

Interview with Prof. Bernard Hoekman, Director of Global Economics at the Robert Schuman Centre for Advanced Studies, European University Institute in Florence, Italy

# Rule-Making in International Trade at a Crossroads – Views of a Trade Policy Expert

By *Japan SPOTLIGHT*

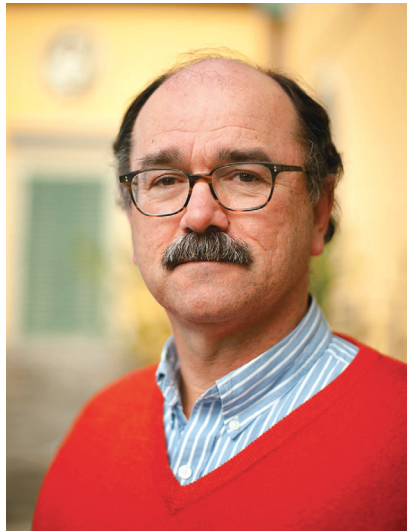
Our *Japan SPOTLIGHT* July/August 2022 issue highlighted a wide range of topics related to the pursuit of a rules-based international trade order. Given the importance of both domestic and international politics in the process of economic policy decision-making, we interviewed Prof. Bernard Hoekman of the European University Institute, a distinguished trade policy expert and former economist at the GATT. (Online interview on Sept. 12, 2022)

## Background of Crisis of International Economic Order

**JS:** Against the background of rising nationalism in some advanced countries' domestic politics and geopolitical crises such as in Ukraine and the US-China confrontation, how do you view the nature of such crises in the international economic order? Do you think there could be an unprecedented historical crisis?

**Hoekman:** In the background, we have seen this coming for quite a while and you see it reflected in the difficulty that WTO members have experienced in negotiating new agreements. We have also seen it in the tension with the appellate body in the WTO. All of that has been building up for some time. There are several factors in the background to the current crisis. One of them is rebalancing of the world economy; the system was very much designed by mostly OECD countries. It wasn't really designed for a world in which we have very large countries with very different economic systems with very different governance approaches, not to mention very different political systems.

Although politics shouldn't be that much of an issue for economic cooperation, it is one big factor that revolves around how incumbent countries deal with China and the competitiveness of China but also the sheer size of the Chinese economy and the important share that it now accounts for in terms of world trade. There are many allegations about subsidies and state-owned enterprises (SOEs) and how international competition is distorted. The new factor that has become a lot more visible is dealing with the potential or the actual



*Prof. Bernard Hoekman*

exercise of economic power and military power.

We are seeing this in the context of Russia's invasion of Ukraine; we are also seeing it in recent years in other areas such as countries restricting trade of critical products as a way of exercising leverage. The European Union has become more focused on linking trade to non-trade objectives – labor standards, environmental protection, sustainable development and so forth.

Again, these are not necessarily new issues, but we are seeing large economies increasingly using trade as an instrument. Some nations are using trade policy to coerce other countries – including in the extreme case of war in Ukraine. But more generally we are seeing a trend towards linking trade to

non-trade objectives.

## Restoring the WTO

**JS:** The key question is how to revitalize multilateral trading systems. We need a rules-based international order to avoid falling into power games, but how should the WTO be revitalized?

**Hoekman:** It's a very important question. To a very large extent it depends on what the large trade powers are going to do and then that boils down to the question: do these very large trading blocs see value in having an effective WTO as a tool to deal with their problems? Much of the focus and discussion on the WTO has been for a long time now on how to make trade work for development and how to deal with a very heterogeneous membership. Most WTO members are developing countries and many of them are low-

income economies. One challenge is to make the WTO a more effective instrument in addressing issues of development while at the same time providing a platform in which large powers work out potential solutions to their problems, while ensuring that everyone has a voice.

Conditional on EU/US/China/Japan seeing the WTO as a potentially useful platform to deal with these issues, we need two types of changes. On the one hand we need to fix the machine as it is not working very well and we don't have a functioning dispute settlement system. We also lack a clear framework for allowing groups of countries to negotiate agreements amongst themselves that everyone would benefit from but that not everyone has to participate in. We don't have a robust mechanism to bring "open plurilateral agreements" into the WTO.

To deal with the problems that are created by subsidies or SOEs, you need a negotiated agreement between the EU, the United States, Japan and China. Those countries need to agree to new rules of the game but there is no need that all WTO members do so. WTO reform that facilitates plurilateral cooperation is important and involves rethinking the consensus working practice. Everything in the WTO works by consensus and this is one factor that has blocked progress not just in terms of negotiations but also in terms of deciding the agenda of committee meetings, and thinking about what WTO membership should be discussing. Many WTO members have recognized consensus as a problem and are moving forward in discussing matters that are of shared interest.

