to stay neutral in the conflict between Russia and Ukraine. Most have little interest and incentive to become embroiled in US–China rivalry, but many are suppliers of key natural resources as well as growing markets. To induce cooperation on national security-related measures by such countries, side payments will be necessary. Deepening economic and foreign policy relationships with such countries with a view to bolstering national sovereignty and supply chain resilience may be associated with trade-offs on other values that became more prominent in trade policy in the recent period where the Western world was at the pole of indifference. Relaxation of the autonomy of trade as an issue, to permit linkages across issues unrelated to trade, can serve such a purpose.

This already occurs on a de facto basis, insofar as initiatives on trade and supply chains that are the subject of discussion in the IPEF, the EU-US TTC and the G7 involve concerted action to diversify sourcing of critical inputs away from potential adversaries, public support for expanding production capacity of the associated industries or responses to attempts to use trade coercively. The question is whether to pursue such initiatives under the WTO umbrella as opposed to (continue) doing so outside the WTO, especially insofar as enforcement of such cooperation is unlikely to involve binding adjudication, historically an important consideration for negotiating agreements in the WTO. Potential payoffs for both members and non-members of XXI clubs include transparency, which would benefit from support from the Secretariat and the type of platform discussed previously to discuss (learn about) the spillover effects of using trade policy instruments. Given that past and current practice makes clear that dispute settlement panels will apply a deferential standard when judging the necessity of trade measures, the prospects of such cases being brought against actions by a club are low. A club that is subject to international scrutiny and fosters policy dialogue while at the same time signalling to potential belligerents that members will respond jointly as opposed to unilaterally but does so in a way that follows a set of agreed disciplines could help attenuate security concerns with fewer adverse effects for the trading system.

6.2 | Other issue-specific clubs

Between like-minded nations where divergences are small, there are strong incentives to go ahead and establish a regime if joint benefits are large, making successful coordination quite likely. When nations are not like minded, coordination is made more difficult as any country can block the establishment of the regime since in the WTO the decision-making mode is consensus. Thinking about plurilaterals, members need to evaluate the opportunity costs of addition of less like-minded states



against the presumably increase in the likelihood that a proposed agreement will receive the green light of the membership. An important rationale for 'Article XX clubs' that include issue-specific use of trade policy – for example, to tax carbon at the border; require firms to put in place due diligence systems for their supply chains, etc. – is to provide a framework to guide what might otherwise be pursued through unilateral action. Unilateral policies, if non-discriminatory, are perfectly consistent with the WTO. Assuming adherence to non-discrimination, clubs of states that otherwise could (would) act unilaterally to condition trade on non-economic criteria can decrease transaction costs, as exporters will have to comply with the club standard, instead of complying with dozens of unilateral production requirements, even if these apply on a non-discriminatory basis. Formation of clubs that abide by agreed good practice principles can help clarify objectives, improve transparency and provide a framework for dialogue, monitoring and evaluation.

WTO members could approach this discussion by identifying NEOs where there is a presumption that norms must be observed by all. Labour, environmental and/or public health standards that have been adopted internationally by a large number of states are natural candidates. If such agreement cannot be obtained, like-minded WTO members may negotiate OPAs in which they agree on a set of shared policy objectives and the use of trade measures to pursue them, ensuring non-discriminatory implementation of whatever is agreed upon. Such agreements are likely to pass muster under Article XX, and arguably under Article III as well. Credible commitments that ensure OPAs are open to new accession, including an obligation on club members to assist countries interested in joining but not able to attain requisite regulatory standards are important preconditions for OPAs to support the multi-lateral trade regime (Hoekman & Sabel, 2021).

