

2nd Edition



Future of the Global Trade Order

Edited by
Carlos A. Primo Braga and Bernard Hoekman



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Craig VanGrasstek, according to *The Economist* (January 22, 2000), “keeps a sharp eye on the politics of trade.” He has taught this subject at the Harvard Kennedy School of Government since 2000, and has been president of Washington Trade Reports since 1985. Dr. VanGrasstek's clients include the World Trade Organization, the Organization for Economic Cooperation and Development, the United Nations Conference on Trade and Development, the Latin American Economic System, the Organization of American States, and many other international organizations, as well as government agencies and private firms. He is the author of *The History and Future of the World Trade Organization* (WTO, 2013) as well as other books, chapters, journal articles, and monographs. Among his other projects have been advising countries on their free trade agreement negotiations with the United States and accessions to the World Trade Organization; designing and executing capacity-building programs in trade policy; preparing national trade strategies; and aiding firms and governments in trade disputes. He holds a doctorate in political science from Princeton University and has worked in over four dozen countries on five continents.

Foreword

Multilateralism is under threat. In recent years, the inability of WTO members to conclude the Doha Round has led many to question the effectiveness of one of the major pillars of global governance and the commitment of governments to the multilateral trade order. Matters were compounded in 2016 by the election of a US president who espouses a strong preference for bilateral trade agreements and questions the benefits of multilateral cooperation, and the referendum in the UK in favor of Brexit.

As argued in the contributions to this volume, the performance of the international trade order is better than it is perceived to be, but confronts major challenges. The WTO has enhanced the rule of law in commercial policy, as exemplified by its effective and unique dispute settlement mechanism and the accession of large new trading nations, most notably China. But major shifts in economic power balances since its creation in 1995 have made it more difficult to negotiate new rules of the game and led countries to turn to preferential trade agreements. These increasingly address areas of policy that are not, or are only tangentially, covered by the WTO, and raise important questions regarding the future of the world trade order.

The contributors to this book make a strong case that it is past time that WTO members move away from a business as usual approach, but also demonstrate that there are strong incentives for multilateral cooperation to both address longstanding policy concerns – such as agricultural support policies – and to fill global governance gaps in new areas, such as regulation of the digital economy.

The original idea for this book came from debates about the future of the WTO in which the editors and contributors have been engaged. The book was designed also to serve as a reference text for the International Trading System program offered by IMD, which involves several of the authors that contributed chapters for this publication. This second edition updates all the contributions in the first edition, and includes new chapters reflecting on the forces impacting on globalization, prospects for US trade policy and competition policy and the global trade regime. Comments and suggestions from Stuart Harbinson, Abdel-Hamid Mamdouh, and Victor do Prado, among many others, were extremely helpful. Funding from Philip Morris International, and support from Fundação Dom Cabral and IMD's Research Department, are gratefully acknowledged. Professional editing was provided by Anil Shamdasani.

I am very pleased that the Global Governance Programme at the Robert Schuman Centre for Advanced Studies has been a partner in this effort and contributed to bringing out this updated and substantially revised and expanded second edition.

Brigid Laffan
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CHAPTER 1

Future of the Global Trade Order

Carlos A. Primo Braga and Bernard Hoekman

IMD and Fundação Dom Cabral;
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The global economy is going through major economic and geopolitical shifts. The balance of economic power between the established powers of the North and the emerging “new” ones of the South has changed, not only fostering tensions in the global governance structure that has characterized the post-World War II era – centered around the Bretton Woods institutions (the IMF and the World Bank), the GATT/WTO and the Security Council of the United Nations – but also leading to new alliances among emerging economies.

The typical narrative for economic and geopolitical trends in the 21st century involves considerations about the impact of globalization, the role of disruptive technologies in changing the economic landscape, as well as the terms of international competition, and the growing economic relevance of emerging economies. These economic considerations are often complemented by geopolitical considerations focusing on the relative “decline” of the United States and the rapid economic ascendancy of China.

This collection of papers looks into one of the main pillars of global governance: the multilateral trade system, anchored by the World Trade Organization (WTO). Membership at the WTO requires credible market-oriented economic policy credentials – it’s tough to get in and accession by new Members invariably requires significant reforms. In 2016, the WTO reached 164 Members with the accession of Afghanistan. Another 21 countries have requested accession and are in different stages of the accession process. The WTO is therefore close to reaching universal coverage of trading nations – a stark contrast to the original 23 GATT contracting parties in 1948.

The accession of China to the WTO in 2001 will probably remain as one of the landmark trade developments of the 21st century. The year China acceded to the WTO is the same year the Doha Development Agenda (DDA) – the

first round of multilateral trade negotiations in the WTO era – was launched, following eight earlier rounds conducted under the GATT. More than 15 years later negotiations are formally still ongoing, but the conclusion of the negotiations remains a distant goal. The 2015 Nairobi Ministerial Declaration underscored the deep divisions that exist between WTO Members with respect to the DDA. Its Article 30 states that “many Members reaffirm the Doha Development Agenda, and the Declarations and Decisions adopted at Doha and at the Ministerial Conferences held since then, and reaffirm their full commitment to conclude the DDA on that basis. Other Members do not reaffirm the Doha mandates, as they believe new approaches are necessary to achieve meaningful outcomes in multilateral negotiations.”

The long-dragging DDA had a negative effect on the reputation of the WTO. The private sector in particular became increasingly frustrated with the multilateral trade system, but civil society groups were also disenchanted with lack of progress in addressing issues of interest to them. There is a general perception that WTO disciplines and *modus operandi* are outdated and have not kept pace with globalization. Unsurprisingly, some observers are even asking whether the WTO is worth “saving.”

This is the wrong question. Multilateral negotiations are just the tip of the “iceberg” that encompasses a much broader set of WTO functions. Even without successful conclusion of the DDA – and as indicated above, many WTO Members take the view that it has failed – the WTO continues to play an important role in fostering transparency in trade practices, monitoring of trade policies and implementation of existing multilateral rules and agreements, and providing dispute settlement services. Notwithstanding the difficulties of the DDA, following the 2008 global financial crisis the WTO made a contribution to the world economy by disciplining trade protectionism and helping prevent the Great Recession morphing into a Great Depression *à la* 1930s. The efficacy of – and challenges confronting – the transparency and enforcement pillars of the WTO are the subject of Chapter 8 by Simon Evenett and Johannes Fritz, and Chapter 6 by Giorgio Sacerdoti.

One consequence of the DDA deadlock has been that trade liberalization and new trade rules are increasingly being negotiated in the context of preferential trade agreements (PTAs). As discussed at greater length by Clem Boonekamp in Chapter 9, in 1990 there were roughly 70 active PTAs; today there are more than 300. The interest in PTAs is not limited to the market access issues on which the DDA was not able to make progress. Many of the matters that are on the table in PTAs are driven by deeper integration objectives that often have WTO-plus or WTO-extra characteristics. This is the case for

many policy areas, including protection of intellectual property rights (IPRs), mutual recognition or harmonization of “behind-the-border” regulations, liberalization of investment flows and provisions on investor protection, to name just a few.

The PTAs that have been pursued by major OECD member countries, notably the mega-regional initiatives centered on the US – the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP) – in principle are better attuned to the needs of transnational corporations and the dynamics of international trade in the 21st century than is the WTO (see Chapter 9 by Clem Boonekamp).¹ Their launch reflected not just the inability to move forward in the WTO but also geo-political considerations, in particular a desire to demonstrate the ability of the countries involved to establish new rules of the road in areas that are resisted in the WTO by many developing countries. Both the TPP and TTIP were in part motivated by the economic rise of China – an effort to deepen integration among like-minded, democratic market-based countries and through joint action set rules that would help retain Western (more specifically, US) hegemony over global trade governance. However, domestic opposition in the United States by civil society groups to provisions of the TPP – especially on protection of intellectual property and the inclusion of investor–state dispute settlement – and a perception that the TPP did not address sufficiently practices and policies that were deemed to adversely affect the balance of trade between the United States and TPP members with current account surpluses led President Trump to withdraw the United States from the agreement that was ultimately concluded in early 2016 and signed by President Obama, after five years of negotiation.

In parallel and in response to the mega-regional trade and investment negotiations launched by the United States and its partners, China pursued its own strategy. This is centered on the Belt and Road initiative, the creation of the Asian Infrastructure Investment Bank (AIIB) and participation in the Regional Comprehensive Economic Partnership – an effort to establish a traditional free trade agreement among Asian economies. The withdrawal of the United States from the TPP and the decision by the Trump administration to put TTIP talks on hold may turn out to be transitory decisions. Whatever the case may be regarding US trade policy looking forward – see the discussion by Craig VanGrasstek on this topic in Chapter 3 – the recent actions by the United States have resulted in a weakening of its influence vis-à-vis China and its capacity to set the rules of game for the global trade order.

1 The TPP included Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Vietnam. The TTIP negotiations between the European Union and the United States were launched in 2013 and have yet to be concluded.

This collection of essays looks into possible future scenarios for a multilateral trade system in which the United States is no longer the hegemon and is pursuing actions that erode its soft power and ability to influence global trade governance. It is important to consider that while the United States remains a major economic and political force, other WTO Members have a strong interest in maintaining the rules-based trading regime. There is much that can and should be done in this regard by the Membership as a whole and by subsets of WTO Members working together. The chapters focus on some of the major critical issues that confront the WTO Membership and the stakeholders in the multilateral trading system. As mentioned by Miguel Rodriguez in Chapter 4, one could argue that the WTO is currently facing an “adaptability” crisis. This is nothing new in the history of the multilateral trade system. Actually, a similar crisis occurred in the 1980s during the Uruguay Round negotiations (1986-1994), which led to the GATT morphing into the WTO with an associated increase in the number of policy areas covered by multilateral rules of the game.

In a nutshell, the creation of the WTO was made possible by a bargain that involved the inclusion of two new agreements under the multilateral system of trade governance (GATS and TRIPS), a priority for industrialized nation negotiators, in exchange for new disciplines for agricultural trade and the dismantling of the system of quotas that governed textile and clothing trade (the MFA), priorities for most developing countries. The history of the “marriage of convenience” between traditional trade policies and the inclusion of new policy areas such as services and protection of IPRs illustrates the capacity of the multilateral trade system to adapt over time and to reflect the changing constellations of interests at national level – a topic that is the subject of Chapter 5 by Alejandro Jara.

IPRs are territorial by nature (i.e. the rights are awarded and enforced at the national level) and attempts to promote harmonization and coordination across countries can be traced back to the 19th century.² International conventions (the Paris Convention in 1883, the Berne Convention in 1886, and so on) in this area typically adopted national treatment provisions as the basic standard for international harmonization. As international trade in knowledge products and foreign direct investment (FDI) flows expanded significantly in the post-World War II era, conflicts between innovators (at the level of countries and enterprises) and imitators began to increase.

2 This section on IPRs relies on Primo Braga (2016).

Already in the 1970s, the United States began to push for the adoption of an Anti-Counterfeiting Code at the level of the GATT. This effort – launched in the final stages of the Tokyo Round (1973-1979) of multilateral trade negotiations – was driven by the lobbying of trademark-holding companies, which were trying to limit counterfeited products in international trade. This attempt did not succeed, but it signaled the way of the future for innovation-leading nations – in particular, the United States. When the eighth round of multilateral trade negotiations (the Uruguay Round) under the GATT started in 1986, the strategy was refined to go beyond anti-counterfeiting with a view to establishing minimum standards of protection and enforcement across a broad array of IPRs instruments. The appeal of this approach was to connect the strengthening of IPRs protection to the broader trade agenda and to provide access to the dispute settlement mechanism of the multilateral trade system. Most developing countries, in turn, preferred the World Intellectual Property Organization (WIPO) as the institutional locus for IPRs discussions. The lack of effective enforcement powers in the WIPO conventions, however, is often presented as the reason behind the US efforts in favor of a GATT-related solution.³ This time the strategy succeeded, leading to the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

A similar dynamic occurred with services. As was true for IPRs, there were no multilateral disciplines on trade in services in the GATT. Services were put on the GATT agenda in the early 1980s by the United States, which had a significant surplus in its balance of trade in services, as opposed to running a deficit for trade in merchandise. This led to a process of reflection and the preparation of a series of national studies on the state of play for trade in services and the possible benefits of developing rules for services trade. The suggestion to expand the coverage of the trading system to encompass services was controversial, however, and many developing countries, including Brazil and India, were initially of the view that the Uruguay Round should not address services. At the ministerial meeting that launched the Uruguay Round negotiations, it was agreed – based on a compromise proposed by Colombia and Switzerland – that services negotiations would proceed on a parallel track.

The agreement that was eventually negotiated was innovative in defining trade in services very broadly, including FDI and provision of services through temporary movement of natural persons, and permitting countries to make (or not make) specific commitments for sectors and the different modes of supplying services across borders. The main result was to establish a framework for future rule-making and liberalization. Few commitments were made by

3 See Kastenmeier and Beier (1989) and Primo Braga (1990, 1996).

countries to open their services markets – the main result was to expand the coverage of the trading system but to do so in a way that allowed for great flexibility by countries as to how much to do in the way of making market access opening commitments. This was left to future negotiations, which were to start within five years of the entry into force of the WTO. In the event, new services negotiations became an element of the DDA.

The relative success of those advocating stronger protection of IPRs at the global level via the negotiation of trade agreements, and the expansion of the WTO to include trade in services, however, did lead to reactions from affected countries. This was particularly the case with respect to the impact of TRIPS on access to medicines amid public health crises, as underscored by the HIV/AIDS epidemic. This reaction, in turn, led to some adjustments at the multilateral level as illustrated by the Doha Ministerial Declaration (2001), the related Declaration on the TRIPS agreement and public health, and subsequent decisions/waivers on compulsory licensing with special emphasis on the needs of least developed countries.

Industry groups from innovation-led countries, however, continued to lobby for the inclusion of IPRs chapters in trade agreements, focusing on preferential trade negotiations. As discussed in detail by Fink (2012), the new generation of PTAs negotiated by the United States – starting with NAFTA – typically included “TRIPS-plus” provisions. The European Union also followed a similar track. Moreover, IPRs provisions became standard in bilateral investment treaties entered both by the United States and the European Union with other nations.

The latest major development in this area was the Trans-Pacific Partnership agreement that was originally signed in early 2016 by 12 countries in the Pacific Rim. Although its fate remains unclear following the withdrawal of the United States, the TPP is important in indicating the potential direction of trade governance – whether through PTAs or the WTO. Not surprisingly, one of the most controversial chapters of the TPP was its IPRs provisions. The United States put emphasis on longer terms of copyright protection, regulatory changes that would effectively translate into longer patent terms and constrain the entry of generic drugs into these markets, as well as additional rules for biologic medicines (pharmaceutical products developed from living organisms), including minimum standards for data protection.

The final terms of the TPP agreement did not deliver on all the demands of the US negotiators. Still, several of these “TRIPS-plus” measures were initially adopted. Some noteworthy measures in the original TPP agreement included: trademark terms of protection of no less than ten years (TRIPS

requirement is of seven years) and the removal of barriers for the protection of sound marks; a minimum copyright term of protection of at least 70 years (TRIPS minimum standard is 50 years) and stronger copyright enforcement (including the possibility of criminal prosecution against acts of removal of rights management information and the requirement that TPP countries be signatories of WIPO “Internet treaties”); requirement of enforceable legal means for the protection of trade secrets (TRIPS does not specify these means); protection of undisclosed test data submitted for marketing approvals for at least ten years in the case of agricultural chemicals and five to eight years in the case of pharmaceuticals (TRIPS does not have such a requirement); the explicit protection of new pharmaceutical products that are or contain a biologic (the TPP is the first trade agreement to do this);⁴ and adjustment for patent office delays in the granting of patents that will promote harmonization of patent granting practices among TPP parties.

Some of these provisions go beyond the “TRIPS-plus” aspects that the United States had already negotiated on a bilateral basis in the context of its FTA treaties with countries such as Australia, Chile and Peru, reflecting existing US law.⁵ Several provisions generated significant controversy, even among like-minded countries. One concern was that the TPP could “export” to other countries the flaws of the US IPRs system with its emphasis on litigation – as illustrated by the growing role of non-practicing entities, or NPEs (i.e. entities that focus on licensing and litigation of IPRs rather than production and innovation) – and strategic behavior to block the introduction of generic drugs.⁶

On 11 November 2017, 11 of the original 12 TPP signatories announced that they would be willing to go ahead with a new agreement – the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) – that builds upon the TPP text. There was also a decision to suspend 20 sensitive provisions of the original agreement on topics such as express shipments, investor rights, and IPRs. Eleven of the suspended provisions are in fact related to IPRs, reflecting the controversial character of some of the rules of the original TPP

4 In the United States, a biological product is defined as a “virus, therapeutic serum, toxin, antitoxin, vaccine, blood, blood component or derivative, allergenic product, protein (except any chemically synthesized polypeptide), or analogous product, or arsphenamine or derivative of arsphenamine (or any other trivalent organic arsenic compound), applicable to the prevention, treatment, or cure of a disease or condition of human beings.” See BIO (2013) for further details.

5 One major exception – reflecting resistance from other TPP parties – was the term of regulatory data protection for biologics. In the United States, this term is of at least 12 years from the date of approval. Article 18.52 of the TPP provides only for an eight-year term of protection. For further details see ITAC-15 (2015).

6 For an excellent discussion of NPEs and strategic manipulation to delay the introduction of generic drugs in the United States, see Feldman (2016).

as discussed above. The suspension of these provisions, rather than their simple elimination, suggests that the CPTPP partners want to keep the door open to an eventual return of the United States to the agreement in the future.

IPRs are just one subject that are controversial. Other topics that contribute to the “sense of malaise” that currently characterizes the multilateral trade system include the lack of progress in services negotiations at the multilateral level and the perception that the WTO is not well equipped to deal with new themes such as policies affecting the operation of GVCs, digital trade and e-commerce, and environmental issues, to name just a few.

Services figured much less prominently in the DDA than in the Uruguay Round, reflecting a decision by negotiators to first determine what the contours of a possible DDA deal could be for trade in agricultural and industrial products. This, in turn, can be explained in part by the fact that international businesses were less active in pushing for making the services agenda a priority. The inclusion of services on the Uruguay Round agenda owed much to the proactive efforts of services providers, including large transnational companies such as American Express. Such firms were much less engaged in the DDA. Whatever the reason, services talks made little progress, and at the 8th WTO Ministerial Conference in December 2011 it was agreed that WTO Members should pursue talks in parallel to the DDA with the aim of reaching “provisional or definitive agreements based on consensus earlier than the full conclusion of the single undertaking.” This led to the launch of negotiations in 2012 on an agreement on trade in services (TiSA) outside the WTO.⁷ Thus, services – which represent 60-70% or more of the GDP of many economies and are the most dynamic category of global trade growth (and trade growth potential) – were essentially taken off the WTO table.

Services trade and investment policies now figure mainly on the agenda of PTAs and the TiSA negotiations. The status of the latter is unclear at the time of writing, as this is another initiative in which the United States played a major role in launching and which the Trump administration needs to decide whether it wants to pursue. These plurilateral efforts do not include most of the major emerging and developing economies, who have the most to gain from services policy reforms and that offer the greatest prospects to generate an increase in trade flows. For the global trading system, much will depend on whether participants in the TiSA decide to make the outcome a PTA or, instead, inscribe the results of the negotiations into their GATS schedules of

7 The TiSA includes Australia, Canada, Chile, Chinese Taipei, Colombia, Costa Rica, Hong Kong China, Iceland, Israel, Japan, the Republic of Korea, Mexico, New Zealand, Norway, Panama, Paraguay, Pakistan, Peru, Switzerland, Turkey and the United States.

commitments and make the TiSA a “critical mass agreement.” From a trading system perspective, the latter would be an important boost; making the TiSA a PTA would, in contrast, be a major blow.

Challenges Looking Forward

The most immediate challenge confronting the WTO as an institution is to move on from the failed DDA negotiations. This has proven difficult as a result of the changing balance of power – the rise of China and other emerging economies – and the working practices of the institution. Practices such as consensus and special and differential treatment for developing countries have impeded progress in addressing new areas of policy for which rules are needed to allow business to compete internationally on a level playing field – examples include policies impacting on the growth of the digital economy, regulation of data protection and privacy, and establishing disciplines on the ability of governments to support domestic firms in ways that distort competition.

The shift to a PTA-centered trade strategy by many countries is not just a result of the difficulties that have been experienced in getting to “yes” on the DDA, it also reflects the increasing complexity of dealing with the spillover effects of a broad set of policies affecting global value chain (GVC) trade, and the changing composition of trade as technology supports a rapid increase in trade in services and associated cross-border data flows. The structure of international trade has changed in recent decades as a result of the increasing fragmentation of global production that is associated with GVCs. A GVC involves a collection of firms (plants) located in different countries jointly forming a “production line,” with different parts of the production process undertaken by firms (plants) in different countries. Depending on the location of a firm (country) in a GVC, participation may either involve forward linkages (where an activity produces an output that is used in production for export in another nation) or backward linkages (where a firm uses imported parts and components that are inputs for production that is exported). An example is country *A* producing hides from cattle that are tanned and dyed in a neighboring country *B* using chemicals imported from a third country *C*, with the leather produced in *B* used in the production of a car seat cover in country *D* that is used by a car plant located in country *E* that exports the cars to country *F*.

GVCs permit enterprises in different countries to concentrate on (specialize in) specific tasks and activities without having to source required inputs locally or to vertically integrate to produce and market the end product. GVCs increase interdependence – each link in a chain relies on the upstream producers

delivering their output on time and meeting the required quality and safety standards, while upstream firms are dependent on the downstream segments working efficiently, as stoppages or distribution problems there will affect the demand for inputs. The growth in GVCs has been accompanied by greater cross-border movement of capital and knowledge, as well as workers.

GVCs span a huge variety of firms, ranging from small and medium-sized enterprises (SMEs) that provide a variety of inputs, to logistics providers, processors, manufacturers and service suppliers. While large multinational lead firms decide where to locate plants, where to invest and who to source from and how, these lead firms source inputs and buy services from numerous local suppliers and subcontractors that provide a range of goods and services. Much of the value added that is embedded in a product reflects the payments for intermediate goods and services. Thus, a wide range of firms and sectors, including companies providing services to firms in other sectors, benefit from and are affected by GVC-based trade and investment decisions. Available data indicate that about one-third of the value of all traded manufactured goods reflect the value of embodied services, and that, overall, if account is taken of sales of services by foreign affiliates, services account for more than 50% of world trade (Francois and Hoekman, 2010).

The structure and volume of GVC trade is very sensitive to operating and transactions costs. This makes a wide range of policies relevant – both policies that impact directly on financial and operating costs and policies that affect the reliability and predictability of flows within GVC networks. Uncertainty and (risks of) delays associated with unpredictable operating environments give rise to a need to maintain higher stocks and other forms of hedging and insurance, the costs of which may preclude supply chain-related investments.⁸

An open trade regime matters for GVCs, but equally important are actions to minimize trade frictions, such as delays in border clearance and low-quality transport and logistics that lead to physical losses, and to facilitate investment in operating or distribution facilities. Connectivity – including the quality of transport and logistics services and information and communications technology (ICT) networks and related services – is often critical. The policy agenda becomes more complex, spanning many areas that may not be covered by the WTO, or only partially. For example, very specific types of government intervention may be needed to address coordination failures that negatively affect GVCs, but at the same time such measures may have negative spillover effects on other countries.

8 See Hoekman (2104) for an extensive discussion.

Other areas that could benefit from multilateral disciplines – such as competition policy – are now hostages to the DDA impasse, since WTO Members are unlikely to negotiate on new themes until the fate of the DDA is agreed upon. But, as discussed in Chapter 11 by Pérez Motta and Murra, a multilateral solution (maybe in the context of a plurilateral agreement under the WTO) could better harness the complementarity between trade and competition rules.

The way forward is likely to entail greater reliance on variable geometry – cooperation between subsets of WTO members (“clubs”). Numerous observers have argued that cooperation on regulatory “behind-the-border” policies cannot occur between 164+ countries.⁹ An implication is that the WTO Membership may need to accept greater small group cooperation inside the organization as opposed to leaving the field to PTAs. The expanding number of PTAs illustrates that club-type cooperation is the preference of many countries. Movement in this direction has already been occurring, and indeed, has always been an element of cooperation in the GATT/WTO. Recent examples of agreements between only a subset of the WTO Membership include the Information Technology Agreement (ITA), ongoing negotiations on an agreement on environmental goods, and past agreements on basic telecommunications and financial services that were incorporated into the GATS. As noted above, it is possible (and desirable) that the TiSA will become another example. A key feature of these agreements is that benefits extend to all countries, not just those that sign them – they are “critical mass agreements.”

The task for the WTO is to channel more of the energy that currently is invested in PTAs towards rule-making under the WTO umbrella. Necessary conditions for this to occur are deliberation on both old and new policy areas that generate negative externalities and call for concerted action and cooperation, and more collective learning about the experiences of PTAs in dealing with these policy areas. As discussed by Bernard Hoekman in Chapter 7, the 21st century agenda confronting the WTO centers on “behind-the-border” regulatory policies as well as “legacy” 20th century (or indeed, 19th century) issues such as remaining tariffs. Reducing the market-segmenting effects of differences in regulations is difficult because of concerns that it may compromise the attainment of regulatory objectives (a “race to the bottom”). Identifying areas of regulation that could be the focus of cooperation in the

9 Baldwin (2016), for example, suggests that world trade governance is likely to evolve into a two-pillar system, with the WTO focusing on traditional trade issues and mega-PTAs dealing with disciplines for GVCs, capital flows, enhanced protection of IPRs, and so on. The difficulties in negotiating and ratifying such agreements suggests this may prove more difficult than envisaged.

WTO requires discussion and deliberation, with active participation of the business community, policy research institutes and international regulatory networks.

In addition to the forward-looking agenda, another important challenge is to address the complaints by some WTO Members regarding the operation of the institution. Of particular urgency at the time of writing is the refusal of the United States to approve new Appellate Body members, reflecting its view that changes need to be made to the mandates and modus operandi of the Appellate Body. As noted by Giorgio Sacerdoti in Chapter 6, the dispute settlement mechanism of the WTO, long considered by most WTO Members and observers to be the crown jewel of the trade order, is being actively questioned by the United States. Unless this matter is addressed, there is a threat that dispute settlement will go the way of the negotiation function of the WTO – spelling the effective demise of the system.

Another challenge for the WTO as an organization concerns the need to establish and deepen partnerships and harness complementarities with other international organizations dealing with trade policy, and the international business community. Greater engagement with business organizations is necessary for better economic governance, not least because of GVCs, which increase the interface between private and public international law, are giving rise to transnational initiatives among firms to agree on norms and standards, are an element of corporate social responsibility initiatives, and are a focal point for public and private capacity-building programs (to name just a few dimensions of the governance dimensions associated with GVCs). Public-private partnerships are now commonplace when it comes to investment projects and the operation of (segments of) GVCs. The purely state-to-state nature of WTO operations is increasingly outdated.

Many international organizations, regulatory networks and standards-setting bodies play a role in creating the governance frameworks for policy areas that impact on trade and investment. The WTO is in many respects a weak organization in comparison with the multilateral development banks, the IMF, the OECD, and so forth when it comes to its mandate and financial resources to undertake monitoring, research and analysis, engage in policy dialogue and advisory services, capacity-building, etc. There are many “linkages” between the domain of the WTO and the areas of activity of other institutions. Examples include sectoral regulation and associated international efforts and networks through which regulatory cooperation is pursued; governance of (multinational) business and associated GVC-based production and trade (including private product and production standards, labeling and traceability

requirements, etc.); PTA-based initiatives in areas of direct relevance to the trade order (e.g. the decision by the European Union to establish permanent investment courts in new agreements that cover investment); as well as the regimes governing international financial flows and exchange rate policies.

Mention should be made here of the UN system as well, in particular as it relates to the achievement of the Sustainable Development Goals (SDGs). Trade is mentioned as an instrument to achieve some of the SDGs, including by correcting distortions in world agricultural markets, improving Aid for Trade support for developing countries, regional and trans-border infrastructure investments, and increasing the integration of small-scale enterprises into GVCs. An open, rules-based, non-discriminatory multilateral trading system and doubling the LDC share of global exports – in part through the timely implementation on a lasting basis of duty-free, quota-free market access – are other instruments identified in the document presenting the SDGs (United Nations, 2015).

Hoekman (2015) suggests the adoption of a trade cost reduction goal would help to leverage trade to achieve the SDGs. Reducing trade costs benefits both exporters and importers as well as households in developing countries. A trade cost reduction target would also encourage governments to identify actions that will do the most to facilitate trade, including in areas that are not covered by the WTO. There are many reasons why costs may be high, including own trade policies of developing economies, a lack of trade facilitation and weaknesses in transport and logistics services. A trade cost reduction target leaves it to governments to work with stakeholders to identify how best to reduce prevailing excess costs – thus encouraging the type of public-private partnerships and cooperation with other organizations discussed above.

Conclusion

The inability to get to “yes” in the DDA does not imply a lack of relevance of the WTO. Indeed, the recent questioning and re-opening of PTAs by the United States under the Trump administration and the opposition of many citizens in Europe to agreements such as CETA and TTIP imply that the WTO may become more salient in the coming years. Multilateral negotiations have become more complex because developing countries are more active and engaged in pursuing their objectives – and have greater market power as a result of their expanding share in world trade. PTAs may well be more effective mechanisms to address matters of a regulatory nature, or that involve the liberalization of politically sensitive areas such as

the movement of people. It is noteworthy that PTAs increasingly address matters such as labor and environmental standards and include a focus on human rights, rule of law and other dimensions of public governance. These are areas of policy that are not covered, or are covered only tangentially, by the WTO. In other regulatory policy domains there is already a substantial interface between the WTO and other international regimes – one example is in the area of product standards (health and safety norms for food and animal products), another is the protection of IPRs. In these various areas, other institutions take the lead in setting substantive norms (ISO, FAO/Codex Alimentarius for product standards; WIPO for intellectual property). The same is true for development assistance, where the WTO today interacts more with international development agencies than it did in the past under the umbrella of the Aid for Trade initiative.¹⁰

These are all areas where PTAs have little role. PTAs also generally do not address subjects that have been the source of disagreement in WTO negotiations such as agricultural support policies, which are important to developing countries. As discussed by Nick Ashton-Hart in Chapter 10, as the world economy becomes even more interconnected as a result of the “Internet of things”, e-commerce and the associated increase in cross-border service flows, policies that limit or raise the cost of digital trade and data flows will become ever more important. Mega-PTAs may result in agreements on how to address such matters, but from a global efficiency perspective what is needed are rules of the game for digital commerce and cross-border data flows that span all major economies. The difficulties that have been experienced in establishing mega-PTAs suggest that these are not a panacea and that governments may see greater value in redirecting their efforts in cooperating on new matters towards the WTO – even if this is initially limited to plurilateral initiatives. In short, as discussed in greater depth by Primo Braga in Chapter 2, the future of the WTO is an important topic not only for the institution itself, but also for the health and expansion of global trade in the 21st century. At present, the danger of economic disintegration is a real threat to the world economy.

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CHAPTER 2

The Threat of Economic Disintegration

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There are moments in history that herald the beginning of a new era in terms of economic, social, and international relations. The new millennium has brought many of these dates to our attention. September 11, 2001 will always be remembered as the moment that terrorism became a global player. Thomas Friedman argues that technological innovations (the iPhone platform, IBM's Watson and progress in cognitive computing, as well as advances in the architecture for microchips, developments in clean technologies and in DNA sequencing techniques, and so on) clustered around 2007 launched the “age of accelerations,” characterized by a high speed of social change, as well as growing interdependence and complexity of economic relations (Friedman, 2016: Chapter 2). September 15, 2008 and the bankruptcy of Lehman Brothers, in turn, will be remembered as the moment when the global financial crisis became a global threat and the benefits of financial deregulation were called into question.

The focus of this chapter, however, is the year 2016. That is the year when the growing appeal of populist messages and doubts about the benefits of globalization materialized into two major developments: the referendum that led to decision of the United Kingdom to leave the European Union (“Brexit”), and the election of Donald Trump in the United States. These developments add to concerns about the future of the liberal trade order and, in particular, of its institutional underpinnings associated with the World Trade Organization (WTO). In what follows, this chapter discusses the concept of “peak globalization,” the renewed appeal of protectionist policies, as well as recent political developments in the United States and in the United Kingdom (the original pillars of the liberal trade order), and the implications of these developments for the future of the WTO.

Globalization: Retreat, Pause or Reset?

Globalization is an old process that can be traced back to the origins of human civilization. Its hallmark is the growing interdependence of different societies fostered by trade, migration, knowledge, and capital flows. Although analysts typically emphasize the modernity of the concept, it is worth noting that more than 2,000 years ago, the perception of growing interdependence across economies was already part of the intellectual discourse. Polybius, a Greek historian, noted that “[b]efore, the events that took place in the world were not linked. Now, they are all dependent on each other” in the 2nd century BC.¹

It is true, as pointed out by Wolf (2004), that the term only became widely used in the second half of the 20th century. In practice, it provides a kind of Rorschach test for analysts – i.e. it means different things to different researchers. In what follows, an economic approach is adopted, focusing on the process of growing economic integration driven by trade (of goods and services), capital, people and information/knowledge flows across borders. Needless to say, there are many other relevant dimensions to this process (such as cultural globalization).

Independently of the focus adopted, however, this is a process that remains quite controversial. In 2014, a PEW survey covering 44 countries, for example, found that a strong majority (a median of 81%) of the respondents believed that international trade is good for their country and a majority (a median of 74%) also saw foreign direct investment (in the context of greenfield investments) as positive for their economies (PEW, 2014). But perceptions about the impact of globalization on wages and prices were typically much more skeptical about its benefits. Ironically, the level of skepticism about the benefits of globalization was higher in the United States (and other advanced economies) than in most developing countries. These negative reactions have been confirmed by more recent international surveys. A recent YouGov survey (Smith, 2016) found that the highest levels of skepticism about globalization are nowadays observed in countries such as France and the United States, where only 37% and 40% of the population surveyed, respectively, answered that globalization was “a force for good”, in contrast to 91% in Vietnam and 85% in the Philippines.

Such attitudes are often associated with the impact of the global financial crisis and the rise of populist parties/leaderships that blame international trade for job destruction and rising income inequality. There is historical evidence that in the aftermath of financial crises, populist messages tend to gain support. Funk et al. (2015) document the history of general elections in

¹ For further details, see Huwart and Verdier (2013).

20 advanced economies after financial crises over 140 years. Their findings suggest that voters tend to be attracted by populist rhetoric after such crises, blaming minorities/immigrants or foreigners for the crises.

It is not surprising to note that, in the aftermath of the recent global financial crisis, the process of financial globalization slowed down significantly. In response to the financial crisis, many countries imposed new regulatory restrictions on capital account transactions or tightened existing regulations. Financial globalization (that is, international flows associated with equity markets, corporate and government bonds, and loans) expanded at an annual rate of 8.1% from 2000 to 2007. Since 2008, it has lost most of its dynamism (growing at less than 2% per year in the first five years after the crisis), even though the depth of financial integration today remains at a multiple of the levels observed in the 1990s.² By 2016, global cross-border capital flows had declined roughly 65% vis-à-vis the peak (of US\$12.4 trillion) reached in 2007.³ Most of this dramatic adjustment, however, was associated with the retreat of Eurozone banks that significantly reduced their foreign exposure amid the Eurozone crisis. Investment flows have also declined from their peak (\$1.83 trillion) in 2007. Foreign direct investment (defined as investment that leads to at least a 10% stake in a foreign entity) fluctuated significantly over the last few years, and it only recovered to levels similar to those reached at the eve of the crisis by 2016, when they amounted to \$1.75 trillion (UNCTAD, 2017).