The dispute settlement problem is serious. The appellate body is no longer operational which means we don't have effective dispute settlement anymore. An important area for WTO reform is to make dispute settlement operational again. To date there has been a lot of focus on bringing the appellate body back. That focus is not necessarily a constructive approach – we need to have a discussion as to why the US is so dissatisfied with the appellate body and refocus the discussion on what do we need from an effective dispute settlement system and then consider the institutional framework to get there. This will probably involve some kind of appeal system but not necessarily an appellate body type approach. We need to step back, be more open, and be flexible in terms of what we have learned from the last 25 years of dispute settlement and how to improve it.

A necessary condition for this type of discussion is to be honest about what are the real problems the US and other members see with the system. We really need to have an approach that is open, substantive, and constructive.

**JS: What do you think about the EU proposal for a Multiparty Interim Appeal Arbitration Arrangement (MPIA)? Do you think it could work as a temporary**

**solution to restore at least tentatively the function of the dispute settlement mechanism?**

**Hoekman:** It was a creative solution to an urgent problem. But I don't think it is the solution partly because it didn't involve the whole membership; there was no real thought given to its institutional design and governance. Essentially it was a replacement for the appellate body and to keep an appeal system in place. The real test is discussing how to put in place something that is more long term and that everyone agrees with. If that doesn't happen, the MPIA offers an appeals opportunity. A major test of how well that is going to work is whether disputes between the EU and China will be brought to the MPIA, as both are members – then we will see if it actually works. As it stands, most WTO members haven't joined and they are waiting and looking for a more permanent solution to the conflict on the appellate body

### **Possible Contribution of Regional FTAs**

**JS: What is your view on the possible contribution of regional trade agreements to the restoration of an international economic order? For example the CPTPP and the Japan-EU FTA – would the integration of those two be a good replacement for the WTO or at least some parts of the multilateral trading system? Or the possible integration of the RCEP and the CPTPP that could eventually lead to an APEC FTA?**

**Hoekman:** It would help. If you look at where rule-making has occurred in the last 20 years on trade it has occurred in the context of these types of agreements, not in the WTO. At the same time there have been lots of efforts at trade agreements that have failed. The TTIP was one example; the Trade in Services Agreement is another example where we had failure. Now China has knocked on the door of the CPTPP so insofar as it actually ends up being a successful process, China could accede to the CPTPP and this would be a very challenging process.

The United Kingdom of course has also asked to join the CPTPP so we'll have one European country as part of it. If you think about the dynamics this would create for the WTO, in principle you have pretty much all of the major players agreeing on a set of rules that go beyond what we have in the WTO. If you could bring that to the WTO and link it somehow by saying there are elements of the CPTPP that we can extend to everyone and make into plurilateral agreements, then that might be a stepping stone towards revitalizing further some of the discussions in the WTO.

The big question here is the US. Former President Donald Trump

made it very clear that trade agreements in his view were bad for the US and the administration of President Joe Biden has essentially said the same thing in a different albeit more diplomatic way. The US has made it clear that it is not interested in negotiating new trade agreements and intends to pursue other types of cooperation not involving market access. So that's where I see the potential for the path of a CPTPP-based kind of exercise where you take elements of the CPTPP which don't involve market access and you say let's bring some of those issues to Geneva in the WTO.

**JS: How do you assess the US proposal about the Indo-Pacific Economic Framework (IPEF) that doesn't include any market access? Many East Asian countries would not be very interested in promoting it. Do you think the US should provide market access in the IPEF negotiations as quickly as possible?**

**Hoekman:** This is the issue I was just raising, whether you can or need to turn these things into trade agreements. Clearly everyone has an interest in market access including the US, but a lot of what is being discussed now including in the IPEF is non-trade issues and regulatory policies. Partly these are security related but a lot of it is to do with regulatory questions. Those are things we need to deal with as we move towards a digital economy as technologies are changing and we need to worry much more about issues related to cybersecurity. There are a lot of areas where we need cooperation.

If mechanisms like the IPEF do that it would be useful. The approach makes it much easier to involve other countries as long as it is designed to be open as opposed to closed agreements. The trouble with trade agreements is they tend to be closed and we often see agreements among several countries where it is very difficult for other countries to join them. So going back to your previous question, in terms of connecting the CPTPP to the Japan-EU FTA that sounds straightforward conceptually but in practice it's going to be very difficult because there are different approaches, so doing it is complicated. The one thing the CPTPP has that most agreements don't – which makes it a rather unique instrument – is that it is open to new accession. Most trade agreements are not.

