WTO Reform – Its Prospects & Possibility

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The World Trade Organization (WTO), like its predecessor, the General Agreement on Tariffs and Trade (GATT), has long been at the center of the international economy. It is an international organization dependent on voluntary membership, but it has some power of coercion over its members. Whereas most international organizations can do no more than withdraw membership, the WTO can authorize penalties on any member that breaks the rules.

The Pervading Influence of Politics

Throughout the history of GATT and the WTO, political constraints have modified the economic basis of the organization. The underlying economic argument is simple: the logic of comparative advantage implies that the limit to world income and living standards is determined by each country using its resources so as to maximize output at international prices, and engaging in international trade so as to reconcile production with desired consumption. The core argument can be put even more simply. The output from any given resources will be maximized if as few constraints as possible are placed on the use of those resources. International boundaries are a constraint on the use of resources.

The simple argument soon becomes more complex. It is about world income, rather than about each individual country. (Income can be broadly defined; the argument is about well-being.) Even more, it is about aggregate income in each country, not about each individual or even each industry. Most important, the argument, as stated, is about optimal use of given resources. It can be modified to take explicit account of growth over time, but it needs modification if the resources available depend on how they are used. This has most commonly been discussed in terms of "infant industries" – economic activities which would become efficient if only they were allowed to grow somewhat. A common experience was that infants given "temporary" assistance never grew up, and the assistance was much more distorting than it needed to be. But the argument is really much wider; it directs attention to learning from experience, any learning which has the effect of increasing the resources available. Separate scrutiny is needed for any such possibility but they are few and responses need not be distortionary.

However, precise economic argument was not what dominated GATT or the WTO. After World War II, important leaders wanted to avoid the lack of co-ordination which they saw as having caused economic dislocation throughout the 1920s and 1930s. They planned an International Trade Organization (ITO) which would complement the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD which became the World Bank) and which would respectively provide monetary security and investment funds. The IMF and IBRD were formed quickly, but conferences debating the ITO spread over several years. They eventually resulted in an ambitious Havana Charter but it was never ratified. The attention of the United States had moved on, and significant political forces in the US opposed elements of the Havana Charter. For example, the Executive Committee of the US Council of the International Chamber of Commerce denounced the draft ITO charter as a "dangerous document because it accepts practically all of the policies of economic nationalism; because it jeopardizes the free enterprise system by giving priority to a centralized national governmental planning of foreign trade; because it leaves a wide scope to discrimination, accepts the principles of economic insulation, and in effect commits all members of the ITO to state planning for full employment" ("The GATT's Contribution to Economic Recovery in Post-War Western Europe" by Douglas A. Irwin, *Board of Governors of the Federal Reserve System International Finance Discussion Papers* No. 442, March 1993). There are clear echoes in some contemporary US rhetoric about the WTO!

While the conferences proceeded, some of the participants agreed to an interim General Agreement on Tariffs and Trade, GATT. It was not based on theoretical economic arguments but on the practical notion that conflicts should be minimized. While it was an international agreement, it was based less on a consensus among all the contracting parties than on what could be expected to gain approval from the US Congress. From the Reciprocal Trade Act 1934, the US Congress had been willing to authorize the president to enter into *reciprocal* agreements to reduce tariffs and barriers to trade. While US requirements were decisive, many countries were accustomed to notions of reciprocity, and indeed the idea of a reciprocal exchange of concessions was and is more instinctive than the principle of comparative advantage.

GATT, which gradually became a permanent institution, was based not on the economic argument for free trade but on a legalistic approval of reciprocal trade. GATT became an institution for promoting and registering bilateral agreements for reciprocal reductions in tariffs or other barriers to trade. From the array of institutional rules and procedures proposed for the ITO, GATT

preserved the "most favored nation" principle. Every member of GATT was to be regarded as a "most favored" trading partner, and the terms offered to any member were to be made available to all members. Negotiations took place between a member and the member which was the principal international supplier to its market; the outcome of those negotiations became the basis on which any member of GATT could supply that market. Furthermore, GATT preserved the notion that while future tariffs could be lower, they could not be increased except by agreement with all parties; tariffs were *bound*. This is now taken for granted but the idea of binding future parliaments was a novel idea to many lawyers in the late 1940s, more so to those who thought they had a constitution to which no international body could be superior.

