Where Is the WTO Heading?

By Gary Hawke


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The WTO After Bali

The WTO is unchallenged as the preeminent guardian of the international trading system. Its Dispute Resolution System is highly valued despite its limitations — its slow pace and its reliance on sometimes reluctant compliance processes by members. Small economies realize that they have no alternative means to secure consideration from large economies, and large economies know they benefit from avoidance of disputes and lingering resentment. But resolving disputes alone cannot inspire continued commitment. Hence there is general agreement that more is needed to maintain the multilateral trading system.

This sometimes spills over into nostalgia for a past which never existed. The most-favored-nation clause and nondiscriminatory trade were qualified throughout the history of the General Agreement of Tariffs and Trade (GATT). The "former enemy" clause permitted discrimination against Germany and Japan for several years. British preferential tariffs lasted as long as they suited the interests of the United Kingdom and former colonies (and most quotations from American sources after World War II about the evils of preferentialism were attacks on imperial preference rather than advocacy of economic liberalism which has never been instinctive in US economic thought). The "agricultural waiver" essentially excluded agriculture from the system until the Uruguay Round. Plurilateral codes were developed as reduced tariffs directed attention to other trade barriers and they were not universal in membership. The European Economic Community (EEC) and other preferential trading arrangements were permitted in pursuit of the strategic objectives of major powers, and GATT never developed effective monitoring of its provisions about free trade areas and customs unions.

The "special and discriminatory" treatment evolved for developing countries was always a major departure from pure multilateralism and failure to specify criteria for beneficiaries is now a major handicap to continued development of the multilateral system. While there is a case for saying that Asia's economic growth was facilitated by open multilateral trading arrangements, it did not depend on adherence to textbook perfection — it is indeed probable that Asia's utilization of its comparative advantage outweighed considerable discrimination against it. None of this means that the multilateral trading system is unimportant, but it does argue for rigorous analysis of the content of the multilateral system and a recognition that it has evolved over time, not been a perfect model assailed by an outbreak of preferential trading arrangements. It may even be that the WTO is actually a victim of its own success; it has generated unrealistic expectations which may have the effect of undermining it.

Bali 2013 showed that it is still possible to reach multilateral agreement. The 9th WTO Ministerial Conference in Bali in December 2013 attained a very welcome, if modest, consensus on a limited package of measures. As the first multilateral agreement since the Uruguay Round was concluded, the Bali package is important for showing that WTO members are still willing to make significant compromises to sustain the multilateral system. Its actual content was limited, and implementation is likely to be contested and difficult but the WTO survives.

The Changed International Economy

The agenda of economic diplomacy has moved decisively from tariffs to behind-the-border barriers. This has been a long and slow process as the agenda of first GATT and then the WTO moved beyond tariffs to subsidies, government procurement, sanitary and phyto-sanitary standards, standards and technical barriers to trade, the Singapore issues of transparency in government procurement, trade facilitation (customs issues), trade and investment, and trade and competition, and on to trade and labor standards, and trade and the environment. There are at least three reasons for this.

First, as soon as tariffs were reduced, the impact of other barriers to cross-border trade became more significant and more visible. "Trade negotiations" changed accordingly and the process continues. Secondly, the search for optimal resource allocation despite jurisdictional boundaries widened. Investors appreciated that overseas investment could be a means of minimizing the impact of border barriers, and services could be provided among jurisdictions. Rules about investment, about cross-border service provision, and establishing commercial presence to provide services in another jurisdiction became important parts of economic diplomacy. Thirdly, the game was really changed as trade as an exchange of goods between economies gave way to "trade in tasks" in which producers from international production networks combine activities in many economies to serve widespread markets. The familiar conception of economic diplomacy as responding to border barriers to trade in goods has been supplanted by an agenda of removing unnecessary obstacles to the ease of doing business across borders. Regulatory policy which has traditionally been seen to have a domestic focus is now at the centre of international economic diplomacy. For international production networks, services trade is not a minor supplement to trade in goods but essential to business operations, and because services trade cannot be separated from international investment flows, trade and investment have to be considered together. The conventional separation of real and financial integration is deeply entrenched in international economic governance through the WTO on the one hand and the World Bank and IMF on the other, but it is incompatible with how the game has changed.