7 | CONCLUSION

Geopolitics has moved centre stage in world trade. Whereas the main focal point for deeper cooperation on trade matters used to be PTAs, a form of deeper integration foreseen by the GATT and the WTO, there is now an increasing focus on reshoring, near-shoring and friend-shoring trade, investment and associated value chains that are not necessarily embedded in PTAs. Trade integration that goes beyond the WTO baseline is increasingly conducted between like-minded players, reflected in – and supported by – a mix of domestic policies motivated by competitive neutrality objectives, national security goals and the defence and projection of values. Lead firms that operate international supply chains to produce and distribute goods and services around the world confront rising political risk and policy uncertainty, forcing a re-think of their international investment and commercial partnership strategies.

National security and other NEOs emerge as threshold criteria determining the ability of firms (willingness of governments) to engage in cross-border trade and investment. The frontier between national security and other NEOs such as sustainable development, protection of the environment and combatting climate change has become fuzzier. The scope of national security has expanded because of technological developments and accompanying threats that go beyond traditional military considerations such as regulation of arms or exports of dual-use technologies.

The WTO membership must recognise the threat to the open rules-based trading system and the global integration that this system has helped support if the WTO does not adapt to changed circumstances. The costs of not doing so are likely to be significant, particularly for developing nations but also for firms, consumers and workers in high-income and emerging economies. Recourse to policies to induce reshoring and friend shoring, whether for economic or non-economic reasons, is not only likely to be costly but perhaps more importantly, ineffective. While this is a matter for national govern-

ments (and their politics) to determine, international cooperation can help inform and guide policy decisions with a view to reducing negative spillovers, while recognising and accepting – as the WTO already does – that members retain the freedom to regulate their economies as they deem appropriate to attain domestic objectives.

For some analysts, the extent of differences with respect to the existing core members of the international liberal economic order means that China cannot be incorporated as a member in good standing of the system. The idea is that there can be no agreement on common purpose between countries with very different economic and political systems. This reasoning is fallacious as the common purpose relates to the international regime. There is no reason why the core members of the WTO cannot find an understanding of common purpose.⁵⁷ That said, the system differences make clear that such a regime will not be a marginal adjustment in the current rules. This is a very real challenge, but it is not clear to us that it is a bigger challenge than many of the changes the international order has already absorbed. The framers of the post-War order were dealing with radically new domestic political-economic environments that differed quite widely across GATT contracting parties. Part of the story is the United States, as hegemon, pushing for the new order for geo-strategic reasons. But this would not have succeeded without a broadly common sense of purpose, beyond agreement on Cold War geopolitical goals. In addition to liberal norms like liberalisation and non-discrimination, sovereignty norms were built into the system via the right to pursue safeguards (broadly construed), and the use of a principal supplier rule and reciprocity in negotiations. Notwithstanding the end of the cold war and the decline in hegemonic capacity of the United States, the foundational commitment to national sovereignty, with wide variance in domestic economic structures, continued more or less unbroken until 2016.

China is not a democracy, but the government (and the Communist Party) must still seek political legitimisation, in part by delivering strong economic performance. Given the lack of input legitimacy (elections, free press, open public discourse, etc.), the reliance on economic performance (output legitimacy) is particularly important. China's very strong economic performance over decades was underwritten by extensive use of markets and international trade, on essentially liberal terms. China has a strong interest in a robust global market and the right to access that market on the same terms as democracies do. Thus, it seems quite plausible that China would be supportive of a liberal trade regime that works for China and its other trade partners. Determining the renewed contours of such a regime that addresses the competitive frictions that arise because of the more direct involvement of the state in the economy should be a central focus of efforts to reform the WTO's substantive disciplines on the use of trade policy instruments.