There were further complexities. Some preferential agreements which were in existence when GATT was formed could be retained (but not increased). These mainly concerned arrangements between metropolitan powers and their colonies. The most important were the existing arrangements between the United Kingdom and members of what was becoming the British Commonwealth. Opposition to "imperial preference" was a driver of American negotiators – even then the US Congress was sensitive to anything which looked like unfair discrimination against America – but the UK resisted anything more than constraints against increases. They largely withered over the next 20 years. More enduring was provision for preferential agreements among pairs or groups of members which covered "substantially all trade", the basis for authorized "free trade agreements" which gradually became more frequent as countries experienced and became comfortable with higher levels of international trade.

Furthermore, agriculture was essentially excluded from the ambit of GATT. The US wished to preserve its own arrangements for subsidizing and managing agriculture and it secured a "waiver" from the rules of GATT. Furthermore, the US was keen to see a coordinated Western Europe able to resist the Soviet Union, and as European countries developed the antecedents of the EEC (now EU) it was able to secure for them exemption from the GATT commitment to extend concessions to all GATT members as they reduced barriers to trade among themselves. Politics of various kinds trumped economic logic from the early days of GATT.

Liberalization Under GATT

Although it was far from an economist's design, GATT presided over a significant liberalization of trading conditions. In combination with other influences such as the growth of incomes and advances in technology, it facilitated a marked expansion of international trade. The experience of the 1920s and 1930s was not repeated.

As governments became more comfortable with the experience of international trade, the basis of GATT in bilateral agreements was modified. Contracting parties agreed to prescribed reductions in tariff levels. There were still voluminous negotiations over exactly how reduced levels of tariff applied to specific products or classes of product, but liberalization of trade was greatly accelerated.

GATT developed the practice of "negotiating rounds" – meetings of the contracting parties resulting in a final agreed schedule of tariff reductions or related provisions. The rounds which existed under GATT are listed in the *Table*. From the 23 parties which negotiated in Geneva in 1947, GATT grew over a succession of rounds (each

TABLE

GATT rounds

Rounds		
1947	Geneva	tariffs
1949	Annecy	tariffs
1951	Torquay	tariffs
1956	Geneva	tariffs
1960-61	Geneva (Dillon Round)	tariffs
1964-67	Geneva (Kennedy Round)	tariffs and anti-dumping measures
1973-79	Geneva (Tokyo Round)	tariffs, non-tariff measures, framework agreements
1986-94	Geneva (Uruguay Round)	tariffs, non-tariff measures, rules, services, intellectual property, dispute settlement, textiles, agriculture, creation of WTO, etc

Source: The Economist, Oct. 3, 1998, "World Trade Survey"

named after the location of the initiating meeting) until 123 parties participated in the Uruguay Round. Remembering that GATT parties negotiated bilaterally, this means that GATT expanded from a potential number of bilateral agreements of 253 to 7,503. In practice not every pair of countries had significant trade, but finalization of a GATT round was always demanding and by the end of the Uruguay Round, rounds were fearsome undertakings.

It was not only the increased number of parties which made GATT more complex. As tariffs were reduced, other barriers to trade became more obvious. Tariffs were the most obvious deterrent to potential traders, perhaps especially so for their legal advisers, but not the only ones. There was no point in reducing tariffs if trade was prevented by another barrier. So the negotiations among the contracting parties to GATT widened. In a search for "level playing fields" provisions were added to prevent strategic behavior known as "dumping", deliberately lowering prices to eliminate competitors and then exploiting a monopolistic position created by their withdrawal. Such behavior was more often alleged than demonstrated, but provisions about "safeguards" and anti-dumping penalties were added to GATT agreements. Then subsidies by which governments changed the prices of traded goods were proscribed. Prices for specific products could be influenced not only by subsidizing what was traded but also by changing the balance of supply and demand in a domestic market. So rules were developed about subsidies not only on exports but also on domestic production.