The growth of international production networks is far-reaching. Above all, management of intellectual property and innovation is central to the operations of international production networks. International trade in intermediate products is not just discrete transactions between anonymous buyers and sellers but takes place as repeated transactions within relationships among sequential producers. International production networks are more than vehicles for trade in intermediate products. International production networks could not exist without international trade in intermediate products, but there could be trade in intermediate products without international production networks.

Trade in intermediate goods means that exports require imports and it is no longer possible to think of tariffs as simply part of an export-led growth strategy, but international production networks pose challenges to policy development which are even wider and deeper. Asian writers tend to see international production networks as related to Japanese foreign direct investment (FDI) in Southeast Asia and China, part of market-led integration, and generating changes in production methods which includes dissemination of innovation. Outsourcing may actually be greater for longer-distance trade, reflecting Japanese FDI in ASEAN, and international production networks may be more stable than most outsourcing — firms invest in sunk costs to establish relationships and work to maintain them. European and American sources, on the other hand, tend to identify supply chains with the presence of intermediate inputs and so see mostly short chains.

Much can be traced to the balance of agglomeration and dispersion. Japanese firms were attracted by lower wage costs elsewhere which more than outweighed increased transport costs on components and higher management costs. But that is merely a starting point for much variety. Modern value chains have different sources. Electronics and motor vehicles rely on specialization in production and increasingly in design, but in fish processing, supermarket chains demanded a complete product range — finfish, shrimp, tuna and aquaculture — and forced processors to form chains in order to assemble the required range. The result could be described as a market-based chain.

Furthermore, chains are not static. Even a production network which began from a simple cost-minimizing exercise, balancing wage costs against the costs of transport and management, was likely to change over time. Production networks adopted just-in-time manufacturing, itself partly a trade-off between minimizing inventory costs versus the implicit or explicit costs of possible interruptions of supply, but soon a tool of modern management techniques. Just-in-time manufacturing turns any potential interruption into a crisis and demands highly motivated and informed management. A production network also requires interoperability, with components made with precision to the standards needed in the next stage of production. An international production network is likely to require professional services across borders — engineers from the "home" economy to solve problems encountered in a subsidiary supplier, legal services to define agreed standards, and so on. International production networks generate the importance attached to new topics in economic integration, standards, intellectual property, trade in services, movement of natural persons, and investment. They are much more than the sources of trade in intermediate goods.

Photo: Reuters/Aflo

Director-General Roberto Azevedo is congratulated by delegates after the closing ceremony of the 9th WTO Ministerial Conference in Bali on Dec. 7, 2013. The WTO reached its first ever trade reform deal to a roar of approval from nearly 160 ministers who had gathered in Indonesia to decide on the make-or-break agreement that could add $1 trillion to the global economy.

There are, of course, many other changes taking place. Especially in Asia, there is increased concern with inclusive growth, and narrowing development gaps both between economies and within economies. Free trade agreements (FTAs) have always been conceived as an instrument for economic growth and the more inclusive notion of economic integration makes that even more apparent. The objective has always been to facilitate the operation of economic activities throughout the region in such a way as to maximize their contribution to the welfare of the region as a whole. That conception is conventional in relation to economic thinking — the most fundamental question of economics since Adam Smith has been under what conditions self-interest achieves a social optimum — but it is less instinctive for thinkers accustomed to zero-sum games, whether sporting contests or national struggles for position and status. "Regional economic integration" points towards minimizing the impact of national boundaries whether by tariffs or other barriers, while preserving rules and institutions which make

Photo: AP/Aflo

Senior delegates pose at the opening of the 9th WTO Ministerial Conference in Bali in December 2013. From left: Peruvian Foreign Trade and Tourism Minister Magali Silva, Chairman of the WTO General Council Shahid Bashir, Indonesian Minister of Trade Gita Wiryawan, Indonesian President Susilo Bambang Yudhoyono, WTO Director-General Roberto Azevedo of Brazil, Indonesian Foreign Minister Marty Natalagawa, British Minister for Trade and Investment Stephen Green, and Rwandan Minister of Trade and Industry Francois Kanimba.

private interests compatible with social ambitions.