In many of the economic policy areas that generate trade tensions and conflicts, the large trade powers could (and should) engage in discussion with a view to agreeing to rules of the road that would attenuate spillovers. The fact that China has requested accession to the CPTPP, agreed to provisions on subsidies and SOEs in the CAI with the EU, and participates in WTO Joint Statement Initiatives suggests there is scope for such efforts to succeed. Agreements between the largest trading powers to ensure competitive neutrality could do much to reduce trade tensions and associated policy uncertainty for firms. WTO reforms are not needed for such discussions to take place or for agreements to

⁵⁷This is not to say doing so will be straightforward. Discussions on this subject in the G20 context revealed there is not necessarily a commonality of views. See Trade and Investment Ministerial Meeting Communiqué, September 22, 2020, Annex I: Riyadh Initiative on the Future of the WTO. [http://www.g20.utoronto.ca/2020/2020-g20-trade-0922.html#:~:text=The%20Riyadh%20Initiative%20on%20the%20Future%20of%20the%20WTO%20\(the,necessary%20reform%20of%20the%20WTO.](http://www.g20.utoronto.ca/2020/2020-g20-trade-0922.html#:~:text=The%20Riyadh%20Initiative%20on%20the%20Future%20of%20the%20WTO%20(the,necessary%20reform%20of%20the%20WTO.)



be concluded. Such agreements can be constructed as OPAs that apply on a non-discriminatory basis in terms of conditioning access to the markets of the signatory nations.

Cooperation must extend beyond a focus on addressing the cross-border economic (competition) spillovers – the ‘bread-and-butter’ of the WTO. Members should also consider the use of trade policy in the realm of national security and pursuit of other NEOs. WTO members that use trade policy to pursue NEOs – for example, conditioning access to the market on satisfying specific production requirements⁵⁸ – have an interest in others doing so as well as this enhances the prospects that NEOs will be attained. This can take the form of agreements to act unilaterally in a concerted manner. While this, in principle, can be consistent with WTO rules, it is arguably better to put in place a framework that encourages WTO members to use WTO-sanctioned clubs instead of PTAs or concerted action outside the WTO to use trade in support of NEOs. This is in all WTO members' interests. Greater scrutiny, transparency and discussion of the rationale and analysis of the effects of trade–NEO issue linkages that are pursued by groups of WTO members would both benefit the countries pursuing such policies as well as those that do not join them but may be affected.

WTO reform discussions should revisit the GATT case law on non-discrimination and work towards an understanding of protectionism/discrimination informed by regulatory considerations. An implication is that NEOs should be considered when assessing if GATT Article III (national treatment) has been met, as opposed to a presumption that if countries condition access to their market on values and are challenged, they must invoke Article XX. Labour and environmental standards are now routinely included in PTAs involving high-income countries. Despite many if not most WTO members having signed many if not all ILO conventions and international environmental agreements that establish national performance targets, there is no unanimity across the membership that such norms should be incorporated into the WTO. Allowing for OPAs among like-minded nations that do so would be beneficial for the trading system. Consider the counterfactual: every WTO member unilaterally defining its policies and applying these in non-discriminatory manner, thus in principle behaving like a good WTO citizen. Coordination is beneficial for outsiders as well as insiders, reducing transaction costs for both because firms only need to comply with a common set of standards applied by club members.

Creating avenues through which actions motivated by national security and other NEO-related concerns can be raised at the multilateral level, through the type of deliberation that has become a focal point of the TBT and SPS committees, would provide for the possibility to discuss and scrutinise specific measures. There are several reasons for differentiating between national security and NEO-related issues in this regard. WTO members' revealed preferences suggest that, while they may be willing to discuss security-related concerns in an informal setting, they are reticent to submit disputes to formal adjudication. In any event, the standard of review adopted by panels in the realm of disputes concerning national security has been very deferential, no doubt in part in recognition that it is very unlikely that WTO members will implement adverse rulings. This suggests national security-based actions should be raised exclusively through policy dialogue and deliberation and use of STC-type processes, including, as appropriate, discussions on the magnitude of spillovers and associated levels of rebalancing by WTO members that decide to go down this path. In contrast, complaints regarding use of trade measures to achieve other NEOs could, if not resolved through an STC process, be subject to formal dispute settlement procedures.

⁵⁸Examples include the draft EU directive mandating that firms exercise due diligence in the supply chains used to produce goods and services sold on the EU market and banning imports of goods produced with forced labor. The September 2022 G7 Trade Ministers statement makes clear all G7 members support such measures.

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