The performance of international trade flows is of particular interest for the discussion of the future of the global trade order. Merchandise trade had been growing on average 7% per year before the onset of the global financial crisis. Since 2008, however, trade growth has been anemic and in some years below the expansion of world output (e.g. 2.3% at market exchange rates for global GDP versus 1.3% for global trade volume in 2016).⁴ All of these trends raise the question: has globalization reached its peak and is it now retreating?⁵

If one focuses on international trade flows, there are cyclical factors that help explain the slowdown. Weak aggregate demand and uncertainty (dragging down business investment, which tends to be trade-intensive) are often characterized as the main culprits in this context. But there seems to be more

2 See Lund et al. (2013) for a detailed analysis.

3 See Lund et al. (2017) for recent data on financial flows.

4 For a review of recent analyses on the global trade slowdown, see Hoekman (2015) and WTO (2017).

5 It is worth noting that the relative popularity of the term “globalization” has declined significantly over the last decade, as illustrated by trends in Google searches; see Goldin and Kutarna (2016).

structural forces at work.⁶ The long-run elasticity of trade with respect to world GDP, for example, which used to be above 2 in the 1990s, is estimated to be much lower now (around 1.31 for the period 2001–2013), suggesting that trade has become less responsive to GDP growth.⁷ The shortening of supply chains to better cope with environmental and geopolitical risks, increased recourse to trade protectionism in some markets, the domestic integration of the Chinese market leading to increased local content in exports, and the evolving shift toward services in the world economy are some of the usual suspects identified in this context. Timmer et al. (2016) note that since 2011, both demand and supply factors have impacted the dynamism of international trade. Global demand has continued to shift, particularly in China, towards services, which are less trade-intensive. Moreover, the process of product fragmentation associated with global value chains (GVCs) seems to have stalled and even reversed in recent years.

As discussed in Primo Braga (2015a), the debate on the future of globalization is considered by some as a waste of time. According to this perspective, growing economic integration and interdependence is inevitable, driven by technology (as illustrated by technological change impacting transportation and communication costs), and the breaking down of barriers to trade, capital flows, and movement of information/knowledge, as well as people, in the context of unilateral trade liberalization and economic reforms, or via negotiated trade agreements.

Technological determinism is an influential “ideology” in promoting the view that growing economic integration is inevitable. There is no doubt that innovation in all spheres of human knowledge – from the introduction of the alphabet to the invention of the wheel, from technological progress in shipping to new communication technologies – has been a major driver of the process of globalization. And distinct cycles of technological innovation have not only driven, but also shaped this process in modern times. The telegraph and the steam engine were key forces behind international economic integration in the 19th century. In the same vein, the container and information communication technologies (ICT) revolutionized the way that companies and nations have engaged in international trade in the last five decades. Moreover, digitization is currently transforming many industries and significantly increasing the tradability of services as ICT networks expand internationally.

6 For those who believe in “secular stagnation” (the proposition that long-term potential growth for the world economy has declined, driven by lower rates of technological progress and productivity growth, demographic trends, growing inequality, excessive debt overhang, and instability associated with low real interest rates), the trade slowdown is part of a new normal for the world economy.

7 See Constantinescu et al. (2015) for recent estimates of the long-run elasticity of world trade with respect to world GDP.

All these considerations, however, should not be interpreted in a vacuum. Although technological progress increases the costs of resisting globalization, this does not mean that policies and regulations at the national level have necessarily always evolved in a way to facilitate this process. Actually, as already mentioned in the context of financial regulations, government reactions – and sometimes technology itself (as illustrated by the impact of advanced robotics fostering reshoring decisions by multinational corporations) – can move in an opposite direction. In other words, policy matters, and those who profess a certainty on the inevitability of economic integration, even if proven right in terms of long-term trends, may be disappointed in the near future.⁸ Moreover, as discussed by Evenett and Fritz in Chapter 8 of this book, the conventional wisdom that WTO disciplines “succeeded in preventing the widespread resort to protectionism since the onset of the global economic crisis” needs further scrutiny. As described in detail in the Global Trade Alert reports,⁹ there is evidence that discrimination against foreign commercial interests has increased significantly in the post-crisis era. Subsidies, localization requirements, and trade finance have been playing an important role in this new wave of protectionist actions that often evade multilateral disciplines. It is difficult to quantify the exact impact of these actions on global trade flows, but there is no doubt that, even though we have not witnessed a trade collapse similar to that observed in the 1930s, these measures are contributing to the trade slowdown.

It may be too early to announce that we have reached a “peak” in the globalization process. One could even argue that we are in a moment of resetting global structures of production and that opportunities associated with “e-commerce” and lower transaction costs for small and medium-sized enterprises to engage in international trade may soon reverse these trends. Moreover, as the global economy regains strength – as illustrated by the latest IMF forecasts for 2018 (IMF, 2017) – and demand for consumer and capital goods recover, we should expect a recovery of global trade flows. In short, declarations that we have entered a phase of retreating globalization may be exaggerated.

8 One should not forget that the “optimism” about the geopolitical implications of globalization also influenced the intellectual debate at the beginning of the 20th century. In 1909, Norman Angell (a Nobel Peace Prize winner in 1933) published a pamphlet that later became a popular book (*The Great Illusion*), in which he argued that economic interdependence had become so pervasive in Europe, that war was very unlikely. Two world wars, and policy mistakes around the Great Depression, underscored the fact that predictions about an ever-growing international economic integration are not necessarily correct.

9 Available at www.globaltradealert.org.

It is clear, however, that unless political will to continue to pursue economic liberalization – either unilaterally or in the context of trade negotiations – is rekindled, the specter of a less integrated world economy may become a self-fulfilling prophecy in the medium term. After all, even if one espouses a technologically driven rationale to explain globalization, it is important to recognize that the environment for the required supporting policies is not a favorable one in moments of shifting economic and geopolitical power. Recent political developments (such as the above-mentioned 2016 “shocks”) suggest that the potential for economic disintegration cannot be ignored. In particular, “peak trade” (the proposition that we should not expect international trade to continue to grow faster than global GDP) qualifies the appeal of trade-led development strategies and it may further impact the support for a liberal trade order (BIS, 2017).

The Liberal Trade Order Under Attack

For much of the first half of the last century, especially during the 1930s, the world economy and business were affected by predatory trade wars. The architects of the post-war edifice of global economic governance were committed to repairing the system and ensuring that it should be robust, fair, and sustainable. Trade especially was recognized as a critical foundation for peace and prosperity. An attempt to complement the Bretton Woods institutions (the IMF and the World Bank) with the creation of the International Trade Organization (ITO) failed because, among other factors, the US Congress refused to ratify US participation in a multilateral trade organization. The General Agreement on Tariffs and Trade (GATT) became a second-best solution for this institutional vacuum, reflecting the negotiations for tariff reductions that had been conducted in 1947, before the conclusion of the ITO talks. Originally, the basic objective of the GATT was to avoid that negotiated tariff concessions were withdrawn before the ITO Charter became a reality.¹⁰ The GATT entered into force in 1948 as an inter-governmental treaty – expected to be an interim agreement on the road to the ITO. Its spirit and letter, however, provided the multilateral framework that saw trade and economic growth among its members flourish in the ensuing 50+ years.

Indeed, the GATT was so successful that during the Uruguay Round of multilateral trade negotiations (1986-94), GATT contracting parties agreed to establish an international organization to administer multilateral trade

¹⁰ For details see Irwin et al. (2008).

agreements (including the GATT) – the World Trade Organization (WTO). Since then, virtually every nation, with a very small handful of exceptions, came knocking at its door to seek membership.¹¹

It is ironic to note, amid the latest developments in trade policy under the Trump administration, that the leadership of the United States was fundamental in establishing the pillars of the liberal trade order in the post-World War II era. The United Kingdom also played an important role in this process since the multilateral trade rules emerged from initial negotiations at a bilateral level between the United States and the United Kingdom, designed to restrict the adoption of protectionist measures and to set the parameters for trade liberalization.

History, however, suggests that the United States could be characterized as a “reluctant” hegemon. As Kagan (2013) points out, its engagement in international affairs has typically followed a cyclical path characterized by initial reluctance, followed by “aggressive” intervention, with the cycle often ending in withdrawal or indifference. But its influence in the context of major geopolitical developments in the 20th century, as well as in shaping the current global governance structure, has been profound. Definitions of what global governance means vary, but typically they emphasize the following key objectives for the network of institutions involved in such an undertaking: (i) to avoid “great power” wars; (ii) to sustain global economic prosperity; and (iii) to constrain tyranny and extra-territorial interventions.¹² It can be argued that US power has also been influential in adding the spread of democracy and market-oriented economic policies as additional objectives of its foreign policy goals.

There is no doubt that the “world” that the United States helped build in the post-World War II era has been quite successful in advancing economic prosperity and constraining “great power” conflict. The Cold War tensions with the Soviet Union also fostered a strategy of engagement on economic (e.g. the Marshall Plan) and military terms (e.g. North Atlantic Treaty Organization and the Treaty of Mutual Cooperation and Security between the US and Japan) that facilitated the re-orientation of two of the major military powers of the past (Germany and Japan) toward a pacifist path. The US-driven “liberal” world order achieved its pinnacle in the 1990s with the disintegration of the former Soviet Union and the collapse of communism as a serious alternative socioeconomic order. The euphoria of the moment even led some to announce

11 By the end of 2017, the WTO had 164 members, covering more than 98% of global trade flows, and 21 additional countries were engaged in accession procedures.

12 See, for example, Kissinger (2014) and Jones (2014).

the “end of history” in the sense that liberal market democracies had become the universal evolutionary goal of societies around the world and ideological tensions would become a thing of the past.¹³

This “triumphalism” did not resist the harsh realities of economic and political developments in the 21st century. Moreover, the benefits of a liberal trade order also begin to be disputed amid the populist wave of the last few years. The Inaugural Address of President Trump makes explicit this new attitude towards trade as illustrated by the following excerpt:

“Every decision on trade, on taxes, on immigration, on foreign affairs, will be made to benefit American workers and American families. We must protect our borders from the ravages of other countries making our products, stealing our companies, and destroying our jobs. Protection will lead to great prosperity and strength.”

Donald J. Trump, Inaugural Address, January 20, 2017.

Initial measures of the Trump administration and its rhetoric – including the withdrawal from the Trans-Pacific Partnership (TPP), the proposed renegotiation of NAFTA, the renewed interest in pursuing trade-remedy investigations, the emphasis on the trade–security nexus, and so on – which are discussed in detail by Craig VanGrasstek in Chapter 3 of this book, seem to confirm its intention to implement a protectionist strategy. To a certain extent, this policy trend would be consistent with the cyclical pattern identified by Kagan and one could argue that the US “retreat” will not last for too long. Its institutional implications in terms of global governance, however, could be quite significant in the coming years.

The strategy of the Trump administration emphasizes reciprocity and a preference for bilateral trade deals vis-à-vis multilateral engagements. It is also characterized by a “fetish” about the negative implications of trade deficits. The emphasis on reciprocity has historical precedent in the context of previous strategies adopted to frame US trade policies. The 1934 Reciprocal Trade Agreement Act (RTAA), adopted by the Roosevelt administration, for example, relied on this concept as the guiding principle for trade negotiations and reduction of tariff barriers. As discussed in Bown et al. (2017), the RTAA guided the negotiations of 29 bilateral agreements by the United States between 1934 and 1947.

13 See Fukuyama (1989) for the original articulation of the concept, and Glaser (2014) for an updated critique.

The concept of reciprocity, however, was applied in a pragmatic manner – that is, tariff cuts were negotiated to achieve “a balance of perceived advantages at the margin” (what Bhagwati characterizes as “first-difference reciprocity”) rather than equality of market access for the trade partners.¹⁴ This approach was complemented with adherence to the unconditional most-favored nation (MFN) principle, which guaranteed to trading partners that if eventual future tariff cuts were negotiated they would also be applied to them, as long as the same unconditional principle was adopted by the trading partner. In other words, tariff cuts negotiated under the RTAA were extended to all third countries to which the United States had accorded MFN status. This approach to reciprocity combined with MFN treatment would become one of the pillars of the multilateral trade system in the GATT era.

The current approach to reciprocity, however, seems to be driven by the concept of a “level playing field.” The rhetoric of the Trump administration sounds like an attempt to derive full equality (instead of equality at the margin) of market access in its bilateral negotiations.¹⁵ This may be simply a negotiating ploy, but it will make more difficult for trading partners to engage in view of their own domestic political constraints, raising the danger of trade conflicts. Moreover, the approach adopted so far in announcements about renegotiation of existing agreements suggests that reversible preferences are now a possibility, as illustrated by the idea of a “sunset clause” raised by US negotiators in the context of the NAFTA review. In other words, trade policy uncertainty is bound to increase if such an approach is fully implemented.¹⁶

Another characteristic of Trump’s trade agenda is its emphasis on reducing balance-of-trade deficits. China (\$347 billion), Japan (\$68.9 billion), Germany (\$64.9 billion), and Mexico (\$63.2 billion) were the countries with the largest bilateral trade merchandise surpluses vis-à-vis the United States in 2016.¹⁷ It is not surprising that these countries have been frequent targets for trade threats in the Trump era. These tensions are also impacting the NAFTA renegotiation and discussions on amendments to the Korea–United States Free Trade Agreement (KORUS). Needless to say, attempts to reduce trade imbalances via trade protectionism is a “fool’s errand” to the extent that these imbalances mainly reflect savings and investment macro relations and

14 For a more detailed discussion of the concept, see Bhagwati (1989).

15 In a speech delivered in Vietnam (November 10, 2017) ahead of the APEC Summit, Donald Trump noted that: “We expect that markets will be open to an equal degree on both sides and that private investment, not government planners, will direct investment.”; see Holland and Tostevin (2017).

16 See Handley and Limão (2017) for an analysis of the impact of Trump’s policies on indicators of trade policy uncertainty.

17 The US Treasury Department considers countries with a bilateral trade surplus of at least \$20 billion (roughly 0.1% of US GDP) as having a *significant* trade surplus. In 2016, Italy, South Korea, and India – in addition to the four countries mentioned above – reached that threshold. For details, see US Department of Treasury (2017).

comparative advantages. Protectionist measures may affect these macro variables at the margin, but they are unlikely to significantly change the overall trade balance of a country.¹⁸ In practice, these actions are more likely to shift the profile of bilateral imbalances across countries and to exacerbate the danger of trade wars.

The main message of the Trump presidential campaign was his appeal to the US voters to consider “how much better our future can be if we declare independence from the elites who’ve led us to one financial and foreign policy disaster after another”. In this context, he mentioned that “[o]ur friends in Britain recently voted to take back control of their economy, politics and borders,” pointing out that he had been on the right side of this debate (i.e. supporting Brexit) (Trump, 2016). Many analysts have pointed out that the “Brexit” vote and Trump’s election were driven by similar factors, including working-class anxiety about trade deals and the impact of immigration.

The result of the Brexit referendum on June 23, 2016, caught the British establishment by surprise. The populist rhetoric of those in favor of Brexit – notably that of Nigel Farage, the leader of the UK Independence Party – had many similarities with the arguments of the Trump campaign. To point out that those who felt left behind were attracted by populist messages does not necessarily imply, however, that their appeal to voters was grounded on similar motivations. In the case of the United States, trade protectionism was appealing to the extent that it was expected to shield disgruntled voters from international competition. In the case of Brexit, according to Sampson (2017), economics and self-interest played less of a role. In his view, the main motivations were concerns about the erosion of UK’s sovereignty (for example, EU membership limiting the United Kingdom’s capacity to control immigration and implying the supremacy of EU laws and regulations); and blaming the European Union for a feeling of being left behind by modern life, even if the causes of discontent were driven by other factors (the “scapegoating” hypothesis).

Independently of the motivations behind the support for Brexit, its potential impact may mimic trade protectionism in the medium term.¹⁹ It is difficult to predict at this stage its precise impact since the withdrawal negotiations, triggered by the United Kingdom’s notification to the European Union of its intent to leave on March 29, 2017, are still ongoing. In theory, these negotiations

18 In theory, the impact of trade protection on the current account of a country will depend on the magnitude of the Laursen-Metzler effect – that is, the extent to which it will generate an improvement in the terms of trade leading to an increase in savings. Empirical efforts to document such an effect have not been successful, however (Eichengreen, 2017).

19 For example, George Osborne, the former Chancellor of the Exchequer, declared Brexit to be “the greatest act of protectionism” in the United Kingdom’s history in a TV interview in December 2016.

may last up to two years, as codified by Article 50 of the Lisbon Treaty. In practice, the experience with trade negotiations suggests that this timetable is unlikely to be respected, but in order for negotiations to be extended this will require consensus among all 27 EU states.

The format of Brexit is also an open question. Options being considered encompass a whole array of scenarios from the United Kingdom joining the European Economic Area (EEA) (often characterized as the “Norway solution”) to the United Kingdom negotiating either an FTA (like the EU–Canada Comprehensive Economic and Trade Agreement) or a customs union agreement (like that negotiated between the European Union and Turkey) with the European Union, or simply falling back on WTO terms (the “hard Brexit” option).²⁰ It is clear that in view of the importance of trade relations with the European Union (which accounts for more than 40% of UK exports and more than 50% of UK imports), there are strong incentives for both sides to enter a new trade agreement. But the possibility of a “hard Brexit” cannot be ignored. It is true that the European Union’s MFN tariffs average only 4.4%, but one should not forget that there are significant tariff peaks (such as in the case of road vehicles and agricultural products), not to mention non-tariff barriers and eventual future discrepancies on regulations. In the case of autos, for example, UK exports to the European Union would face a 9.7% MFN tariff. The implications for services could be even more significant as UK financial firms are likely to lose their “passporting” rights in such a scenario.

It is important to recognize that in contrast to the Trump administration, the current UK government does not seem intent on pursuing explicit protectionist policies. Actually, some of the arguments in favor of Brexit tend to emphasize the opportunities for the United Kingdom to pursue its own brand of FTAs with non-EU countries and to advance a deregulation agenda at home that will foster new trade opportunities. It is quite clear, however, that at least until the terms of the Brexit “divorce” are formally agreed upon, it will be difficult to implement such a strategy. In short, the unintended consequences of Brexit (in terms of potential business disruptions and negative impacts on trade flows) add to the fears that we have entered an era of international economic disintegration.

20 For a more detailed discussion see Chapter 4 in this book by Miguel Rodríguez Mendoza.

Wither the WTO?

There is broad consensus that the WTO is facing major challenges. Some have characterized it as an “adaptability” crisis to a new world of trade relations driven by GVCs, the difficulties in coping with the growing economic influence of emerging economies, and the proliferation of preferential trade agreements.²¹ The most obvious evidence of these problems concerns the unfinished business of the Doha Development Agenda (DDA) of multilateral trade negotiations. When the DDA was launched in 2001, there was hope that it would rekindle interest in multilateralism amid a global environment characterized by growing dissent about the benefits of globalization. This optimism was quickly debunked by a series of crises (Cancun in 2003, Geneva in 2008...) and delays in the completion of the negotiations that underscored the deep divisions among the WTO membership on how to implement the DDA mandate.

Writing in 2005, I characterized the dangers to the multilateral trade system as a combination of complacency (some analysts would argue that delays in concluding trade negotiations were nothing new), a mismatch between expectations and reality (no consensus on what a Development Round really meant, with many developing countries arguing that it should be equated with more degrees of freedom for the protection of infant industries rather than a trade-liberalizing agenda), and systemic challenges (the revealed preference for FTAs, the complexity of applying mercantilist calculations to non-traditional trade themes, and so on).²²

Sixteen years later, it is clear that the DDA is in a terminal coma. Some countries, driven by their exasperation with the never-ending negotiations and with the obstructionist behavior of some participants, gave up hope of concluding this round. At the Nairobi Ministerial in December 2015, the divide between the United States (with the support of some other developed countries) and the majority of developing WTO members with respect to the fate of the DDA became evident. In the end, in the best tradition of constructive ambiguity, the Ministerial Declaration in its Article 30 states that “many Members reaffirm the Doha Development Agenda, and the Declarations and Decisions adopted at Doha and at the Ministerial Conferences held since then, and reaffirm their full commitment to conclude the DDA on that basis. Other

21 See Chapter 4 in this book by Rodriguez in this book, and Baldwin (2016).

22 For details, see Primo Braga and Grainger-Jones (2006).

Members do not reaffirm the Doha mandates, as they believe new approaches are necessary to achieve meaningful outcomes in multilateral negotiations” (WTO, 2015).

It has been pointed out that these protracted negotiations against the background of fast-moving developments in international trade (GVCs, e-commerce, etc.) did not help the system. Moreover, the transformation of China into a mega-trader over the period in question contributed to eroding the relevance of the “great bargain” between developed and developing nations that was the basis for the multilateral deals under the Uruguay Round – that is, services, trade-related intellectual property rights (TRIPs) and non-agricultural market access (NAMA) liberalization, priorities for developed countries, in exchange for disciplines for agricultural trade and the end of the Multi-Fiber Arrangement, MFA, priorities for many developing countries. It is now much more difficult to build effective coalitions willing to compromise and to reach acceptable deals along the North–South divide. The growing importance of non-trade concerns in a multipolar world has added to the complexities of the negotiations.²³

It is important to recognize that the negotiations did achieve some relevant results (such as the Trade Facilitation Agreement), but it is evident that the credibility of one of the main roles of the WTO (the promotion of comprehensive trade liberalization via multilateral negotiations) is now in question. Needless to say, the WTO has many other important functions as discussed in this book (including its dispute settlement system, the monitoring and implementation of its agreements and disciplines, and its functions in promoting transparency in trade practices via the Trade Policy Review Mechanism and aid for trade). Hence, its overall relevance is not in question. But as Robert Gilpin once observed: “A liberal international economy cannot come into existence *and be maintained* unless it has behind it the most powerful state(s) in the system” (Gilpin, 1975: 85, emphasis added). In the current environment, one could translate this proposition into the following question: does the United States still believe in the importance of preserving the multilateral trade system and its institutional underpinnings?

Recent actions of the Trump administration (as discussed in detail in the chapters by Craig VanGrasstek and Giorgio Sacerdoti in this book), as well as US Trade Representative documents, suggest that the answer is now open to debate.²⁴ A pertinent follow up question would be: if not the United States, who? The obvious next candidate, the European Union, is now focused on its

23 See, for example, Martin and Messerlin (2007).

24 For a good discussion of the legal system governing US international trade policy, see Wolff (2017).

own disintegration threat, namely, Brexit. It is unlikely that it would be willing to allocate significant political capital and negotiating assets to re-energizing the multilateral trade system in the near future.

These considerations inevitably take us to the other mega-trade power – China. In 1990, China's share of global trade stood at 4%; by 2010 it had risen to 20%, while global trade itself had expanded from \$3.5 trillion to \$15.5 trillion, with China's total trade (exports + imports) growing from \$138 billion to \$3,122 billion. As recently as 2000, China was the first- or second-largest trading partner for only 13 countries, accounting for 15% of global GDP, whereas by 2010 it was the first- or second-largest trading partner for 78 countries, accounting for 55% of global GDP.²⁵

The accession of China to the WTO in 2001 will probably remain one of the landmark trade developments of the 21st century. In order to preserve the predictability of market-access conditions, an important variable for the sustainability of its outward-oriented development strategy, China agreed to implement major economic reforms in the context of its WTO accession. Not surprisingly, it has a vested interest in the health of the multilateral trading system. Actually, it is ironic to note that an autocratic regime, which is formally a communist country, has now become the main voice in favor of globalization in international fora like the G20 and APEC Summits.²⁶

Would China be willing to exert leadership in supporting the multilateral trade system? As pointed out by Thakur (2017), China does not necessarily see the provision of regional or global public goods, based on institutions created by Western powers, as a priority in terms of Chinese interests.²⁷ Although China has become a vocal support of the globalization process, it has played a less assertive role at the WTO, relying on its position as a recently acceded member to claim that it was in no position to make significant additional liberalization offers or to take a leadership role in the DDA.

25 See Hille and Jacob (2012). It is worth noting that this expansion was not confined to international trade. Between 1978 and 1990, the Chinese economy by a factor of 26, albeit from a very low base. In 1990, it was the tenth biggest world economy; by 2001, it was in sixth place; and in 2010 it overtook Japan to become the world's second biggest economy. It has become the world's biggest economy in purchasing-power parity (PPP) terms, overtaking the United States in 2014 (PwC, 2015). While economic forecasts are notoriously risky, it seems reasonably safe to predict that the Chinese economy will overtake the US economy at market exchange rates GDP in the coming decade or so. The velocity and dimensions of these changes in the case of China have no parallel in the history of economic development.

26 There is some evidence that political regimes do influence the chances of international cooperation. Mansfield et al. (2002), for example, find that more democratic countries are more likely to engage in trade agreements than autocracies.

27 Some analysts note that the OBOR is simply a pragmatic response to the Chinese needs to address its over-capacity in steel and cement production; see French (2017).

If history is to provide any guidance, China will first try to cement its regional hegemony focusing on Asia – as the United States did with respect to the Western Hemisphere in the 19th century.²⁸ The efforts of China in championing the Regional Comprehensive Economic Partnership (RCEP) agreement in the region are consistent with such an interpretation.²⁹ In the same vein, the “One Belt, One Road” (OBOR) initiative, with its emphasis on the development of physical infrastructure connecting more than 60 countries across Asia, Africa, and Europe, seems to be the centerpiece of China’s geostrategic objectives. In sum, it is unlikely that China would be willing to take a proactive role in replacing the United States as a pillar of the multilateral trade system.

There are no other serious candidates to exert the required leadership.³⁰ As discussed in Primo Braga (2015b), one of the main assets of the United States in the post-World War II era has been its capacity to explore diverse political and economic coalitions in exercising global leadership. No other country can match these capabilities at this stage. Large emerging economies, for example, are ready to fight for their individual agendas in the trade arena, but seem unwilling (or unable) to exert positive leadership in advancing effective multilateral solutions. Existing alternative coalitions – such as the BRICS and its related institutions – remain at best work in progress.³¹ In short, the chances of a systemic crisis are real.

Concluding Remarks

International institutions can foster the ability of nation states to cooperate. The prevailing trend toward “multipolarity” in economic power, however, does not facilitate multilateral solutions (as illustrated by the difficulties in finalizing the DDA). The threat of economic disintegration has been further magnified by the leadership vacuum generated by the populist wave that led to the political shocks of 2016. History has shown that in the absence of clear

28 For an analysis of the likely geopolitical implications of the Chinese ascent and the potential for conflict, see Mearsheimer (2014).

29 RCEP negotiations, focusing on trade and investment preferential liberalization, involve Australia, Brunei, Cambodia, China, India, Indonesia, Japan, Korea, Laos, Myanmar, New Zealand, Philippines, Singapore, Thailand, and Vietnam. For a discussion of the implications of power shifts for the trading system, see Baru and Dogra (2015).

30 For a detailed discussion of the role of emerging economic powers in the WTO, see Michalopoulos (2014).

31 The term “BRICS” is a Western construct. It was originally coined by Jim O’Neill, then chief economist of Goldman Sachs, as a convenient tag for the new phenomenon of emerging large economies. Initially the acronym “BRICs” encompassed Brazil, Russia, India and China with the lower case “s” at the end to serve as a plural. The BRICs began to engage in formal meetings in 2006, and in 2010 South Africa joined the group, hence the elevation of the “s” from lower to upper case. It is worth noting that in 2012, O’Neill observed that “in economic terms, South Africa joining the BRIC economies makes little sense” (O’Neill, 2012).

leadership and support from major economic powers, multilateral institutions are unlikely to succeed, as illustrated by the experience of the League of Nations (VanGrasstek, 2016).

Some analysts (such as Dani Rodrik) argue that the collapse of global rule-making (and the devaluation of the cosmopolitan ideal as a driver for economic policy) will not necessarily spell economic disaster. In this perspective, policy failures and the resurgence of protectionism “reflect poor domestic governance, not a lack of cosmopolitanism” (Rodrik, 2017). Be that as it may, the current situation is not a good omen for the future of the international order in the 21st century.

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CHAPTER 3

Back to the Future: US Trade Policy under the Trump Administration

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Introduction

No other developed democracy has ever changed its trade policy as rapidly and as thoroughly, and with as great a potential impact on the trading system, as has the United States since the inauguration of Donald Trump. His priorities are not entirely dissociated from those of his predecessors, as there are a few strands of continuity – neglect of the Doha Round and a sharp focus on China offer two cases in point. In most respects, however, this administration seems intent upon undoing much of what has been accomplished since the second term of the Reagan administration (1985–1988), especially the many bilateral, regional and multilateral trade agreements reached by Presidents Reagan through Obama. And while there are some ways in which the current trade policy environment resembles the first Reagan term (1981–1984), which was marked by several high-profile episodes of protectionism and retaliation-based negotiations, to find its true predecessor we should look not to past decades, but to past centuries. Trump’s trade policy is reminiscent not merely of simple protectionism, but instead of that dangerous cocktail of mercantilism, nationalism and militarism that was so prevalent before the nineteenth century.

This analysis proceeds in three steps. It starts by reviewing our path to this juncture, chronicling how the recent history of US trade politics presaged the advent of Donald Trump. That review stresses how this amateur politician perceived and catered to demands that the professionals seemed to have ignored when they downgraded trade policy from a top-tier to a tertiary issue. One of the chief reasons that Trump won the Republican nomination, and then the

presidency, was that he recognized and exploited not just the economic loss but also the social alienation and political disenfranchisement felt by those on the losing side of globalization.

The protectionist promises that Trump made on the road to the White House set the direction for the second part of the analysis. There, I examine what has been done in the first nine months of the Trump presidency, and also speculate on developments in the near term, to consider how the broad principles of campaign rhetoric are being translated into concrete policy. This review stresses that the administration has already taken several steps, and threatens to take still more, that may radically change the means and ends of US trade policy.

The final section considers what may come in the medium to long terms. Much will depend on how long Trump remains in power, and whether Trumpism survives Trump – especially if other Republican officeholders decide that the message is more enduring than the man. The section also considers where this leaves the trading system. There is every reason to expect that the fragmentation that was already underway before the 2016 election will now accelerate, and that the cross-contamination between trade and security issues will grow ever worse.

Looking Backward: How We Got Here

In 2016, the trading system received three shocks in quick succession. The first came around May, by which time it was clear that Donald Trump had executed a hostile takeover of the Republican Party; the second came a month later, when the British electorate confounded expectations by approving a “Brexit” from the European Union; and the third came in November, when Trump won an even greater upset victory in the general election. All three events showed that the depth of trade skepticism is more profound than pundits and politicians had appreciated, even in the two countries that successively led the system for the past two centuries. With the benefit of hindsight, however, the triumph of protectionist demagoguery puts one in mind of what de Tocqueville said of the French Revolution: it was both unforeseeable and inevitable. No less than in the *ancien régime*, the build-up of resentment at the bottom, coupled with complacency at the top, made a cataclysmic eruption seem inescapable.

Before Trump came on the scene, an analyst might reasonably have supposed that trade policy – and especially protectionism – was an issue that had passed its prime in the United States. It had been a top-tier issue a generation ago, when several US industries faced a competitive challenge. Some of them

saw globalization as a threat and demanded protection, while others saw an opportunity and favored further liberalization, but either way they elevated the political profile of this subject. Politicians responded by making trade a leading issue from the mid-1980s until the dawn of the new millennium. Between the elections of 2000 and 2016, however, the salience of this topic had fallen considerably. By *salience* I mean the revealed preference of elected officials to invest their political capital in an issue. A rational politician may be assumed to concentrate on topics that are electorally rewarding, but to take a pass on issues that do not contribute to the overarching objective of re-election. Presidents and members of Congress found it profitable to concentrate on trade during the more intense phase of the post-industrial transition, but most of them subsequently made their peace with globalization. This apparent consensus proved to be remarkably fragile, cracking in the space of a single presidential election.

The Rising Merchandise Trade Deficit and the Decline of Manufacturing

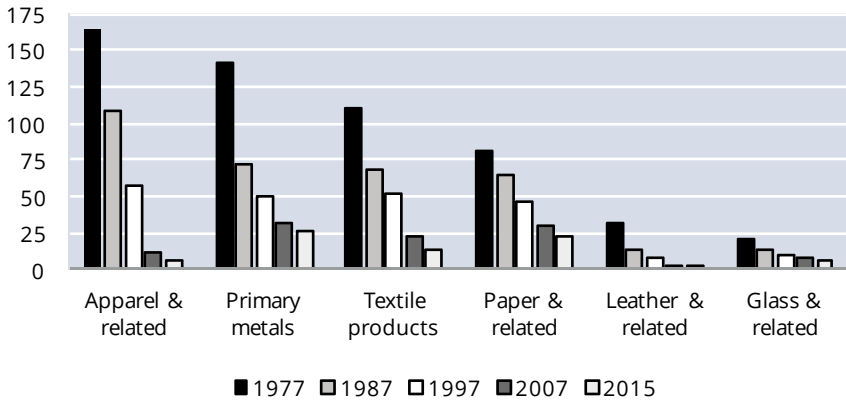
In a time when the US merchandise trade deficit seems like a permanent feature of the global economic landscape, it can be difficult to remember that for most of the twentieth century the United States quite consistently ran a trade surplus. It therefore came as a shock when the first trade deficit appeared in 1971, and the ink only got redder as the decade progressed. Between 1980 and 2000, the merchandise trade deficit rose from 0.6% to 4.1% of GDP. Since then it has hovered in the 4–6% range.

The rising and persistent trade deficit is not solely responsible for the secular decline in manufacturing jobs, but it is the cause that is most visible to the general public. The losses have been especially steep in those labor-intensive industries that will by definition face a competitive challenge from lower-wage countries. Chief among them are the six industries shown in Figure 1. As of 1977, nearly one out of every 18 persons employed in the United States worked in apparel, steel, or one of the four other vulnerable sectors. By 2015, these industries collectively provided less than one in 130 jobs. They did not go quietly, at least not initially, as they fought a series of battles for protection from import competition; some of the remaining firms are still fighting. They did score some short-term victories, winning import relief through a variety of means. Protection could slow the decline, but not reverse it. By the dawn of the millennium, the economy had undergone a transition in which numerous industries either figured out how to ride the global tiger or were swallowed

by it. The one thing that the winning and losing firms had in common was that they tended to shed jobs in the process, whether incrementally through automation and outsourcing or altogether through relocation or bankruptcy.

Figure 1: Employment in the principal protection-seeking industries, 1977–2015

Employees in an Industry per 10,000 non-farm jobs in the United States



Notes: The comparability of data for the periods before and after 1997 is complicated by the transition that year from the Standard Industrial Classification (SIC) to the North American Industry Classification (NAIC) nomenclature. While the categories appear to cover the same territory, it is possible that some SIC categories may be slightly broader or narrower than some of the corresponding NAIC categories. Data for apparel are based on SIC 23 and NAIC 315; data for primary metals are based on SIC 33 and NAIC 331; data for textiles are based on SIC 22 and NAIC 313 and 314; data for paper are based on SIC 26 and NAIC 322; data for leather are based on SIC 31 and NAIC 316; and data for glass are based on SIC 321-323 and NAIC 3272.

Sources: Calculated from the Census of Manufactures (for employment by industry in 1977-2007), the Annual Survey of Manufactures (for employment by industry in 2015), and Bureau of Labor Statistics (total non-farm jobs) data.

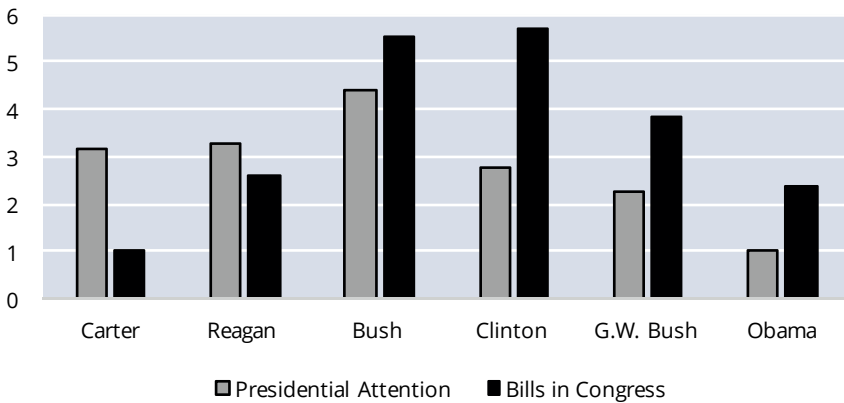
Economic leaders gradually grew less interested in demanding protection not *despite* the rise in import penetration, but indeed *because* of it. That option appears more threatening than enticing once a firm is globalized in its investments, ownership, sources and sales. The economic transition, and the concurrent arc of protectionist demands, are reflected in the attention that elected officials pay to trade. The profile of this topic rose in the early stages of the debate over globalization, but declined as the political center of gravity among corporate leaders and other elites shifted towards acceptance of open markets and competition.