The trends in international production networks and towards more concern with inclusive growth come together for international economic diplomacy in the treatment of standards and intellectual property. Standards have long been part of the agenda of technical barriers to trade since standards purportedly adopted for consumer safety or to provide for interconnections among products (between, for example, fire hydrants and fire-hoses) could be used to preclude competition between imports and domestic products. But standards have become much more important because of the need for interoperability among members of international production networks. In turn, standards can be private property and so an important part of intellectual property rules (IP). Public policy conceives IP as finding the optimal balance between encouraging invention and disseminating knowledge so as to promote efficient use of resources. But there can well be conflicts between economies where patents are held and economies which seek to innovate.

There is a tension between standards and innovation. Standards can freeze technology. That can be an incidental by-product of the search for "fitness for purpose" and interoperability. Or it can be the deliberate result of firms seeking competitive advantage by manipulating access to intellectual property. Hence an international regime for managing Intellectual Property and Standards is an essential component for economic integration. But it is no easy task. Any idea of a uniform international IP regime has to be complex.

For most economies, economic development is a matter of catching up with the frontier. In poor countries, a weak IP regime is optimal — to encourage dissemination; utilization of knowledge invented abroad should be preferred to incentives for innovation. Advanced economies will naturally prefer stronger IP regimes. That can be derived as an abstract argument, or it could be deduced from the economic history of many countries, including the United States, not known for its ready adoption of European copyright agreements in the 19th century. The problems are not only between developed and developing economies. It is fascinating to watch the impact of the difference between the European tradition of centralized management of standards with the US tradition of decentralization. The former looks tidier and more easily comprehended; the latter is far more responsive to change. It will be no easy task in the Transatlantic Trade and Investment Partnership to reconcile the two approaches and what suits the US and Europe may not suit Asia. And yet the WTO of the future has to work with a sensible conception of innovation and appropriate rules for intellectual property. It cannot be content with protecting the existing holders of patents and copyrights.

The WTO of the future has to deal with a world very different from that in which GATT developed. Plurilateral agreements and bilateral free trade agreements are not a challenge to the multilateral trading system; they are elements on which the future WTO has to build.

Club Management

The spread of Preferential Trade Agreements is sometimes attributed to the lack of progress in multilateral liberalization at the WTO. More is involved. The growth in the number of participants in the WTO has made agreement more difficult, but more participants also increase the gains available from agreements. GATT agreements were never a simple process of consensus. The basic dynamic evolved was bargaining among the Quad — the US, EU, Japan and Canada — modified to take account of undeniable core interests of other participants (such as Iceland and fishing). The modern international economy has new major participants, especially China and some other emerging markets, and the WTO has not been able to create a mechanism equivalent to the former Quad. The new director-general, Roberto Azevedo from Brazil, needs support as he endeavours to make WTO procedures effective. (His allocation of portfolios among his deputies, who appear to have been chosen according to a familiar pattern of an American, a European, and two "others", suggests that he has change in mind.)