It was always usual for tariff rates to vary among different goods. "Necessities" were often charged less than "luxuries", inputs to domestic production less than finished consumer goods. Tariffs were taxes, intended to raise government revenue and influence behavior. There therefore needed to be statements of how specific products were allocated among tariff classes. Furthermore, governments were appropriately concerned with consumer safety and specified characteristics for various goods, especially but not only sanitary and phytosanitary requirements. Conformance with standards opened up room for negotiations among GATT parties. The *Table* shows in very summary form how the range of GATT agreements widened over successive rounds,

In some contexts, "trade" has connotations of the movement of goods across international boundaries attracting the imposition of tariffs. But in economic terminology "trade" is simply shorthand for all aspects of the interdependence of distinct economies. It is sometimes said that in the past "trade" was distinct from "domestic policy". That was never true. The range of international agreements simply took time to catch up to the complexity of economic interdependence.

Alternatively we might deduce that over time understanding of GATT gradually recovered from the narrow legalistic approach to which political constraints initially restricted it, and its coverage extended to all elements of economic interdependence as had been envisaged when the ITO was attempted.

The Experience of the WTO

The Uruguay Round culminated in the creation of the WTO, but it left some unfinished business and generated new structural issues. The agenda inherited by the WTO included transparency in government procurement, trade facilitation (customs issues), trade and investment, and trade and competition. Initially there were hopes that the euphoria of completion of the long Uruguay Round would carry over into momentum for further progress, but agreements were few and far between.

The general agreements reached under GATT had never been simple matters of agreement among all members. The earliest rounds were negotiated by suitably empowered delegates at a meeting venue. But governments came to insist on direct management which improved communications made possible. The basic structure of negotiations came to be not direct bargaining with delegated authority, but meetings of negotiators with clear incentives to reach agreement (and conclude their work) but constrained by the need to obtain concurrence from their national capital where politicians consulted with affected producers and consumer groups. The basic dynamic became less a simple trading of "concessions" than determination of common ground in what negotiators could "sell" to their own capitals.

Furthermore, membership of the WTO grew. The 123 participants of the Uruguay Round grew to 164 members and 24 observers. Decision-making is by consensus, and while many decisions remain bilateral, any general rule is subject to the agreement of many governments. GATT evolved a pattern in which major participants met in a "green room" (the common term for a space in which artists prepare before entering an event space) and drafted a text to which general agreement could be expected. Those in the green room were the major traders such as the US and main European parties along with members with a special interest in the topic under discussion – Iceland for fisheries, or New Zealand for agriculture. "Green room" drafts attracted respect not only because those with the greatest interest were included, but also because the major powers could be expected to understand and respect the likely concerns of all other members.

The system was under strain by the last years of GATT because significant members were less confident that their interests were understood by parties like the US and EU. China became a member of the WTO in 2001 but it generally accepted the existing agenda of the WTO. Developing countries, however, became much more vocal and unwilling to accept the leadership of parties like the US and EU.

In addition to more members, the WTO operated in a more

complex world than had existed through most of the history of GATT. International exchange of services had grown relative to that of the more easily understood trade in goods. For some services traded across borders, it is possible to observe (and manage) the trans-border movement of customers or suppliers but even so it is not easy to measure the value of the traded services. Other services are even more intangible as when a business enterprise has a commercial presence in another country or when services are graded electronically. The WTO has a General Agreement on Trade in Services, GATS, but the issues involved engage with many more aspects of domestic policy than is the case with goods.