The Declining Salience of Trade for US Elected Officials

Perhaps the best way to gauge political interest in a topic is to look at the bills that legislators introduce (as seen in Figure 2).

Figure 2: The salience of trade policy by US administration, 1977–2016

Percentage of presidential and congressional activity devoted to trade



Notes: “Presidential Attention” is the share of transcripts, press releases, executive orders, fact sheets, and other White House documents for which the title or description included (1) the word “trade” (excluding cases in which it had a meaning other than “international commerce,” such as references to the Federal Trade Commission, the building trades, etc.) and/or (2) one or more of the words “import” (or “importation”), “export,” “tariff,” or “safeguard” (when used in a trade-related sense). The values represent averages for each presidency, whether it lasted four years or eight. “Bills in Congress” are the average for all public bills introduced in the House and Senate bills that included at least one of the following keywords and phrases in the text: “African Growth and Opportunity Act,” “Andean trade,” “antidumping,” “Caribbean Basin Economic Recovery Act,” “fair trade,” “free trade agreement,” “GATT,” “General Agreement on Tariffs and Trade,” “Generalized System of Preferences,” “most favored nation,” “NAFTA,” “normal trade relations,” “Omnibus Trade and Competitiveness Act,” “Tariff Act of 1930,” “trade act,” “trade adjustment assistance,” “Trade and Tariff Act,” “Trade Expansion Act,” “trade preferences,” “unfair trade,” or “World Trade Organization.” These values were first calculated for each chamber in each two-year Congress, then averaged for the congresses that comprised a given four- or eight-year presidential term (giving equal weight to each chamber).

Source: Calculated from data on the Library of Congress website and from documents posted by the American Presidency Project.

Unlike many of its foreign counterparts, where most or all bills originate in either the executive branch or the parliamentary majority, the US Congress allows all members to sponsor any number of bills on any matter they wish. The result is that thousands of bills are introduced in each two-year congress, and while only a few become law they all offer evidence of legislators’ interest

in associating themselves with specific issues.¹ The share of bills devoted to a topic tells us a lot about whether lawmakers think that subject is worth their while, even if they do not necessarily expect their bills to clear every hurdle in the legislative process.

The high point for trade came in the 103rd Congress (1993–1994), when 366 bills introduced in the House of Representatives (or nearly 7% of the 5,310 total) dealt with this issue. The numbers were higher still in the Senate, where over 9% of all bills introduced in the 103rd Congress related to this issue. It is not surprising that those two years proved to be the peak, considering all that was then happening: the conclusion and approval of both the North American Free Trade Agreement (NAFTA) and the Uruguay Round agreements, the launch of mega-regional negotiations in the Americas and the Asia-Pacific region (both of which ultimately failed), and continued concerns over US competitiveness and the trade deficit. Trade had also been a hot topic in the 1992 presidential election, which was the first time — but not the last — that an unorthodox billionaire without prior political experience would run for the presidency on a protectionist platform. Third-party candidate H. Ross Perot managed to capture 18.9% of the popular vote, and while that was not nearly enough to win, his showing seemed to inspire emulation on Capitol Hill.

Trade's heyday passed as quickly as it arrived. By the 114th Congress (2015–2016), trade accounted for just 2.2% of all House bills and 2.6% of Senate bills. The data thus imply that dealing with trade was less than one-third as attractive to the median legislator in the two years that Donald Trump ran for the presidency as it was in the first two years of Bill Clinton's presidency.

Presidents followed the same path, as shown in the share of events and documents that they generate on trade policy. The salience of trade hit its peak in the George H.W. Bush administration (1989–1992), when it accounted for 4.4% of the presidential paper trail. The high point for the White House thus came just before the same thing happened on Capitol Hill. The political profile of trade then declined, and the drop accelerated with the inauguration of Barack Obama. That trend may initially be seen as a simple function of decreased activity — neither the executive nor Congress showed more than cursory interest in trade during Obama's first two years in office. The issue got a major upgrade in his second term, especially in mega-regional negotiations across both the Atlantic and the Pacific, but even then there was no discernible rise in its political profile. Trade accounted for just 1% of the documents and

1 For example, in the 114th Congress (2015–2016) there were 6,536 bills introduced in the House of Representatives and 3,548 in the Senate. Only 329 of the bills made it all the way through the legislative process to become public laws, amounting to just 3.3% of the combined House and Senate bills (calculated from data at <https://congress.gov/browse/114th-congress>).

events in both the first and second Obama administrations, an observation that speaks volumes about the low political saliency of trade at the very end of what future historians may label as the pre-Trump period of US trade politics.

The Declining Saliency of Trade in Presidential Elections

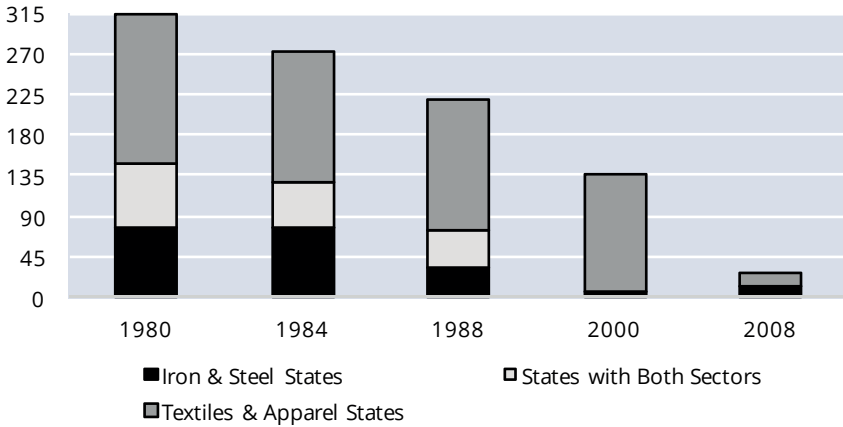
While the high profile of trade policy in the 2016 presidential election might seem unprecedented, it actually hearkened back to an earlier time. Neither party had nominated a committed protectionist since the 1930s, but presidential candidates have sometimes engaged in selective backsliding. That was especially notable in the final decades of the twentieth century, offering yet another example of how the political saliency of trade rose and then fell.

In four of the six presidential elections from 1980 through 2000, one of the candidates – always a Republican – promised major protection for one of the two largest import-challenged industries. Ronald Reagan pledged to protect the textile and apparel industry in 1980 (thus appealing to voters in the South) and made a similar promise to the steel industry in 1984 (thus appealing to voters in the industrial Midwest), and the two Bushes also offered protection to the steel industry in their respective 1988 and 2000 campaigns. No candidate in either party made similar promises for this type of “big ticket” protection in any election from 2004 through 2012.

The disappearance of major, product-specific protectionism reflects three tectonic shifts in political geography. The first shift, as already reviewed, is the declining level of employment in protectionist industries. Second, many of the states in which these industries are concentrated have themselves experienced relative declines in population, meaning that after each decennial census they have lost votes in both the House of Representatives and the Electoral College. Michigan, Ohio and Pennsylvania collectively controlled 73 electoral votes in the 1980 presidential election, so that a candidate who won all three was 27% of the way towards racking up the 270 electoral votes needed to win. By 2012 they had been reduced to 54 votes, thus providing just 20% of that magic number. The third change is in the contestability of states, with more states becoming firmly aligned with one or the other party. In 1980 there were 27 contested states controlling 336 electoral votes (62% of the available 538), but by 2008 there were just 18 states in play with 181 electoral votes (34% of the total). Several former “swing states” used to host troubled industries, and thus offered tempting targets for protectionist appeals, but have lately turned so darkly Republican red or Democratic blue that the veteran politicians saw no incentive to contest them.

Figure 3: Electoral votes in swing states associated with protection-seeking industries

Electoral votes in swing states where the industry accounted for an above-threshold level of employment



Notes: A state is associated with an industry if employment in that industry accounted for at least 0.25% of the state's population in the election year. Swing State = A state that split its vote in the four most recent elections, including the year in question. For example, a state was in play in 2008 if there was at least one election during 1996, 2000, 2004, and 2008 in which that state went Democratic and at least one election in that same period in which it went Republican, but was out of play if it went for Republicans all four times or for Democrats all four times. Election years prior to 2008 in which the major-party candidates made no significant promises to protect major industries (i.e., 1992, 1996, and 2004) not shown.

Sources: States in play determined on the basis of election results posted by the National Archives. Data for iron and steel are based on SIC 331 and 332 for 1977-1992 and on NAIC 331111 for 1997-2007; data for textiles and apparel are based on SIC 22 and 23 for 1977-1992 and on NAIC 313-315 for 1997-2008. In each year the calculations of industry size for states are based on the Census of Manufactures that was conducted closest to that election.

The data in Figure 3 illustrate the electoral stakes in four elections, showing the number of electoral votes associated with states that were (a) not firmly in either camp and (b) tied to the steel or textile industries.² The aggregate data demonstrate how thoroughly the political economy of protection has changed. Back in 1980, when Reagan promised to protect textiles and apparel, that industry was associated with nineteen swing states that collectively controlled 235 electoral votes (87.0% of the needed 270). Four years later, when Reagan ran for reelection and promised to protect steel, that industry was associated with nine of the states in play and 128 electoral votes (47.4% of 270). By 2008, however, the protectionist pool had all but emptied. Obama won both the sole remaining steel swing state (Indiana) and its counterpart among the textile

2 This criterion requires that the industry employ at least 0.25% of the state's total population. This number comports with the decision that the G.W. Bush campaign made to offer protection to the steel industry in the very final days of the 2000 campaign. The Bush pledge was reportedly made in order to sway voters in West Virginia, where jobs in the iron and steel industry accounted for just 0.27% of the state's population.

and apparel states (North Carolina), doing so without resort to protectionist appeals. And while trade policy played a role in both of the two presidential elections that followed, none of the four major-party nominees made any sector-specific promises like those in the 1980–2000 races.

The Issue that Workers Forgot to Forget

The process outlined above may look like a virtuous circle from the free-trader's perspective, with the initially negative response to globalization gradually giving way to a more favorable political climate. The picture looks quite different, however, for those workers who see globalization not as a rising and benevolent tide that lifts all boats, but instead as a malevolent wave that threatens to inundate their way of life.

Workers have fewer options than firms. Because moving to Monterrey or Shanghai is not as easy for apparel workers as it is for apparel companies, it will almost always be in labor's interest to demand that import competition be restricted. Employees are typically less able than employers to make these demands effectively, as they lack the resources that firms enjoy. Many are unorganized, with the share of unionized labor having fallen from 23.3% in 1983 to 12.3% in 2015,³ and few can afford the hefty expense of filing petitions under the antidumping or other trade-remedy laws. The only way that most workers can benefit from that option is if their employers prefer protection to off-shoring.

One might also suppose that workers' demands for protection will lose potency after their jobs are definitively lost. Today's steelworker who fears the competitive challenge of imports might represent a potentially powerful force, but the same cannot be said for the ex-steelworker who was pushed out of that industry years ago. That is how things appear if we start from the assumption that voters' preferences are rooted in their present sectoral affiliations, but what if something else is at work? What if the working class defines its interests precisely as a class, rather than in narrowly industrial terms, and what if the resentment against globalization long outlasts employment in a dying industry? These are questions that only a few politicians – least of all the Republicans – seemed interested in addressing before Trump ran for office. His answer thoroughly scrambled partisan voting patterns that had seemed immutable, breaking down the “blue wall” of reliably Democratic states.

3 Bureau of Labor Statistics data at <https://data.bls.gov/pdq/SurveyOutputServlet>.

Income inequality is one of the defining themes of the *zeitgeist*, having captivated the chattering classes for the last few years. They have variously taken on this issue by way of economics (e.g. Thomas Piketty's (2014) *Capital in the Twenty-First Century*), moral philosophy (e.g. Pope Francis' 2015 speech to a joint session of Congress), and biography (e.g. J.D. Vance's (2016) *Hillbilly Elogy: A Memoir of a Family and Culture in Crisis*). A paper by economists Pierce and Schott did not receive anything like that same level of attention, but did speak directly to the concerns of an industrial underclass. They found "higher rates of suicide and related causes of death, concentrated among whites, especially white males" in communities with greater exposure to the consequences of trade liberalization (Pierce and Schott, 2016: 1). Their data suggested that the costs of the trade deficit can be counted not just in lost jobs and lower wages, but also in mental anguish, social isolation, addiction and self-destruction. Put another way, Trump engaged in severe hyperbole when he declared that "China is raping this country" via trade,⁴ yet there was a more literal (if indirect) sense in which imports actually killed some Americans.

In short, where professional politicians saw a dead issue, Trump instead perceived an underserved political market. A large pool of displaced workers could be rallied to support a man who spoke their language, acknowledged their pain, and promised to relieve it. The protectionist positions that Trump adopted were closely aligned with a substantial minority of the Republican electorate, together with sizeable numbers of independents, disgruntled Democrats and people so estranged from the process that they had no prior party affiliations or voting records. In both phases of the election, this political neophyte put together winning coalitions by appealing to groups who had been economically and politically marginalized for decades.

Looking Forward: Where We May Be Headed

Donald Trump thus managed to harness a political force that other contenders had neglected, and he has shown no inclination as president to back away from the trade-skeptical rhetoric that helped him win the election. The extent to which that rhetoric is translated into actual policy, however, is still under development. The only complete and irrevocable step that he has thus far taken was repudiation of the Trans Pacific Partnership (TPP). Most of his other steps have only created the potential for wholesale policy revision. These include the launch of negotiations (under threat of abrogation) to revise NAFTA,

4 Quoted at <http://www.cnn.com/2016/05/01/politics/donald-trump-china-rape/index.html>.

directives mandating the implementation of Buy American and hire American policies, targeted investigations of bilateral trade deficits that may lead to retaliation-based consultations, an apparent revival of the “reciprocity” laws, and the initiation of cases under a national-security law that could result in unilateral restrictions on imports of steel and aluminum. It remains to be seen whether these moves ultimately erect new barriers, or were instead engineered to create leverage.

The analysis below starts by painting the bigger picture of this administration’s approach, which entails a major shift in the style, substance and even the vocabulary of trade policymaking. It then turns to how the Trump team is handling four key issues: the renegotiation of existing trade agreements, the use of safeguards and other trade-remedy laws, the conduct of trade disputes inside or outside the WTO, and the relationship between trade and national security.

When Monarchical Style Meets Mercantilist Substance

Trump’s approach to trade policymaking can most concisely be described as monarchy in style and mercantilism in substance. These are two of the numerous ways in which Trump bears a closer resemblance to King George III than he does to the 44 men who preceded him as president.

There are four aspects of pre-modern monarchies that find disturbing parallels in this administration. Chief among these is a highly centralized approach to decision-making, including impatience with bureaucratic or legislative processes and a proclivity to treat government officials like unruly servants. This administration has already been roiled by an unprecedented number of firings and resignations at the top level, and Trump even seems to consider members of Congress to be his employees. Monarchies are also marked by a close association between the person of the sovereign and the nation as a whole, and may treat any slight to that monarch as a *casus belli*. Trump’s foreign policy is marked by the very personal nature of his relations with other leaders, a sense that the state of US relations with any given country will be determined primarily by the tone of those personal contacts, and a perplexing preference for autocrats. A third characteristic of monarchies is the blurring of the lines between the public and private business, such that national policy might be determined as much by its impact on the monarch’s personal fortunes as it is by concerns over the commonweal. Trump famously did not divest himself of his business interests upon taking office, and rarely passes on an opportunity to promote his family brand. That relates to a fourth characteristic of monarchies, namely, a dynastic approach to governance. Concerns over nepotism seemed

to fly out the window as soon as Trump walked through the door of the White House, and the court gossip of this administration often centers on the tensions between the hired help and those family members whose tender years and slender preparation are no bar to power.

It is difficult to dissociate the monarchical bent of this administration from the character of this man who would be king, as this is where style and substance become indistinguishable. More than any other administration in living memory, the ability of this White House to deliver on its promises may depend upon the personal involvement of the president – often in a negative way. Here the world has come to know just how thoroughly this man’s habits differ from those of nearly all his predecessors, including a severe lack of self-control, a seemingly insatiable hunger for adulation, and a tendency to treat political contests at home or abroad as phalometric exercises. While these personal traits may not be specifically monarchical – indeed, the most admired and effective monarchs of the past behaved much better – their impact on policymaking is magnified by the extreme deference that Trump demands from sycophantic subordinates. This administration’s conduct of disputes and negotiations is heavily influenced not only by Trump’s instinct to overturn whatever bargains may have been struck by his predecessors, but also to undermine his own team and to second-guess any bargains that they might reach.

This monarchical style is wedded in the Trump administration to a mercantilist approach to international economic relations. Modern analysts tend to use the term “mercantilism” crudely, as if it merely connoted a preference for exports over imports or represented an especially severe form of protectionism. I refer instead to the classical mercantilism practiced in most European states in the centuries that preceded the *Pax Britannica*. Classical mercantilism was a comprehensive doctrine in which the high politics of war and peace were not isolated from what we have come to consider the low politics of trade and investment, but instead treated these as intimately related components of unified statecraft. Its essentials can be reduced to the following syllogism:

- **Major premise:** All political and economic relations are hierarchical dealings in which one must either dominate or be subordinate. The state is the dominant domestic institution, and in international relations the stronger states are dominant over weaker states.
- **Minor premise:** Power and wealth are inextricably linked, being both interchangeable and roughly equal in importance. Each of these *desiderata* are zero-sum, such that any state’s gains in either power or wealth must necessarily come at the expense of other states.

- **Conclusion:** Trade is an essential component in the power relations between states. Governments should use their power to intervene in domestic and international markets in order to maximize exports, minimize imports and promote a positive trade balance, and the state should not restrict its freedom of action via agreements that limit its sovereignty.

Contemporary free-traders are often comforted by the mistaken belief that this form of reasoning died long ago. Adam Smith established the philosophical foundations of the modern system by arguing that the gains from trade can be shared, and David Ricardo put that argument on a sounder mathematical footing, allowing their successors to build an impressive and persuasive structure of ideas and ideals that eventually inspired today's network of agreements and institutions. We may all too easily forget that real-world economic practitioners typically have a greater affinity for the zero-sum thinking of the past than they do for the positive-sum inclinations of economic theorists. It is no mere coincidence that the only two businessmen to make credible runs for the presidency in recent history⁵ – H. Ross Perot in 1992 and Donald Trump in 2016 – were also the most protectionist candidates since Herbert Hoover left office in 1933. Men who have lived in the rough-and-tumble world of economic competition may be naturally inclined to see these relations in transactional terms, and to count each transaction as either a win or a loss. It should not surprise us when they take a similar approach when setting the goals of foreign policy (economic and otherwise).

The Revised Terms of Trade

In order to understand what this president and his policies are all about, we need to learn the new meanings that his administration assigns to old words. This goes beyond their revised understanding of what the words “presidential” and “normal” mean. For practitioners of trade policy, the most important new dictionary entries are for “protection,” “trade deal,” “bilateral,” and “multilateral.”

The president's first foray into defining the terms of his trade doctrine came in the inaugural address, when the new chief executive declared that the principle of “America First” would guide everything that his administration does. Deliberately eschewing the rhetoric of every predecessor since Franklin D. Roosevelt, all of whom used the terms “protection” and “protectionism”

5 These are the only two men who ran credible presidential campaigns without ever having had military experience or held another elective office, a point that distinguishes them from those candidates who had substantial experience in both business and politics (e.g. Mitt Romney in 2012). The closest historical parallel to Perot and Trump would be publisher Horace Greeley, who served just one term in Congress. This protectionist ran as a Democrat in 1872, losing to Ulysses Grant.

only in a pejorative sense, Trump insisted that the United States “must protect our borders from the ravages of other countries making our products, stealing our companies, and destroying our jobs.” He reversed generations of policy by clearly portraying protection in a positive light, declaring that it “will lead to great prosperity and strength.”⁶

The doctrine acquired a little more detail three days later, when Trump signed the presidential memorandum withdrawing the United States from TPP. That order began with the following statement of principle:

It is the policy of my Administration to represent the American people and their financial well-being in all negotiations [*sic*], particularly the American worker, and to create fair and economically beneficial trade deals that serve their interests. Additionally, in order to ensure these outcomes, it is the intention of my Administration to deal directly with individual countries on a one-on-one (or bilateral) basis in negotiating future trade deals.⁷

Two terms in that statement merit close examination. While most trade professionals believe they know what someone means by the words “bilateral” and “trade deal,” these terms carry different connotations for the Trump team. “Bilateral” to them does not merely imply the ordinary English meaning of something “affecting reciprocally two nations or parties [as in] ‘a bilateral trade agreement,’”⁸ but instead carries the same policy implications now that it did in the decade preceding the Second World War. In those days, a “bilateral” approach meant striving in each relationship for a trade balance or (preferably) a surplus, and to that end countries were prepared to intervene with tariffs, quotas, or other instruments. It was, in short, a synonym for the more narrow meaning of mercantilism.

The new administration’s emphasis on bilateral balances was evident in its 31 March 2017 Presidential Executive Order Regarding the Omnibus Report on Significant Trade Deficits. In a move reminiscent of the “reciprocity” debates from the mid-1980s to the mid-1990s, it initiated an investigation that could lead to the threat or imposition of restrictions on imports from “those foreign trading partners with which the United States had a significant trade deficit in 2016.”⁹ Six months later, the US Trade Representative had yet to release

6 See <https://www.whitehouse.gov/inaugural-address>.

7 <https://www.whitehouse.gov/the-press-office/2017/01/23/presidential-memorandum-regarding-withdrawal-united-states-trans-pacific>.

8 <https://www.merriam-webster.com/dictionary/bilateral>.

9 <https://www.whitehouse.gov/the-press-office/2017/03/31/presidential-executive-order-regarding-omnibus-report-significant-trade>.

the report that it was given three months to prepare. The order was thus emblematic not just of the administration's mercantilist leanings, but also its predilection for bluster.

The new team's use of the term "trade deal" is also notable. Any other president from Reagan to Obama used these words to mean a formal agreement to remove or reduce barriers, after which the government would get out of the way and let the market sort out the actual results. The priorities seem to be reversed in the Trump administration, for which those results – as measured by investment, exports, and above all jobs – matter more than the rules by which they are reached. The Trump team sees a "trade deal" to be any agreement with governments or firms that either saves existing jobs or generates new ones, and they will not consider government's job to be done after the ink has dried on a treaty. Trump's readiness to intervene at the level of specific firms and their transactions was already clear during the post-election transition, when he used threats and inducements to convince the heating and cooling company Carrier to revise its plans for off-shoring production to Mexico. That bit of jawboning was vastly outweighed ten months later by a deal under which the state of Wisconsin will provide \$3 billion in incentives for the Taiwanese firm Foxconn to establish an LCD plant. This factory, for which the White House took credit, will be set up in the district of Speaker of the House Paul Ryan (Republican of Wisconsin).

A final term with a new meaning is "multilateral," a word that the Trump people treat almost as an epithet.¹⁰ The administration's deep-seated dislike for multilateralism appears to be based on the expectation that the United States will always have more leverage when it faces one rather than many partners on the other side of the table. As used by most trade practitioners, this term connotes agreements that are reached within the WTO, and especially the formal list of "Multilateral Agreements on Trade in Goods" that is enumerated in Annex 1 of the Agreement Establishing the WTO. As used by the Trump team, this term appears to mean any agreement involving more than two parties. In fairness, we should note that here they are in fact abiding by the ordinary English meaning of the term. In the world at large, "multilateral" does indeed mean something "involving or participated in by more than two nations or parties [as in] 'multilateral agreements.'"¹¹ The administration's departure

10 It is worth noting that Trump and his subordinates are not the first U.S. policymakers to show an aversion to this term. The World Trade Organization was originally supposed to be called the Multilateral Trade Organization, but the late Senator Patrick Moynihan (Democrat of New York) objected to the sound of the word (VanGrasstek, 2013). The Trump administration's objections are more to the substance than to the style of multilateralism.

11 See <https://www.merriam-webster.com/dictionary/multilateral>.

from the specialized meaning given to this term in trade policy, however, will carry unwelcome implications for anyone who wants to invite the United States to participate in an initiative that is either regional or global in scope.

The Negotiation, Renegotiation and Abrogation of Trade Agreements

TPP certainly falls within the Trump team's definition of a multilateral agreement, as would both the European Union itself and the proposed Transatlantic Trade and Investment Partnership (TTIP) between the United States and that "multilateral" European entity. And while the White House has not yet given a definitive indication as to its plans for TTIP, its disdain for the multilateral character of both the negotiating partner and the intended agreement would appear to suggest that the negotiations for this agreement are as dead as TPP.

The first opportunity that the Trump administration has to redefine US negotiating objectives in trade agreements comes in the renegotiation of NAFTA. This agreement with Canada and Mexico is the first free trade agreement (FTA) to be targeted for revision, but not the last. We can expect the US negotiators to use these talks to establish new principles and rules that might then be applied to other agreements, starting with the US-Korea FTA. A 17 July 2017 paper outlines the Trump administration's objectives in the renegotiation (Office of the US Trade Representative, 2017). Viewed in isolation, many of the specific goals appear consistent with what the United States has often sought from its trading partners. Taken as a whole and put in context, however, the overall effect of these proposals is to shift the purpose of an agreement from free (if preferential) trade to targeted, managed trade. These are the key points:

- The improvement of the US trade balance is made the chief objective of trade agreements, such that the focus of negotiators (and policymakers who implement the agreement) would be on actual outcomes rather than the opportunities that the agreement creates.
- The agreement's rules of origin are to be revised so as to encourage the use of US inputs and to discourage the incorporation of inputs from outside North America, along with a strengthening of Buy American rules.
- The agreement would no longer allow for Canada and Mexico to be exempted when the United States imposes any import restrictions under the global safeguards law.

- The limited concessions that the United States made to Canada and Mexico on antidumping and countervailing duty rules would likewise be removed.

The last two points are especially ironic for anyone familiar with the genesis of the US-Canada FTA. That agreement had been principally inspired by Canadian concerns that in the Reagan era the United States was beginning to employ the trade-remedy laws with a vengeance — as data presented below confirm — and Ottawa’s main objective in the bilateral negotiations of 1986–1988 was to win an exemption from this form of protectionism. Washington made very limited concessions to that demand. There is even a resemblance between a *contretemps* that attended the launch of the US-Canada negotiations and a comparable dispute in the current renegotiation of NAFTA. Back in 1986, there was some doubt as to whether the Congress would consent to a grant of fast-track negotiating authority when the Reagan administration launched the bilateral talks, with legislators conditioning their approval on the executive’s agreement to employ the “correct” approach in a countervailing duty (CVD) investigation that was then pending against Canadian softwood lumber. Today, a spate of CVD and antidumping (AD) investigations against Canadian products once more adds a wild card to the NAFTA renegotiation, and a softwood lumber CVD case is again part of the mix. Together with another high-profile case involving aircraft, and a less notable one against paper, that perennial dispute threatens once again to roil US-Canadian talks. For old hands in this field, it feels like the 1985 film *Back to the Future*.

Where Trade Agreements Meet Trade Remedies: Safeguards

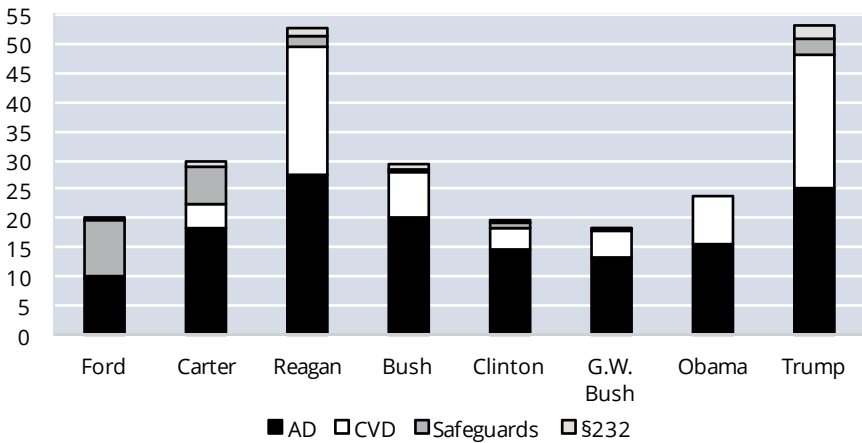
Safeguards may offer the best exemplar of trade policy under the Trump administration. Here, we see an instrument that past generations of policymakers came to abuse for protectionist purposes, and later seemed to be outlawed, but may now be raised from the dead. In so doing, the Trump administration may simultaneously demonstrate its affinity for protectionism, its proclivity to play hardball with negotiating partners, and its contempt for multilateral rules.

The United States and Mexico struck a deal in 1942 that offered an important innovation. Article XI of that reciprocal trade agreement allowed either government to withdraw any tariff concession if it found that “as a result of unforeseen developments” the product in question was “being imported in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers of like or similar articles.” This first-ever appearance of a safeguard clause proved to be so popular in Congress that

legislators extracted a promise that it would be replicated in all future trade agreements. This is how safeguards became a core provision of the GATT. Nor did the precedent stop there. In 1951, Congress enacted a law requiring that the United States retroactively insert similar clauses in any bilateral agreement that did not already include a safeguard. Several US partners were given a stark choice: if they did not agree to amend their agreements to provide for safeguards, the United States would abrogate the pact. Much the same thing could happen in our own time, with the Trump administration using the NAFTA renegotiation as a testing ground for the development of new provisions that it will then seek to retrofit into agreements with other partners.

Figure 4: Activity under the trade-remedy laws in presidential administrations, 1975–2017

Average annual number of investigations initiated in each administration



Notes: All data are for the full calendar years shown, including presidents' first year in office (when they are sworn in on January 20). Data for the Ford administration begin with the entry into force of the Trade Act of 1974 (January 3, 1975). Data for the Trump administration are annualized, based on activity during January-September, 2017. Data for antidumping and countervailing duties are based on products rather than partners (e.g. if simultaneous petitions are filed against imports of a given product from three countries that is counted as one petition rather than three).

Sources: Compiled from U.S. Department of Commerce, U.S. International Trade Commission and World Bank.

To understand the significance of this development it is important to review how safeguards – also known as the escape clause – rose and fell as an instrument of US trade policy. The data in Figure 4 hint at this arc, showing the average annual number of cases considered by the Ford through Trump administrations under this and other trade-remedy laws. The data for the Trump administration are an extrapolation, based on the pace set in the first

nine months of 2017. The parallel to the Reagan administration is immediately apparent, as shown in the sheer quantity of cases. The more important point concerns the qualitative issue of which laws are in play.

The data show that there was a flood of safeguard petitions immediately after the Trade Act of 1974 took effect in 1975, but that torrent subsided to a trickle in subsequent administrations. Two factors account for the declining use of this law, the first being that petitions were often denied. The law may be invoked if (1) the US International Trade Commission (USITC) finds that increasing imports are a substantial cause of serious injury to the US injury, and then (2) the president opts to provide import relief through tariffs, quotas, or other means. Early petitioners under this law were disappointed when several of their cases failed at the USITC stage, and many of those that cleared this hurdle were then defeated by an adverse decision in the White House. Troubled industries increasingly decided that the CVD and especially the AD laws offered a surer path to protection, and the rate of safeguard filings dropped with each subsequent administration. The second reason for the evaporation of safeguard petitions is that this instrument has been essentially outlawed in the WTO. That was not the explicit intent of those Uruguay Round negotiators who drafted the Agreement on Safeguards, but dispute-settlement panels have interpreted their handiwork in a way that makes it all but impossible for any country's safeguard measures to pass legal muster. Nearly all such measures have been challenged, and every challenge thus far has been effective. For all practical purposes, the Bush administration's decision to impose safeguards on steel products in 2001 – which was inevitably overturned by a WTO panel – appeared to be the last time that the United States would ever resort to this law.¹²

Two petitioners tested this proposition in early 2017, seeking safeguards against imports of photovoltaic cells and residential washing machines. The USITC reached affirmative injury determinations in these cases in September and October, and will recommend the appropriate remedies soon. The president will then have two months to decide whether to accept, reject or modify whatever actions the commission has recommended. The first of these cases could therefore result in the imposition of tariffs, quotas, or other import restrictions within a year of Trump's inauguration, with the second coming shortly thereafter.

12 There was an abortive attempt made in April, 2016 when the United Steelworkers requested protection from imports of primary, unwrought aluminum, but the union suspended this effort four days after it filed the safeguard petition.

The data in Figure 4 show that this potential revival of the safeguards law is part of a broader trend whereby both government and industry are increasingly turning to the trade-remedy laws. This is a category that also includes the AD and CVD laws, a national-security law known as Section 232 (for its place in the Trade Expansion Act of 1962), and other, more arcane instruments of trade law.¹³ It is notable that apart from the Section 232 cases (which are discussed in the next session), this return to Reagan-level petitioning is due entirely to the petitioners' expectations about how the Trump administration may handle their complaints. There have been no changes in the statutes or the regulations since Trump's inauguration.

Multilateral Dispute-Settlement Procedures versus Unilateral Enforcement

This resurgence of trade-remedy investigations poses two distinct threats. One is the obvious risk that they may lead to the imposition of new restrictions on US imports. The other danger is less direct but more severe: they could eventually hasten the threat, and perhaps even the reality, of a US withdrawal from the WTO. There is every reason to expect the affected trading partners to challenge these measures in the WTO's Dispute Settlement Body (DSB), and it is virtually as certain that some of these challenges will be successful (especially for any measures that might be imposed via safeguards). This implies that by early 2019, and perhaps sooner, the Trump administration will need to decide whether to come into compliance with international judicial rulings that find fault with some of its most cherished policy objectives. It is not difficult to imagine how this White House – which prides itself on counter-punching any criticisms or opposition – might respond to such a challenge.

There are four distinct, but not mutually exclusive, dangers that arise in the Trump administration's conduct of trade disputes. One is that the United States might spark a tremendous growth in the docket of the DSB, both by taking actions that provoke complaints from US partners and by bringing tit-for-tat cases against those partners. At the opposite extreme, it would be a worrisome development if the United States were to bring no complaints at all to the DSB; that might confirm the fears that Washington no longer sees any value in the WTO. A third danger is that the United States may revert to the use of unilateral pressure under the "reciprocity" laws or other instruments, sidestepping the DSB in order to deal more directly and aggressively with its

13 They include Section 406 of the Trade Act of 1974 (in cases where imports from a Communist country are alleged to cause market disruption), Section 122 of the Trade Act of 1974 (which allows the president to impose tariffs and/or quotas for up to 150 days against countries with large balance of payments surpluses), the Trading with the Enemy Act of 1917, and the International Emergency Economic Powers Act of 1977.

partners. The fourth and most serious danger is that unfavorable rulings in the DSB, especially those affecting important White House initiatives, might lead to explicit threats – and perhaps even the reality – that the United States will do the same thing to the WTO that it has already done to the United Nations Educational, Scientific, and Cultural Organization.¹⁴

The only one of these risks that we might safely dismiss, at least for the time being, is the concern that the United States no longer sees any value in the WTO as a forum for the settlement of disputes. That cloud lifted on 28 September 2017, when the United States brought a formal complaint against Canada to the DSB. This case concerns that contention that wine-sales rules in the province of British Columbia violate the principle of national treatment. What is so extraordinary about this filing is just how ordinary it is: the pace of complaints set so far by this administration is similar to what we saw in the recent past (both the G.W. Bush and Obama administrations each brought just one new complaint to the DSB during the president’s first year of office), it involves an industry on whose behalf the United States has previously pursued complaints (and in fact reiterates the final complaint brought by the Obama administration),¹⁵ and there is nothing unusual about the target country (Canada is, after China and the European Union, the third most frequent subject of US complaints).

We might thus put a positive spin on this filing, but could still see too much of a good thing in the DSB. While there has as yet been only one new filing against the United States since Trump’s inauguration (a Turkish complaint against US countervailing measures on pipe and tube products), the number and the significance of these cases may soon rise. Any challenges to the administration’s actions in the aforementioned safeguard cases may raise hackles in the White House (see above), and that could be doubly true for any adverse rulings related to the national-security claims of this administration (see below).