Economic logic suggests that each economy could respond by appropriate unilateral liberalization. The simplistic notion that barriers should be removed only if the other party also removes barriers is too powerful, reinforced as it is by the US notion that only reciprocity justifies US "concessions". Furthermore, political leaders are like members of Alcoholics Anonymous. They knew perfectly well that the best course of action rested entirely in their own hands, but they gained assurance from coming together with others in a similar situation, sharing experiences and encouraging one another to proceed on the path of righteousness. In the early years of APEC, it was hoped that this would develop into "concerted unilateral liberalization", mutually supportive programs of liberalization that were essentially unilateral. While the hopes of the most optimistic were not realized, there was considerable success, and the habits of sharing experiences and supporting analogous efforts have been carried into efforts to reduce behind-the-border barriers. But conventional ideas of trading concessions and preferring "legally binding" commitments clearly expressed in writing remain strong. They now hinder the interactions among governments — communication — which is required to develop a shared understanding of how business can be done in a way that is competitive and also compatible with reasonable national norms.

Ironically, a conventional bargaining approach to concessions had some beneficial effects whose loss is disadvantageous. Even when reduced barriers were presented as "concessions" justified by gaining through negotiation at least equivalent benefit in access to another market, they were really changes which promoted competition that was directly beneficial whatever happened elsewhere. When we turn to the wider agenda of economic integration this gap between the real and the apparent — the disguising of promotion of competition as an exchange of a sacrifice of one set of benefits for another — is no longer so readily available. There is a danger that removal of a barrier may be achieved by adoption of regulatory policies which are known to be in use elsewhere but which are sub-optimal in the circumstances of the adopting economy. Furthermore, determining optimal regulatory policies requires expertise not always held by even experienced and highly competent negotiators, especially those who come with a conventional mix of legal and lobbying skills. In the modern world, economic diplomacy requires capacity building in developed economies as well as in developing economies.

Above all, the need for deep understanding of the regulatory policies and processes of partner economies and trust in their integrity and implementation ensures that economic integration will proceed not by optimal domestic policy, nor by adaptation of the WTO only, but in "clubs" of economies. This is the fundamental reason for the proliferation of FTAs in the modern world. We hear a great deal about complementary economies but that is an echo of the analysis of FTAs of the mid-20th century. Now economic integration is much more likely between economies which can trust one another's regulatory systems.

WTO in the Set of International Institutions

Preserving a multilateral trading system remains important. The WTO will have important functions. It will need much closer relations with other international organizations such as the World Intellectual Property Organization, World Customs Union, IMF and World Bank. The divisions among them reflect an earlier world rather than one of international production networks. Many contemporary international institutions reflect the world of 1945 and change is difficult but demands for perfection can frustrate rather than promote improvement, and the immediate need is for coherent management of change.

The WTO will have the task of managing the compatibility of "clubs" to ensure they are not "closed clubs" but remain "open clubs" which do not seek to disadvantage outsiders, are transparent in their rules and norms, especially their criteria for new members, and actively promote wider membership. Sometimes it will be possible to persuade a club to act as though it were multilateral. If membership constitutes a sufficiently great portion of the total relevant trade, members may be willing to be magnanimous and provide a "public good" to remaining economies. This is the basis on which the International Technology Agreement and the proposed Plurilateral Agreement on Environmental Goods and Services are being negotiated. But these agreements are little more than disguised concerted unilateralism in tariff reduction substituting an inevitably contentious definition of a particular kind of good for unilateral liberalization. The technique is unlikely to be successful where mutual confidence in different regulatory systems is required.

The WTO will therefore have a particular role in monitoring and advising on accession arrangements for all clubs. No economy of even moderate size is likely to be able simply to sign up to an existing agreement without some consideration of how its terms apply in the particular circumstances of the applicant economy. That consideration should be as technocratic and removed from extraneous political consideration as possible. There should be agreement that new applicants should have transition paths no less favorable than those accorded existing members who have similar levels of development. Assessment of how existing terms apply to the particular circumstances of an applicant should be entrusted to well-known but independent organizations such as the Economic Research Institute for ASEAN and East Asia — political decisions cannot be excluded but they should be constrained so that accession is not hostage to domestic politics in an existing member. The staff of the World Bank Group has shown how technocratic independence can be valuable in their advice to the G20 on the financing of infrastructure investment, and the WTO should be entrusted with developing similar mechanisms for club management of plurilateral agreements designed for modern economic integration. JS

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