

# A Way Forward – or Backward – for the WTO?

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## Introduction

Even before Covid-19 hit the world, the World Trade Organization (WTO) was in deep trouble. First, the WTO was accused of contributing to a kind of globalization which deprived many citizens in developed as well as developing countries of an equal share of the benefits of an increasingly liberal trade system. Secondly, the WTO had become no longer able to provide rules for an increasing number of new categories of international trade (e.g. the role of data-driven economy and information technologies). Thirdly, the WTO was no longer seen as guaranteeing the adherence of member states to its rules. This concerned in particular the Dispute Settlement System (DSS). Fourthly, great damage to the rules-based trading system was done by the protectionist moves of the administration of US President Donald Trump, which thought that such measures would be an easy way to deal with its structural industrial problems and unemployment.

Trump used punitive tariffs against WTO rules to force other countries to bend to his will, and singled out China in particular. Many criticisms of Chinese industrial and trade policies such as enforced technology transfer and state subsidies were justified and shared by other trading partners of China, but should have been made long before, using the WTO. Moreover, the Trump administration lost its credibility as an honest reform-willing member by its anti-multilateralism statements, as well as by its trade war measures. These punitive measures further undermined the role of the organization as they did not conform to WTO rules and seemed to impress on other members that might is right. This American protectionism also risks, ironically, putting the United States on the same level as China, which has been criticized as a major offender of WTO rules.

## The Impact of the Pandemic

The protectionist measures taken by many countries to cope with the Covid-19 pandemic have been a further blow to the standing and functioning of the WTO. This health crisis has awoken if not strengthened latent protectionist instincts in many countries, often under the guise of protecting themselves from foreign Covid-19 infections (closing borders and blocking trade), but also openly trying to procure protective health materials and medical supplies in non-competitive ways. French President Emmanuel Macron recently

admitted that some European Union members are already in effect flouting injunctions in European treaties against state aid for companies.

The US trade war with China, followed by the closure of many Chinese production sites after the virus outbreak, have interrupted – at least temporarily – many international production chains on which the developed world depends (e.g. 80% of pharmacological raw materials come from India and China). The trust in these production chains which had been developed over the years to save costs are now being questioned and will prompt many countries to want to depend less on the supply of crucial parts and raw materials from abroad.

As if these developments were not already sufficiently threatening, we don't know yet what the oncoming worldwide economic recession and trade contraction will do the ideal of a rules-based multilateral trading system, for which the WTO is supposed to be a facilitator and ultimate arbiter! The WTO expects global merchandise trade alone to shrink by 12-32%. The pandemic has not only shown the huge gap between developed and developing countries, and risks making it even wider, but has equally dramatically highlighted the failure of the political and economic system of the US, which would normally have been a global leader in coping with such a health catastrophe and its aftermath. Governments will be so preoccupied with reviving national economies through immediately visible and vote-catching fiscal and monetary measures that they will have no time and energy for more laborious and time-consuming international negotiations which would be required to repair one of the prime institutions to serve the international trading regime. The EU, another major actor in international trade, is also less capable of acting multilaterally because it is weakened by dissensions and has to deal with the impact of the United Kingdom's decision to leave the bloc. Given this difficult international trade background, one may ask justifiably whether we can still even talk about WTO reform, or whether we should rather attempt a scaled-down rescue of WTO functions.

## Missed Reforms

The WTO would have been in a better position to cope with these challenges if its members had been willing to make the organization more responsive to those who felt left behind by trade globalization (rather than relying on a slow and therefore politically increasingly

unsustainable trickle-down effect), kept up with the fast-rising diversification of the international economy (e.g. the digital economy), reformed an inefficient operational structure, strengthened its monitoring role (e.g. not allowing a major member like China to play a double game only because many Western companies made big profits in their interactions with it), and reformed the dispute settlement system.

As is well known, the member states could no longer agree on a new trade liberalization round which would have been helpful in overcoming the expectation gap between developed and developing countries. Instead we have seen a growing number of bilateral, plurilateral and multilateral trade agreements which were only partly supporting “free trade” and varied in degrees concerning their legally binding nature, let alone their compatibility with WTO rules for such free trade agreements. Moreover, such agreements favor developed countries which have greater clout and knowledge in pushing through their agenda. While there was hope that these agreements would in the end help to bring about a new global trade round, it is clear – even more now with the current Covid-19 crisis and its aftermath – that they had the contrary effect.

### Dispute Settlement System

The most talked about problem is the collapse of the DSS at the end of 2019 as a result of the US boycott over appointing new members to its Appellate Body (AB). The US asserts that the AB has repeatedly overstepped its role and mandate since the establishment of the WTO and that the other WTO members have not shown a willingness to reform the DSS. There is a consensus that the first US grievance is correct, but also that there have been many constructive proposals to remedy the situation and that the US boycott is now more a means to reform the WTO more generally to the liking of the current US administration and reflects its preference for bilateralism over multilateralism, since it can then more easily assert its strength (“America First”). Behind some of the grievances is also a growing animosity toward the trade and competition distorting policies and subsidies of China (and to some degree other countries) which are not sufficiently countered by the WTO. China still demands the benefits of “developing country” status while being now much more developed and lacking in fulfilling all its obligations to the WTO.