It would be a mistake to assume that the Trump administration sees the DSB as the only forum in which to pursue complaints against other countries. One of the pre-WTO laws that seemed to have gone permanently dark was Section 301 of the Trade Act of 1974, also known as the “reciprocity” statute. This law, which gives the US Trade Representative (USTR) the authority to retaliate against foreign countries’ practices that violate (self-defined) US rights, had been employed in many high-profile disputes in the 1980s and

14 On 12 October 2017, the White House announced that it was withdrawing the United States from UNESCO; see <https://www.state.gov/r/pa/prs/ps/2017/10/274748.htm>.

15 The United States originally brought a complaint on this matter two days before Trump was inaugurated. The latest filing amounts to a reactivation of that complaint, without substantive changes. The details of this case are at https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds531_e.htm.

early 1990s. It was one of many statutes that appeared to have been defanged by the Uruguay Round, which not only “reformed” safeguard actions out of existence but also replaced unilateral action with stronger dispute-settlement rules. The president cast severe doubt on that conclusion when on 14 August 2017 he signed a memorandum directing the USTR to “to investigate any of China’s laws, policies, practices, or actions that may be unreasonable or discriminatory and that may be harming American intellectual property rights, innovation, or technology development.”¹⁶ The resulting investigation, which the USTR promptly announced,¹⁷ has not yet produced either a conclusion or the threat of retaliation. It has nevertheless revealed one more way in which this administration is prepared to send US trade policymaking back to a pre-WTO pattern.

The Special Danger Posed by the Trade-Security Nexus

Section 232 of the Trade Expansion Act of 1962, which grants the president broad authority to impose import restrictions on goods that threaten to impair the national security, is yet another long-dormant law that the Trump administration is intent on reviving. The statute was invoked several times during the GATT era, when imports of energy and strategic goods (e.g. machine tools) raised concerns over dependence on foreign sources. The profile and the perils of the newest cases are higher than in the “ordinary” trade-remedy laws discussed above, insofar as it is the White House itself that set these investigations in motion (i.e. it did not wait for an industry to take the initiative), and it raised the stakes by citing national security. That latter point changes not only the domestic political profile of the issue, but also its international legal repercussions.

On 20 April 2017, President Trump mandated a Section 232 investigation of US steel imports. He directed the secretary of commerce to consider such factors as “the domestic production of steel needed for projected national defense requirements” and “the existing and anticipated availabilities of the human resources, products, raw materials, and other supplies and services essential to the national defense.”¹⁸ One week later, the White House followed up by directing a similar investigation of aluminum. While both of those investigations might ordinarily have been concluded by the time of this writing, no reports have yet been issued. There is a possibility that these investigations

16 <https://www.whitehouse.gov/the-press-office/2017/08/14/presidential-memorandum-united-states-trade-representative>.

17 <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2017/august/ustr-announces-initiation-section>.

18 <https://www.whitehouse.gov/the-press-office/2017/04/20/presidential-memorandum-secretary-commerce>.

will prove to be another example of bluster, and that the cases will quietly disappear. If they instead lead to import restrictions, however, they may pose a greater risk to the integrity of the WTO system than anything else that the Trump administration does.

The founders of the post-war economic and diplomatic order devised a series of barriers to separate the high politics of war and peace from the low politics of trade and investment. In the first instance, we hope that when countries do have political or security conflicts, they do not use trade restrictions as an instrument of leverage. Failing that, if countries do use trade as a political tool, we hope that the injured party brings its complaints to other legal fora that are more suitable than the GATT/WTO (especially the International Court of Justice). And as a final line of defense – as much for the regime itself as for the disputants – countries can make security-related complaints disappear by invoking GATT Article XXI.¹⁹ This article allows each country to take actions that might otherwise be inconsistent with its GATT and WTO obligations when that country declares that the deviations are in its essential security interests. It is a well-established norm, though not a formal rule, that an invocation of Article XXI is not reviewable by dispute-settlement panels. In the WTO era, that same rule applies to the Appellate Body. Unlike the general exceptions provided under GATT Article XX, for which panels often demand a high level of proof on the part of the invoking country, GATT Article XXI has thus far been treated virtually like the “Get Out of Jail Free” cards familiar to anyone who has ever played the game Monopoly.

The near-automatic acceptance of countries’ invocations of Article XXI is a politically necessary norm, founded upon recognition that countries might prefer to leave the system altogether if the actions that they take in pursuit of national security are subject to review by trade lawyers. It is also supported by the expectation that countries will not abuse this privilege by casually using security claims as an excuse for blatantly protectionist measures. Even a cursory examination of the history of Article XXI invocations shows the wisdom and efficacy of this norm, confirming that the article is very rarely invoked and even more rarely abused. There have been only a handful of known instances in

19 Note that in some instances a political issue might alternatively be isolated via the “non-application” clause. Originally provided under GATT Article XXXV, which has since been superseded by WTO Article XIII, this provision allows one WTO member to act as if another member were not in the organization. The utility of this article as an isolation device is limited by the fact that it can be invoked only upon the accession of a country. That rule has the effect of restricting invocations of Article XIII to cases in which a pair of countries are divided by deep and apparently permanent animosities, and preventing countries from employing it in disputes that are more transitory.

which a country has formally resorted to the national-security defense,²⁰ most of which came at the end of the GATT period and involved declared wars (e.g. the Falklands/Malvinas conflict of 1982), undeclared wars (e.g. U.S. sanctions on Nicaragua in 1985), or other police actions (e.g. international sanctions on Serbia and Montenegro in 1991). Only one of these cases appeared abusive, with Sweden claiming in 1975 that it needed to protect the domestic footwear industry in order to have the capacity to produce boots for soldiers in wartime. The rest of the trade community shamed Sweden into removing the offending measures within two years, yet did so without obliging Stockholm to provide a legal justification for its invocation of Article XXI.

From the perspective of the trading system and its political sustainability, the imposition of economic sanctions for reasons of security is less objectionable than using security as an excuse for protectionist restrictions. The old Swedish footwear case was almost comical, but the challenge to the system would be far more grave if the world's largest importer abused the security exception to impose restrictions on a sector as significant as steel and/or aluminum. Assuming that these Section 232 cases do not simply disappear, there is a serious danger that one of three things may happen in the near future:

- Contrary to the rule outlawing such arrangements,²¹ the United States and other steel- and/or aluminum-exporting countries might negotiate market-sharing arrangements. This may indeed be what the Trump administration has intended all along, using the Section 232 case as leverage, but if so that amounts to contempt for the letter of the law. It could inspire similar transgressions in other sectors, thus reviving the 1980s-era practice of resorting to “grey-area measures.”
- If the United States does impose unilateral measures under Section 232, it might get away with it simply by invoking GATT Article XXI (assuming that the DSB adheres to precedent and does not demand that the United States justify its claim). This would amount to contempt for the spirit of the law, and could encourage other countries to follow suit in other sectors that they wish to protect under the guise of national security.

20 It should be acknowledged that many observers believe that in addition to these formal invocations there have been many more instances in which countries have informally made it known that they were prepared to invoke Article XXI if a complaint were brought against one of their measures. This point does not invalidate the general proposition, however, because what is most at issue here is not the quantity but the quality of the cases. The author is not aware of any “informal” invocations of the article that concerned laws or policies that appeared *prima facie* to bear a closer resemblance to the Swedish footwear case than to other, more legitimate episodes.

21 See Article 11.1(b) of the WTO Agreement Safeguards, which bans negotiated quotas and the like by providing that “a Member shall not seek, take or maintain any voluntary export restraints, orderly marketing arrangements or any other similar measures on the export or the import side.”

- Alternatively, there is a chance that a DSB panel and/or the Appellate Body might decide to toss precedent aside and pass judgment on a *prima facie* abuse of GATT Article XXI. Such a challenge could be very provocative to the Trump administration. Should the United States treat this as a pretext for desertion of the WTO, it would send the system back not just to the 1980s but indeed to the 1930s.

Here we have the precise nature of a dilemma, forcing us to choose just how we prefer to undo the WTO. Is it better for countries to stay nominally in the organization while cynically flouting its rules and norms, or to abandon the project altogether and go back to a self-help system?

Looking over the Horizon: What Will Come in the Medium and Long Terms?

As should be apparent from the number of unknowns identified in the preceding analysis, we are still at a point in the Trump administration where the questions outnumber the answers. We may nevertheless synthesize three sets of meta-questions from what has been reviewed above. First, how long will Trump remain in office? That relates to the second question of just how much damage he can do to the trading system and to US' standing in it. Or to restate that question in terms used throughout this analysis, how far back into the past will this experiment push us? The third meta-question concerns the implications that all of this holds for the international trading system. How best can that system cope with a United States that has at least cast doubt on the permanence of its commitments, and may actually be prepared to undo those commitments altogether? These are not questions that the present analysis can hope to answer, but they can be put in some context.

How Long Will Donald Trump Remain in Power?

It is unusually difficult to make a confident forecast regarding the longevity of Trump's presidency. Only two scenarios would come to mind in almost any other administration: either he joins the ranks of single-term presidents and is out on 20 January 2021, or he gets re-elected in 2020 to another four-year term. The latter scenario would normally appear more likely than the former, considering the fact that nine of the last 12 presidents who sought re-election won this prize. That outcome is less certain for a man who has been remarkably efficient in alienating leaders of the party that he hijacked, has made little effort to broaden his appeal beyond a narrow but (thus far)

loyal base, and has yet to score a single legislative victory of any significance. Moreover, both Congress and a special counsel are investigating the conduct of the 2016 election, including possible collusion between Trump's associates and Russia. Those investigations may extend into the president's own business dealings and possible obstruction of justice, and could ultimately lead to calls for his resignation or impeachment (especially if Democrats do well in the 2018 congressional elections). Consider also that Trump was the oldest man ever to take the oath of office, and that pundits, politicians and mental health professionals are now openly discussing their concerns over his cognition and stability. If Congress does not have the grounds or the courage to remove him through impeachment, according to one whispering campaign, members of his own administration may need to consider their powers of removal under the 25th Amendment of the Constitution.²² Taking into account all of the political, legal and even health challenges that he might face, Trump may be more likely to depart before 2021 than to stick around until 2025.

Assuming that he does serve out a full term, it is clear that Trump's influence during its latter half will be greatly affected by the November 6, 2018 congressional elections. Depending on the outcome, Trump could be reduced to a position of reigning while not ruling, and perhaps being preoccupied by a lengthy battle over impeachment. Republicans currently hold a 24-seat majority in the 435-seat House of Representatives, as well as a two-seat majority in the 100-seat Senate. At the time that he took office, many analysts expected that in 2018 Trump's party would stand a strong chance of retaining its majority in the House (where the "gerrymandering" of districts has made Republican incumbents more secure), and was all but certain to do the same in the Senate (where only eight of the 33 seats up for grabs in 2018 are currently held by Republicans). Since that time, the Republican position has been eroded by Trump's unpopularity and the prospects for severe internal struggles between the party's pro- and anti-Trump factions. The odds that Democrats will retake the House now seem roughly even, and while their chances of recapturing the Senate remain long they no longer look hopeless.

Even if Democrats do not control either or both chambers in the 116th Congress (2019–2020), chances are that they will fill significantly more seats than they do today. And while that may make for an even more chaotic policymaking environment on most issues, trade policy could offer a key exception to the

22 This amendment provides in relevant part, "Whenever the Vice President and a majority of either the principal officers of the executive departments or of such other body as Congress may by law provide, transmit to the President pro tempore of the Senate and the Speaker of the House of Representatives their written declaration that the President is unable to discharge the powers and duties of his office, the Vice President shall immediately assume the powers and duties of the office as Acting President."

general rule of inter-branch conflict. This is the only important issue on which Trump's position is more closely aligned with Democrats than it is with Republicans, and it is possible that some of the initiatives that are currently under development – including the negotiation or negotiation of FTAs and US responses to adverse rulings in the DSB – might not reach fruition until 2019. The question then is whether the Republican president and the Democratic leaders in Congress will be willing and able to overcome their general animosity for the sake of this one issue. From the perspective of the trading system, it would be better if they did not.

How Much Damage Will the Trump Administration Actually Do?

One perennial feature of the trading system is the uncertainty that foreigners feel in interpreting the threats of US policymakers, especially when those threats emerge from different quarters. This is all quite deliberate, both by philosophical design – the US Constitution intentionally fragments authority by pitting the branches against one another – and for reasons of negotiating strategy. Leaders in the executive and legislative branches know that they can jointly squeeze more concessions from their foreign counterparts if they play an effective game of “good cop, bad cop,” and that game may be all the more successful if even the good cop is not always sure when the bad cop is merely play-acting. What is new about the Trump administration is that the roles have now been reversed, such that it is the president who poses the most extreme menace, and it is Congress that feels compelled to speak with a more reasonable voice. Or to use a slightly different image, Donald Trump has never made any secret of his belief in the “madman theory” of negotiations. According to this notion, playing the madman can work to one's advantage by keeping adversaries guessing, dissuading them from making provocative moves, and encouraging them to settle quickly and on the best terms they think they can obtain.

There are at least two problems with this approach to governance. One is that it may have disastrous consequences when the other fellow is equally mad, or at least equally committed to making himself appear so. That problem is especially notable in fields where more is at stake than tariff rates or antidumping rules (see, for example, the confrontation between the United States and North Korea). Another problem that is more relevant to trade is the importance that governments and businesses attach to the commitments that countries make. They may not be very willing to conclude treaties or make major investments in a country that has a reputation for negotiating in bad faith or abrogating old agreements whenever government changes hands.

That reasoning has not deterred the Trump administration from reveling in a policymaking style that is marked by bombastic threats, a disregard for established procedures and protocol, and a general sense of making it all up as one goes along. The administration took several steps during its first nine months in office that might – and yet might not – lead to huge changes in US policy. Chief among these are the aforementioned Section 232 cases, the revival of Section 301, and a threat to take action against countries with which the United States has large trade deficits; they are also complemented by a sharp rise in petitioning under the trade-remedy laws. To what extent will these various threats actually be carried out? As has been stressed throughout this analysis, the administration’s underlying intention may not be to impose restrictions, but instead to use the threat of restrictions as a means of leveraging other concessions from foreign governments. And the beauty of the strategy, from the perspective of the ones perpetuating it, is that the countries that feel obliged to make these concessions – even if they are quite damaging – may count themselves lucky for having dodged an even greater hit.²³

Over the long term, the greatest damage that Trump does may be to the role of the Republican Party. This has not always been the party of free trade – indeed, it was the party of protection from the 1860s through the 1960s – but it has reliably played that role for the past generation. Perhaps the main reason that Trump wrested the presidential nomination is that he was the only one of the 17 Republican contenders in 2016 to challenge the established orthodoxy on trade. But no matter what happens to Trump in the coming months and years, other Republican office-holders and hopefuls cannot unsee what they saw in that election. Many may now perceive protectionism to be a winning issue, and will want to stake out the same territory that he did. If Trumpian policies outlive Trump, especially in the party that used to offer reliable support for market-opening initiatives, the damage could be irreversible.

What Does this Mean for the International Trading System?

It is important here to speak not of the *multilateral* trading system that centers on the WTO, but of the broader *international* trading system. In addition to its multilateral component, that international system encompasses a wider universe of bilateral, plurilateral, regional and mega-regional agreements on trade, investment and other topics. There had been a time when the practice of “competitive liberalization” was in vogue, with its advocates arguing that negotiations at each level were complementary exercises that would set precedents and encourage deeper liberalization at the levels above them.

23 For a fuller discussion of this strategy, sometimes known as the “goat in the living room,” see VanGrasstek (2016).

Bilateral negotiations would promote regional arrangements, and the bargains struck at the regional level could then be multilateralized in the WTO. Those notions already appeared quaint before the events of 2016, and even a casual observer could see that the many negotiations then underway were more fragmented than integrated. There is every reason to expect that this process of fragmentation will only accelerate in the Trump era, and that the role of the WTO may be further marginalized.

FTAs and other discriminatory agreements have become far more common than they ever were in the GATT period, and we should expect that trend to continue under Trump. There still exist a great many countries that are eager to reduce or remove the barriers between their economies, both in the developed and the developing world. Ironically, the United Kingdom's "Brexit" from the European Union will lead to ever more such negotiations as London seeks new agreements to cement its relations with economic and political partners. What is less certain is when, with whom and on what terms the United States may do the same. There has been much talk about a US–UK agreement, but real progress towards that end will likely have to wait until Brexit is fully underway. In the meantime, some members of the Trump administration have pointed to Japan as an FTA negotiating partner. Beyond those two major economies, it is unclear to what extent any future US initiatives would be directed by the commercial attractions of a partner's size or by the political benefits of dealing with like-minded governments.

From the perspective of the trading system as a whole, it is the quality and not the quantity of US trade agreements that may matter most. Whether we are considering the revision of existing FTAs or negotiations over new ones, and whether the partners involved are large or small, the most important question is how greatly the terms of these agreements may deviate from the established US template. Is the Trump administration really hoping to transform the goals of trade agreements from market-opening to market-management? To be more precise, should we see the mercantilist posture that it has struck on NAFTA renegotiation as an effort to stake out an extreme position, but may then reshape into something more familiar during the course of the negotiations, or does that position truly represent what the United States will expect from all FTA partners? We may not know the answer to that question until this specific negotiation is completed. The world may draw different conclusions depending on whether NAFTA ends up being tweaked at the margins, systematically revised, or abrogated altogether. It will also be instructive to see how these results are received by Congress, the US business community and the electorate at large.

Where will the WTO be in this process? We may expect for the time being that this forum will continue to be more active in dispute-settlement than in the negotiation of new agreements. As long as Washington views multilateralism in a negative light, and reads “MFN” as a synonym for “concessions to China,” it is difficult to imagine the Trump administration making any effort to revive or replace the Doha Round. Its appreciation of this institution’s value may depend critically upon its own record of wins and losses in the DSB. It will be some time before we know just how many challenges are brought by and against the United States in the DSB, how many of those cases go the US way, and – most important – how the White House responds to any rulings that go against the United States.

The aforementioned nexus between trade and security issues could prove to be an endemic problem. While the focus of this analysis is on trade policy in the United States, it should be noted that this issue poses a broader challenge for the WTO than it ever did for the GATT. This is a simple function of the fact that effective participation in the GATT was, for most of its history, largely confined to those developed countries that also joined with the United States in NATO and other alliances. The WTO, by contrast, is a virtually universal institution in which a more diverse and expanded membership necessarily implies a greater potential for cross-contamination between trade and political disputes. This is demonstrated by the emergence in 2017 of two other security-related disputes among some of the WTO’s newer members, in which Ukraine and Russia have brought a matched pair of complaints against one another²⁴ and Qatar brought complaints against three of its neighbors.²⁵ What distinguishes those cases from the US steel and aluminum investigations, however, is that the underlying issues stem from real and present security concerns. No one could seriously contest the fact that for both the Russia–Ukraine and Qatar cases, the contending parties are engaged in actual conflicts that have already, or might soon, lead to the use of force. The same cannot be said for the grounds on which the Trump administration might base any unilateral restriction of steel or aluminum imports.

24 On February 9, 2017 Ukraine brought a complaint “concerning multiple restrictions on traffic in transit from the territory of Ukraine through the territory of the Russian Federation to third countries.” On June 1, 2017 Russia countered with a complaint that “the effect of [Ukraine’s policies] is discrimination of persons, goods and services of the Russian Federation and drastic restriction of bilateral trade as well as transit.” The particulars of these cases are reported at https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds512_e.htm and https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds525_e.htm.

25 On July 31, 2017 Qatar requested WTO a series of dispute consultations with the United Arab Emirates, Bahrain, and Saudi Arabia concerning measures that it characterizes as “coercive attempts at economic isolation” that *inter alia* restrict “the import, export, sale, purchase, license, transfer, receipt and shipment of goods originating in, transiting through, towards or from, or with the destination of Qatar.” The particulars of these cases are reported at https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds526_e.htm, https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds527_e.htm, and https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds528_e.htm.

In brief, the Trump administration's trade policy is a work in progress that stacks questions upon questions. What is most troubling about this administration is that some of these are questions that knowledgeable observers might never have thought they would have to ask with respect to the United States. We may need to brace ourselves for the answers.

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CHAPTER 4

A New Architecture for the WTO?

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Introduction

The World Trade Organization (WTO) is currently facing an “adaptability” crisis. The world economy has changed significantly since the WTO was created back in the mid-1990s, and new challenges are quickly piling on top of the old ones. The rise of emerging countries and the relative decline of traditional economic powers; the negotiating requests, demands and approaches from different member countries; the proliferation of regional trade pacts and the need to deal with complex new issues, such as climate change and food security, are – in different ways and intensity – shaking the foundations on which the WTO was built some 20 years ago.

To these has been added recently the impact of the new US administration on international trade issues and, in particular, the views of President Donald Trump on trade and trade agreements, as well as the possible consequences of the Brexit negotiations, through which the United Kingdom is defining the conditions of its withdrawal from the European Union. Two of the main largest trade partners are thus evolving in ways that will impact the functioning of the world economy, and in particular the WTO, even if we do not yet fully know or understand their implications.

Nevertheless, a key question continues to be whether the WTO is capable of facing these new and complex issues, or whether there is instead a need to revise the institution in some fundamental ways. Should the WTO’s current negotiating mandate and structure be expanded? Would it be better or necessary to complete the unfinished business of the Doha negotiations before taking up new negotiating initiatives? What should be done to strengthen the

multilateral trading system and to ensure the future success of the WTO? Will the results and/or limited agreements reached at the last WTO Ministerial in Nairobi or the new ones to be agreed upon at the coming Buenos Aires Ministerial make a difference to the rather negative perception developed recently about the “negotiating” function of the WTO?

Strengthening the multilateral trading system is especially important from a sustainable development perspective. Over the past six decades, the system has provided an unprecedented level of stability and predictability in the way WTO members conduct their trade operations. It has also provided – particularly since the establishment of the WTO – a credible and solid mechanism to adjudicate trade disputes, one that is guided by law rather than power.

Developing countries, most of which steered clear of the system during the GATT years, have for the most part joined the WTO, making the multilateral trading system a truly universally accepted set of values and rules, and not the rather limited “club” that it used to be. These developing countries are now using the system to their advantage – they hold the key to forward-looking negotiating outcomes, and account for more than half of the 500-plus disputes dealt with so far by the WTO.¹

But the WTO is at a critical juncture. A renewed sense of international cooperation among WTO members is essential for dealing, first and foremost, with the never-ending Doha negotiations. Completing Doha would allow the WTO to focus on some of the most pressing challenges that, in my view, the system now faces: *first*, defining a new set of negotiating modalities for the future; *second*, revisiting the traditional approach to the participation of the private sector (i.e. the business community) in its activities; and *third*, dealing appropriately with the increasing number of regional trade agreements entered into by its member countries, especially the so-called mega-regional agreements, notwithstanding the rather drastic changes that we may be witnessing in this area.²

1 Dispute number 532 was initiated on October 13, 2017 when Ukraine requested consultations with the Russian Federation on measures concerning the importation and transit of certain Ukrainian products.

2 This chapter draws significantly on the reports and discussions that took place in the context of the E15 Initiative, a program of exchanges and analyses on the current status of the multilateral trading system launched in 2011 by the International Centre on Trade and Sustainable Development (ICTSD) and a number of partnering institutions, including IMD/The Evian Group, and involving an impressive number of leading international experts; see www.icts.ch for more detailed information on the E15 Initiative.

Completing the Doha Negotiations

Trade negotiations are what the WTO was created for in the first place. Concluding the Doha trade talks – approaching their 15th anniversary in 2016 – is a must if the WTO wishes to move forward and tackle future challenges head on. Not delivering on Doha will damage the organization’s very core function, discredit its efficiency, and make it extremely difficult for the WTO to acquire a mandate to deal with pressing non-Doha issues (such as climate change and food security) and, as I mentioned before, the large number and complexity of regional trade agreements. Thus, the issue is not whether the WTO should complete the Doha negotiations – that’s a given. The issue instead is how to put an end to the current deadlock and keep the negotiating machinery rolling on.³

Dealing with the “Single Undertaking”

Over the years, a number of options have been suggested for moving the negotiations forward. However, these have run against the wall of the “Single Undertaking,” a procedural device that has been elevated to the category of guiding principle in WTO negotiations. Initially designed to facilitate an equitable global agreement during the Uruguay Round, the Single Undertaking is no longer a negotiating tool. Instead, it has become a way for those countries least willing to take on new commitments to hold the negotiations hostage.

There is a need to revisit the meaning and purpose of the Single Undertaking. Does it mean that every single word in every single agreement needs to be agreed simultaneously by all participants to have an agreement on the whole? Do the negotiating issues all have the same value to all the negotiating partners? Are they all equally important? The common answer to these questions is, obviously, a rotund “no.”

If the GATT negotiating history is to offer any lesson, it’s that every negotiating round has always left aside some pending issues, with the goal of addressing them later on in future negotiations. In the early years of the system, during the first GATT negotiations – which dealt mainly with tariff cuts – it was clear that further, additional cuts had to be dealt with in future negotiations. During the Tokyo Round – the first to deal with non-tariff issues – the concluding deals also left a number of pending subjects to be resolved at a later stage.

3 Some analysts and “practitioners” are even questioning the need to “revive” a process that they see as already dead (see the *Financial Times* article of 31 December 2015 by Michael Froman, the US Trade Representative; and Carlos A. Primo’s article on the IMD website at <http://www.imd.org/news/Doha.cfm>).

Even the Uruguay Round, despite being based on the Single Undertaking, was no exception to this rule, as it left aside a number of issues in agriculture and trade in services – the famous “built-in agenda” – with the goal of addressing them later in a post-Uruguay Round environment. Thus, the Single Undertaking does not mean solving all negotiating issues at the same time; it just means finding an appropriate outcome for all of them at a particular point in time, even if occasionally some of these issues are to be dealt with in the future.

Moving to a Final Doha “Deal”

At present, of all the Doha issues, an agreement on non-agricultural market access (NAMA) is the one that holds the promise to move the negotiations toward a final deal. Even if tariff reduction is perhaps not the most “economically” significant of all the subjects included in the Doha negotiations, negotiating tariff cuts and consolidating them in the various country schedules is something that trade negotiators are used to doing, can be done relatively quickly, and has a very high visibility. Progress in this area may thus have a “demonstration effect” in the other areas of the negotiations, and this is perhaps something which the Buenos Aires Ministerial could give a push to.

The situation that WTO members face today is not unlike the one faced by GATT members in the early rounds, i.e. a need to reach an acceptable level of tariff cuts among the key trading partners – including now China and the other emerging economies – and to apply them on a most-favored nation basis. Thus, strange as it may seem, the old issue of tariffs cuts might today help to unlock the paralysis in the other areas of the negotiations and finalize a global pact, just as they have traditionally done.

It may seem ironic that a protectionist device that most analysts had written off as insignificant and outmoded could continue to play such an important role in today’s negotiations. However, the reason may lie not in the intrinsic value of tariff protection, but rather in the visibility that it would give to a negotiating package. In politics, reality almost always takes a back seat to perception, and in developed countries the perception that some countries are “free riding” in the negotiations has taken a strong hold.

Tariffs are not a major impediment to global trade. Existing tariff protection has not prevented world trade from growing significantly in the last few decades. Applied tariffs are now at historically low levels, due, in part, to past trade negotiations, WTO accessions and unilateral tariff reductions undertaken by a number of countries, mainly developing countries. However, tariff protection in most emerging markets, which account for a growing proportion of world

trade, is well above tariffs in many developed and developing countries. For example, average applied tariff levels in China and Brazil are 9.6% and 13.5%, respectively, as compared with average tariffs of 3.5% in the United States, 3.4% in Peru, or 6.7% in Switzerland (WTO, ITC and UNCTAD, 2015).

Importantly, opening emerging economy markets is not only in the interest of the industrialized countries, but also benefits developing countries, whose exports go increasingly to emerging markets and to other developing countries. According to UNCTAD, in 2013 South–South trade flows represented more than half of overall developing country trade. This share varies by region, ranging from above 40% in Latin America and transition economies to almost 70% in South Asia and East Asia. Although a proportion of South–South trade encompasses intraregional flows, the largest part involves trade with the East Asian region, and since 2008 this region has become an increasingly important trading partner for all other developing country regions (UNCTAD, 2015).

A solid agreement on the market access negotiations – one that requires all countries to make a meaningful contribution consistent with their economic realities and possibilities – will give the Doha Round a renewed sense of progress. But this alone will not be enough. A solid deal on agriculture is also required, as no final Doha deal will be possible in the absence of more disciplined farm markets. The agreements reached at the Nairobi Ministerial go in this direction, and the commitment of WTO members to eliminate export subsidies for agricultural exports may help the Doha negotiations to move to a final stage, but the “jury is still out” on this, and here again the coming WTO ministerial conference in Argentina, a major food exporter and a key participant in the agriculture negotiations could offer the opportunity to move on in this area.

Negotiations on services, on antidumping rules, on intellectual property issues and on trade facilitation are all important, but none of these could individually facilitate agreement in other areas of the Doha trade talks in the way a market access deal, including agricultural reform, would.

Getting New Negotiating Modalities

As for the future, WTO negotiations should not necessarily be based on the Single Undertaking, at least not exclusively. They will require a different, complementary approach. This approach should be predicated on the need for a more cooperative understanding among members – one where negotiations, authorized by the entire WTO membership, could be undertaken by groups of interested countries if and when certain specific conditions are met, and,

importantly, provided the multilateral nature of potential WTO agreements is preserved.

This overall approach, however, should have one important exception: negotiations involving only a limited number of countries would not be appropriate when they include existing rules and disciplines. The WTO is a legal and institutional framework that requires its member countries to conduct their trade and trade policies in a clearly defined manner. Therefore, the rules of the game cannot be modified without the agreement of the entire membership, and nor can new deals be incorporated into the system without the acceptance of all WTO members.

In almost all other instances, negotiations among groups of interested countries could take place and their results incorporated within the WTO framework. In fact, we have already seen this type of approach at work in the case of the WTO's "plurilateral" agreements. These deals – which were made possible via the Marrakesh Agreement – are normally entered into by groups of "like-minded" countries that decide to establish among themselves a common set of rights and obligations to deal with a particular subject matter or sector. Notably, these agreements create rights and obligations only among the participating WTO members, rather than being multilateral deals. The WTO "plurilateral" agreements were originally negotiated during the Tokyo Round of trade negotiations (and were thus "codes") but, unlike most Tokyo Round "codes," did not become multilateral obligations. They became part of the WTO in 1995, and have been known since as "plurilateral" agreements. There were initially four "plurilateral" agreements dealing with trade in civil aircraft, government procurement, dairy products and bovine meat, but the latter two were terminated in 1997.

There is a need to move beyond "plurilateral" agreements as defined by the WTO agreement; if these deals are allowed to expand much further, we could end up with a repeat of the post-Tokyo Round GATT system, with a divided and fragmented WTO. A better alternative would be to move towards a "plurilateral *plus*" environment, where the benefits of the agreements are extended to all WTO members, and not only to the participating countries. The Information Technology Agreement (ITA) is a perfect example of this approach. This agreement was negotiated in 1996, during the first WTO Ministerial Conference, by a group of 29 countries. A year later, it entered into force with even more members, creating an agreement that would cover more than 90% of the trade in that sector. Market size was an important consideration for the agreement to come to life – today, more than 80 WTO members are part of ITA, and they have recently agreed to expand its

product coverage significantly. More importantly, right from the outset the participating countries agreed that the benefits of the deal would be extended unconditionally to all WTO members, whether or not they belong to the ITA.

Thus, groups of WTO members need to have the option of undertaking negotiations among themselves on matters of their interest. Not allowing them to do so will just lead these countries to take their deals elsewhere. Therefore, we need rules in order to create new rules. This process should include at least three key considerations. *First*, it must provide for an “opt in” and “opt out” approach, entitling all WTO members to participate in the negotiations at their own choosing, with the option of withdrawing from the talks at any point. *Second*, the benefits of the agreements should be extended unconditionally to all WTO members. And *third*, the final deals should be incorporated into the multilateral set of rules and regulations as “plurilateral plus” agreements, with appropriate accession clauses (i.e. be open to all WTO members under certain conditions).

In short, an alternative approach to trade negotiations moving beyond the Single Undertaking needs to be put in place by WTO members, setting aside the confrontational nature of the current Doha talks. We perhaps need to abandon all-encompassing “rounds” of negotiations for more “à la carte” negotiations where subjects are more likely to produce more significant and quicker results.

Finding an Appropriate Place for the Private Sector in the WTO

Although the WTO is an intergovernmental organization and decisions are taken exclusively by its member governments acting collectively, the business community has an important stake in its performance. It is bound to be affected by WTO operations, as it is mainly business, not governments, that engages in international trade. In practice, business and governments interact in the WTO in many different ways, sometimes advancing the negotiating agenda and at other times ensuring that governments abide by their multilateral commitments.

However, defining a role for the business community in the WTO is not an easy task. The essence of the WTO lies in its negotiating function, and negotiating trade deals is not something that can always be facilitated by the involvement of business interests along the lines of negotiating teams. Thus, when considering the participation of business interest in the WTO, an important distinction

should be made right from the outset: the presence of business in the day to day activities of the WTO (i.e. its public discussions, its research activities and the provision of information specifically geared toward their economic concerns, among others) should not be equated with its involvement in the WTO trade negotiations, as these need to be conducted in private, behind closed doors and very often in small groups before receiving the blessing of the entire membership.

This has always been the case – trade negotiations are private affairs whose conduct are in the hand of government officials; they are not, and cannot be, conducted in the open, as publicity is the last thing negotiators need to make deals.

This does not mean, however, that the business community should be totally absent from these negotiating process. There are many ways the business community could be made part of negotiating processes, be informed of negotiating outcomes and also be allowed, even if indirectly, to influence them.

During the NAFTA negotiations, the United States, Mexico and Canada put in place the “*cuarto de al lado*” (“room next door”) where business representatives from these countries regularly met their respective government’s negotiating teams, with the dual purpose of being informed of the evolution of the negotiations and making their views known on the various negotiating items and outcomes. Over the years, this “room next door” approach was replicated in the negotiation of the trade agreements that the three NAFTA partners conducted with other countries, particularly in the Latin American region. The approach was facilitated by the rather limited number of the negotiating partners; it would be highly unrealistic to try to replicate it at the WTO level.

In a negotiating process – whether bilateral or multilateral – the way each country deals with its business community is its own responsibility. However, in an institution like the WTO, some mechanisms could be put in place to ensure the effective, even if indirect, involvement of business organizations in its activities. Although the WTO has been formally authorized to “make appropriate arrangements for consultation and cooperation with non-governmental organizations,”⁴ which presumably include business entities, currently there are no formal mechanisms and the participation of the private sector is based on a series of ad hoc practices, such as briefings and public seminars and symposia which the WTO hosts on the occasion of Ministerial Conferences in particular. However, as pointed out in an E15 report (Elsig, 2014),⁵ the business community is less involved in the WTO than in other

4 See Article V.2 of the Marrakesh Agreement.

5 See also Primo Braga and Kondis (2014)

international fora such as APEC, where a Business Advisory Council has been established, the OECD, which has a Business and Advisory Committee, or the G20, with its regular B20 meetings.

Much more can be done, but it is not easy to define the appropriate or ideal mechanism that can ensure the effective participation of the business community in an institution like the WTO, whose main functions – negotiating trade agreements and monitoring their effective implementation, including by recourse to dispute settlement – are by their very nature government led.

It would be difficult, not to say inappropriate, to give business representatives full participation in these two sets of activities, since – as indicated in the E15 report (Elsig, 2014) – in addition to logistical issues of significant complexity, full participation of business representatives in, say, trade negotiations may render the crafting of trade agreements much more difficult than is currently the case.

At the last two WTO Ministerial Conferences, a number of private entities, business organizations and non-governmental organizations took the initiative of organizing a series of debates where their particular concerns were examined and discussed with key government representatives. These debates took place for the first time during the Bali Business Forum, whose organization and purposes are explained in detail in Box 1, and subsequently during the Nairobi Ministerial Conference in 2015.

Box 1: Bali Business Forum

At the Ninth WTO Ministerial Conference, which took place in Bali, Indonesia from December 3rd to 7th, 2013, the International Chamber of Commerce (ICC), the Evian Group@IMD and the International Centre on Trade and Sustainable Development (ICTSD) decided to jointly organize a day-long event to focus on issues of particular interest to business representatives from WTO member countries. The Bali Business Forum (BBF) – a first event of its type – took place on December 5th, 2013.