**JS: There are trade agreements like the IPEF that do not include market access but include non-tariff trade barrier-related issues. Is it correct to assume that once such an agreement is done on some non-tariff barriers, the result will be multilateralized? Could this be an incentive to implement such trade negotiations?**

**Hoekman:** It is very much akin to the discussions that have been ongoing for a long time, and we have agreements now on trade facilitation where we say, OK we take as given whatever our country is doing in terms of tariffs or in terms of regulation, but it is really about facilitation. It is about simplification of procedures; it's about reducing red tape. We're not questioning the policy that is being applied, we are trying to work together to reduce transaction costs, and the implementation costs for business and for the government.

A lot of what is in the IPEF is really on those types of issues. Clearly they are important from a market entry point of view, but we are not talking about commitments on trade policy, rather about how to define what is good policy. It is more about coordination and equality and recognizing each other's regimes. All of this is going to be good for business and also for the regulators because it makes their lives easier as they need to do less to actually control what is being done in another country in terms of products, goods and services that are being traded. It is a different mindset in a different framework that we are inching towards – you are seeing some of that happening in these joint-statement initiatives of the WTO as well.

**JS: As you mentioned, an emerging China is really a challenge. How to modify China's market-distorting government support or regulations and how to encourage China to adopt a more rules-based approach will be very important questions. Given that China is interested in joining the TPP, would you agree that it could be invited to join the CPTPP if it first improves its trade or industrial policies?**

**Hoekman:** The mere fact that they have knocked on the door is already a very good signal because obviously they have already done their homework. They have really studied the CPTPP and they know what is in it; they also know what is going to be expected of them and they have decided internally that they can handle it. I think that is a positive signal. They have already joined the RCEP and so there is some scope for optimism to do this; but clearly we're not going to see China changing its economic system. However, if you look at the track record of China's compliance with WTO rules and dispute settlement rulings, it's actually pretty good.

Maybe those WTO rules weren't good enough and this is something that the CPTPP is going to try to address. It suggests to me that there is scope for some optimism in terms of dealing with some of the policy spillovers that are created by what China does in terms of the operation of its SOEs. One thing I would point out in this regard, and again to be cautiously optimistic, is that in what was agreed between the EU and China and in the comprehensive agreement on investment there were very specific provisions that

had to do with SOEs, and there was a creative approach found by the negotiators to operationalize this.

This suggests that there are potential things that have already been worked out by negotiations on how you might move towards more competitive neutrality and ensure that there is more transparency. A key element of this is whether China will see it as in its interest to consider making explicit commitments on these types of issues. I think the Chinese government is very aware of this; there's a lot of waste associated with the subsidies that are being given today, so putting in place a system where you have more transparency and greater accountability in terms of the allocation of subsidies will improve efficiency in China and that is in their interest.

A necessary condition for moving forward is that there is greater awareness and focus on things that are important in an economic sense. This requires analysis and it requires an entity that collects the information needed to assess the effects of subsidies and SOEs. We need to have more of an economic approach to inform negotiations. In Europe there are still many SOEs but there is a system to ensure that those firms compete on commercial terms with private firms. Elements of such systems could also be adopted and put in place in an international framework. To cut a long story short, there is quite a lot of scope for progress on negotiating agreements, but we need to work harder to identify and focus on issues that are likely to have the biggest benefits for both sides. Balanced is needed; it can't just be good for one side but bad for the other.

## **Balance Between Economic Efficiency & Security**

**JS:** I agree with your assertion that economic analysis should be highlighted, but we are living with a rising geopolitical crisis and the concept of economic security is emerging. Put simply, we need a balance between economic efficiency and economic security, and I'd like to hear your view on how to achieve an equilibrium between the two.

**Hoekman:** That is where you really need to have the analysis because I don't know what economic security means. The first thing we need to do on a national basis whether it's Japan or the EU is to be clear in our own minds about what we mean by economic security and what constitutes economic security. Given some clarity on what that means, the next step is to think about what instruments we need to actually get us to achieve or increase our economic security. To what extent does that involve trade policy and to what extent does that involve other types of policies? There has been too

much of an immediate knee-jerk reaction by many politicians that says, "Oh well, we get to economic security through domestic production."