One big issue of the WTO is the role of state-owned enterprises (SOEs) and how to integrate them into a rules-based liberal trading

system. While other major countries also do not always live up to the letter of WTO rules (e.g., the US vs the EU regarding state subsidies to Boeing and Airbus), the case of Chinese SOEs is even more glaring and threatening to the economies of many members. The DSS is moreover slow and cumbersome, and a final judgment is often so late, even if supporting the injured party, that it fails to address the competition damage suffered in the meantime.

The urgency and need for the DSS has prompted the EU to act. In response to a European Council request in June 2018, the European Commission presented a Position Paper to address what it called the “deepest crisis of the rules-based multilateral trading system since its inception”. The paper mentions the need to create rules that rebalance the trading system and level the playing field which called notably for a better system of disciplining the use of trade distorting subsidies and control of SOEs. Another demand requests new rules to eliminate barriers to services and investment, which incidentally also contains criticism of Chinese economic policies. A third item covers the need for sustainability objectives for the global community and suggests greater flexibility in the provision of special measures for sustainable development goals.

But the major part of the EU paper deals with the US complaints about the DSS and how to reform it. In this matter the EU has shown particular initiative because the US boycott of nominations practically ended the operations of this system in December 2019.

Since the US continued to stall and seemed unwilling to compromise, the EU and 15 other WTO members (including China, but not Japan!) decided on March 27, 2020 to set up a Multiparty Interim Appeal Arbitration Arrangement that will allow them to bring appeals and solve trade disputes among themselves. This arrangement is to be inside the WTO and only of an interim nature. It became effective on April 30.

### US-China Relations

Any consideration of WTO reform has to take into account the impact of worsening US-China relations. The US now considers China as the main adversary and challenger to its global supremacy, and is using the Chinese origin of the Covid-19 pandemic as a tool to attack the Chinese government. Moreover, Trump and the Republican Party are employing their China criticism in the presidential election campaign to present the Democratic Party as “weak on China”. The competition between the “Panda huggers” and “China bashers” has

had quite a history in presidential elections during the last decades, but it is very different now with a known radical “China basher” dominating a previously pro-international trade Republican Party and now vying for a second presidential term. Whoever wins the presidential election will have to take a much more adversarial stance against China as the US mood has moved so far in that direction.

Many US complaints about the operation of the WTO are shared by other countries, but they should have been addressed more forcefully long ago instead being allowed to accumulate and reach an incendiary degree of confrontation. At its most fundamental level, the political economic systems between Western bloc countries like the US, European nations and Japan on the one hand, and countries like China, India and Vietnam on the other, seem incompatible. Accordingly, the latter countries are perceived as engaging in unfair trade practices and the WTO as incapable of reining them in. These countries are also accused of being late in required notifications and deficient in their transparency.

Whereas the EU has now also called China a “systemic competitor”, it has not gone as far as the US and the latter will not be able to count on EU members to make a common front against China. How far these dissensions between the EU and the US will soften the Trump administration’s position is impossible to say, but it will make WTO reform even more difficult. The EU still considers China as a vital trading partner and Beijing is cleverly exploiting dissensions among the EU members over the bloc’s China policy. The UK government has been seen as being particularly friendly towards China, possibly in the hope of offsetting any trading losses that might occur from leaving the EU by concluding advantageous agreements with China. It was the first European country to join China’s Asian Infrastructure Investment Bank in 2015 and it refused in 2019 to exclude China from joining the building of the UK’s G5 network. How the British government can strike a balance between a China-friendly trade policy and an advantageous post-Brexit trade agreement with the US remains to be seen.

### Globalization or De-Globalization?

A tendency towards de-globalization rather than increasingly wider globalization is fundamentally alien to the principles of the WTO. Trump wants to level down the current huge economic interdependence between the US and China. It will be crucially important in addressing WTO reforms to convince the global public

that the rules-based international trading system between countries with vastly different political and economic governance systems can be made fairer. Similar stark choices apply to the protection of the global environment and global health which incidentally make the future of the international trading system even more fraught with difficulties. It is difficult to share Macron’s recently expressed hope that the pandemic which has prompted governments to prioritize human lives over economic growth will become an opening to tackle environmental disasters and social inequalities.