Two particular trends in the world economy contributed greatly to this. First, digitalization and the development of the Internet changed the role of electronic communication. Services tend to become a larger part of any economy as income levels rise but the information revolution made that more significant. Creating international rules about trade in services became much more difficult. Secondly, while trade in intermediate goods was noticed and much discussed from the 1960s onwards, the development of production networks in which tasks were distributed among producers in several economies as materials were gradually transformed into finished products was much more marked in the era of the WTO. They made it more obvious that products were composed of services as well as goods and so made more prominent the role of all regulation of services in influencing any trade among parties.

Because commercial presence is important to trade in services, provisions about investment flows among contracting parties cannot be kept entirely separate. International investment was seen as part of the responsibility of the IMF and World Bank but the boundary was not a hard one. The Uruguay Round generated agreement on Trade Related Investment Measures but the attempt to add further agreed disciplines in a Multilateral Agreement on Investment failed. International negotiations degenerated from efforts to facilitate access to investment funds and became wrangles about participation in government procurement systems, or about the terms for joint ventures between investing companies and local producers.

Efforts to develop and extend agreed rules on other aspects of economic interdependence were also fraught. In the course of the Uruguay Round, an agreement was evolved on Trade Related Intellectual Property issues, TRIPS, with clauses on topics like minimum provisions for patents, copyright, trademarks and trade secrets and with provisos for such things as access to medicines in the presence of patents. Unfortunately, the rules were written very much with the emphasis on *property* and not on the notion of rewarding *intellectual* effort which generated innovation and new resources for the international economy. More and more negotiations consisted of pressure to increase returns to owners of IP such as pharmaceutical companies and film studios, and resistance by relatively poor economies which needed access to technologies and medicines.

Even such apparently innocuous topics as trade facilitation became contested. It was narrowed from an agenda of "ease of doing business" to essentially management of regulatory processes at the border and even then it took arduous negotiations to get any common understanding on how customs procedures could be streamlined. (Using electronic systems could facilitate control of corruption among border officials and so "trade facilitation" became entangled with local politics.)

The elements of the "Singapore issues" therefore came to be not steps on a path towards further economic integration along the lines of the GATT rounds, but sources of fractious disputes among the membership of the WTO. The Doha Round, presented as a "development round", became a contest between those who saw managed integration as a means of development and those who tried to use suggested changes in the rules of the WTO as ransom for transfers of wealth to "developing economies".

The failure of WTO negotiations brought into question other elements of the WTO. Especially important is the Disputes Settlement System (DSS). The Uruguay Round generated a process whereby a party aggrieved by what it saw as an action by another party contrary to the agreement could initiate a system of arbitration. The resulting decision could be appealed to an Appellate Body (AB) and if eventually the dispute was not resolved satisfactorily, a successful claimant would be authorized to impose retaliatory action. Under GATT, discussions could be initiated but if a party refused to implement a proposed settlement, no further action was possible. The WTO was unusual among international organizations in having some (limited) powers of coercion. Small parties were especially prominent supporters of a mechanism which equalized their ability to act relative to large parties. The text of the authorizing agreement could be interpreted in various ways and the way in which panels and the AB were composed and the manner of their proceedings could be controversial.

Numerous parties used the DSS. Many disputes were settled by agreement, and some were settled after a report by an initial panel, but some went to the AB, the final decisions of which were largely implemented, if slowly and not in an expansive manner. Decisions were often controversial. Eventually the administration of US President Donald Trump decided that the DSS was no longer acceptable. This was not because the US lost cases. Claude Barfield of the American Enterprise Institute provides a convenient summary: "Of the roughly 35 to 40 percent of the disputes that end up before panels and the WTO Appellate Body, the US, which has been the most active WTO complainant, has won just under 90 percent of the cases it has brought against other WTO members. … the US has lost about 75 percent of the cases brought against it. This number is

strongly affected by the large number of anti-dumping disputes the US has lost because it has refused to change its practices after repeated adverse judgments. The US is a complainant in more disputes than other WTO members, and, conversely, it is also the defendant in more cases that any other WTO member" (https://www.aei.org/economics/president-trumps-persistent-falsehoods-about-the-world-trade-organization/).

