

# International Economic System Standing on the Edge of a Cliff

By Masakazu Toyoda

The crisis in Ukraine, which began with the military invasion by Russia on Feb. 24 this year, has not only brought tragedy to the people of Ukraine, but is also causing many people around the world to ask serious questions every day as to why this is being allowed to happen. And we are reminded that the postwar world security system was only possible with the United States as the world's policeman, in addition to the security scheme of the United Nations.

We are not qualified to criticize the US. It is a big power, but it is no longer a superpower. It is time to consider our responsibility as free riders. It is not only the global security system that is broken. In fact, the international economic system is now standing on the edge of a cliff.

The WTO, which moved from the postwar GATT system to the more robust WTO system in 1996, with its two-tier dispute settlement system, is unfortunately now dysfunctional. In some countries, there has been growing dissatisfaction mostly with deviations from the stipulated function of the Appellate Body, and since December 2019 no members of the body, the superior tribunal, have been appointed, resulting in the absence of judges. This is despite the fact that the Appellate Body was called the “jewel in the crown” when the WTO was established.

As for its legislative function, it has been adrift long after the breakdown of the 2008 ministerial meeting held to finalize the Doha Round. In the past decade or so, many FTAs and RTAs have been agreed to because it is practical for a small number of countries to agree to remove trade barriers. However, these FTAs and RTAs have recently been in a state of stagnation. This is because anti-globalization sentiment is growing not only in the US but also in many other countries.

Is globalization really a negative factor? It is undeniable that there are some industries and companies that require structural reform. However, this can be overcome by appropriate policies. From the perspective of overall optimization, globalization is a great plus not only for each country and region, but also for the global community.

With this in mind, the Japan Economic Foundation (JEF) convened a study group of domestic and foreign experts with the aim of reconstructing the international economic system, and recently compiled a set of recommendations in seven fields titled “A Rules-Based International Economic System Japan Should Pursue”.

For details, please refer to the special roundtable discussion and the recommendations in this issue. Here, we would like to summarize some of the major trends.

(1) Regarding the “revitalization of the WTO”, it is inevitable that the Appellate Body should be restored. But it is essential to

build a consensus on the role of the Appellate Body at an early stage. Until this is realized, the interim alternative appeal system, mainly in the EU, should be utilized, rather than shelving matters by appealing to the non-existent Appellate Body.

(2) As for “utilization of RTAs”, while the US has withdrawn from the CPTPP, China and Taiwan have applied to join it. While China's interest is welcome, it is important to carefully assess whether China is in a position to comply with rules on such issues as intellectual property and forced technology transfer. Furthermore, the EU and the CPTPP should begin to explore connections and linkages. With the addition of the US, it is expected that the CPTPP could become a “stepping stone” for multilateral rules, similar to the WTO.

(3) As for “China's market-distorting government support”, for example, non-participation in the WTO's Government Procurement Agreement is feared to leave foreign companies effectively discriminated against. Sovereign funds also have the potential to distort markets due to their high risk-bearing capacity.

(4) Regarding “new rule-making”, it is necessary to realize the formation of new rules outside the WTO as well. Digital, cyber espionage, theft of trade secrets, prevention of human rights violations, trade and labor, and the environment are important areas. In particular, with regard to carbon border adjustment, before harmonization with WTO rules, sufficient consideration must be given so as not to provoke opposition from developing countries that the cause of global warming lies with developed countries, which have large cumulative emissions to begin with.

(5) In developing “economic security” policies, sufficient consideration must be given to the balance with the free trade regime in order to avoid protectionism.

(6) In areas where it is difficult to establish hard rules, a “soft-law approach” using such organizations as APEC and the OECD should be considered.

(7) Finally, the effectiveness of “rules-based solutions to territorial disputes” should be examined. From this perspective, the final act of the Ukraine crisis will be important. If it becomes clear that power-based solutions are not effective in international disputes, it is expected to provide an opportunity to seek rules-based solutions.

And it will be Japan that will take the initiative in implementing these recommendations. It is Japan that has benefited greatly from a rules-based, rather than power-oriented, international economic system. **J.S**

Masakazu Toyoda is chairman and CEO of the Japan Economic Foundation (JEF). He previously served as chairman and CEO of the Institute of Energy Economics, Japan, after having been vice minister for International Affairs at the Ministry of Economy, Trade and Industry.