The BBF provided an open forum where the business community could examine the most critical issues in the international trade agenda and interact with ministers and other high-level officials to contribute towards a constructive outcome in Bali. The agenda of the BBF included issues such as: 1) the quantitative benefits of a Doha deal (or costs of a non-Doha deal); 2) the impact of mega-preferential agreements (e.g. TPP and TTIP) on the WTO; 3) the complementary nature of trade in services, trade facilitation and global value chains; and 4) the role of the private sector in the WTO.

Box 1 (contd.)

An accompanying high-level luncheon focused on the topical issues at the intersection of the WTO and digital economy, and a business/ministerial roundtable wrapped up the ambitious agenda at the end of the day in a high-level setting. Throughout the panel discussions, members of the private sector and government officials, including CEOs and key ministers, engaged in an open dialogue on the above-mentioned topics.

The ICC, the Evian Group@IMD and ICTSD acted as the core co-conveners of the Bali Business Forum, in partnership with the Inter-American Development Bank and the International Trade Centre. The BBF also had the support of relevant business organizations and associations, such as the Washington-based National Foreign Trade Council (NFTC), the Coalition of Services Industries (CSI), the European Services Forum (ESF) and the Federation of Industries of São Paulo (FIESP).

The Forum helped to facilitate, through engagement and dialogue between business executives and policymakers from all over the world, a better understanding on the possibilities of enhanced multilateral cooperation and on the need for a vibrant WTO.

Another key objective of the BBF was the identification of ways for the private sector to get more effectively engaged in WTO activities – for example, by setting up the institutional mechanisms that would facilitate engagement, such as a Business Advisory Council at the WTO, and/or the holding on a more permanent basis (e.g. on the occasion of WTO Ministerial Conferences) of a forum/dialogue along the lines of the BBF, something which was also implemented at the Tenth Ministerial Conference in Nairobi in December 2015.

Dealing with Regional Trade Agreements and Negotiations

For the last few years, the main issue regarding the relationship between regional trade agreements (RTAs) and the multilateral trading system has been to make sure that they reinforce each other; and the main proposal contained in the first version of this chapter was that the WTO should widen its rule-making function by adopting (i.e. incorporating into the multilateral

legal framework the advanced trade rules contained in some regional trade agreements).

This approach may no longer be applicable. Anti-free trade sentiment is gaining ground all over. It is not regionalism – as we have known it so far – that poses a challenge to multilateralism; rather it is a new nationalism that seems to be gaining ground.

Through the 1980s and 1990s, many developing countries embraced open markets and reduced the role of government in economic policies. This led to an economically interdependent and more globalized world while at the same time paving the way for the negotiations of new and expanding regional groups. Some of these regional groups were inspired by the successful European economic integration process, and led to the formation of similar customs unions and free trade areas – such as ASEAN, Mercosur and NAFTA – that facilitated trade between members through the removal of trade and non-trade barriers.

In addition to these more “classical” regional arrangements, a number of mega-trade agreements began to be negotiated, including the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP) between the United States and the European Union, an initiative officially launched in 2013. China eventually entered the fray through a China-led mega-trade agreement, the Regional Comprehensive Economic Partnership (RCEP), which brought together 16 countries.⁶

This trend towards more and bigger regional agreements, which until recently seemed unstoppable, may now be drastically changing. RTAs have recently evolved in a most unexpected way. In June 2016, the British people voted to take their country out of the European Union, setting in motion a process whose contours continue to divide both British and non-British European nationals, and is threatening to disrupt the further development of the European Union itself.

In the United States, until now the strongest supporter of mega-regional agreements and/or free trade negotiations, a new approach to trade agreements and trade policy in general is taking root. During the US electoral debates, the Republican candidate Donald J. Trump made clear that should he prevail in the elections, his government would not continue the politics of his predecessor vis-à-vis trade agreements, and his vocal criticism of the trade agreements

6 The Regional Comprehensive Economic Partnership (RCEP) is a proposed free trade agreement (FTA) between the ten member states of the Association of Southeast Asian Nations (ASEAN) and the six states with which ASEAN has existing free trade agreements (Australia, China, India, Japan, South Korea and New Zealand). RCEP negotiations were formally launched in November 2012, and the agreement is scheduled to be finalized by the end of 2017.

entered into by the United States was tacitly – and sometimes explicitly – supported by his Democrat opponent. Soon after taking office, President Trump began to honor his promises.

The “New” US Trade Policy

In one of his first official acts, President Trump signed an executive order removing the United States from TPP, a 12-nation trade deal whose negotiations commenced under President George W. Bush and were concluded under President Obama. In another executive order, President Trump signaled his intention to re-negotiate NAFTA. Together with his approach to immigration – including the intention to build a “wall” along the US–Mexico border – these decisions represent a re-orientation of US trade policy, moving away from regional and multilateral initiatives towards bilateral ones.

In fact, President Trump has made clear that he believes bilateral trade deals are better than regional or multilateral agreements. Abandoning regional and multilateral deals for a bilateral worldview could institutionalize President Trump’s mercantilist approach to the international trade system, in which countries are locked in *zero-sum competition* to win market shares, rather than cooperating to improve economic efficiency. Over the long term, the risk is that the rules, norms and laws that govern trade relations will erode, along with the effectiveness and legitimacy of the WTO, which Mr. Trump has branded as another one of “our disasters,” raising the prospect of the United States pulling out of the global body all together.

Currently, the Trump administration is focusing on the NAFTA (re)negotiation and is expecting to conclude this by the end of the year or early in 2018. This is a rather ambitious goal given the position taken by the United States *vis-à-vis* Mexico since the beginning of the Trump administration, and even before during last year’s presidential elections. On the campaign trail, Mr. Trump consistently called NAFTA the “worst trade deal” the United States had ever signed, and after notifying Congress of its intentions to renegotiate the agreement, the US Trade Representative unveiled its major objectives (USTR, 2017) for the NAFTA renegotiation: to reduce the US trade deficit, which president Trump has blamed for shuttering factories and contributing to significant job losses in the US manufacturing sector.

NAFTA, which entered into force in January 1994, has fundamentally reshaped North American economic relations (Council on Foreign Relations, 2017), driving unprecedented integration between Canada, Mexico and the United States. It also ushered in a new era of regional and bilateral FTAs, which have proliferated as the WTO’s global trade talks have stagnated. Indeed, NAFTA

was the beginning of a new set of regional trade agreements, the first great experiment in freeing trade between developed and developing countries. It set the basic template for many deals that followed, including the CAFTA with Central America and the Dominican Republic, and China's entry into the WTO.

The outcome of the NAFTA renegotiations will be determined as much on the negotiating table as away from it, with President Trump constantly renewing calls for the US to pull out of the agreement – a drastic course that US officials say he has come close to pursuing. As reported by *The Wall Street Journal*, on at least four separate occasions since mid-2017 – in speeches, on Twitter, and at a press conference – Mr. Trump has raised the prospect of forcing the United States to withdraw from NAFTA.⁷ “We’re working right now on NAFTA, the horrible, terrible NAFTA deal that took so much business out of your state and out of your cities and towns,” he told a cheering crowd in Missouri. “Hopefully we can renegotiate it, but if we can’t, we’ll terminate it and we’ll start all over again with a real deal.”

The NAFTA renegotiations, which were originally intended to be completed by the end of 2017, have recently been extended into next year due to “significant conceptual gaps” in how to rewrite the 1994 trade pact. In renegotiating NAFTA, the United States, Mexico and Canada are still far apart on a series of issues, some of which have only recently been brought into the negotiations. Those “dividing” issues include a five-year “sunset clause” that would cause NAFTA to automatically expire unless the three countries voted to continue it – a proposal that businesses say would inject so much uncertainty into the deal as to effectively nullify it.

The Trump administration is also pushing for drastic revisions to the mechanisms that help to resolve disputes under NAFTA. Its proposals would allow countries to reject the ruling of independent panels on state-to-state disputes, as well as change the investor–state dispute settlement provision to an opt-in basis, and substantially curtail the ability of investors to bring such cases.

The Trump administration is pushing for higher thresholds for the amount of a product that must be manufactured in North America for it to qualify for NAFTA's zero tariffs (for instance, 85% for automobiles, up from 62.5% previously). The United States has also proposed that cars manufactured in Canada and Mexico be made with 50% US content, effective immediately.⁸

7 See https://www.wsj.com/articles/u-s-mexico-sparring-before-nafta-talks-sets-dim-tone-1504258203?shareToken=st363e17f6b18749b79657a934c872c885&reflink=article_email_share.

8 See https://www.nytimes.com/2017/10/17/us/politics/nafta-negotiators-extend-talks-delaying-its-expected-demise.html?_r=0.

There is no guarantee that the extension of the negotiations will help bridge the differences on these issues, as negotiations will collide with political events in all three countries that will only complicate each nation's negotiating positions. The NAFTA renegotiations may become a sensitive topic in the Mexican presidential race, which concludes with the July 1 election; provincial elections will take place in Canada; and in July in the United States, the Trump administration will lose trade promotion authority (TPA) by which it can submit to Congress new trade deals for a simple "up or down" vote.

The extension of the talks until early 2018 signals the potential demise of a trade pact that, while critical to North American commerce, has come under withering criticism from the Trump administration as a bad deal for American workers.⁹ The failure of the NAFTA renegotiations would be a heavy blow to the economies of the three member countries, as it covers reciprocal trade worth more than \$1 trillion a year.

Moving on Brexit

The Brexit process, for its part, is proving more complex than even its strongest supporters realized one and a half years ago, when the choice was offered to the British people to either remain in or leave the European Union, a community to which they have belonged for more than half a century. The Brexit controversies – "Brexit means Brexit", a "hard" versus "soft" Brexit, Brexit "first" and then agreements with other countries – have dominated the British political debates ever since the Brexiteers won the referendum in June 2016.

While leaving the European Union after 44 years of membership, the United Kingdom is planning to redesign its trade relationships with the rest of the world. It is not going to be easy. Not only is the United Kingdom breaking up from its biggest trading partner, but it is doing so when its next largest partner, the United States, appears to be moving towards protectionism. Also, the United Kingdom is part of a global – but above all, European – *value chain* and has a relatively weak trade position in other markets.

As underlined by Martin Wolf early this year in an article in the *Financial Times*, the UK wants, rightly so, an amicable divorce "to continue to trade with the EU as freely as possible, to co-operate to keep our countries safe, to promote the values the UK and EU share – respect for human rights and dignity, democracy and the rule of law both within Europe and across the wider world, to support a strong European voice on the world stage, and to

9 See <https://www.nytimes.com/2017/10/11/business/economy/nafta-trump.html>.

continue to encourage travel between the UK and EU.”¹⁰ It is not evident, however, that it will be able to achieve all of this at the same time.

On 29 March 2017, Prime Minister Theresa May signed the letter that set in motion the negotiations for the withdrawal of the United Kingdom from the European Union. This gave the British government and its European counterparts a period of two years to define the terms of their separation as well as the conditions on which their mutual future relationship will be established.

Divorce proceedings are never easy, and the Brexit process may be no exception. The three most conflicting and divisive issues in the Brexit negotiations are (i) citizens’ rights, which must cover employment, eligibility for benefits and conditions for permanent residence, among others; (ii) the so-called Brexit bill and its coverage (including Britain outstanding financial commitments to the European Union; and (iii) the nature of the post-Brexit trade relationship between the United Kingdom and the European Union, and the timing for negotiating and implementing the new arrangements.

A year and a half into the Brexit process, more questions than answers continue to dominate the discussions. Prime Minister May repeatedly stated that “*Brexit means Brexit*” when trying to explain the results of the June 2016 referendum that set in motion the Brexit process. She has claimed that “*no deal is better than a bad deal*” when referring to the on-going Brexit negotiations. And she is even more vague when trying to explain what the future will hold for the relationship with the European Union once the Brexit process is completed, beyond saying that “*the UK is leaving the European Union, not Europe*”.

The clock is already ticking on the Brexit negotiations, however, and the United Kingdom and the European Union have until the end of March 2019 to reach an agreement. Thus, despite Britain’s shifting politics, the schedule for the next two years will determine what sort of deal, if any, the two parties can strike.

A UK Treasury study (HM Government, 2016) published before last year’s referendum assessed continued UK membership of the Union against three alternative scenarios: (i) membership of the European Economic Area (EEA), like Norway; (ii) a negotiated bilateral agreement, such as that between the European Union and Switzerland, Turkey or Canada; and (iii) WTO membership without any form of specific agreement with the European Union, like Russia or Brazil.

10 See www.ft.com/content/6e3aeb4a-cc65-e6-930f-061b01e23655.

Following the *Norwegian model*, the United Kingdom could become part of the European Economic Area (EEA), which was established in 1994 to give non-European countries the possibility to participate in the EU Single Market while not committing to other, non-trade aspects of the Union. All EU countries plus Iceland, Lichtenstein and Norway are members of the EEA. The non-EU members of the EEA are not part of the Customs Union, and neither they belong to the Common Agriculture Policy (CAP). They can set their own external tariffs and conduct their own trade negotiations with countries outside the European Union. However, EEA members have to accept free movement of people, rulings by the European Court of Justice (ECJ) and payments to the EU budget, all of which are anathema to Brexiteers.

Then, there is the *Swiss model*, which is somewhat more flexible than the Norway model. Switzerland has entered into a number of bilateral treaties with the European Union to regulate its “bilateral” relations with the member states. Switzerland – together with the non-EU members of the EEA – belongs to the European Free Trade Association (EFTA), which provides for free trade with the European Union in non-agricultural goods. A Swiss plus model could be to join EFTA, an association the United Kingdom helped to found when in 1957 it decided to remain outside of the European Economic Community EEC, the predecessor to the European Union.

Relying purely on WTO rules is another option. The UK could restructure its relationship with its trading partners at the WTO. The UK was an original member of the General Agreement on Tariffs and Trade (GATT) and remains a member of the WTO in its own right. However, as it subsumed its trade policy to that of the European Union over the years, the Union took over negotiations on its behalf, and the United Kingdom’s WTO membership is now intertwined with that of the European Union. The job of the UK trade negotiators would be to disentangle the United Kingdom from the European Union, and to establish the itself as a fully independent member of the WTO. Under the WTO scenario, the United Kingdom would have the possibility to conclude trade agreements with the countries it chooses, such as the United States, traditionally the United Kingdom’s preferred partner.

Whatever post-Brexit scenario prevails, it seems certain that there will be a rather long period of uncertainty during and after the Brexit negotiations that will affect the United Kingdom as well as existing and prospective UK trading partners, and will certainly influence the evolution of the WTO via its adaptability to its new independent member (the UK), and via the shifting of the focus of EU attention to accommodating the disruptions, institutional or otherwise, caused by the Brexit negotiations.

As put by Timothy Garton Ash in an article in *The Guardian*,¹¹ Britain will probably end up, after a transition period during which current Single Market arrangements are maintained, with some novel variant of Norway's European Economic Area deal, Switzerland's customized free-trade package with the European Union, or Turkey's membership of the Customs Union.

He adds that this will effectively mean that the United Kingdom will have second-class membership of the Common Market, that it will have to abide by rules it will have no say in making, that it will continue to pay into the EU coffers, that immigration from the European Union will be only slightly reduced, and that it will have to accept legally binding arrangements in which the European Court of Justice still plays a significant role (along with a British court, and perhaps a third-party court or tribunal).

But things are not settled until they are final, and the above scenarios are not inevitable. So Garton Ash calls for British Europeans to "gather all our strength to say, at the moment when the half-baked negotiation result is presented to parliament: 'This is the worst of both worlds, neither having our cake nor eating it. Why settle for second-best, associate membership, with many clear disadvantages and few advantages, when you could just stay and have the real thing?'"

As the Brexit negotiations approach their second and final year, the situation is even more confusing than it was at the beginning, and people are starting to wonder whether there will ever be an outcome to the negotiations and are asking whether completing the Brexit process makes any sense at all. Thus, the assertiveness of the "Leave" campaign is being replaced by a more nuanced approach to the whole idea of leaving the European Union.

As Vince Cable, the leader of the Liberal Democratic party, said, there is more than a possibility that Brexit may never happen due to tensions among the Labour and Conservative parties, and there is probably a need for a second referendum to let the people decide, based on the facts, whether this is something they want to go ahead with. This is perhaps an extreme view expressed by someone who was elected to lead the pro-EU Liberal Democrats promising voters an "exit from Brexit," but he is not alone in his concerns.

11 See https://www.theguardian.com/commentisfree/2017/jun/22/year-ago-britain-voted-leave-eu-worse-both-worlds?utm_source=esp&utm_medium=Email&utm_campaign=GU+Today+main+NEW+H+categories&utm_term=231905&subid=23336106&CMP=EMCNEWEML661912.

Conclusions

Although it is too early to reach definitive conclusions from these rather recent decisions and processes, countries need to start seriously considering not only how to react to them, but also the alternative options that can be put in place to keep and consolidate their development strategies, and to continue fomenting their reciprocal trade arrangements.

Also, after years neglecting the value of the WTO, it is time to reconsider the important function the institution could play under the current circumstances. As stressed recently by Arvind Subramanian, the time may have come for “emerging” countries to revalue the role of the WTO as the place where their development options, which include open markets and liberal economic policies, can be fostered and, indeed, promoted (Subramanian, 2017).

But a revival of the WTO will not happen automatically. Willing stakeholders must actively pursue it and the most obvious candidates for the job, in the view of Subramanian, are the mid-size economies that have been the greatest beneficiaries of globalization. Thus, the champions of multilateralism should include countries such as Australia, Brazil, India, Indonesia, Mexico, New Zealand and South Africa, among others. Because none of them is large enough on its own, they must work collectively to defend open markets and multilateral deals.

One of the reasons why countries moved to regional negotiations is often said to be the long-lasting deadlock in the Doha negotiations. Yet, the WTO continues to play a critical role in today’s global economy. It ensures the transparency of the trade practices of its members, enforces existing multilateral rules and disciplines, and adjudicates trade disputes in case of breach of WTO obligations by any of its members.

And it is precisely because of these important functions that delays in completing the Doha negotiations and the focus on preferential trade initiatives are challenges that the WTO cannot ignore or underestimate. And this should certainly be the preferred approach by developing countries, most of which are outsiders to regional and/or bilateral deals, including mega-regional negotiations.

Summing up, none of the issues examined in this chapter is new – they have been discussed by policymakers, academics and practitioners, both within and outside of the WTO, for a long time. The suggestions for reform put forward are also well known to most trade practitioners and, to varying degrees, could be accepted by most of them. However, no action has been taken so far to put them in place, and no process is envisaged to collectively discuss them,

as WTO members and trade negotiators seem too busy escaping the current stalemate to engage in discussions on the future of the WTO.

Yet, something needs to be done, and done quickly, to keep a vigorous multilateral trading system from stagnation. And if governments are too busy to engage collectively in a reform process, perhaps the WTO leadership (i.e. its Director-General and its Deputy Directors-General) or a group of like-minded governments could take the initiative and, with the help and support of interested institutions from civil society and the business world, engage in a collective, open and effective discussion of the kind of multilateral trading system that would be best suited to the trade and economic challenges of the 21st century.

This suggestion, which seemed quite obvious when the first version of this chapter went into print some two years ago, may be more relevant today due to the disruptive impact of the new US trade policy and the effect of Brexit on the European Union (the largest and most significant of all regional agreements). All these changes may bring the opportunity to revisit the place of the WTO in trade negotiations and to revalue its role as the key international body with responsibilities in the trade field – hardly a bagatelle.

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CHAPTER 5

Why Engage in Trade Negotiations and the Relevance of the WTO

Alejandro Jara

Trade liberalization has been a feature of the multilateral trading system since 1948. However, the latest effort in this direction, the Doha Development Agenda (DDA) negotiations at the World Trade Organization (WTO), has failed. Negotiations have been stalled since 2008. The failure of the WTO to deliver in more than 15 years calls into question the capacity of the multilateral trading system to pursue deeper international cooperation. It is true that two agreements have delivered important results – namely, the Trade Facilitation Agreement (Bali, 2013) and the elimination of agriculture export subsidies (Nairobi 2015) – but these are either uncontroversial or carve out certain exceptions.

The reasons for this are several, but two stand out. First, the DDA was launched to make pursue liberalization of trade in agriculture, which means, among other aspects, the elimination or reduction of tariffs and the most trade-distorting instruments of domestic agriculture support. Some parties have lacked the political support to make concessions. Others have sought to rewrite the agriculture rules agreed upon in the 1994 Marrakesh Agreement.

Second, huge and rapid changes have taken place in the world economy, such as the emergence of new trading powers (the emerging economies), the spread of global value chains, and the 2008-09 financial crisis. All together, such changes have substantially altered the balance of power. Since the organization of the DDA negotiations reflected the realities of the 20th century, it could no longer cope with the politics of this century.

This crisis contrasts with the increasing spiral of trade agreements negotiated around the world that shows that the appetite for trade liberalization is present and active. We shall call these “preferential trade agreements,” or PTAs.

This paradox is explained by the fact that such agreements do not deal with agricultural support (there are other areas in this situation), and frequently exclude some agriculture products from liberalization. As a consequence, those seeking further liberalization have sought other means, PTAs being the main vehicle.

PTAs have made progress to improve international cooperation – particularly on regulatory coherence, e-commerce, state-owned enterprises, business facilitation and transparency, foreign investment, and so on – thus responding to the diversification of economies, global value chains and technological changes. PTAs may well be the “breeding” ground where new disciplines are crafted that, if successful, may become the foundations of an updated WTO rulebook, when the political conditions change.

Aside from agriculture, PTAs have shown little, if any, progress in areas such as subsidies and trade remedies. Since the 2008 crisis, several big players have resorted to the application of trade-restrictive measures, which have piled up. Both the Global Trade Alert (GTA)¹ and the WTO Secretariat² have documented such measures and their impact. This shows that the rulebook of the WTO needs to be updated and tightened to limit protectionist measures by governments.

Consequently, PTAs remain the only feasible liberalization game, at least for some time. Countries that wish to liberalize their economies and/or need to avoid discrimination in other markets engaged in PTAs will face increasing pressure to conclude such arrangements. As more and larger PTAs become part of the international legal and economic landscape, they have important economic and systemic implications.

This chapter poses some key questions that policymakers must face when setting up a trade policy strategy that involves negotiations of trade agreements with other economies. While a seasoned trade negotiator would take for granted most of, if not all, the questions and analyses that follow, that may not be the case for those who are at the beginning of a career in trade policy. Indeed, some elements of what follows may serve as a good basis to assess trade agreements after their conclusion and for those with a more inquisitive mind. The questions are based on the assumption that the country concerned is already a member of the WTO. It is also worthwhile to raise some issues concerning the organization of the negotiations and the corresponding allocation of resources, as these are bound to have political impacts.

1 <http://www.globaltradealert.org>

2 https://www.wto.org/english/tratop_c/tpr_c/trade_monitoring_c.htm.

- 1. Why is it necessary or convenient to negotiate a trade agreement (bilateral, plurilateral or multilateral)?** What is the purpose of the negotiation? Most, if not all, trade agreements have the purpose of liberalizing and/or facilitating trade and investment, which implies that it will go beyond what it has already agreed upon in the WTO (unless, of course, the country is negotiating with a non-member of the WTO). Consequently, a trade agreement will no doubt result in a change in the country's policies and/or in the policies of the counterpart(s). Presumably, a government will decide to negotiate when it perceives that such changes will be to the *overall* benefit of its economy, even though there may be adjustment costs to certain sectors.
- 2. Unilateral liberalization.** To the extent that these changes are limited to domestic policies, they can also be pursued unilaterally. In other words, liberalization and/or facilitation can be achieved by implementing the corresponding measures without the intermediation of a negotiation with another country. Liberalization is easier and faster to achieve if made unilaterally. Assuming there is no internal resistance, unilateral liberalization may achieve optimal outcomes, since no compromises are necessary with other countries. This is usually not the case, however, and negotiations with another country may be used to countervail domestic resistance. Moreover, a unilateral liberalization may be rolled back by an ulterior piece of legislation or regulation, as the case may be. A trade agreement does not prevent this from happening but it comes at a price, because it is not simple to denounce or modify international agreements, and benefits will be foregone in the market of the counterpart. Thus, a trade agreement brings greater stability to domestic changes (the "lock-in effect") that, in turn, probably gives greater confidence to economic agents. Finally, unilateral liberalization presents some political economic limitations, since it imposes adjustment costs to the domestic producers without any direct benefits for exporters (although it may help indirectly by diminishing the indirect anti-export bias of trade protection). Consequently, the resistance that some domestic producers may put up will only be countervailed by the support that may be elicited from importers and consumers, who usually have weaker organizations.
- 3. What policy changes should be pursued?** In other words, what are the objectives of a negotiation? Usually there is no one single reason, but rather a combination of motivations that respond to the various interests and stakeholders that participate directly or indirectly in the decision-making process, that leads to a trade negotiation. The greater the number of interests that are reflected in the objectives, the greater

the support for the negotiation. However, to define the objectives of the negotiations requires the agreement of the other party (or parties), and some of those may generate resistance from particular interests in a given jurisdiction. Some countries elect to have the objectives to be pursued in the negotiations pre-stated in a public statement, sometimes worked out with the legislative and after consultations with stakeholders. For example, the United States achieves this by approval by Congress of the Trade Promotion Authority (TPA). This is a vehicle whereby Congress agrees to not use its prerogative to amend draft laws, provided the Executive acts within the agreed-upon objectives to be pursued in trade negotiations.³ Likewise, the European Commission publishes its trade policies objectives after extensive consultations with the European Parliament, among others (European Commission, 2015). The following are some objectives typically pursued by governments in a trade negotiation:

- i. To lock-in domestic reform. For example, in the GATT Tokyo Round (1973-1979) Chile negotiated an across-the-board binding of 35% for all products (while the applied tariff across-the-board was 10%) to ensure there would be no rollback above the bound level.
- ii. To liberalize its own trade regime. For example, throughout the 1990s and beyond, Chile deliberately pursued free trade agreements (FTAs) to further liberalize imports.
- iii. To prise open other markets for its goods, services and investments. An FTA involves reciprocal opening of the market of the other party (or parties), which makes any adjustment cost more politically palatable. However, if the negotiation is with a duty-free country such as Singapore or Hong Kong, China, such partners will “appear” to give nothing since they have virtually no tariffs. This is a mere appearance, since binding the duty-free is very valuable, as are other provisions related to services and investment that may part of the deal.
- iv. To introduce more competition and combat inflation in the domestic market. Trade policy is part of an overall economic policy, and for the policymakers there will be welfare benefits because of enhanced competition, thus limiting domestic prices from rising.
- v. To prevent discrimination against its exporters and investors in other markets. For example, towards the end of the 1990s under the leadership of its new Trade Commissioner, Pascal Lamy, and in order to give priority to the Doha Round of multilateral negotiations,

3 <https://www.congress.gov/bill/114th-congress/senate-bill/995/text>.

the European Union self-imposed a moratorium on the initiation of negotiations for new FTAs, only continuing those already in the pipeline. However, in 2006 the moratorium was terminated as the European Union observed that the United States and Korea were starting negotiations for an FTA and invited Korea to begin talks for a bilateral FTA, for fear that otherwise its exporters would face less favorable treatment than competitors from the United States in the Korean market. This has become one of the most powerful drivers of negotiations; in other words, a struggle against discrimination in the absence of further liberalization through the WTO.

- vi. To enhance security, cooperation and bilateral relations. Examples include FTAs such as the one between the United States and Israel.
 - vii. To settle problems and prevent conditionality. For example, developing country beneficiaries of benefits under mechanisms such as the Generalized System of Preferences are regularly subject to pressures to change regulations such as environmental or labor standards, under the threat of losing the preferences. An FTA will ensure duty-free treatment once and for all, without prejudice to challenges under the dispute settlement mechanism for not complying with such standards.
4. **What are the advantages and disadvantages of bilateral, plurilateral, regional and multilateral formats?** Trade agreements can have different geographical coverage. Normally, the lower the number of participants, the easier it will be to reach agreement and achieve a better result. However, three or more participants can assist in achieving a balance that otherwise would not be possible. This is particularly effective when one of the parties is a much bigger economy than the other participants. NAFTA would be a good example in this regard. Also to be considered are the distortions that preferences introduce in the allocation of resources. From this perspective, a multilateral agreement would be the optimal format. Except in the case of the latter, all other formats imply a choice of the parties to the negotiation. Such choice has obvious political and geopolitical considerations. Putting these aside, there a number of other factors that could be considered in this decision.
- i. The first consideration is the model to be used in the integration project. These are well known because Article XXIV of GATT defines what is a “free trade area” and a “customs union.” An essential element in a customs union is that beyond the formal definition that requires the existence of a common external tariff, many more common or harmonized policies are in fact required to ensure a proper functioning,

such as competition policy, subsidization, government procurement, standards and trade remedies, among others. Little wonder that the only customs union to function effectively in the last 60 years is the European Union, followed by the Southern African Customs Union (SACU)⁴ (and the jury is still out on the Eurasian Economic Union).⁵ The choice of the integration model is of course a determinant of the partners.

- ii. Gains. A trade agreement needs support from government, business, politicians, unions, and so on. While the results cannot be measured until the text is divulged, it is nevertheless inevitable that the intention of initiating a negotiation is sustained on perceived gains or benefits for the economy. The assessment of gains should not be overstated to avoid the risk of overselling and losing credibility. Increases in existing exports of goods and services, new exports, cheaper imports, more and better paid jobs, and new investments are all important selling points. If none of these gains is perceived in the case of a possible partner, it becomes difficult to justify a negotiation.
- iii. By the same token, sensitivities are equally crucial in terms of their identification and assessment. If they outweigh the perceived benefits, a negotiation becomes difficult, if not impossible. An example to illustrate this is the case of New Zealand and Chile. Starting in the mid-1990s, officials met frequently and proposed, with the approval of the respective heads of government, to initiate negotiations for a bilateral FTA. They regarded it as being of systemic long-run interest to establish a trans-Pacific model that could be expanded to other APEC economies. However, bilateral trade was small and the structure of production was similar, and the initiative did not elicit much enthusiasm in Chile. On the contrary, New Zealand is a powerful exporter of dairy products and Chile is a net importer, and Chilean domestic producers – who are highly sensitive to international prices – expressed firm opposition to the idea of a bilateral FTA. They had the support of other agricultural producers and the Ministry

4 Botswana, Lesotho, Namibia, South Africa and Swaziland. However, South Africa chose to negotiate an FTA with the European Union independently of its SACU partners. The latter in practice treat EU imports duty-free, but their exports do not enjoy the same access as South African products to the EU market, without prejudice to the Everything but Arms initiative of the European Union.

5 Belarus, Kazakhstan, Russia, Armenia and Kyrgyzstan.

of Agriculture, in effect killing the idea for a few years. It was only in 2003 that an expansion of the number of participants to include Singapore and Brunei made it possible to carry out the negotiation that concluded in 2005 giving birth to the P4, the precursor to the TPP.

- iv. Size and quality of the market. By negotiating a trade agreement, a country is “exchanging” access to its market for better access to other markets. For a small country, it would seem a very good proposition to negotiate with a much larger economy. But “size” can be measured in different ways: GDP (at market or PPP exchange rates), total imports by value or volume, imports of products exported by the bigger country, and so on (or a combination thereof). A real example to illustrate this occurred in the second half of the 1990s, when Chilean exporters observed that Mexico was negotiating FTAs with several Central American countries and requested that their government do the same to avoid being discriminated against. Putting aside the maxim that “any market is a good market” and any political considerations, the decisive factor behind allocating resources to negotiate with Central America was the fact that, though small (measured in different ways), these markets imported more manufactures from Chile relative to other markets. In this case, the *quality* of the market was a compelling reason.

5. **Defining the agenda.** In parallel with the above points, another important consideration is the determination of what exactly will be the subjects of the negotiation. This involves an understanding of what are the objectives to be pursued in each item or chapter. For example, it makes a difference to say that there will be a chapter on cross-border trade in services with the objective of liberalizing *all* services, as opposed to binding the present *status quo* of access and national treatment for services supplied from the negotiating partner, which implies that existing restrictions are maintained.⁶ The political impacts of the two are very different. In many cases, using existing agreements as a template can facilitate the determination, since there will a clearer view of the possible outcomes. The more parties that are involved, the greater the need for this understanding and the more formal it becomes, to the point that multilateral agreements need a document to launch a negotiation, such as the Doha Ministerial Declaration. In a bilateral setting, this usually takes the form of a press communiqué.

6 Usually the preservation of existing restrictions is accompanied by the “ratcheting effect,” which implies that any future changes cannot increase the degree of non-conformity with the treaty; changes can thus only be more liberalizing.

- 6. The communication of “red-lines”** is important but not essential. “Red-lines” refer to limits to liberalization or other disciplines that, for whatever reason, a government will not agree to, even if implies that an agreement will not be reached. This is a process that runs in parallel with the definition of the agenda, and involves communicating to the counterpart what is not negotiable. However this is done – in writing or through verbal exchanges – it is important to avoid unpleasant surprises down the road that may impact key expectations and upset the balance of interests, and that may derail a negotiation and generate mistrust. A typical example would be communicating that everything will be negotiable except certain products (the United States typically excludes sugar from most of its trade agreements) or a service (most countries follow the GATS and exclude air transportation from PTAs). The red-lines should not be used to acquire bargaining chips. If during the negotiation a red-lined issue is negotiated away, then all other red-lines may be regarded as negotiable, thus losing its effect. In the absence of red-lines, there is less trust and the parties will not be willing to table their final/best offers in order to retain chips should red-line issues suddenly appear in the negotiation. For example, in the TPP negotiation, because of internal electoral politics, the United States took a long time to communicate its approach and positioning with regards to textiles and apparel, and other sensitive areas. According to some negotiators, this was the cause of unnecessary delays.
- 7. The political economy of the other party (or parties).** As in most negotiations, difficulties often arise because of domestic political constraints, however beneficial a particular outcome may be. To have a good understanding of what lies behind a particular position is crucial in order to determine what is important and what the limitations are that the counterpart faces. This also allows those positions that are motivated by a negotiating tactic of acquiring bargaining chips, instead of a genuine concern or resistance, to be weeded out. To have the necessary and undistorted relevant information at hand probably implies the employment of law firms or other sources of legal, economic and political analysis of the other party. For example, negotiating services and investment implies dealing with complex regulatory frameworks that are better understood by local lawyers, particularly when the other party does not share a similar legal and administrative culture.
- 8. The domestic consultative process** with most, or all, stakeholders is an imperative of modern day trade agreements. Moreover, as the agreements cover other areas besides tariffs (in particular, services and intellectual property), the number of parties with opposing interests increases. Time

and resources spent on consultations before and during the negotiations are therefore a key element to neutralize the resistance, or at least force stakeholders to develop arguments with the relevant evidence. In this process, it is likely that many sectors that fear greater external competition will argue that they should be excluded from the negotiation. In other words, they will want to become part of the national red-lines. Such positions are best dealt with when the government communicates *ex ante* that exclusions (or other exceptional treatments) will only be entertained when certain objective criteria are met. Once the negotiation is launched, this dimension becomes more difficult because a balance must be struck between the transparency that is required to engage domestic stakeholders in consultations on the one hand, and the necessary confidentiality of the negotiations, particularly the texts as they are developed, on the other. The manner in which consultations are organized is not something for this chapter to dwell upon. However, it seems valuable to point out that some of the best practices are those that force the stakeholders to organize themselves in order to bring to the table approaches that have already been negotiated, eliminating extreme and unrealistic positions. Since the stakeholders will be many, it follows that such practices will increase efficiency and help generate consensus. Without counting other ministries and governmental agencies, examples of other stakeholders include: i) business; ii) politicians; iii) parliamentarians; iv) unions; v) non-governmental organizations (NGOs); vi) academia; and (vii) professional associations

9. **The consultative process: The special case of business.** While all stakeholders are important, business is special in the sense that it bears the risks, and therefore has much to win or lose depending on the quality and size of the markets. By the same token, business has special responsibilities to engage by expressing its views and, if the case warrants, by providing political support. Understandably, however, business is a mix of competing and sometimes contradictory interests. It follows that at a national level, its messages often get diluted in generalities that accommodate all sectors, which renders the content quite useless. In this regard, sectoral expressions are more valuable for a government. Having said that, business should be encouraged to state its views of the type and quality of rules it needs to make more investments and exchanges of goods and services possible. This is at the heart of the modern trade agreements, including the WTO. While business acts mostly at the national level, it should also build international coalitions and be active, particularly in Geneva. While the International Chamber of Commerce or the Coalitions of Services Industries in several

countries (and also grouped in the Global Coalition of Services) offer good examples, the fact is that they are present in Geneva only two or three times a year, and consequently involvement in the details of negotiations is not possible. A much better example is the Global Express Association, which groups express delivery industries, with a permanent presence in Geneva.