There has always been a strong sentiment in the US that its own constitution is supreme and not to be subject to any international jurisdiction. There is an equally strong belief that US legal doctrines should prevail in any international setting. The US is not entirely alone with this – in relation to the Investor-State Dispute Resolution, the EU has expressed discontent with reliance on panels whose members might be advocates in some contexts and adjudicators in others, a feature alien to European ideas of how courts should proceed. Other parties, too, were frustrated with the slow pace of some panels and other aspects of the process. But the US alone was responsible for blocking appointments to the AB, making it inoperable. It is important not only for what it does but because its existence encourages parties to any dispute to seek amicable resolution by negotiation rather than arbitration. Without an ability to resolve disagreements, the whole structure of multilateral governance of interdependence comes into question. Participation in any international agreement requires finding common ground with others, not imposition of national processes on them.

Bilateral, Regional & Multilateral Agreements

While the WTO has had little success in generating explicit progress in facilitation and liberalization of trade, it has presided over many subsidiary agreements. GATT provided for an exception to the most favored nation clause for agreements among partners or groups of countries which agreed to lower barriers among themselves for "substantially all trade". GATT parties were required to notify such agreements and they gradually became more common. As of Jan. 17, 2020, 303 Regional Trade Agreements (RTA) were in force. (There were 483 notifications from WTO members, because goods and services were notified separately and accessions of an additional party to an existing RTA were also notified.)

"Substantially all trade" proved to be an elastic term but there was an observable trend for RTAs to become more comprehensive over time. The process which widened the GATT agenda was repeated in smaller settings. Some RTAs have substantial membership, notably the Pacific Alliance, the Regional Comprehensive Economic Partnership of the 10 ASEAN countries plus Australia, China, Japan, South Korea, and New Zealand – India having stood aside after participating in negotiations – and the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) of Australia, Brunei, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam.

The RTAs of the last 25 years have encountered the same challenges as the WTO. So have plurilateral agreements such as agreements among (most) WTO members on environmental goods and services. Nevertheless, these processes have permitted groups of economies to make progress on cooperative approaches to utilizing global resources.

Prospects for Reform

It is most unlikely that the rounds of the GATT years can be revived. There are too many conflicting national agendas and the principal challenges of economic interdependence are too complex to be resolved by set-piece interactions.

Nevertheless, there are clear examples of progress in smaller groups. As has been found most clearly in studies of International Regulatory Co-operation, the key is that members have to have deep confidence in one another's ability to manage and implement the terms to which they have agreed, and to maintain continual dialogue about how exactly they understand those terms ("International Regulatory Cooperation: Case Studies and Lessons Learnt" by Derek Gill, *NZIER*, October 2018). Frequent and collegial interaction rather than media-attractive spectacles are what is needed.

The WTO has a continuing role in ensuring that RTAs do not degenerate into competing blocs. While each RTA will have different provisions, all should be consistent with the rules of the WTO. That assumes that membership of the WTO continues to be virtually complete, and that the processes of the WTO remain feasible. In this respect it is heartening that Australia, Brazil, Canada, China, Chile, Colombia, Costa Rica, the EU, Guatemala, Hong Kong, Mexico, New Zealand, Norway, Singapore, Switzerland and Uruguay have established an interim arrangement to compensate for the absence of the AB ("EU and 15 World Trade Organization members establish contingency appeal arrangement for trade disputes" (EU statement, Brussels, March 25, 2020). Adherence to the interim agreement by members of ASEAN in addition to Singapore, and by economies in Northeast Asia in addition to China, would be especially welcome.

Equally important, however is the self-government of RTAs. They usually come with a profession of being "open". "Open regionalism" was popularized by the Asia-Pacific Economic Cooperation (APEC) forum, an Asian way of managing co-operation without the supranational apparatus of the EU. It was always an indicative rather than precise term but with the idea that membership accepted commitments among themselves without raising barriers to non-members (which is actually a requirement for approval of any RTA by the WTO). Any preferential arrangement looks like discrimination to a non-member but they should be in no worse position than they were

before. Even that was hard to establish and open regionalism came to mean that membership was open to all who accepted the conditions and obligations of membership.