Now obviously that is going to come at a very high efficiency cost because after all we don't have it now. So we also need to be very transparent and explicit about the tradeoffs and that brings us back to the need for this type of economic analysis just to make informed decisions. You would need to know how much more economic security you will get, assuming we define what that means, and at what cost. That is a discussion which we have not really had in terms of public discourse.

There has been talk about supply chains failing and that products need to be produced locally. But the facts suggest that relying on international trade has worked quite well. The Covid pandemic was quite a unique situation where suddenly everyone wanted the same products but there wasn't enough global supply. Again, I would go back to the need for explicitly focusing on what our objectives are and what we need, and then to think about how we get there and what the costs would be.

Clearly, diversification is part of the solution but we need to ask ourselves to what extent is the private sector already doing that? Because they have suddenly seen what can happen in a world which is more dangerous in the sense that governments can say we're going to shut down trade. That is something we certainly learned from the pandemic and it's something that is going on now with Ukraine and Russia and the sanctions that are being imposed by both sides.

**JS:** In talking about economic security, some people are referring to sensitive technologies. In terms of what you said, we need a very vigorous definition of what sensitive technologies are to narrow the scope of protectionism.

**Hoekman:** Absolutely, and that needs to be very explicit and to be the focus of analysis and evidence. Again, what is critical, what is essential? To some extent on the high-tech side it'll probably be a bit easier. We will have control systems already in place. We have export controls and investment screening systems already in use. So some of that is there but we need to draw boundaries around this.

Again, we need to be clear what we are talking about and to what extent we are talking about technologies that are really at the cutting edge as opposed to products that are not high tech and can be sourced from many countries. And there the issue really becomes one of do we have enough sources of supply to ensure security, and do we have access to those products? In most cases I would think these do not require domestic production and forgoing the gains

from trade. In most cases, security is not going to require 100% domestic production.

## Areas Where New Rules Are Needed

**JS:** Aside from economic security issues and some other issues related to geopolitics, there are new areas requiring new rules. As you mentioned, the digital economy is certainly one good example of this. We also have the issues of human rights and labor standards, the environment and cyber security. How do you assess the feasibility of rule-making efforts in these new areas?

**Hoekman:** A lot of this relates to figuring out how to achieve non-trade objectives, for example consumer protection or data privacy. How do you achieve those goals in a way in which you minimize adverse effects on trade? That is an old question but there are new issues with new technologies so people don't necessarily know what the answers are. Putting in place platforms where the experts and the regulators and the trade people can sit together and discuss what we are trying to do, what works and what doesn't work, is very important. Ultimately the focus needs to be on figuring out what is good policy. Assuming we care about data privacy, what are good policies to ensure that we meet that objective in a way that we still facilitate and allow trade to occur?

Often there will be common, shared objectives; the focus should be on the options to achieve these objectives. How can we do that while still facilitating trade? We need to cut these things up into different categories. On the one hand we have technical types of issues that relate to standardization and domestic regulations which influence trade. Partly the solution is international standardization, which is what we are seeing in the area of food safety, for example. There has been a steady shift away from national standards towards international standards. We are going to see the same thing in other areas but will need a mechanism for agreeing on what those standards are. There are many international organizations able to do that and that's not a role for the WTO as it is not a technical standards entity.

The other bucket is global emergencies and global challenges. These affect everybody. Climate change of course is the prime example, but dealing with pandemics is another example. Cooperation here is more difficult than it is on technical matters. Again, you need systems in place to assist governments in identifying what they need to do to help achieve national objectives that contribute to the global public good. This not an area for the WTO. We have the Paris agreements on climate, and we have the ILO

that has for a long time already agreed on international conventions for labor rights and labor standards. So the issue becomes one of enforcement and that's where trade and thus the WTO comes in.

We are seeing an increasing willingness by some of the larger countries to use trade as an enforcement device. That is certainly the case with the EU which is a leader in this area. Increasingly you are going to be in a situation where you cannot export goods to the EU if the company involved does not meet labor standards or does not exercise due diligence over its supply chains.

There are two dimensions here: one is what are the rules and standards (which is mostly a technical issue)? The EU applies international labor standards, and for the environment it is taking the Paris agreements seriously. Second, there's the implementation side of this – how do you use trade? There is a need for rule-making because right now this is decided unilaterally. It would be much better to agree to discuss these issues in Geneva around the WTO table and to agree on how members should use trade to attain non-trade objectives. WTO reform could facilitate that type of discussion, because it's not going to be done by 164 countries. This is much more likely to involve a plurilateral process where the focus is on what makes good practice acceptable in terms of the use of trade policy to enforce these types of non-trade obligations or commitments.