By the same token, governments and international agencies should do more to engage business, particularly by opening institutional channels for their participation (and that of other stakeholders as well). This could be done at the WTO, for example, by opening to observers the proceedings of the trade policy reviews and allowing business to pose questions directly to the government under review; or by allowing business to express its specific trade concerns to the Committees of Technical Barriers to Trade and of Sanitary and Phytosanitary Measures. These are but a few examples of how engagement by business can be improved. In shaping the future agenda of trade negotiations, the view of business will be crucial regarding content, and its support indispensable to move to higher levels of international cooperation.

10. **The role of the media, including social media**, is also a central element to be considered in pursuing a negotiation. With few exceptions, the professional media is not specialized and cannot be expected to accurately communicate to a wider public, issues relating to complex public policies.
11. Points 8 and 9 above have an external dimension insofar as the process of **consultations can also be carried out with stakeholders of the other party**, particularly those that could be more supportive. Likewise, the media of the other party should not be neglected as an important dimension of the political effort to advance and conclude negotiations of a trade agreement.
12. **The organization of a negotiation**. In the absence of an institution (like the WTO), and therefore of a Secretariat, the organization of a negotiation is a time-consuming and not inexpensive affair. Consequently, much effort and resources are devoted to developing the institutional backup and efficient processes. For example:
 - i. Who will play the role of secretariat?
 - ii. How will texts be controlled and circulated?
 - iii. Which are to be the negotiating groups, and who shall preside and report?

- iv. Who will be responsible for providing background information (texts of other negotiations and jurisprudence)?
- v. What language(s) will be used to conduct the negotiations and in the texts?
- vi. The legal scrubbing
- vii. Translation.

13. The legislative process of incorporating international obligations into the domestic legal framework. While this is not part of the negotiation proper, the manner in which the incorporation takes place has an important impact on the scope of trade agreements. Broadly speaking, there are two models. As an example of one approach, in the United States the Executive doesn't seek the approval of the treaty itself, but instead submits to the legislature the text of the changes to domestic law that are necessary to implement the international obligations.⁷ This implies that, by and large, once this process is completed no further legislative action is required to implement a trade agreement. It also means that any future law approved by Congress can modify prior law, and thus the international obligation contained therein.

The other approach is approval of the treaty itself by the legislature, and under many legal systems future law cannot derogate or modify such treaties. However, many treaty obligations may need further legislative action. For example, if a treaty provides that there will be an authority to carry investigations when an application of a safeguard measure is requested, a separate law must designate who will be the investigating authority. This can be avoided if in the treaty itself such designation is made (typically in an Annex), and is thus of the text that the legislature approves. It is doubtful, however, whether this technique can be used in more complex matters. If ulterior legislative action is required for some treaty obligations, there is an element of uncertainty over whether or not approval will be forthcoming after ratification of the trade agreement. Other parties may require full approval not only of the treaty, but also of the implementing legislation before allowing entry into force. This may generate tensions because it may be perceived as an intrusion by a foreign government in the legislative process. A prior understanding of the procedures in this regard, along with the appropriate explanations,

7 To approve trade agreements as treaties, under the US Constitution the advice and consent of two-thirds of the Senate would be required. In contrast, domestic laws can be approved by simple majority in both Houses.

may facilitate the incorporation of trade agreements into domestic law and the subsequent implementation.

The Future of WTO Trade Negotiations

Despite the failure of the DDA negotiations, it is inconceivable that the multilateral trading system will cease to be a forum – and arguably the best forum – to negotiate trade liberalization.

However, under the present circumstances it seems unlikely that a round of multilateral trade negotiations encompassing several areas will take place. The Trump administration has stated in no uncertain terms that it will not pursue negotiations at the multilateral level. Instead, it has signaled its willingness to engage on a bilateral basis, presumably because the United States will have more leverage. In addition, the United States has expressed concern and disappointment at the functioning of the WTO, including the dispute settlement mechanism. Without the participation of the main trading nation no multilateral action is feasible, unless the United States were to actively seek reforms in the WTO to address its concerns, which for the time being looks unlikely.

Other forces are coming into the play. Brexit is one, full of uncertainties and costs. At least, in a post-Brexit world, the United Kingdom seems to envisage a proactive attitude in the WTO and elsewhere in favor of freer trade. The United Kingdom has stated it will maintain the present access it grants to import under EU bilateral and multilateral commitments. In addition, over time the United Kingdom will probably review and presumably improve present EU trade agreements with other countries since on its own it will probably have fewer sensitivities than the European Union.

The European Union, for its part, has been active in trying to finalize a free trade agreement with MERCOSUR, following new pro-market governments in Brazil and Argentina. It is also negotiating a massive PTA with Japan that will no doubt have economic and systemic impacts, along with other negotiations to strike new deals (with New Zealand and Australia) or to modernize existing arrangement, such as with Mexico and Chile.

The situation in Asia is no less active, with RCEP, ASEAN and other processes. The Chinese “One Belt One Road” initiative is also an attractive process of physical integration.

In Latin America, the Pacific Alliance stands out and will probably engage in trade agreements with other extra-regional countries. MERCOSUR might also undertake an internal liberalizing reform and engage with other trading partners, following the outcome of its negotiation with the European Union.

Though the United States has withdrawn from pursuing the Trans-Pacific Partnership, the remaining members have agreed to apply the accord amongst themselves, with a few modifications.

These examples are a partial illustration of the extent to which liberalization continues to be pursued and expanded thematically and geographically, in spite of economic and political resistance. Such processes are bound to exercise a strong “gravitational pull” leading to PTAs that will occupy as much room as is politically possible.

In such scenarios, what are the options for smaller players who have an interest in improving and deepening international trade cooperation in the WTO? First and foremost, the system needs to be defended and protected. Preserving the WTO rulebook and the machinery to carry out the functions of administration of the agreements is vital for those who have a stake in a rules-based system.

Second, if negotiations are not presently possible in WTO, time can be used to prepare future action. The failures of the past 17 years leave no doubt that the manner in which negotiations are conducted must change, at least to reflect present realities and future needs. Achieving a new understanding of the format and substance of the negotiations will take time. The following flags some of the most important issues that members will have to confront.

No negotiating process can continue to be organized along traditional lines (developed, developing and least-developed countries). By the same token, flexibilities like special and differential treatment will no longer work as an instrument for inclusiveness unless they are based on the individual needs of each economy, as in the approach used in the Trade Facilitation Agreement.

For example, a different basis for negotiations could be explored, such as binding everything at the applied level, including industrial tariffs, agricultural domestic support, services and government procurement. This confidence-building approach would set the stage for effective liberalization, thus making any negotiations a very attractive proposition to business.

Plurilateral negotiations have surfaced. Some of these are based on the perception that a critical mass exists and thus the outcomes are made extensively on an MFN basis, such as the Information Technology Agreement (ITA) and Environmental Goods Agreement (EGA) exercises. In contrast, other processes, such as the Trade in Services Agreement (TiSA), envisage results that only

benefit the signatories (even though nothing could prevent a TiSA signatory from binding its individual concessions under the GATS). However, some form of packaging still seems necessary to ensure that the necessary trade-offs are present. For example, it is difficult to foresee a stand-alone agreement to reduce or eliminate trade-distorting domestic support in agriculture. To what extent and in what format are plurilaterals an appropriate substitute to multilateral agreements? How can transparency in the system be ensured so other members can appraise the impact of plurilaterals on their interests?

The real economy requires an expansion of the agenda, along at least two dimensions. Since the financial crisis, protectionism has been on the rise, even though trade disciplines have undoubtedly contained some pressures. A review is required of the existing disciplines on subsidies, anti-dumping measures, government procurement, export duties and restrictions, among other areas, to check the worst manifestations of protectionism. Perhaps a good way to start is to value the economic impact of measures adopted in order to determine what the priorities should be.

Another dimension concerns rules in “new” areas such as investment, competition policy and state-owned enterprises. Special attention should be paid to implementing agreements reached in other multilateral fora, such as the elimination of fossil-fuel subsidies agreed upon at COP21. Based on a common template, governments could conduct national studies to determine what problems these agenda pose, and what possible solutions exist. Analysis and internal consultations are necessary, as well as sharing and exchanging information with the rest of the interested members of the WTO.

In 1982, the GATT contracting parties held a conference at the ministerial level. The Tokyo Round had been finalized three years earlier and its results were under implementation in 1982. The trading system was under great strain due to weak disciplines. In addition, the United States, with support from other parties such as the European Communities, proposed to initiate negotiations for a framework for the liberalization of trade in services. This met with strong resistance from most developing and some developed countries. Without a consensus and the membership deeply divided, the conference was deemed to be a failure. Towards the end of the Ministerial Declaration, three paragraphs addressed the issue of services. The first recommended that each contracting party with an interest in services undertake a national examination of the issues in this sector. The second paragraph invited contracting parties to exchange information on such matters. In the final paragraph, contracting parties agree to review the results of these examinations at their 1984 session and to consider whether any multilateral action on these matters was appropriate and desirable.

As a result of these studies and exchanges, by 1986 the resistance to negotiate services had been reduced to eleven developing countries, and the Uruguay Round was launched including services. This shows how governments took “time out” of trade negotiations and created the conditions for a major overhaul and upgrade of the multilateral trading system.

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CHAPTER 6

The Future of the WTO Dispute Settlement System: Confronting Challenges to Consolidate a Success Story

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Overview

Results Achieved

Having passed its 20th anniversary in 2016, the Dispute Settlement System (DSS) of the WTO continues to be considered a success story, and rightly so. The mechanism has been defined by a former Director General as the “jewel in the crown” of the WTO, a statement which is even more justified in the light of the failure of the WTO members to conclude the Doha Development Round (started in 2001), notwithstanding the limited success of the Bali (2013) and Nairobi (2015) Ministerial Conferences, and to reinforce other non-judicial mechanisms within the WTO.

It is interesting to note that the DSS, specifically the Appellate Body, is now taken as a model for “judicializing” other fields. Thus the European Commission proposed in 2017 within UNCITRAL to replace investor-state arbitration (ISDS) generally with a two-level Multilateral Investment Court, after having succeeded in introducing an international investment tribunal in its free trade agreements with Canada (CETA) and Vietnam.¹ At its beginning, however, the

¹ See also the similar proposal by the European Union in the (now suspended) negotiations with the United States on TTIP at http://trade.cc.europa.eu/doclib/docs/2015/november/tradoc_153955.pdf. For the final CETA text, see European Commission trade doc. 154329 (February 2016) and at www.international.gc.ca.

DSS was criticized both by some WTO members and by non-governmental organizations (NGOs) for allegedly devolving to unrepresentative international “faceless judges”, and moreover it has been accused of indulging in “judicial activism” – that is, in disputes also affecting non-trade interest and individual governments’ regulatory powers.

This positive evaluation is based on:

- the high number of cases introduced (the 531st dispute was initiated on 28 September 2017) and almost always (90% of those brought to adjudication) resolved effectively by the removal of restrictive measures of an importing country found in breach of WTO obligations by independent and impartial rule-based adjudication;
- the effective functioning of its multi-stage procedure (from consultation to implementation, through a double-stage adjudication phase), which is meant to solve specific, mostly bilateral disputes, but at the same time to give guidance to all the interested members and to take into account the multilateral dimension of the trading system;
- the participation in it of both major trading powers and small developing countries (signaling the importance of the DSS also for small players and developing economies to ensure access for their products to the larger economies’ markets); and
- the development of a balanced and consistent case law, sensitive to non-trade concerns such as environment protection and health, which recognizes on one hand the need to uphold market access obligations, and on the other hand the existence of evolving non-trade values and policies – domestic and international – that need to be safeguarded as part of the domestic policy space of WTO members.

This has afforded “security and predictability” to the system (as set forth in Article 3.2 of the Dispute Settlement Understanding, or DSU), including in the recent times of financial crisis and economic slowdown. According to official documentation, opportunistic resort to protectionist measures (anti-dumping, subsidies, safeguards) has been contained, although independent research tends to challenge this claim and has a more pessimistic view.²

2 For a relatively positive view, see the various reports submitted by the WTO to the G20 meetings pursuant to the latter’s request and the related data available at <http://tmdb.wto.org>. For a critical position, see the chapter by Simon Evenett and Johannes Fritz in this volume.

Current Problems: The Issue in General

On the other hand, the system shows signs of stress (as a victim of its own success, mainly due to the increase in the number of disputes and their complexity), while multilateral negotiations in the Doha Round have de facto come to a halt. The following major issues have emerged which threaten its effectiveness and may thus diminish the trust in, and recourse to, the system:

1. The increasing number of cases brought to panels and the increasing complexity of disputes and sophistication of arguments made is extending the length of proceedings beyond reasonableness, especially at the panel stage, and is putting strain on the limited resources of the Secretariat.
2. The willingness of losing respondents to promptly comply with the decisions appears to be decreasing, in that effective implementation, while usually performed, requires on average more time. Alternatives to compliance (such as compensation), which appear to be on the rise, may tilt the system towards the protection of the interests of major trading nations, who may be able to pay off weaker members while maintaining their import restrictions.
3. WTO members appear unable to agree on further liberalization (notably in services) and on adding new rules to the multilateral system to face new issues (such as the green economy, environmental subsidies, electronic commerce, overcoming the divergence between national standards and regulation affecting trade).³ This may lead to an increased reliance on the DSS to settle conflicts
4. The parallel massive increase of regional trade agreements (RTAs), to which WTO members are increasingly turning (including “mega-RTAs” such as TPP and TTIP), risks reducing the relevance of the WTO rules through regional provisions. This has not affected however the recourse to the DSS.⁴

This chapter addresses these issues and points to possible solutions, several of which have already been aired in various circles in the past. These proposals fall into two groups. The first group addresses the most pressing problem, which has been repeatedly raised at the Dispute Settlement Body (DSB), namely,

³ See Bolycky and Mavroidis (2017).

⁴ It has been noted that RTAs have practically never been challenged in the WTO DSS. This could be due to the fact that they are considered by and large to be compliant with WTO obligations. Alternatively, it is possible that participants in RTAs refrain from challenging other RTAs in order to avoid provoking challenges to their own (the compliance of any RTA with all WTO requirements being doubtful). For the limited derogability of WTO agreements through bilateral treaties see the Appellate Body report in DS457: *Peru – Additional Duty on Imports of Certain Agricultural Products*, adopted 31 July 2015.

delays in the process at the panel stage due to the lack of legal resources in the Secretariat to staff the many panels that are being established.⁵ The second set of proposals looks at broader changes to remedy structural problems, but still through changes to the DSU that can be adopted within the current framework.

The Impact of Delays at the Panel Stage

Notwithstanding action taken at the organizational level in 2016 to resolve (at least in part) the issue, due to lack of resources and other bottlenecks, panel proceedings that should in theory take no more than six months (Article 12.9 DSU), but which in practice took around one and a half years in “normal” cases until recently, now may well take between two or three years from the formal establishment of the panel by the DSB to the circulation of their report. This is of course not the end of the game, since appeal is possible and implementation, even without any further dispute, takes considerable time until redress is fully obtained, not to mention the further possible proceedings before full implementation by the losing party.⁶ This time lag undermines the value of any favorable decision for obtaining effective redress against domestic measures in breach of WTO commitments, which is especially damaging in respect of temporary measures such as anti-dumping duties.

More broadly, this dysfunctional operation of the DSS – in disregard of one of its basic tenets and praised features, namely, its speed – may undermine the whole operation of the system and recourse to it as the key instrument for

- 5 A forceful complaint was that by Korea at the DSB of August 31st, 2015. Korea complained that in DSS 488, where Korea challenged US anti-dumping measures, the Secretariat had notified Korea that the panel established on March 25th, 2015 would not begin its work until the end of 2016 at the earliest, a date some 15 months from the time Korea had been notified of the delay, “not because the panelist were unavailable, but due to the constraints affecting the Secretariat.” Korea pointed out that this “remarkable, extraordinary, unreasonable delay” in light of both the DSU provisions and the economic reality, just for the case to get started, “was almost twice as long as the period foreseen by Art. 12.9 DSU between the establishment of the panel and the circulation of the report.” As of October 2017, this panel (in DS488, *US – OCTG (Korea)*) had not yet issued its report.
- 6 As an example, at a DSB meeting in 2015 Canada complained that four and a half years after the establishment of the panel, the COOL dispute with the United States was still far from being settled. After the panel, the appeal, the fixing by an arbitrator of the reasonable period of time for the United States to comply that was not respected, a compliance panel (Art. 21.5 DSU) against the United States by Canada and Mexico (the other complainant) where the panel and the Appellate Body found that the measure taken by the United States had not brought compliance (but possibly even worsened the breach), the arbitration panel (Article 22.6 DSU) was just starting its work to establish whether the countermeasures announced by Canada and Mexico were excessive in comparison with the trade loss caused to them by the COOL measure, as submitted by the United States. President Obama announced the repeal of the relevant US provisions on 18 December 2015, just a few days after the arbitration panel had concluded its work, determining the level of retaliation that Canada and Mexico could put in place to offset the adverse effect of COOL on their exports. For a realistic view, see “Torture by Tariff – Retaliating against unfair trade practices is a calculation in cruelty”, *The Economist*, 20 June 2015. As to the current situation, in DS495 the panel informed the parties on 29 September 2017 that the panel, established by the DSB on 28 September 2015 and composed on 8 February 2016 would issue its report to the parties in October 2017, WT/DS495/7.

ensuring respect of trade-opening commitments. As stated by Korea at the DSB meeting of 31 August 2015:

“WTO disputes are not about abstract disagreements. Real world economic interests underlay every dispute. There were real people suffering while a dispute was pending (...) The problem would get worse if left unaddressed. Long delays created perverse incentive by lowering the cost of adopting and maintaining WTO-inconsistent measures, insisting, rightly, that they would not be subject to review by the WTO for years. Members could therefore expect more protectionist measures and more, not less disputes being brought to the WTO. These in turn, would cause further delays, prompting a vicious, never-ending cycle. It was in the interest of everyone, the parties, the wider membership and the Secretariat not to let this happen.”⁷

It is curious, however, that Korea itself, followed by other speakers, did not ask for more effective remedies – which the Director-General instead initiated thereafter – beyond increased transparency and information from the Secretariat as to the reasons for the “queue,” and as to the situation in the line and the outlook for “their” case being decided. The same attitude prevailed in the discussion that followed the Director-General’s lengthy and detailed statement at the DSB of 28 October 2015, where he made the point that the problems would not be resolved just through administrative measures and a shifting of resources within the Secretariat. Several members acknowledged this issue and decried the negative consequences of the current set on the effectiveness of the DSS, but abstained from launching any ideas for tackling the problems more seriously.⁸

7 Doc. WT/DSB/M/ 367, pp. 22-29. The concerns of Korea were shared at the meeting by a number of countries, starting with Guatemala (whose delegate stated aptly, “[t]he WTO dispute settlement system was one of the most effective and prompt international systems of adjudication. Victim of its own success, the system faces the risk of becoming slower. If no effective action were taken to address this unfortunate situation, the principle of “prompt settlement of disputes” in art. 3.3. DSU would become a mere ‘best effort’ provision, not more than an illusionary aspiration (...) long delays in the DSS mechanism may create perverse incentives for the adopting political motivated WTO-inconsistent measures.” Other interventions came from (in order) Chile, China (“this unprecedented situation would seriously undermine the effectiveness and credibility of the WTO DSS”), Australia (“willing to consider any option that might help alleviate the current situation and improve the system over the long term. This included ensuring that the Secretariat had the resources needed to service disputes in a timely manner and also exploring ways for the membership to reduce the burden on the system in terms of the length and complexity of disputes”), Russia, Mexico, Pakistan, Japan, Brazil, Canada, India, (“the credibility of the system was at stake”), the European Union (“manage the situation at hand” and “find solutions to the mid and long-term situation against the background of ever increasing pressures in the WTO DSS”), Argentina, Chinese Taipei and Norway. In contrast with the serious concerns voiced by most other countries, the United States was more restrained, stating briefly that “Korea has raised an important systemic issue (...) This raised some significant concerns, particularly in light of the fact that the WTO DSS had, for many years, operated with admirable efficiency. The US shared the view that members needed a better understanding of the causes behind delays so that they could develop and consider appropriate solutions.”

8 See the minutes of the meeting at WT/DSB/M/369 of January 20th, 2016, p. 20. DDG Brauner has been entrusted by the DG to follow up with the members on these issues.

Subsequently, in 2016, the Director-General was able to increase the legal staff of the Legal and Rules Divisions of the Secretariat, both by shifting inside resources and by hiring, thus partially reducing the problem. Since 2016, the chairman of the DSB reports at each regular monthly meeting about the situation and these reports show that the situation is far from having normalized. Thus, as reported at the DSB of 20 July 2017, at that time there were 15 active panels that had not yet issued their report to the parties:⁹

“limited staff resources currently prevented assigning dispute settlement officers to assist panels in three pending disputes before the autumn of 2017... There were a further seven panel at the composition stage... In addition five final panel reports that had been issued to the parties were currently being translated.”¹⁰

Issues Relating to the Appellate Body

Delays

Panel reports are subject to appeal, where the Appellate Body faces increasing difficulties in respecting the short 90-day period prescribed for issuing its own reports. This is due to the overlapping of appeals procedures, the increased number of issues appealed (even if this remains, as currently, at around two-thirds of the panel reports issued), the lack of competent staff that, for obscure reasons, are not made available to the Appellate Body, and the complexity of the cases. To this the additional problem must be added of the Appellate Body operating at less than its full composition due to the DSB not filling vacancies promptly. Even without the current blocking of the selection process (addressed below), the DSB has often not fulfilled its responsibilities in a timely manner.

The Deadlock Over the Selection Process

A new, possibly devastating deadlock that risks making a havoc of the whole DSS – not just the appeal phase – and thus risks undermining the very functioning of the WTO,¹¹ is the lack of consensus since mid-2017 on the launching of the selection process to fill vacancies at the Appellate Body,

9 Once the parties have received the (interim) report and made their comments, the final report has to be translated before being circulated to the membership, triggering the 60-day time for adoption by the DSB or for appeal (See Article 15 and 16, Dispute Settlement Understanding – DSU)

10 See WT/DSB/M/399, Minutes of the DSB meeting of 20 July 2017, issued 29 September 2017, statement by the Chairman of the DSB on the dispute settlement workload, pp.13-14.

11 See “America holds the WTO hostage – The rules-based system of trade faces threat beyond Trump’s tariffs”, *The Economist*, 23 September 2017. More generally on this issue, see Dunnoff and Pollack (2017), specifically Section III “Tougher than the Rest: The Judicial Trilemma at the WTO” at page 260 ff.

which currently number two (as of October 2017), but will increase to three in December 2017.¹²

This situation first arose at the DSB in spring 2017 due to the divide between Latin American members and the European Union over whether one selection process or two separate processes should be launched to fill the two vacancies due in 2017. Subsequently, after the abrupt resignation of Mr. Hyun Chong caused an immediate further vacancy in August 2017, a new factor rendered the issue more worrying. The United States obstructed the launching of the selection process in general at the DSB of 31 August 2017 (and thereafter). The United States raised objections to certain “technical” aspects of the operation of the Appellate Body,¹³ aiming however at a broader objective of changing key aspects of the functioning and role of the Appellate Body, and the binding nature of the DSS outcomes more generally.¹⁴ US criticisms echo some previous complaints of alleged “gap filling”, “judicial activism” and indulging in “obiter dicta.”¹⁵ By preventing consensus, the United States puts pressure on the system by depriving the Appellate Body of several members, which hints at a future paralysis of the DSS should the deadlock not be resolved. The first observation is that the launching of timely selection processes is a duty of the DSB and WTO members.¹⁶

The linking by the United States of the process for filling seats to a reform of the Appellate Body – especially one which would run contrary to its basic function, such as diminishing its independence, making it more “accountable” to members, or reducing its powers to interpret the WTO agreements – is clearly unacceptable to the rest of the membership.¹⁷ Other US statements

12 The term of Ricardo Ramirez Hernández (Mexico) expired on 30 June 2017, Hyun Chong Kim (Korea) resigned abruptly on 31 July 2017 (effective the following day), and the term of Peter van den Bossche (European Union) expires on 11 December 2017.

13 As *casus belli*, the United States has used the argument that the Appellate Body would have exceeded its powers in allowing members who have concluded their mandate to go on deciding cases pending at their term’s expiration. The argument is legally not grounded because Rule 15 of the Working Rules of the AB allow this explicitly. In a situation such as the current one with many complex appeals pending at the same time and timely reappointments to fill vacancies increasingly uncertain, not resorting to this rule would exacerbate delay and even lead to paralysis. Not allowing completion would entail that Appellate Body members with only a few months of service left would be unavailable to serve on a division.

14 See “Pressure rises as U.S. maintains link between Appellate seats, WTO reform”, *Inside U.S. Trade*, 22 September 2017.

15 See footnote 49 for references to the reasons given by the United States in 2015 for objecting to the renewal for a second mandate of Seung Wha Chang.

16 Obstruction of such a process could be viewed as a breach of Article 3.10 DSU according to which all members have to engage in dispute settlement procedures in good faith.

17 See *Inside US Trade*, 1 September 2017 reporting of the positions expressed by the US at the DSB meeting of 31 August and their rejections by all other members.

have called into question the adherence to the basic tenet of the rule-based multilateral trading system established in 1995.¹⁸

A political divergence such as that emerging here on the very function of the DSS and the role of its ultimate umpire, its independence, impartiality, and the legal binding effects of the reports once adopted by the DSB (hinting to a preference for the discredited GATT system) cannot be cured by small technical remedies, but needs rather an open clarification between all the participants to the multilateral trading system. Any acceptable change should be reached through DSU reform, or through a binding interpretation under Article IX.2 of the WTO Agreement.

Proposals

This chapter subscribes to the practical measures at the administrative level that the Director-General is implementing, as he has declared to the DSB.¹⁹ At the same time, the initiatives taken by him have not been able to fix the problem, as evidenced by the current situation of panel delays described above. Other solutions are called for that go beyond the competence of the Director-General.

Accordingly, the second set of proposals below are more far reaching and forward looking, as they are meant to address the long-term sustainability of the DSS with regards to effectiveness and outputs. While these proposals do not require any overhaul of the current system and would not affect the basic tenets of the original WTO DSS, in order to be adopted, they – as with any other proposal to this effect – would require a broad consensus of the membership that is currently lacking, and not just in relation to these issues.

Due to the lack of impulse for advancing negotiations on the DSU reform, a number of members at the initiative of Canada have explored and then

18 In his speech at the UN General Assembly on 19 September 2017, President Trump criticized “mammoth multinational deals, unaccountable international tribunals and powerful global bureaucracies” as being responsible for millions of jobs vanishing and thousands of factories disappearing in the United States. See also criticisms of the DSS by Robert Lighthizer, the USTR, as being “deficient” and for allegedly “changing the terms the US agreed to when joining the WTO” (*Inside U.S. Trade*, 22 September 2017, pp. 15-16). It is surprising that this critical statement comes at a time when the US has won a series of cases in a row (DS 477,381,487). As to the United States disengaging from the WTO and the other members having to learn to live without its leadership, see the speech by the American DDG Alan Wolff on 8 November 2017, as reported in *Inside US Trade*, 10 November 2017.

19 His first intervention on the subject was at a DSB in September 2014, when he announced the creation of 15 new lawyer posts in the three dispute settlement divisions: Legal Affairs, Rules, and the Appellate Body. However, the organization had difficulties in filling these. In his address to the DSB on 28 October 2015, the Director-General explained in detail the further steps he had taken and was taking to mitigate delays, consisting mostly of reallocating of personnel; hiring new legal staff; adjusting the grades and salaries to the competence of the lawyers, taking into account the competition by law firms; increasing internal mobility; and pooling junior lawyers of both divisions assisting panels. This should result in more efficiency and has already nearly doubled the relevant positions – from 30 to 57 – since 2013.

proposed practical solutions to improve the panel process, to be adopted on a voluntary basis by the parties involved in specific cases. These proposals, a kind of second best in respect of an agreed change in procedural rules, though broadly supported have not been put into operation until now, perhaps precisely because of the above reasons.²⁰

At the Panel Stage

More substantial reforms to resolve these issues at the panel level would require considering more far-reaching options, such as:

1. discouraging the bringing of complaints to the panel stage by making the initial phase (consultations) less of a mere formality, possibly with the engagement of the Director-General and resort to mediation and conciliation;
2. putting more financial resources to the service of the legal Secretariat, overcoming the zero-growth budgetary constraint that tilts in favor of first shifting resources within the WTO Secretariat without the possibility of adding new resources from the legal market place;
3. reorganizing the legal Secretariat by merging the Legal Division with the Rules Division, a distinction which reflects a division of work from GATT times which is no longer justified;
4. enlarging the available pool of panelists (resorting also to non-governmental panelists from third parties in any dispute), using more systematically available competent panelists (leading to the de facto creation of a pool of recurrent, semi-permanent panelists), and reducing procedural delays due to the “interim report” and translation. The availability of a greater number of more devoted and competent panelists could in turn make it possible to rely more on them also for drafting, as is the practice in both international courts and investment or commercial arbitration; and
5. making the disputing parties pay a share of the costs of the proceedings, which are currently charged to the whole membership.

20 As results from the minutes of the DSB meeting of 20 July 2017, referred to in footnote 10, under the heading “Mechanism for developing, documenting and sharing practices and procedures in the conduct of WTO disputes” these proposals relate to (i) streamlining panel composition by inviting nominations and appointments of non-governmental third-party nationals and suitable candidates who had not previously served on a panel; (ii) promoting electronic filing and service procedures in disputes; (iii) encouraging prompt responses to third parties requests to participate in consultation; (iv) publishing disputes’ procedural documents and preliminary rulings.

The Appellate Body

To face the problems caused by the increased number of appeals that are coming, and will come to the Appellate Body, possible remedial solutions include:

1. staffing the Appellate Body more adequately;
2. increasing the number of Appellate Body members from seven to nine;
3. making their positions permanent, a status that would also better ensure the future selection of competent, diverse and truly independent judges; and
4. making their reappointment for the second four-year term automatic, or replacing the two four-year terms with one non-renewable seven-year term.

The Implementation Phase

The monitoring role of the DSB should be made more effective in order to induce more prompt compliance.²¹

The procedure should be tightened so that the prospective nature of WTO remedies (i.e. the obligation to comply not being retroactive from the date of the breach, but to be implemented only after a “reasonable period of time” from the adoption of a panel or Appellate Body report) does not reward the dragging of feet by the losing party in respect of compliance with adverse decisions.

The issue of “sequencing” between compliance proceedings (Article 21.5 DSU) and arbitration on the level of suspension of concessions in case of non-compliance (Article 22.6 DSU) should be tackled by express provisions in the DSU in order to avoid parallel proceedings, since the practice of agreeing bilaterally on sequencing seems to lose ground.

Preliminary Considerations

Maintaining the efficiency of the DSS and its effectiveness in ensuring compliance with the WTO multilateral trade rules entails broader benefits beyond ensuring the effectiveness of expected trade openings from the commitments that WTO members have undertaken, as important as these are.²²

21 As advocated by Canadian Ambassador Jonathan Fried when he was chairman of the DSB in 2013.

22 On the view that the multilateral trading system and its rules are a global common good, see Tietje and Lang (forthcoming).

It ensures, at the same time, the role of the WTO as the guardian of the multilateral trading system and the position of its multilateral rules as the accepted global framework within which interested countries may engage in regional trade agreements. RTAs should be the basis for extending international cooperation and trade liberalization (“WTO-plus”) without endangering the WTO *acquis*. They should represent building blocks, and not stumbling blocks, by establishing supplemental frameworks to further facilitate trade through coordinated regional action, such as in the area of standards and recognition and harmonization of regulation. They should be supportive of the multilateral rules with a view to extending global standards and rules (Bollycky and Mavroidis, 2017).

It must be recognized that the possible solutions to the current problems set forth above do not entail just a quick fix that may be implemented without WTO members engaging in these issues, evaluating the most appropriate remedies and being open to looking for shared improvements. This of course presupposes a shared view that the fundamentals of the current rule-based system serve equally all parties and are worth preserving. Anyone wishing to go back to a power-based system such as the GATT, under which panel reports would not be binding and bilateral negotiations would be the only means to settle trade disputes, would have to show that its own interest and that of all members (as required by the current context featuring a plurality of major trading actors and groups) could be satisfied without leading to disruptive trade wars.

If these premises are maintained, possibly through a renewed global undertaking to abide by the rules and principles, with or without amendments or interpretations updating the existing provisions, the proposals set forth here do not represent an ambitious program that is out of reach or an all-comprising shopping list.

Rather, it is a realistic and modest agenda for fixing, within the existing framework, the current problems and enabling the DSS to go on serving the WTO membership and complying with its objectives and purpose in the years to come. We do not propose to transform the panels in a first instance tribunal or to abolish the adoption of panel and Appellate Body reports, or other similarly radical overhauls.

Moreover, there is a specific instrument for members to discuss and elaborate on the necessary amendments to the dispute settlement rules. This is the DSU review negotiation framework agreed by a Ministerial Declaration in 1994 and extended by the Doha Ministerial Declaration in 2001, under which amendments to the DSU may be agreed without having to activate

the cumbersome WTO amendment process. This exercise should have been completed first by 1997/1999, and then by 2003, but it is still going on indefinitely at almost standing pace.

In his statement to the DSB on 28 October 2015, the Director-General presented the various measures he has put in place to add resources to the Secretariat in order to address the most pressing problems, but he warned members that more is needed. However, the unconcerned attitude of most WTO members towards these issues, at least until recently (they see the problems but prefer to leave any solution to the Director-General, despite being conscious of his limited capabilities to resolve them), does not bode well for any effective solution, even without taking into account the latest US challenge.

On the contrary, the DSS not being too efficient and allowing delays in implementation and political twisting may even accommodate some frequent users of the DSS. They may view themselves more as defendants and thus not be in a hurry to implement changes through politically difficult domestic processes of compliance, rather than as successful claimants eager to obtain as promptly as possible the other party's due market opening to the benefit of its producers and exporters.

Analysis and Suggestions

The Current Situation

Results Achieved, Disputes Resolved, Legal Security Provided

On 10 November 2015, the WTO website featured within its news items the statement of DG Roberto Azevêdo celebrating the WTO Dispute Settlement System (DSS) having reached the mark of 500 disputes initiated. In the two years since then, 31 new disputes have been initiated.

The receipt of the 500th trade dispute for settlement, said the Director-General, "shows that the WTO's dispute settlement system enjoys tremendous confidence among the membership, who value it as fair, effective and efficient mechanism to solve trade problems." The 500th dispute was submitted when Pakistan filed a request for consultations with South Africa regarding the latter's provisional anti-dumping duty on cement from Pakistan. The parties involved and the subject matter of the dispute are also significant, because they show that developing countries use the system both as complainants and respondents in South-South relations, and that trade remedy measures feature importantly

in matters brought to the WTO. This trend is confirmed by a glance at the disputes initiated in 2017, which include disputes initiated by Ukraine against Kazakhstan, Indonesia against Australia, Mexico against Costa Rica, and Qatar against Saudi Arabia, Bahrain and the United Arab Emirates.

The success is evidenced by the fact that resort to the DSS has become a normal feature in the operating of the multilateral trading system, displacing resort to unilateral measures. Practice has confirmed what had been set forth in Article 3.10 DSU, namely, that “requests for conciliation and the use of the dispute settlement procedures should not be intended or considered as contentious acts.” This setting distinguishes the WTO from other international fora, where respondents often raise lack of jurisdiction as a preliminary objection to escape the process. It makes it more business-like, as is the case in the national context.