That helps ensure an RTA is consistent with the basic rules of the WTO, but in practice there always has to be some negotiation about how the rules of an RTA apply to the specific conditions of an applicant for membership. As RTAs generally provide for decisions by consensus, an applicant has to satisfy each existing member that they are able to satisfy that member's interpretation of the common obligations. There is plenty of room for prejudice or importing of other considerations. The implications of adding an additional member, especially a major economy, may not be obvious – as is shown by studies of US-China conflict – even before non-economic issues are considered ("When Elephants Make Peace: The Impact of the China-US Trade Agreement on Developing Countries" by Caroline Freund, Aaditya Mattoo, and Michele Ruta, *World Bank Policy Working Paper* No. 9173, March 5, 2020).

RTAs would contribute more to progress in economic interdependence and the ideals of the WTO if they provided for some kind of technocratic assessment of how the agreement of existing members should be interpreted for application to the applicant. It is likely that comparison would be concentrated on the most comparable existing member. It would be less open to political influence (although not free from policy discussion).

RTAs consistent with WTO rules may well be able to explore the feasibility and desirability of new rules which could then spread in an incremental manner. In this way the legal provision for international interdependence could become better suited to a world characterized by the size and significance of international exchange of services, the importance of data and electronic communication, and the role of international production networks. The clearest recent example of this is the "Digital Economy Partnership Agreement (DEPA) between Singapore, Chile and New Zealand" which awaits legal scrutiny and ratification (https://www.mfat.govt.nz/assets/FTAs-agreed-not-signed/DEPA/DEPA-Chile-New-Zealand-Singapore-21-Jan-2020-for-release.pdf). Significantly, it deals with "digital economy", not "digital trade", recognizing that aspects of data management internally impinge on economic interdependence. It is a "living agreement" envisaging change in the future and committing parties to a collaborative approach as issues emerge.

Another example is the agreement again led by Singapore and New Zealand, adherents to which commit to avoiding any barriers to trade in medical supplies and equipment, and to continue to rely on trade generally. While the G20 and even APEC trade ministers could agree on only very general intentions of good behavior, the smaller group established rules to govern their behavior ("How the G20 Could Promote Trade and Investment" by Jeffrey J. Schott, Gary Clyde Hufbauer and Euijin Jung, *East Asia Forum*, April 12, 2020). New Zealand has an obvious interest in maintaining agricultural trade but its participation in production networks which are under strain because of the Covid-19 pandemic extends to parts for ventilators.

A longer established example is the attempt to create a multilateral agreement on trade in services parallel to the agreement on facilitation of trade in goods. The parallels between trade in goods and trade in services is not as simple as may at first appear – there is not a single equivalent to the processes of regulating and managing the passage of goods through customs procedures. Managing services trade directs attention to good regulatory practice. Finding common ground is likely to be restricted to groups of countries who have confidence in each other's regulatory management ("Facilitating Trade in Services" by Bernard Hoekman, *World Bank Policy Research Working Paper* No. 9228, May 5, 2020) but progress has been possible even though "good regulatory practice" is necessarily more complex than simply reducing the costs of transacting trade, since there has to be attention to the continued achievement of the policy objectives for which regulations were put in place.

Conclusion

Covid-19 has increased sensitivity to potential dangers in international dependence. It has also clearly demonstrated the value of international cooperation. The balance of these influences has yet to become apparent. For some time, the urgent is likely to dominate international relations at the expense of longer-term ideals.

Even without Covid-19, the prospects for speedy change were not bright. It is hard to develop new international rules, whether global or regional, without the participation of major economies. Enthusiasm for such participation is not common in the US, especially but not only in the current administration. Global rules cannot be formulated in the absence of the US any more than they can without acceptance by China, or India, or any other significant player but regional and plurilateral agreements can continue to develop just as the CPTPP evolved from the TPP. JS

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