Without properly addressing the tensions between economic nationalism and economic interdependence over the long term there will be little hope of convincing the public in either the developed or developing world of more fairness. A fundamental change is needed in how to distribute the benefits of the liberal economic exchange system of which international trade is an integral and indispensable part. A simple return to yesterday is not sustainable. Unfortunately, even the public in the wealthier and stronger nations may be more persuaded to believe in economic nationalism – until they feel the blow-back in the form of more refugees and lost markets as a result of economic failures in the weaker countries.

Public support for a rules-based international trading system and further globalization rather than de-globalization has further been eroded by the Covid-19 pandemic. In an opinion poll in April 2020, 46% of French people (an increase of 6% over a similar poll in February 2020) said they want a deep reform of the liberal economic exchange system. The percentages in Germany and the UK were somewhat lower. There are similar figures for those expressing the need to control borders more tightly. These concerns are shown in opinion polls in countries which have benefited much more from the international trading system than those in the developing world!

One concrete illustration of the dilemma between further globalization and de-globalization, economic nationalism and economic interdependence, and development and protection of the environment concerns the future of our far-flung production chains. More national production and shorter production chains are now demanded by many companies (but also by people concerned about the environment) which have been hurt by natural catastrophes, technology theft and epidemics. However, the system of long production chains provides more opportunities to those countries in the Third World which surround the major developed countries but have been clamoring for a fairer share within and outside of the WTO framework.

Addressing the demand for more fairness in sharing the benefits of the rules-based trading system must therefore include more investment by the developed world in these countries. However, as a result of the current pandemic the trend seems to be for shorter production chains, and not only for the above reasons: Western companies are reluctant to widen production chains since the countries involved have mostly weak governance systems, underdeveloped infrastructure, low skilled labor, and are in some cases threatened by terrorism and civil wars.

### Conclusions

There is no point in simply preaching the need for the maintenance of a liberal trading system, with the WTO as its major multilateral institution, without squarely confronting the above obstacles and having modest expectations of the functional and geographic scope of the WTO's future. If we assume that the WTO cannot exist without the US or China because of their immense role in the international trading system, is reform of the WTO with these two adversarial countries possible? Would anything alter Trump's perception that the WTO allowed the US "to be treated unfairly while the US was adhering to WTO principles on protecting intellectual property and ensuring fair and equal market access" as the president put it in his address in 2017 to the Asia-Pacific Economic Cooperation meeting in Da Nang? In this speech he stated that the US would henceforth deal with trading partners on the basis of bilateralism and not submit itself to third party arbitration. By leaving the Trans-Pacific Partnership Agreement despite Japan's strenuous efforts, boycotting the DSS, and imposing non WTO-conforming tariffs on several countries, Trump has shown that he is sticking to his position. And even if there was an attempt to reform (or reinvent) the WTO along US-proposed lines, China and other countries would not agree to it. Moreover, American coercive measures are poisoning the atmosphere and repulsing countries who share many of the American complaints about the WTO. A further issue of contention between the US and other countries is how to integrate the major Big Tech companies like Amazon, Apple and Microsoft into the world trade system, particularly after they seem to have become even more powerful as a result of the pandemic.

The best one can hope for is a new US administration in January 2021 taking a less confrontational and radical approach to WTO reform. Given the current US-China conflict, the reluctance of most

other WTO members to agree to the US proposals (assuming they are actually made in good faith), and the global preoccupation with the pandemic and its grave economic consequences, nothing will be settled until at least 2021. But even then we may have at least a very divisive and partisan American political landscape where any compromise conducive to WTO reform would be very difficult while China is able to exploit any divisions in the developed as well as the developing world to its own benefit.

In the short run, it will be best to concentrate on very limited issues where at least some member states can find a consensus. One example is the above-mentioned EU-sponsored agreement for the establishment of the Multiparty Interim Appeal Arbitration Arrangement to replace temporarily the DSS. Another limited issue concerns countermeasures to deal with the impact on trade caused by the pandemic. On April 22, the EU and 21 other WTO members, at the initiative of Canada, pledged to ensure well-functioning global agriculture and agri-food supply chains and avoid measures with potential negative impact on the food security, nutrition and health of other members of the organization and their populations. Although it is only a pledge to avoid further damage to international trade in one limited albeit important area, the statement was signed by the US, Japan, Taiwan and other major Western countries, but not China.

Further ahead one can imagine various coalitions of the willing to establish frameworks which will (temporarily perhaps) take over various WTO functions deemed important enough by a sufficiently large part of the membership to make sense. The establishment of such frameworks will depend on political leadership which will have to come from major trading nations other than the US or China. Japan, and particularly the EU as the biggest single trading bloc, will have a special responsibility whereas smaller trading nations (Canada, Norway) can create important initiatives and help iron out differences. These various measures and frameworks may or may not ultimately coalesce into a re-invented WTO with fewer functions and global reach, or just be *à la carte* adjuncts to many bilateral, plurilateral and multilateral trade agreements. In any case, we may have to move backwards before we can hope to move ahead. **JS**

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