At the time that the mark of 500 disputes notified to the WTO was reached, only 282 of those had been brought to litigation. Resolution through bilateral negotiations, including formal withdrawal of the request, had been notified to the WTO in 110 of the cases, while the parties had not informed the WTO of the status of the other 108 (which could be considered dormant or de facto settled).²³ As of the end of 2016, 222 original panel reports had been issued, of which 151 had been appealed (68% of the total, on average). In 2016 there were 13 panel requests appealed, while the Appellate Body issued six reports, of which one was a compliance report issued under DSU Article 21.5.²⁴

In 2017, four panel reports had been issued by mid-October covering five disputes and 11 had been adopted by the DSB, while the Appellate Body had issued appellate reports in four disputes on different subject matters.²⁵

A measure of success is also the broad participation by WTO members in the process. By October 2017, about two-thirds of members (105) had participated in dispute settlement proceedings, either as parties (claimants and/or respondents) or as third parties (34 members as third parties only). Looking at the consultation requests, developing and developed countries are

23 This lack of information signals the need to strengthen the obligation of members to notify the WTO in a timely manner of the status and outcome of all disputes that have been formally filed.

24 The data provided are drawn from those provided, mostly in the form of tables, by the Director-General in his statement to the DSB of 28 October 2015, those annexed to Annual Appellate Body Reports and those included in the news item of 12 November 2015 on the 500 mark (https://www.wto.org/english/news_e/news15_e/ds500rfc_10nov15_e.htm). Some data are not easy to compare, especially since there is a difference with regards to the relevant year between panel and Appellate Body reports issued and adopted by the DSB. Moreover, some proceedings concern several disputes brought by different claimants against the same measure of the respondent State, that are examined together by a single panel. On the other hand, some appeals are formally separate (and counted individually) because the claimants are different but are dealt with in a single report.

25 The exact numbers do not always match because of the different practice of the panels and the Appellate Body in calculating as single or separate disputes those in which different claimants challenge the same measures of the respondent state, the same panel being appointed to hear all the challenges.

equally represented as complainants, while complaints are mostly directed towards developed countries.

As can be expected, the largest economies are both the most frequent initiators of cases (with the United States leading with 115, followed by the European Union, Canada, Brazil, Mexico, India, Japan and Argentina all above the 20 mark) and the most frequent defenders (with the United States again leading with 130, followed by the European Union, China, India, Argentina). Finally, the compliance mark is said to be about 90%. Countermeasures in the form of withdrawal of benefits – i.e. the imposition of selective additional duties – have been imposed only in a handful of cases, while no member has ever denied responsibility to comply with an unfavorable final decision.

Of course, the number of disputes is not by itself a sign of a healthy system; the ability to process them timely and according to the rules is.²⁶ Notwithstanding some delays in full compliance, there is no sentiment that WTO members have become less inclined to respect the rules. On the other hand, a certain surge of national anti-dumping measures, as monitored by the AD Committee, could be a sign of increased pressure on export markets at a time of economic slowdown, to the point of being a sign of resort to unfair competition.²⁷ This is possibly a cyclical phenomenon, rather than a structural disregard for the rules.

In fact, Article 3.7 of the DSU would discourage members from bringing disputes which might be resolved amicably without even resorting to the system, stating that “[b]efore bringing a case a Member shall exercise its judgment as to whether action under these procedures would be fruitful” and that “[a] solution mutually acceptable to the parties to the dispute and consistent with the covered agreement is clearly to be preferred.” In the same spirit of not considering the starting of a case to be an unfriendly act and encouraging at the same time parties to exercise some kind of self-restraint when considering bringing a case, Article 3.10 states in its final sentence that “[i]t is also understood that complaints and counter-complaints in regard to distinct matters should not be linked.”

This notwithstanding, on several recent occasions the initiation of a case by a country against another country has been immediately followed by the initiation of a separate case by the respondent in the previous case against the first country (notably between the United States and China, and between Argentina and the United States and the European Union). Although there

26 According to the AB Report for 2014, “[i]n its first 16 years the DSB has handled disputes spanning over USD 1 trillion in trade flows” (WTO, 2015, p. 3).

27 This could be the situation in the steel market, where sources indicate overproduction in the face of a decrease in demand (see https://www.steelorbis.com/steel-news/latest-news/oecd_steel_committee_calls_for_immediate_action_to_address_excess_capacity_-909449.htm).

is no evidence that the second case was a kind of tit-for-tat response to the first, this belief has been informally expressed as a sign of abuse or political strategic use of the DSS contrary to its purpose.²⁸

Finally, the smooth functioning of the DSS and the accumulation of consistent interpretations of key provisions of the WTO agreements, while not discouraging the bringing of new disputes, has made reliance on those provisions more firm. Outcomes are more foreseeable, thanks to the role of the Appellate Body in providing consistent case law on which panels in turn can rely. The overall role of the DSS has been expanded by the lack of action by members in other capacities. Authoritative interpretations by the General Council acting under Article IX of the WTO Agreement have never been issued and other quasi-legislative action by members, such as within WTO-specialized committees, has been scant. Thus, the DSS has remained the only source of authoritative guidance for the multilateral system at large.

The Increased Number and Complexity of Disputes as a source of problems

In his statement at the DSB on 28 October 2015, following that of 24 September 26 2014 on the same issues and informing the membership of initial measures undertaken by him to face the problem,²⁹ the Director-General presented a range of information and figures evidencing the increased use of the DSS and the increased complexity of cases that are putting a strain on the resources and generating delays. The number of new panels established by the DSB has increased from six in 2010 to nine in 2011, to 11 in 2012, to 13 in 2014, to 18 in 2015, reaching 16 in 2016.³⁰

Disputes have also become more complex in that more domestic measures of the respondent country are being challenged. The evidentiary burden before panels is also more demanding – one ongoing dispute (not one of the two massive Boeing-Airbus aircraft disputes, which are still before the panels under Article 21.5 at the compliance stage) has reached more than 1,700 exhibits at the initial stage alone. “On average, there are three times as many exhibits per panel now than in early WTO days,” noted the Director-General.

28 See Feinberg and Reynolds (2006); “European Union requests WTO Panel on Chinese Anti-Dumping duties on Steel Tubes,” European Commission Press Release (IP/13/772), 16 August 2013 (<http://trade.ec.europa.eu/doclib/press/index.cfm?id=959>).

29 An important initiative of the Legal Affairs Division has been the launch of the WTO Digital Dispute Settlement Registry, which will allow electronic filing of submissions and secure access to briefs and documents by the parties, besides serving as an electronic repository of all panel and Appellate Body records and providing easy online access to non-confidential information on cases to the public.

30 The issue of delays at the panel level caused by resource constraints in the Secretariat had been already raised at the DSB in 2014, and the Director-General explained the shifts and increase in legal resources he had undertaken in a statement at the DSB meeting of 26 September 2014. This statement and the data provided are to be found in the Appellate Body report for 2014 (WTO, 2015, p. 93).

Another complexity relates to the requests by parties for preliminary procedural rulings, for example, to declare some claims inadmissible because they were not included in the initial request for consultations. This has become almost a standard feature in panel proceedings, adding submissions or exhibits and therefore requiring more time from the Secretariat and the panelists.³¹ This is a typical lawyers' trick that shows how much the system has tilted – as have other arbitral fora – towards judicialization, while a more conciliatory approach originally prevailed and was assumed.

Suggestions for Tackling the Problems

Panel proceedings: Radical Remedies to the Growing Delays

As I have explained above, the first effect of the increase in the number of disputes brought to panels is the delay in the effective initiation of the work by panels after the DSB has established them formally at the second meeting in which a member has requested so, pursuant to Article 6.1 DSU. The DSU envisages in Article 8.7 that a panel be composed – that is, the panelists be appointed – 20 days thereafter, if the parties agree on the names suggested by the Secretariat (Article 8.6), or within an additional ten-day period if the DG appoints them due to lack of agreement. Recently, however, the practice has been for several months to elapse between establishment and composition, or between composition and initiation of the panel process. This is not due to procedurally difficulties but is a deliberate, inevitable choice by the Secretariat because of a lack of resources to staff the panels. The difficulty of finding suitable panelists due to the high demand caused by the number of panels operating at the same time adds an increased layer of difficulty and possibility for delay.³² It must be said that the situation of an adjudicating body to which a dispute has been submitted not even starting to examine the matter for several months is not unprecedented at the international level, where various courts and their member states strive to find solutions to the increasing recourse to adjudication.³³ This is, however, not a justification for the WTO not sticking to

31 The high number of third parties in many proceedings (up to 36 in a recent case) adds also complexity in the handling of cases by panels.

32 Besides the 15-month delay complained about by Korea at the DSB of 31 August 2015 referred to above, one of the most recent panel reports, on a case between the European Union and Brazil (joined to one on the same issue involving Japan, DS 472 and 497) was issued on 30 August 2017, more than two and a half years after the European Union had obtained the establishment of the panel.

33 For this reason, in the European Union it was decided in 2015 to double the numbers of judges on the first level tribunal (the General Court) from 28 to 56. At the European Court of Human Rights, various procedural devices have been introduced through the years (such as increasing the possibility of summarily dismissing petitions for manifest inadmissibility) to cope with the explosion of recourses (which, however, are essentially from private parties in both fora).

its short deadlines, which are one of the most distinctive and positive features of its dispute settlement system.

Recourse to the DSS has not slowed down, nor is this likely to happen in view of the increased favor for litigation at the international level, the increase of instances where trade obligations collide with the exercise of domestic regulatory powers, and the increase in WTO members that are actively engaged in international trade. Innovative remedies must be devised by looking at and tackling the roots of the problems.

The inability of the current system to cope with the increase in litigation is due in great part to its structure, which at the panel and Secretariat levels is still basically patterned after the GATT model of panels. As is well known, these panels were made almost exclusively of governmental experts, picked ad hoc to resolve occasional specific disputes among trade diplomats in Geneva familiar with the system, reflecting the non-legal character of trade disputes in those days.³⁴ Even today, panelists are not professional judges or arbitrators: about half of them are trade diplomats based in Geneva who do not have a legal degree and normally work for their government, while the rest is made of governmental experts; rarely are academics resorted to.

As a consequence, these panelists have to rely heavily on the lawyers of the Secretariat assigned to each panel (one senior and one junior, as a rule) to perform their job – from research, to organizing hearings, to drafting. In the abstract, this approach appears contradictory in view of the professionalization required and legalization inserted in the system. However, WTO members are attached to the tradition of being judged by their peers and also value the assistance of the Secretariat as a guarantee of consistency.

Now that the flow of cases is constant and sustained, similar to or perhaps even more so than in a regular court, the system will be increasingly unable to perform its functions effectively unless (a) the Secretariat is expanded in consequence, including its budget; and/or (b) panelists are more devoted to the task and professional, that is, are available on short notice to actively and exclusively perform their tasks and able to do so more autonomously.³⁵

This suggested configuration is found both in permanent international courts and within international commercial and investment arbitration under different

34 Small but important efficiency innovations could also concern the composition of panels, where parties often disregard the provision of Article 8.6 that “[t]he parties to the dispute shall not oppose nominations suggested by the Secretariat under the same provision except for *compelling reasons*,” thus causing additional delays; and the suppression of the Interim Review Stage (Article 15), which has become redundant with the introduction of appeal.

35 In December 2015, the General Council adopted a new fee pattern whereby non-governmental panelists now receive 900 Swiss francs per day, and government panelists 300 francs.

models. At international courts, judges are mostly full time and are assisted by a centralized secretariat and/or by one or two full-time individual clerks. Secretarial support is much less in international arbitration, even compared to the WTO. Arbitrators are selected among recognized experts in the field who are able to research and draft by themselves, possibly with the support of personal assistants from universities or their own law offices.³⁶ The support of the secretariat of the institution is limited to procedural matters and formal external review of the decision as autonomously prepared by the arbitrators themselves.

At the WTO, such a development – that is, engaging more panelists while maintaining the unique role of the Secretariat – would in turn be facilitated by broadening the pool of potentially available panelists. The first easy change is to allow nationals of third parties to a dispute to be selected as panelists, provided they are non-governmental. Currently, nationals both of the litigating parties and of third parties can be appointed only with the consent of the main parties (Article 8.3). Besides depriving the system of competent experts who could act as panelists³⁷ and relieve the shortage, this restriction leads to the panelists being chosen mostly from a small group of (small, mainly developing) countries that are rarely involved in disputes. This means the representative character of the adjudicators is not in line with the geography of the litigants and the issues raised.³⁸

Also, the procedure for selecting panelists, which is currently rather cumbersome and entails a delicate interaction between the Secretariat, the parties and the prospective panelists, should be streamlined so as to discourage parties from dragging their feet (Malacrida, 2015).

Transferred to the WTO, either model would require:

36 The differences between the WTO DSS at the panel level and ISDS, especially as concerns origin, qualification and the role of the adjudicators, has been addressed recently in Pauwelyn (2015). See also my comments to Pauwelyn (2015).

37 This means that in practice, potential US, European, Japanese, Canadian, and Chinese panelists are hardly ever appointed, since the respective countries almost always participate as third parties to proceedings when they are not the main parties.

38 Joost Pauwelyn has noted that by contrast, for investment disputes at ICSID, where most challenges involve developing countries, most arbitrators chosen are nationals of developed countries (Pauwelyn, 2015).

- *more financial resources* for the legal Secretariat (Legal Affairs and Rules Divisions), also for compensating panelists.³⁹ Adequate additional funding cannot be made available by just shifting funds within the budget, so that a real increase of the budget and therefore of the members' contribution would be required; and
- having recourse to a (probably not so) *small group of recurrent panelists*, as is already de facto the case,⁴⁰ who should be able to ensure availability and capability of operating autonomously – they should therefore not be engaged currently in governmental work and be remunerated adequately.

Panels could thus operate somewhat like the Appellate Body, their members meeting for longer periods in Geneva during proceedings and immediately thereafter for the deliberation of their report. It would be for the Secretariat to go on giving support to the panelists in the form of research, previous case law and precedent, while active drafting could be more in the hands of the panelists or, in any case, of the chairman. The current role of the Secretariat would remain necessary in order to ensure that these ad hoc panels, composed of diverse members, do not endanger with their individual decision-making the consistency of case law (which is, in any case, subject to appellate review).

Such an evolution would not even require changes in the DSU provision. It would probably entail a change in the mix of panelists' backgrounds. There would be fewer active trade diplomats and more retired experts and persons with different backgrounds, such as academics and former officials from international organizations. Since high-quality reports are a must that is advocated by everybody concerned, it is difficult to see how this quality can be maintained without changes to the current system. The challenge is that the more and more complex disputes and sophisticated arguments (increasingly exposed by expert lawyers from specialized resourceful law firms) require increasing:

- the legal competence of the adjudicators;
- the availability of legal support to them;
- the time they must be able to devote to each case; and
- their remuneration.

39 Governmental panelists currently work for free since they are supposed to act for the WTO during their working hours (the WTO pays a small sum to the members that lend them); the others receive a small per diem, which does not reflect the engagement that should be required of them, even after a recent small increase. The issue has been recognized and an increase was decided in December 2015, see notes 24 and 35.

40 Pauwelyn (2015) assessed that there are 15 panelist that have been appointed more than six times in recent years, as well as a high number of "single shooters."

What this change certainly requires is *additional financial resources*, whereas members appear/like to believe that quick, high-quality and efficient justice may be obtained at no cost – an obvious impossibility. The mantra that members are not ready to accept increases in the yearly budget (“zero-growth”) of course renders of course a solution quite difficult.

Hardly anybody has looked at *the cost of the DSS*, how it is financed and how it is apportioned among those who directly benefit from it. There is no accurate breakdown of the general costs of the WTO Secretariat and those pertaining to dispute settlement, because it appears that a consistent share of the latter (above the official figure of only 13% of the total) is charged to general administrative costs. Looking at the official data on the WTO website, however, it appears that the services of the organization cost little in absolute terms to the members, and even less so the Dispute Settlement System.

The US contribution to the total WTO budget in 2017 is US\$22 million, China pays \$18.8 million, Japan \$8.3 million, Brazil \$2.6 million, and the EU members together \$66.6 million (although they contribute individually). Without commenting on the incredible imbalances that these figures reveal, especially considering the frequency of recourse to DSS by individual members (such as Austria contributing almost as much as Australia, and Singapore almost twice as much as of Brazil), one is on the safe side submitting that just the costs of the lawyers engaged by either parties (including the lawyers of the industry concerned standing behind them) in the cases involving the United States are higher than the contribution of the United States to the whole WTO budget (and this is the same for any other country involved in disputes).⁴¹

If the overall budget devoted to the DSS cannot be increased (some members may even consider that this constraint is a way to put pressure on the DSS and its components by micro-managing any additional resource and their destination), one should reflect on an alternative solution – *making the users pay* for using the system (either through a fee system or having a separate budget for the DSS), as is the case in most courts and for the international secretariats administering institutional arbitration, such as the International Centre for Settlement of Investment Disputes (ICSID) or the International Chamber of Commerce (ICC).

A final item concerns the *demand side*. Is it possible to limit the number of cases brought to adjudication?

In this respect, it would be worth studying how to make the pre-adjudication phase (the *consultations*) more effective, possibly providing for the input of the

41 By comparison, it has been stated that the legal costs of an average ICSID case are \$4 million.

Secretariat as legal-economic support (What is involved economically? What legal alternatives could be acceptable? What issues are in fact not in dispute?). Also, recourse to “good offices, conciliation and mediation” as envisaged in Article 5 as voluntary steps at any time during the dispute, for which the Director-General is available under Article 5.6, could be reinforced. They might be made compulsory as a preliminary stage for certain types of disputes.

Also related to the demand side is the frequency of compliance proceedings under Article 21.5 DSU.⁴² These are panel proceedings started by the original complainant who challenges the WTO consistency of the measures that the respondent has taken to comply with an unfavorable outcome. This entails the obligation to withdraw or amend appropriately the measure found inconsistent with the provisions invoked by the claimant (as per Articles 3.7 and 21). These disputes are heard by the original panel reconvened for this purpose, whose report may in turn be appealed. Article 21.5 claims are upheld most of the time, signaling a lack of proper follow-up by respondents. At the same time, these proceedings consistently absorb resources of the system, especially considering that some of the most complex disputes have gone through this stage and thus appear almost never-ending. Examples are EC-Hormones, the two aircraft cases (Boeing/Airbus), US-COOL (concluded after more than four years), and US-Tuna II.⁴³ Some kind of simplified or accelerated proceedings should be devised for these cases, which are often the most complex. In these cases, the parties involved could be asked to assume the costs, which are currently charged to the whole membership.

The Appellate Stage: Improving the Organization of the Appellate Body and the Selection and Reappointment Process

The problems faced by the panel stage and the Secretariat due to the increase in the number and complexity of disputes are now reaching the Appellate Body – lengthier panel reports,⁴⁴ more appeals pending at the same time, more complex cases with more issues appealed and more challenges raised.⁴⁵ Cross appeals have also become more frequent. This makes the issuance of shorter reports, as is also often advocated for panels, quite difficult. The issuance of

42 As mentioned at the DSB meeting of 20 July (see footnote 10) of the 15 active panels at that date, four involved compliance proceedings under Article 21.5 DSU.

43 The reports of the compliance panels in the two aircraft cases (DSB 316 and DSB 353) were issued almost five years after the two panels were composed in 2012. The panel in the Australia Tobacco dispute (DS 381), composed in May 2014, has not issued its report as of October 2017. The compliance panel has concluded in its second report issued in October 2017 that the US has complied.

44 The number of pages of “average” panel reports increased from 49 in 1996-2000 to 183 in 2010-2014, as reported in the DG Statement of 26 September 2014 in the Appellate Body report for 2014 (WTO, 2015, p. 88).

45 This evolution has been highlighted by the Appellate Body in a Communication of 30 May 2013 (“The Workload of the Appellate Body”). Concerning the issues discussed here, see also Ehlermann (2017).

reports within the prescribed deadline of 90 days has become an impossible task in most cases, also due to the shortage of competent assisting staff and the fact that the Appellate Body has often been working with fewer than seven members.

This “wave” may put additional pressure on the ability of the Appellate Body to perform its task in a timely manner while maintaining the high quality of its reports, for which it is generally praised and which represents a basis of the trust that the DSS inspires in members and beneficiaries.

The organization of the Appellate Body under the relevant rules of the DSU (Article 17) leaves it little flexibility to cope with a regular higher number of cases; it is made of only seven members, who decide in randomly composed divisions of three.

As to procedure, the Appellate Body has adopted in recent years several practical measures within its competence to establish its “working procedures” (Article 17.9). This includes reducing the time framework of the initial phase of the process in order to have more time to examine the case and decide (in 2010), and asking the parties to supply summaries of their arguments, to be annexed to the Appellate Body report without need for it and its legal staff to perform this task directly (in 2014). In contrast with the increase of staff at the panel level, the legal staff of the Appellate Body – until recently a relatively small group of just ten lawyers – has only been marginally increased. The Appellate Body suggested a limit to the volume of parties’ submissions in a communication circulated in October 2015, in which it gave evidence of its workload and the size and complexity of the cases, with a view to stimulating the debate with interested WTO members and in the hope of a positive response.

Dealing with the case load and the complexity of appeals is directly related to the issue of *respect of the 90-day deadline*. The Appellate Body has tried its utmost to respect this deadline, to which members attribute great importance, although a delay of a few days is irrelevant compared to the delays normally accumulated in the other phases of the proceedings (sometimes by decision of the parties themselves). Currently this has become impossible for the reasons highlighted above, not to mention the Appellate Body operating with a reduced membership.

Going beyond this deadline is sometimes caused by the complexity of the case (such as in the aircraft cases), but recently it has more often been caused by the overlapping of appeals that makes it impossible for the members of the Appellate Body to attend to multiple disputes according to the standard time schedule. This notwithstanding, a few parties, especially the United States, have

insisted that exceeding the 90-days mark should be made only with the consent of the parties to the dispute. The Appellate Body has recognized that involving the parties is appropriate and has done so, but does not want its hands tied and to subordinate the establishment of its agenda, as necessary in these formerly labeled “exceptional cases,” to the agreement of the litigants. The debate had been ongoing for some time, fueled by criticism from some countries in the DSB when a deadline has been missed (although when this does occur, it is usually just by a few days). The complaints have not been against extending the proceedings in case of objective impossibility of respecting the deadline, but focus on the lack of previous agreement with the parties (the United States) or the lack of full information on the reasons thereof from the Appellate Body (Japan).⁴⁶ Other countries (the European Union, India and Brazil) pushed back against Japan’s request, claiming that micro-managing the Appellate Body schedule would not help resolve the issue of delays. An alternative is to have a custom-made schedule, agreed with the parties, for any case where the 90-day deadline does not appear sufficient.

If the workload remains at the current level, relaxing the 90-day deadline by a few days on a case-by-case basis, or even increasing the 90 days to 120 days, will not resolve the issue. *The number of the Appellate Body members should be increased* (and their appointment should of course be timely) taking into account that when it was initially created with seven members, the membership of the WTO was more limited and important current players in the DSS, such as China and Russia, were not even WTO members. Nine has been suggested as a reasonable number of AB members, reflecting geographically the expanded membership, without diminishing the collegiality on which the consistency of the Appellate Body case law and its independence rests.

The Appellate Body would benefit from (modest) reforms limiting the *risk of a reduction of the authority of the Body* as a pivot of the stability and the predictability of the WTO system. First, since the Appellate Body members are de facto engaged full time, it would be reasonable for the terms of their employment to reflect this situation. In case of full-time employment, a fixed monthly compensation might even be less onerous for the WTO budget than the current *per diem* arrangement.⁴⁷

Second, and more importantly, the issue of the modalities of the renewal of their tenure after the first four-year term should be streamlined. Until

46 For example, at the DSB meeting of 28 October 2015.

47 Making the position full time would also make potential candidates more aware of what the position entails and would thus encourage an increase in the pool of competent candidates available. It is regrettable that an Appellate Body member appointed in December 2016 for his first term resigned abruptly after only seven months to accept a ministerial position in his country, as mentioned in footnote 12.

recently, renewal was de facto automatic, and appropriately so, with the DSB extending any mandate as a matter of course if the Appellate Body member concerned had expressed his willingness to renew. Subsequently, under the impulse of the United States, the DSB has asked that the Appellate Body members coming up for renewal meet the WTO members and be available for questioning. The issue has become sensitive – one could foresee a situation in which countries would subtly interfere with pending cases and try to influence the judges, making the renewal of Appellate Body members dependent upon their answers.⁴⁸

The solution was finally found by holding an informal DSB meeting on 12 November 2015, with this encounter taking place on the understanding that questions by delegations would be of a general and systemic nature only. In the subsequent, formal DSB meeting of 25 November, Singh Bathia from India and Thomas Graham from the United States were reappointed by consensus.

Then, in 2016, the United States took the unprecedented step of blocking the re-appointment of an Appellate Body member. The most important and worrying issue emerged when the United States denied its consent to the renewal of Seung Wha Chang of Korea for a second term the day after the members had an opportunity to meet him informally on 10 May 2016, in accordance with the procedure that had been agreed for renewals in 2015. At the DSB meeting of 23 May, the United States recalled first that reappointments were not automatic under the DSU⁴⁹ and, as an explanation for its denial, stated that it had been “troubled [...] about the disregard for the proper role of the Appellate Body” by the Body itself, because in certain reports issued by Appellate Body Divisions (including Mr. Chang) in which the United States was a party – but also in some others – the “report engaged in a lengthy abstract discussion” on non-appealed issues, as well as in *obiter dicta*. The United States raised its “concern with the Appellate Body’s adjudicative approach in a number of appellate proceedings in which Mr. Chang was involved”, and in addition criticised “the manner in which he had conducted oral hearings”.

48 Such a proposal is reminiscent of the hearings by the US Congress of candidates to the US Supreme Court proposed by the president, but the setting, the position of the US Supreme Court and the individual role of its judges is quite different. On the other hand, one should not forget that the Appellate Body, however modest its name and institutional setting, is the only international court with compulsory jurisdiction (moreover in respect of broad sensitive matters) over states such as the United States, China and Russia, which usually accept to participate in international adjudication, if at all, only on an ad hoc, mostly ex post facto basis. Hence the keen interest of large economies in the selection of their future judges.

49 The practice for renewal has consistently been that no selection process for appointment would be launched if the outgoing Appellate Body member had indicated a willingness to be reappointed and the delegations consulted by the Selection Committee had not raised objections, as had never been the case. For this de facto practice, see the 2016 DSB Annual Report 2016, WT/DSB/71 of 24 November 2016, 2.2.

The decision of the United States to single out one Appellate Body member for the positions he had allegedly taken in appeals in which he had participated provoked critical reactions from all the 32 delegations which intervened, including WTO members whose voice are rarely heard in the DSB. The criticisms were repeated at the DSB meetings of 22 June and 21 July 2016.⁵⁰ The fear was articulated that the independence and the impartiality of the Appellate Body members was being put at risk by making them accountable individually for the decisions of the Body, including the reasoning and the interpretation of the covered agreements. It was pointed out that should the membership dissent from any such interpretation, the proper avenue for WTO members would be to adopt an authoritative interpretation in accordance with Article IX.2 of the WTO Agreement. The situation was resolved politically and legally with the appointment of another Korean, Hyun Chong Kim. As mentioned before, however, Mr Kim subsequently resigned from his functions seven years later to become the Trade Minister of Korea, and it is unclear when members will be able to agree on filling his position.

In view of these developments, a one-time term of, for instance, seven years would avoid any inappropriate impression of pressure and interference in the reappointment process by individual WTO members.⁵¹ The looming problems are even more worrying. The current active engagement of key WTO members in the appointment process appears excessive – it gives the impression that some key WTO members are trying to form an Appellate Body composed of members who are responsive to their wishes with regards to their approach to interpretation and similar issues. The process has recently even entailed interviews in Washington and Brussels (a kind of roadshow to which candidates have been submitted lately) and the close scrutiny of their academic CVs and publications.⁵² This resulted in a notable instance in 2014 when a qualified candidate from Kenya, an academic teaching in a US university, who had been accepted by all the membership was then vetoed by the United States because

50 See the Joint Statement at the DSB of 22 June 2016 by Brazil, Canada, the EU, Guatemala, India, Indonesia, Israel, Jamaica, Korea, Mexico, Morocco, Sri Lanka, Switzerland, Thailand and Vietnam.

51 There is a widely shared belief among those familiar with these developments that the unavailability for reappointment of the US AB members Merit Janow (in 2007) and Jennifer Hillman (in 2011) was prompted by the negative position towards their reappointment privately aired by the USTR at the time. The reasoning behind a country not supporting a member of its nationality in a body, such as the Appellate Body, that operates by consensus and where dissents are rare, anonymous and not capable of shifting the course of the case law, is unclear. This attitude may even undermine the trust of his or her colleagues in the independence of such member. In the case of a smaller country not supporting an outgoing Appellate Body member of its nationality, it is almost inevitable that the successor would be of a different nationality. This is what happened upon the resignation from the Appellate Body of Oshima from Japan shortly before the expiration of his term in 2012. His successor was Seung Wha Chang from Korea, and as a consequence, Japan “lost its seat,” which it had held since the beginning of the Appellate Body.

52 Elsing and Pollack (2014) examined this issue through extensive interviews with former candidates.

of opinions he had expressed in the past on the role of developing countries at the WTO, leading to the repetition of the selection process.

The increased tendency for Appellate Body members to come from trade diplomacy and national administration, at the expense of academics and national judges (who in the past were also endowed with practical international experience, as negotiators, arbitrators or administrators), risks diminishing the ability of the Appellate Body to reason and decide with full independence, impartiality and objectivity. This is irrespective of the personal integrity of all Appellate Body members, who have never been criticized from this point of view.⁵³ An appropriate mix of competences within the Appellate Body is key for it to operate at the highest qualitative level, irrespective of the ability of its dedicated legal staff. It is important that the Appellate Body be able to issue well-reasoned reports, based on a full knowledge of international law, that may receive not only the approval of WTO members but also praise from the community of academics and other experts in the field.⁵⁴

The current stalemate preventing the launching of the selection process to fill the three vacancies that came up in 2017, discussed above, shows that the whole process, which requires consensus up to the approval of individual candidates recommended by the appointing committee, is a weak point in respect to the smooth functioning of the DSS in the interest of the entire membership. The DSB is at risk of being held hostage by individual members pursuing unrelated objectives.⁵⁵

Reinforcing the Implementation Process

The DSS ultimately pursues a practical objective: maintaining the balance of rights and obligations, market access and liberalization commitments agreed upon by the members in the various WTO agreements, discouraging breaches and redressing them as promptly as possible.

The *monitoring role of the DSB on implementation* is one of the features that makes the WTO DSS stand out in comparison to other international dispute settlement mechanisms, where implementation is ultimately left to the good will of the party concerned, under threat of diplomatic pressure or unilateral countermeasures.

53 On these issues, see Shaffer et al. (2016)

54 See the piece by former Appellate Body member David Unterhalter of South Africa (Unterhalter, 2015).

55 On this issue, see Dunnoff and Pollack (2017), specifically Section III “Tougher than the Rest: The Judicial Trilemma at the WTO”, page 260 ff. “Accountability” of the Appellate Body, as is the case of other international courts, is collectively towards the WTO membership; it cannot be towards individual members. Consensus as required by Article 2.4 DSU does not imply a veto right by just one WTO member.

Surveillance by the DSB should be made more effective, as advocated by the Canadian Ambassador Jonathan Fried when he was chairman of the DSB in 2013. It should not be just a formal exercise of registering statements or automatically authorizing countermeasures in the form of suspension of concessions when an adjudicative body has confirmed non-compliance.

Ways and means should be devised, based on 20 years of experience, to exercise collective pressure on a recalcitrant member in order to *induce and facilitate prompter compliance*. One avenue might be to suggest ways to effect implementation, which is currently left completely to the party found in breach. This option is available to panels and of the Appellate Body under Article 19.1 DSU when issuing their reports, but they have generally refrained from using it (and wisely so). The reason is that these suggestions risk not being followed (they are not binding), thus indirectly diminishing the authority of the underlying holdings contained in the panels and Appellate Body report. Action by the DSB towards a non-complying party might stimulate more active domestic engagement by the competent national authorities to effect timely and complete implementation.

The implementation procedure should also be tightened to induce compliance by avoiding that the prospective nature of (future) WTO remedies, which already favors non-compliant respondents, rewards even more dragging of feet by the losing party in implementing adverse decisions.

Besides resolving the issue of “sequencing”, as mentioned above, one possible way to reinforce the compliance process might involve rethinking the relationship between the imposition of countermeasures and arbitration on their level under Article 22.6. Such a dispute turns usually on the proportionality of the level of concessions that the winning party intends to put in place. Currently, the principle stated therein is that “[c]oncessions or other obligations shall not be suspended during the course of the arbitration.” As currently framed, this provision favors the party in breach, in that the application of trade sanctions against it is postponed. At the same time, it protects that party from being subject to unilaterally determined excessive sanctions by prohibiting their application altogether. A more efficient compliance-inducing mechanism should be devised. For example, by providing for authorization to apply trade sanctions at the initiation of the Article 22.6 arbitration, subject to restitution with interest and possibly a penalty of sanctions applied in excess of the determination of the arbitrators.

Concluding Remarks

Some concluding remarks should address the interplay between the broader evolution of international trade relations and the functioning of the DSS.

On the one hand, it has been submitted that the existence of an efficient DSS made concluding the Doha Round less pressing, since its smooth functioning alleviates the need to address difficult negotiating issues. The most contentious issues, so runs the argument, may be left to be resolved by the panels and the Appellate Body. Besides the issue concerning the specific Doha Round negotiations – the positive conclusion or viable further extension of which appear unachievable – this argument does not stand in my view for the following reason. Adjudicating disputes concerning existing agreements cannot replace the making of new agreements, whether within the Doha mandate or “post-Doha”, especially if negotiations are meant to cover “new,” hitherto unregulated areas. Nor can dispute settlement “compensate” for the lack of further liberalization of trade, be it in the form of negotiated reductions of tariffs on goods or new concessions on services.

I do not believe that there is any evidence of the inverse either, namely, that the efficiency of the DSS makes WTO members wary of concluding new agreements. There is no evidence that the level of detail that characterizes the provisions of the Trade Facilitation Agreements is due to the intent to tie the hands of future adjudicators, rather than the pursuit of an accurate balance of rights and obligations by the negotiators. Moreover, it would always be possible to carve out some agreements from the DSS jurisdiction should this be the problem. A precedent in this direction exists: the temporary “peace clause” regarding agriculture agreed in the Uruguay Round has been able to shield that agreement from litigation for a number of years.⁵⁶ The greatest challenge to the WTO comes rather from regional trade agreements, since difficult issues that are intractable at the global level may be agreed more easily between like-minded countries or countries with similar or complementary economies. More recently, the challenge comes from those who mistakenly believe that bilateral deals can replace, rather than complement, global rules and governance.

A collective response might be to resort to plurilateral agreements in which the WTO and its DSS maintain a role (Hoekman and Mavroidis, 2015).

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CHAPTER 7

“Behind-the-Border” Policies: Regulatory Cooperation and Trade Agreements

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Introduction

With the establishment of the World Trade Organization (WTO) in 1995, much of the vision of the drafters of the 1948 International Trade Organization (ITO) Charter was realized, albeit some 50 years later.¹ The average level of tariffs for OECD member countries has fallen to the 3% range; for major emerging economies like China and India as well as many developing countries, the average applied tariff is less than 10%. In conjunction with the abolition of most of the quantitative import restrictions to trade that were prevalent through the 1980s, policies to open markets to direct investment – including through privatization – and technological changes that greatly reduced the costs of international communications and transport, the result has been major changes in the structure of global production and trade. One illustration of this change is the increasing share of global value chains (GVCs) in international production and the associated trade in intermediate parts, components and tasks.

Policy-induced market access frictions and trade costs today are increasingly regulatory in nature. The rapidly changing composition of trade as a result of technical changes – reflected not only in supply chains that span many

¹ The ITO was supposed to complement the World Bank and the International Monetary Fund in the area of trade-related policy, but never entered into force as a result of a decision by the US government not to submit the treaty for approval by Congress.

countries, but also in the growth in services trade and cross-border data flows associated with the servicification and digitization of products (the “Internet of things”) – is moving national regulation to center stage in trade debates. The associated agenda is not about deregulation – what is driving concerns in the business community are the trade-impeding (cost-raising) effects of *differences* in applicable domestic health, safety, privacy and data security standards, prudential and licensing requirements, and certification and compliance assessment procedures for both products and production processes used by suppliers of goods and services.