## Role of Group of Like-Minded Countries in Rule-Making

**JS:** How do you assess the role of a small group of like-minded countries in rule-making on such new issues? How do you view a softer approach such as APEC or the OECD that don't have enforcement mechanisms, but that could have a peer review approach?

**Hoekman:** It is quite important partly because it ensures that there actually is a discussion on a particular issue and that there is a focus on what makes sense, what the different approaches are that different countries have taken, and so on. That is very much the APEC model, and it has been proven to be quite valuable in helping governments and officials to figure out that there might be different ways to skin a cat, so to speak. However, it can also be a coordination device. Insofar as there are emerging agreements in a particular area that make things a certain way, if everyone moves in that direction then we might not need enforcement.

This goes back to your question about non-trade arrangements. Insofar as everyone agrees it might be self-sustaining, then technically speaking we have a coordination problem. We don't have

a conflictual situation as such, and you don't need enforcement. What you call "soft law" is a bit of a misnomer. It is not that there isn't any enforcement, it's that we have systems in place where countries work together to try and apply policies that achieve their objectives in an efficient way. Platforms and institutions like APEC and the OECD are important. The advantage of the OECD is that it has a secretariat, while in APEC the secretariat is much smaller. Somebody needs to do that work of putting together a picture of what the countries are doing in an area and then analyze the effects. What do we learn from implementation experience? That is extremely valuable and is necessary when we start talking about regulatory types of instruments. Eventually that might lead into a collective assessment that having some binding rules is beneficial for everyone but that has to come out of the process, as opposed to saying we must have hard law as opposed to soft law.

## **Rule-Making in the Post-Ukraine Crisis Era**

**JS: The Ukraine crisis could eventually lead to a power-based solution which would usher in a power-based national security system that could negatively affect the trading system. What do you think will be the overall impact of the Ukraine crisis on the rule-making system – not only the trading system but also national security systems?**

**Hoekman:** It has really focused the minds of policymakers in Europe and in the US in terms of the need to take these types of risks into account and to be more assertive and willing to do what the economic textbooks tell you that you can do if you have some market power – which is to exploit your terms of trade.

We are seeing the EU being more assertive and this comes under the heading of strategic autonomy. Russia's invasion of Ukraine has made clear that we need to reduce dependence on potential adversaries but also more generally reduce dependence on suppliers that have excessive market power. There will be much more of a focus on ensuring from a policy point of view greater diversification and sources of supply for essential products. Economic security is defined in one simple way – ensuring where there is extreme dependence on one or two suppliers for goods and services. That doesn't really have implications per se for international rules and order, it is just national policies and trying to ensure and encourage firms to do more to diversify.

Another implication of the Ukraine crisis will be the acceleration of the move towards renewable energy, so from the energy side of things a lot of the actions that should have been taken a long time ago are now going to be taken on an accelerated basis. This again

has nothing to do with the international economic order as such, it has to do more with internal politics. In the EU for example we've been talking for a long time about a single market for energy and interconnection of the grid, which has gone much more slowly than it should have done for nationalistic reasons.

So all of that is going to be accelerated and from that point of view is actually a positive in terms of pushing countries to do what they need to do in any event. The other thing that is likely to happen in terms of national security is that we're going to see more and stronger coalitions of like-minded countries who share common values to cooperate on regulatory types of issues on the non-trade side but also trade. To return to the EU, it has been re-focusing on negotiation of trade agreements and partly this is to ensure a more diversified set of suppliers and compensate for the fact that things in the WTO are not going particularly fast.

However, there's nothing new here per se. It's just that we get some more wind in the sails and as I mentioned earlier the big question mark here is regarding what the US will do. Again, I think we're going to see less in the way of multilateral trade agreements and rule-making and more in the way of plurilateral cooperation. So insofar as WTO reform efforts succeed – which depends a lot on the big players – we might see more cooperation in the WTO. It is still very much an open question whether nations are going to go down the route of working with friends and are going to see less of a multilateral trade order and more one that is tied around allies and coalitions and clubs.

All these things are going to play out on the margins. We're not going to see a big shift from one to the other, partly because China is so integrated into the world economy. They have a huge interest in keeping the multilateral trade system working and I think what we talked about earlier, the signal of knocking at the door of the CPTPP, is a very important one. Assuming that works, we may see more happening in the WTO. Assuming that fails and we go more down this track of geopolitical rivalry and bloc formations, then of course it's going to be bad news for the international economic order. **JS**

Written with the cooperation of Joel Challender who is a translator, interpreter, researcher and writer specializing in Japanese disaster preparedness.