Since its creation, WTO members have found it very difficult to negotiate new rules of the game. Disagreements among countries regarding the benefits of committing to additional trade policy disciplines, most notably between the United States and other OECD nations on one side and emerging economies such as Brazil and India on the other, have impeded progress on the WTO’s traditional market access agenda (mostly tariffs and agricultural support) and in turn blocked substantive discussion on the trade effects of domestic regulatory policies. Continued deadlock in the WTO starting in 2008 led to the focus of attention in addressing international regulatory spillovers shifting to other fora – notably preferential trade agreements (PTAs). Examples of recent initiatives with a significant focus on regulatory matters include the negotiations on a Trans Pacific Partnership (TPP) between 12 Pacific countries and the Transatlantic Trade and Investment Partnership (TTIP) between the European Union and the US that were launched in 2013.

Both the TTIP and TPP initiatives illustrate that such new vintage agreements are difficult to conclude. TTIP talks were put on hold by the US at the end of 2016, and one of the first actions of the Trump administration in early 2017 was to withdraw from TPP. However, deep PTAs that span regulatory matters continue to be pursued by major trading nations. Examples include the Comprehensive Economic and Trade Agreement (CETA) between Canada and the EU which entered into force in 2017,² as well as the agreement reached in early November 2017 between the 11 remaining TPP signatories to implement most of the provisions of the agreement notwithstanding the US withdrawal.

2 See <http://international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/ceta-aecg/text-texte/toc-tdm.aspx?lang=eng>. Only two chapters of CETA deal with reductions in import tariffs and the removal of discrimination in government procurement — that is, classic market access issues where there are direct restrictions on the ability of foreign companies to supply products. The majority of the substantive chapters of CETA deal with product regulation, customs procedures, trade facilitation, policies affecting specific services sectors, mutual recognition of professional qualifications, domestic regulation more generally, procedures for regulatory cooperation and dialogue, and sector-specific protocols (e.g. on the mutual acceptance of the results of the conformity assessment of good manufacturing practices for pharmaceutical products).

Pursuit of regulatory cooperation and related rules of the road among small groups of countries may be a second-best solution, given that the organization of production and trade into GVCs and international production networks means that end products are impacted by many regulatory jurisdictions. PTAs almost by definition will not span all the countries involved in many (most) GVCs, thus limiting the positive impact that they can have in addressing regulatory differences and uncertainty for firms and consumers. At the same time, PTA-based initiatives give rise to the possibility of trade and investment diversion. Trade agreements are not the only game in town to address regulatory spillovers. Governments may and have pursued different types of regulatory cooperation efforts, ranging from sector-specific initiatives such as mutual recognition agreements (MRAs) to cross-sectoral, “horizontal” efforts that center on “good regulatory practices” and learning from international experience including via more formal mechanisms such as the Canada-US Regulatory Cooperation Council (Canada, 2014) that operate independently of a prevailing trade agreement (i.e. NAFTA).

What follows discusses the general challenges confronting international regulatory cooperation from the perspective of reducing trade frictions. The next section defines the task confronting policymakers and develops a typology of the approaches that can be used to reduce negative trade spillovers created by regulatory differences across countries. This is followed by a discussion of the question of what role a trade agreement might play in addressing regulatory spillovers, something that arguably has not been considered seriously enough by the trade community. I then briefly review some of the extant disciplines and provisions in the WTO and PTAs that have a bearing on domestic regulatory policies. The chapter ends with some proposals that could be pursued under WTO auspices or in a plurilateral trade setting.

Dimensions of regulatory cooperation

Competition between regulatory regimes is the default situation in international relations, with different jurisdictions independently applying their own set of regulations to products and producers. While competition implies differences in applicable standards across countries, over time, as learning occurs, there may be incentives to emulate more successful approaches and norms, generating convergence. Competition is a powerful discovery mechanism and a force that will help to identify more efficient forms of regulation to achieve a given objective. But competition may also have adverse outcomes. The commonly expressed fear of a “race to the bottom” is one possibility, albeit one for

which there is generally little evidence. A much more frequent consequence of competition is excess costs associated with different regulatory regimes that have similar objectives. In such cases, there are potential gains from cooperation.

International regulatory cooperation is difficult. There have been long-standing transatlantic efforts to cooperate on regulatory matters, with only limited success (Vogel, 2012). The most progress has been achieved in the EU in the context of creating a single European market for goods and services, as this required overcoming the trade-impeding effects of differences in product market regulation. This was pursued through a variety of approaches, ranging from harmonization of new regulations to mutual recognition (Pelkmans, 2012).³ The EU is of course *sui generis*. The more general challenge confronting the trade community is to identify approaches to reducing trade costs through regulatory cooperation in the *absence* of a political commitment to fully integrate markets and *without* supranational institutions that are tasked with reducing the market-segmenting effects of national policies.

In principle, addressing this challenge should be facilitated if regulatory objectives are equivalent across countries and economies have similar income levels. Approaches may differ towards reducing risk and avoiding catastrophic events, but if goals are very similar, regulatory cooperation may reduce compliance costs without undercutting the attainment of national regulatory objectives. The agenda here is not just about reducing compliance costs for firms and thus prices for consumers. More important – and, indeed, a necessary condition for reducing costs (increasing efficiency) – is that cooperation enhances the effectiveness as well as the efficiency of regulation. Cooperation must be a mechanism that improves regulatory outcomes over time in all participating jurisdictions (Hoekman, 2015b). A basic question for policymakers is how best to design international regulatory cooperation so that it does so. This requires knowledge about the potential benefits and the political feasibility of cooperation.

3 Mutual recognition involves agreement that products legally introduced into the commerce of one jurisdiction may be sold and consumed without additional controls in another jurisdiction. To take the example of food safety standards, mutual recognition between *A* and *B* implies that *A* recognizes that the norms prevailing in *B* satisfy its own safety norms and vice versa. If the underlying norms in the two jurisdictions differ enough, such an approach is not feasible. Even if *A* and *B* harmonize their norms, trade still might be affected by redundant costs if both continue to inspect products before they are allowed to be sold. Only if *A* and *B* mutually recognize (accept) that their respective enforcement systems are effective will harmonization eliminate regulatory trade costs.

Figure 1: Net economic payoffs and feasibility of cooperation

		Political/technical costs	
		High	Low
Net economic benefits	Low	A	B
	High	C	D

Figure 1 distinguishes between the magnitude of net economic gains from regulatory cooperation and the political and technical difficulty (cost) of implementing the necessary cooperation. In principle, cooperation should center on areas that fall into the bottom-right cell *D* and on efforts to move items from *C* to *D*. As important is to avoid investing resources in regulatory areas that fall into box *A*. Mapping policy areas into these different categories cannot simply be based on technical analysis but requires active engagement by regulators, business and consumers. Regulators should be interested in those activities and initiatives that increase their ability to achieve their mandate more effectively and efficiently. Business presumably would like to see compliance costs fall, while citizens and consumers may worry that cooperation will erode regulatory standards, resulting in a “race to the bottom.” This is a major factor underlying the resistance by some civil society groups in the EU, Korea and other nations to PTAs that involve “deep integration” (see, for example, Cardoso et al., 2013, on fears that a TTIP could do so). The result of these different entry points implies that not all issues will lend themselves equally to cooperation. Insofar as the areas of concern fall into boxes *C* or *D*, a precondition for cooperation is to address the worries of either regulators and/or consumers that make an issue area politically sensitive. But efforts to do so through joint learning and interaction should prioritize areas that offer the highest potential economic benefits. In some instances this may not be possible; in others it may require a substantial amount of time to establish the needed understanding and trust to allow cooperation to occur. There is therefore a dynamic time dimension to this two-by-two matrix.

Various approaches have been pursued to attenuate international regulatory spillovers (OECD, 2013). These include seeking to converge over time on the substance of new regulatory norms (harmonization and international standardization), accepting differences in regulation and focusing on putting in place processes to address negative spillover effects of such differences through mutual recognition agreements or determinations of regulatory equivalence, and efforts to increase “coherence” across regulatory regimes. The latter generally center on identifying good practices and basic principles such as

transparency, consultations with stakeholders, use of impact assessments, and so on.⁴

Cooperation can be characterized along a spectrum of “soft” to “hard” depending on how binding (enforceable) the commitments are, with agreements ranging from “shallow” to “deep” depending on whether they entail commitments not to do something or go beyond that to require positive action. Efforts to increase coherence across regulatory regimes are an example of “soft” cooperation. They have been a central element of international initiatives on regulation pursued in the OECD and APEC, which focus on principles and processes as opposed to the substance of regulation.

“Shallow” types of cooperation may be limited to commitments to enhance the transparency and visibility of extant regulation and new regulatory initiatives, or they may go further and involve creation of processes through which parties inform and/or consult each other or commit to providing opportunities for comment before adopting new regulations. Some instances of “shallow” regulatory cooperation may be relatively straightforward to apply to a large number of countries, as they are in the nature of focal points and guidance for national policy. Whether or not a country implements the principles or good practices will not have a direct effect on the realization of regulatory goals in another nation.

Deeper forms of regulatory cooperation have implications for the realization of regulatory objectives – they create interdependence between jurisdictions: the attainment of a regulatory goal in country *A* becomes a function of actions by country *B*. Deeper forms of cooperation span a range of possibilities, from harmonization at one extreme – i.e. adopting the same norms – to (mutual) recognition agreements or acceptance of the equivalence of regulatory regimes.

Figure 2 illustrates different types of regulatory cooperation and lists a number international institutions and fora that have been created to support their implementation. There are many examples of both “shallow” and “deep” regulatory cooperation – those mentioned in Figure 2 are just illustrative.⁵ Many (most) of these do not involve trade agreements, but some do. The alternative approaches can all be embedded into trade agreements. There are

4 There is of course an extensive literature on the various options and experiences; see for example, Vogel (2012) and OECD (2014). Much of the focus will (have to) be sector specific; see, for example, Arnold (2005), Bismuth (2010) and Verdier (2011) for analyses of services regulation.

5 Major international regulatory/standards-setting bodies include the Codex Alimentarius Commission, the International Electrotechnical Commission, the UN Economic Commission for Europe (UNECE), the International Organization for Standardization (ISO), the International Air Transport Association (IATA), the International Accounting Standards Board (IASB), the International Telecommunications Union (ITU), the Basle Committee on Banking Supervision, the Financial Stability Board (FSB), the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS).

several mentions of the WTO in Figure 2, reflecting the fact that its multilateral agreements – GATT, GATS and TRIPS – make references to harmonization (international standardization) and/or mutual recognition agreements, even if there is no legal obligation imposed on all WTO members to harmonize their norms or to recognize those of trading partners (the WTO status quo is discussed below).

Figure 2: A typology of regulatory cooperation and illustrative examples

	Global	Plurilateral	Bilateral
“Shallow” cooperation			
Coherence	BCBS, UNCITRAL, ISO; ICN; WTO	OECD, APEC, GPA; GATS (Telecom Reference Paper)	BITs
Consultation	OIE, IOSCO, WHO, WTO: TBT/SPS	EU; G20	RCC (Canada-US)
“Deeper” forms of cooperation			
Recognition (MRAs)	CIPM; ILAC; IAF	EU-US (various); ASEAN (various); ...	US-Australia (securities); Trans-Tasman MRA
Equivalence	SPS (WTO)	EU	EU-US air safety; ANZCERTA
International Standardization	UNECE, Codex Alimentarius; IMF; GlobalGap; VSS	FSB, ESMA, EU, ICH	RCC (new regulations)

Notes: *ANZCERTA*: Australia-New Zealand Closer Economic Relations Trade Agreement; *BCBS*: Basle Committee for Banking Supervision; *BIT*: bilateral investment treaty; *CIPM*: International Committee for Weights and Measures; *FSB*: Financial Stability Board; *GPA*: WTO Government Procurement Agreement; *IAF*: International Accreditation Forum; *ICH*: International Conference on Harmonization of Technical Requirements for Registration of Pharmaceuticals for Human Use; *ICN*: International Competition Network; *ILAC*: International Laboratory Accreditation Cooperation; *OIE*: World Organization for Animal Health; *RCC*: Regulatory Cooperation Council; *VSS*: voluntary sustainability standards.

Coherence involves efforts among jurisdictions to ensure that the regulatory process conforms to what are generally accepted to be good practices (for example, ensuring that regulation is transparent, that there is the opportunity for stakeholders – including foreign firms and governments – to comment on proposed new regulations, or that the process of regulatory development should be informed by an economic impact assessment or a cost/benefit analysis). The aim here is not to question or discuss the objectives or the substance of regulation. Instead, the focus is on the process through which regulation is developed and implemented. Coherence is an important element of WTO disciplines on sanitary and phytosanitary (SPS) measures and technical barriers

to trade (TBT) and has been the focus of work programs in organizations such as the OECD, various UN bodies and APEC for many years.

Consultation goes beyond joint efforts to define and implement good practices (coherence) and begins to engage with the substance of regulation and its spillover effects. Examples include the scope that has been created in the WTO to raise specific trade concerns (STCs) regarding (proposed) TBT and SPS measures (Wijkström, 2015) and the framework that has been established for consultations on regulatory matters through the Canada-US Regulatory Cooperation Council (RCC).

Deeper forms of cooperation go further in seeking to reduce the market-segmenting effects of differences in regulation across countries. Examples are agreements to (mutually) recognize a foreign regulatory process, efforts between regulators to determine instances where regulatory regimes are equivalent, and efforts to adopt common regulatory standards or conformity assessment processes (i.e. harmonization of norms). Such deeper forms of regulatory cooperation are difficult to achieve for a number of reasons. There may be (i) mandate gaps, in that domestic regulators are not permitted to pursue cooperation or have not been given the resources to do so; (ii) coordination gaps in instances where international cooperation requires several regulatory agencies within a country to work together; or (iii) informational gaps within and across countries, such as a lack of data on how a regulatory regime “works” (Hoekman, 2015a). Addressing these gaps requires institutions and processes that foster regular communication and repeated interaction. This is needed both across agencies within countries – frequently, multiple regulators and government bodies are engaged in setting and enforcing product and process regulations – and across countries. This is non-trivial, especially in federal states, where regulation is applied at the state level (for example, in 13 provinces and territories in Canada, 29 states in India and 50 states in the US). In the case of the EU, the 28 member states continue to have significant autonomy in the implementation of regulation in many areas.

Regulators frequently have their own mechanisms through which they interact with each other internationally. Governments at different levels (central, sub-central, municipal), regulators and international businesses are all engaged in mechanisms that entail cooperation with counterparts across borders (jurisdictions). Lead firms set standards for quality, health and safety for both products and processes that occur in their supply chains. They may cooperate in private standards-setting activities that have as a goal achievement of interoperability and minimum standards across supply chains. They may work in cooperation with non-governmental organizations (NGOs) and governments

to do so (an example being the Global Food Safety Initiative). NGOs do the same – there is a plethora of different private standards-setting bodies that develop norms and offer certification services to companies that engage in international trade. The characterization of levels of “regulatory” cooperation in Figure 2 also applies to the world of private standards, as is illustrated by the inclusion of several such initiatives.

What role for trade agreements?

A key question for policymakers is whether, given a presumption that there are good reasons for pursuing regulatory cooperation, this should be embedded in trade agreements. Given a rationale for regulatory cooperation, what is the value added of tying this to a trade agreement as opposed to simply giving regulators a mandate to interact and work together to improve regulatory requirements and processes? Assuming a positive answer to the question on embedding regulatory cooperation in trade agreements, an ancillary question is whether this is best pursued through the multilateral forum (the WTO), through PTAs or both.

Trade agreements are designed to reduce explicit discrimination against foreign suppliers of goods and services. An implication is that traditional sector-specific regulation that entails barriers to entry lends itself to the reciprocal bargaining and market access commitments that are the core feature of trade agreements. As such regulation can be “captured” by incumbent firms who use their political influence to ensure that they have favorable treatment (Stigler, 1975), a very similar dynamic as that underpinning trade negotiations can be used to reform such types of regulation. However, while entry-restricting regulation continues to exist for some sectors – especially in some services – regulation changed in nature in the 1980s and 1990s. It is no longer dominated by efforts to control the behavior of firms in sectors in which entry is restricted.⁶ Instead, the focus is on ensuring that markets are contestable and on the use of market conduct and liability rules that are (supposed to be) applied equally to domestic and foreign goods and services to do so, complemented by mechanisms to elicit revelation of information by firms on their costs (Laffont, 1994; Posner, 2013).

The source of regulatory trade costs lies in *differences* in regulations across jurisdictions and the need to comply with the requirements of multiple

6 A caveat to this is that state-owned or state-controlled enterprises continue to be prevalent in many countries. Insofar as this is associated with barriers to entry for investment by foreign-owned companies, trade agreements can be used as instruments through which to seek to impose market disciplines on such entities.

regulatory bodies in different countries.⁷ As already noted, reducing the market-segmenting effects of differences in regulations is difficult because of concerns that it may compromise countries' regulatory objectives and hinder the execution of regulatory agencies' legal mandates and obligations. This implies that reciprocal commitments to change national policies — the bread and butter of trade agreements — often simply will not be feasible. The nature of regulation is technical and dynamic, involving many actors with different degrees of autonomy and decentralization; moreover, regulators will respond to differences in local circumstances and changes in knowledge over time. This makes it difficult — indeed, undesirable — to 'negotiate' substantive changes in regulation or to impose regulatory harmonization or convergence by fiat. Instead, regulatory cooperation must be premised on mutual assessments of performance of regulatory regimes to enable regulators to assure principals (stakeholders, legislatures) that the other party has effective systems in place. In practice, convergence, if it occurs at all, will most likely be gradual, with partner countries over time moving closer to systems that are constructed and implemented the same way.

The increasing complexity and interdependence of modern economies that is reflected in the growth in collaborative international production networks (i.e. GVCs) has led to forms of what has been called meta-regulation (Coglianese and Mendelson, 2010). Meta-regulation involves the establishment of monitoring and learning regimes. Instead of presuming that regulators should define uniform rules based on scientific evidence, the aim of meta-regulation is to create incentives for companies to invest resources in regular collection and analysis of data to identify and mitigate specific risks they either confront or may generate. Such approaches are salient in the context of GVCs. For example, ingredients contaminated with pathogens are periodically introduced into global food supply chains and widely propagated as the adulterated foodstuffs are incorporated into diverse batches of processed products. The inadvertent co-production of hazards by firms that are part of international networks — often identifiable years after products have entered commerce — calls for regulatory approaches that recognize such possibilities and that are designed to generate and disseminate relevant data to all parties concerned on a timely basis.

As a result of the type of uncertainty that accompanies GVC-based production and extensive cross-border flows and interdependence, the regulatory problem becomes one of organizing and supervising joint investigation by firms of emergent risks and responding to them before they cause harm. This is a

7 The following paragraphs draw on Hoekman and Sabel (2017).

problem that calls for approaches that involve data collection, data analysis and data sharing. An example is the use of hazard analysis of critical control points (HACCPs) for pathogens, implemented on both sides of the Atlantic, involving a mix of administrative action, legislation and private standards (Sabel and Simon, 2011; Humphrey, 2012).

Can trade agreements support this type of regulatory cooperation? This is perhaps less obvious than often seems to be assumed. Trade agreements can be characterized as purposeful efforts to align the behaviors of key players (governments in particular, and through them, regulatory agencies) in a top-down manner. However, insofar as regulation increasingly revolves around a decentralized effort at problem solving – i.e. bottom-up mechanisms – a potential role for trade agreements to support regulatory cooperation is by acting as a device to more credibly commit to pursuing the needed bottom-up approach by creating an institutional framework that promotes and supports this. Whether trade agreements can be designed to do so is an open question.

Perhaps the most straightforward case for using trade agreements is that this will help ensure that the trade effects of regulation are considered explicitly. Regulators often do not consider the international implications of what they do. To a large extent this is simply because they are not called to do so by their authorizing environment. They may be limited in their appreciation of the economic effect and costs associated with implementation of their regime on firms and consumers in other jurisdictions. A necessary condition for regulators to consider the (cross-border) economic implications of their work is that they have incentives to do so, which raises issues related not just to their legal mandates but also the design of institutional mechanisms that facilitate learning and a better understanding of the overall impact of regulatory norms on trade and investment incentives. In terms of the typology of Figure 1, a trade agreement may help in identifying which areas of regulation fall into boxes *C* and *D*.

Trade agreements may also be used as an instrument to generate the political oversight needed for implementation of cooperation. An important feature of trade agreements is that there are a large number of interests represented. This can not only ensure that areas that are priorities from a trade perspective are identified and put on the table, but also help overcome political economy constraints that preclude movement in a direction that governments perceive will enhance aggregate welfare. Regulators may have a vested interest in the status quo, or have been captured by a domestic industry. Focusing on such problems in a trade agreement context may help mobilize the political support needed to push through reforms. Referring back to Figure 1, dealing with

regulatory matters in a trade agreement may help move forward over time on issues that are in boxes *C* and *D*.

Addressing regulatory issues in a trade agreement also may benefit regulators if it helps to mobilize additional resources to support cooperation. This can both support greater attention being given to cooperation – as that will entail a resource cost for the agencies involved – and, indirectly but potentially importantly, allow for a reallocation of scarce resources to other areas. That is, if cooperation is successful – for example, it results in acceptance that two regimes are equivalent – regulators can allocate less to surveillance of that particular issue area and focus more on other concerns. The benefits of regulatory cooperation accrue not just to companies and consumers in the form of lower compliance costs; if it results in reductions in operating costs for a regulatory agency, this will release resources for other purposes.

In practice, capacity constraints may impede even the shallowest forms of cooperation. Basic principles such as transparency, notification and allowing for comment from stakeholders on proposed new regulation may not be implemented because of resource constraints. There is a significant technical assistance and capacity-building agenda associated with improving regulatory systems and governance in developing nations. Including regulatory cooperation in a trade agreement can provide a focal point to mobilize aid for trade. The 2013 WTO Trade Facilitation Agreement (TFA) illustrates one approach through which additional resources can be mobilized to improve national regulation through international cooperation.⁸

The WTO status quo

In principle, the WTO is the global apex institution through which governments can seek to address cross-border spillovers created by national trade-related policies. The primary focus in the WTO is on trade policies, but the agreement also spans disciplines on domestic regulation, motivated by a concern that these not be used to discriminate against foreign products and undercut liberalization commitments. The national treatment rule is a general obligation for goods, whereas it is a specific one in the case of services – applying only to scheduled services/modes of supply. The WTO does not engage on the substance of regulatory measures—all it requires is that foreign products are treated the same as domestic ones. The WTO does embody some disciplines that require

⁸ This was done by linking implementation of the TFA to technical and financial assistance from high-income countries, under the umbrella of the Aid for Trade initiative; see Hockman (2016).

minimum levels of regulation – for example, the TRIPS agreement requires members to implement minimum standards of protection for intellectual property – but the substance of the rights and requirements/criteria involved are left to governments and/or other international bodies to determine.

Concerns that product-specific regulatory norms may be used for protectionist purposes has motivated the negotiation of specific disciplines that go further than the national treatment rule. The main examples are the Agreement on Technical Barriers to Trade (TBT) and the Agreement on Sanitary and Phytosanitary (SPS) Measures. The TBT agreement addresses technical requirements (mandatory regulatory norms) imposed by governments for goods; the SPS agreement deals with mandatory health and safety-related norms for agricultural products (foodstuffs, plant and animal health). The TBT agreement goes further than national treatment by requiring that members base their product regulation on available international standards (whenever appropriate) and adopt the least trade-restrictive measure that is necessary to achieve their regulatory objective.⁹ The SPS agreement makes explicit reference to an indicative list of international bodies that promulgate SPS norms, such as the Codex Alimentarius Commission. If a national product-specific regulatory measure is based on an international standard, it is presumed to satisfy the least trade-restrictive test in that the norms are considered to be necessary and non-discriminatory in effect and in intent.¹⁰ Whether this is in fact the case is another matter, as in practice the process of international standardization may not devote much attention to trade effects. The presumption is that because many countries will be involved in the process of defining international standards, whatever is agreed is regarded as non-discriminatory in intent, no matter the actual effect on trade. As argued below, this is one weakness of the current approach in the WTO towards international standardization.

Many of the standards that confront firms operating internationally address management processes and production methods. Systems such as ISO 9000, ISO 14000 and ISO 26000 are used by companies as a signal of quality, a demonstration of a commitment to social responsibility or as requirements that must be met by suppliers in a trade relationship with buyers or by companies that are part of international value chains and production networks. Standards of this type are not covered by the WTO as they are not mandatory.

9 What follows focuses on the TBT agreement; similar considerations apply to the SPS agreement.

10 One reason why there are two product standards agreements is that the health and safety concerns that arise in the production, trade and consumption of food, plant life and animals are considered to be particularly important. In effect, many SPS norms can be characterized as measures that are aimed at catastrophe avoidance – the spread of diseases, the probability of serious illness, and so on. Such considerations also arise with technical barriers to trade as these may have similar motivations – for example, a ban on the use of lead paint, radioactive residues, etc. – but they often address other types of issues as well (such as radio frequency interference, interoperability, etc.).

Conformity assessment procedures for technical product regulations are also subject to WTO disciplines, including the non-discrimination rule. Relevant guides or recommendations issued by international standardizing bodies are to be used if they exist, except if inappropriate for national security reasons or deemed inadequate to safeguard health and safety. In principle, WTO members are free to join and use international systems for conformity assessment. The results of conformity assessment procedures undertaken in exporting countries must be accepted if consultations determine these are equivalent to domestic ones. WTO members are encouraged to negotiate MRAs for conformity assessment procedures, and not to discriminate between foreign certification bodies in their access to such agreements.

The SPS and TBT Committees have been characterized as technical expert-driven catalysts for multilateral dialogue, providing a forum for the development of guidance (soft law) and peer review of trade measures (Wijkström, 2015). An important dimension of what the WTO does in the area of product regulation is compiling information on new measures. WTO members are required to notify the WTO of new measures that are not based on international standards. Over 45,000 measures have been notified since 1995. The TBT and SPS committees have developed procedures that can be used by governments to raise concerns they have regarding proposed or applicable product standards of another WTO member. This has come to be known as the “specific trade concerns” (STC) procedure (Horn et al., 2013). Between 1995 and 2015, over 800 STCs pertaining to SPS or TBT measures were raised in the relevant committee, implying that fewer than 2% of notified measures raised concerns. This process is widely regarded as a useful mechanism to address concerns raised – about 40% of STCs in the area of SPS have reportedly been resolved (WTO, 2015). Over time the STC mechanism has evolved – for example, in 2014 WTO members agreed to a procedure through which they can seek the services of the Chair of the SPS Committee or another facilitator to help find a solution to their concerns.¹¹

Much prevailing regulation deals with services. The WTO has fewer disciplines for domestic regulations affecting services than for goods (product regulation). Article VI.4 of GATS calls on the Council for Trade in Services to develop any necessary disciplines to ensure that measures relating to qualification requirements and procedures, technical standards and licensing requirements

11 See https://www.wto.org/english/news_c/news14_e/sps_10sep14_e.htm.

do not constitute unnecessary barriers to trade in services,¹² and members may not apply regulatory requirements so as to nullify or impair specific commitments made for sectors/modes (Article VI.5(a)). The GATS therefore embodies a weak "least trade-restrictive" norm, but there is no obligation to use international standards – WTO members may use whatever standards they wish.

GATS Article VII (Recognition) promotes the establishment of procedures for (mutual) recognition of licenses, educational diplomas and experience granted by a particular member. It permits a member to recognize the standards of one or more members, but does not require, or even encourage, members to recognize equivalent foreign regulations. Article VII:2 requires a member who enters into a mutual recognition agreement (MRA) to afford adequate opportunity to other interested members to negotiate their accession to such an agreement or to negotiate comparable ones. Article VII:3 stipulates that a member must not grant recognition in a manner which would constitute a means of discrimination between countries. Members must inform the Council for Trade in Services about existing MRAs and of the opening of negotiations on any future ones. Most such notifications pertain to the recognition of educational degrees and professional qualifications obtained abroad.

The WTO does little at present to support regulatory cooperation on a multilateral basis; the focus has been on national policies. This has included deliberations (in the context of the TBT Committee) on what constitutes good regulatory practice and options that governments can use to streamline the way regulations are prepared, adopted and applied through the "regulatory lifecycle." An example is the deliberation that commenced in 2012 over voluntary guidelines that would reduce the possibility of product regulation having the effect of unnecessarily restricting trade. However, to date no agreement on a set of good practice guidelines has proved possible in the TBT context because of concerns that the Appellate Body might invoke such norms in a dispute, notwithstanding the fact that in any such agreement its provisions are non-binding.¹³

There is much more to be said about the state of play in the WTO on regulatory matters. The foregoing brief snapshot makes clear that the WTO

12 A Working Party on Domestic Regulation was mandated to develop disciplines called for by Article VI:4 to ensure that licensing and qualification requirements and related standards are not unnecessary barriers to trade in services. A precursor to this working party, the Working Party on Professional Services, agreed in 1998 on a set of principles to ensure transparency of regulations pertaining to licensing of accountants and accountancy services.

13 A trigger for this concern was a 2000 Appellate Body finding that a 2000 decision by the TBT Committee on a set of (voluntary) principles for the development of international standards, guides and recommendations was a "subsequent agreement" under the Vienna Convention on the Law of Treaties; see Wijkström and McDaniels (2013).

is more involved than might be expected, but that many areas of domestic regulation are not subject to multilateral rules of the game – especially service sector regulation. The role of the WTO as a transparency mechanism is much better developed for product regulation than it is for other types of regulation that have an impact on trade. The various committees and working parties dealing with different dimensions of economic regulation have acted as foci for deliberation and information exchange. More can certainly be done if governments are willing to do so, but the experience over the last decade or so with attempts to refine and expand disciplines on domestic regulation of services and to agree to voluntary principles of good practice for regulatory processes illustrates that achieving a consensus in these areas may not be possible. As far as regulatory cooperation is concerned, one shortfall in the approach taken in the WTO has been the absence of a concerted effort by WTO members to encourage international standardizing bodies to consider the trade effects of the norms that they develop (Hoekman and Mavroidis, 2016).

Regulatory cooperation in PTAs

How do PTAs compare to the WTO? There is of course huge heterogeneity, but most PTAs do not do much more than the WTO, while the one outlier, the EU, goes far beyond the WTO in the area of regulatory cooperation. The only other PTA that includes substantial regulatory cooperation in specific areas is the Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) (Steger, 2012). The TPP did not go very far beyond the WTO – the value added primarily involves language aiming at greater coherence of regulatory regimes of the signatories (Bollyky, 2012), along with provisions calling for consultations (i.e. the shallow forms of cooperation discussed in Section 1).¹⁴

The EU has used a mix of approaches to remove the market-segmenting effects of national product regulation, including harmonization and mutual recognition. The latter became a key driver following decisions of the European Court of Justice, which ruled that, in the absence of overriding concerns that permit an exception, EU members must accept products into their markets that have been legally introduced into the commerce of another member state. However, the EU experience illustrates that mutual recognition

¹⁴ However, the TPP did include more detailed and far-reaching provisions on specific areas of regulation, notably with regard to digital trade and data localization. The TPP also incorporated innovative provisions permitting data flows that were linked to (conditional on) action by exporting countries to protect privacy and prevent fraud.

requires some minimum level of harmonization of norms (common “essential requirements”).¹⁵

Recent PTAs involving the EU complement mutual recognition with tentative efforts to move towards mutual “equivalence.” This involves agreement that the regulatory objectives of the parties involved are equivalent *and* acceptance that implementation and enforcement mechanisms in the parties’ jurisdictions are effective. Under a “standard” mutual recognition approach, A satisfies itself that B achieves its norms through the similar kind of testing, inspections, sampling and so on that A undertakes. Under regulatory equivalence, A simply accepts B’s processes and systems – each government agrees that the regulatory regime of the other party is equivalent to its own in terms of both objectives and the effectiveness of the institutional apparatus through which these objectives are pursued.¹⁶ A necessary condition for an equivalence approach is trust – there must be a prior process of “mutual assessment” (Messerlin, 2014) or evaluation of the regulatory goals and implementation regime in the relevant jurisdictions that results in a judgment that these are “equivalent.”

CETA — at the time of writing the most recent of the new type of trade integration agreements — includes some language on equivalence (Government of Canada, 2017). CETA calls for the establishment of a regulatory cooperation forum to facilitate and promote the realization of the objectives laid out in Chapter 21 on regulatory cooperation. The chapter provides that the parties *may* consult with stakeholders, including the research community, NGOs and business and consumer organizations “on matters relating to the implementation of” the regulatory cooperation chapter (Article 21.8). Article 21.2 commits both parties to developing their regulatory cooperation to prevent and eliminate unnecessary barriers to trade and investment; enhancing the climate for competitiveness and innovation, including through pursuing regulatory compatibility, recognition of equivalence and convergence; and adopting transparent, efficient and effective regulatory processes that better support public policy objectives and fulfil the mandates of regulatory bodies. Article 21.3 mentions such objectives of regulatory cooperation as building trust; deepening mutual understanding of regulatory governance and obtaining from each other the benefit of expertise and perspective to improve regulatory proposals; promoting the transparency, predictability and efficacy of regulations; identifying alternative instruments; recognizing the

15 See Pelkmans (2012) for an in-depth discussion.

16 A key difference, therefore, is that regulatory equivalence requires a willingness to step back from a focus on technical product considerations and to assess systems as a whole. Thus, whereas mutual recognition means assessing country B’s meat inspection system on the basis of a sampling regime and the results of testing in country A of a sample of products originating in B, an approach based on regulatory equivalence would justify trust in a partner country’s products on the basis of systemic arguments (Hoekman and Sabel, 2017).

associated effects of regulations; and improving regulatory implementation and compliance.

Another objective of CETA is to facilitate bilateral trade and investment by reducing unnecessary differences in regulation and identifying new ways of cooperating in specific sectors. In a similar vein, the agreement mentions the complementary goal of enhancing the competitiveness of industry by looking for ways to reduce administrative costs and duplicative regulatory requirements, and “pursuing compatible regulatory approaches including, if possible and appropriate, through: a) the application of regulatory approaches which are technology-neutral, and b) the *recognition of equivalence* or the promotion of convergence” (Article 21.3(d)(iii); emphasis added).

Language on — and examples of — regulatory equivalence embodied in CETA include Chapter 5 on SPS measures, which requires each signatory to accept the measures of the exporting party as equivalent to its own if the exporting party “objectively demonstrates that its measure achieves the importing Party’s appropriate level of protection” (Article 5.1). Guidelines for the determination of equivalence are set out in Annex 5.D to the SPS chapter, while Annex 5.E lists areas where the parties have agreed there is equivalence. One function of the CETA Joint Management Committee for SPS Measures is to prepare and maintain a document detailing the state of discussions between the parties on their work on recognizing the equivalence of specific SPS measures. A separate Protocol on the Mutual Recognition of the Compliance and Enforcement Programme regarding Good Manufacturing Practices for Pharmaceutical Products provides for the determination of the equivalence of regulatory authorities that certify compliance with these practices. Annex 1 (on Medicinal Products or Drugs) of this protocol lists products for which the parties have agreed that their requirements and compliance programs are equivalent.¹⁷

CETA Chapter 21 (on regulatory cooperation) creates an entry point with respect to greater use of regulatory equivalence among like-minded countries, but puts little emphasis on the use of equivalence as a way to reduce regulatory differences and costs. Indeed, the chapter, while laying out a rather long illustrative list of possible cooperation activities, does not mention “equivalence” in Articles 21.4, 21.5 or 21.7. Article 21.4(r) does call for identifying approaches to reduce the adverse effects of existing regulatory differences

¹⁷ Some mention of regulatory equivalence also occurs in the chapter on financial services, a sector where the approach has been pursued internationally for some time; see, for example, Verdier (2011). The chapter permits Canadian institutions to provide portfolio management services to EU professional clients on a cross-border basis (that is, without having to establish in the EU) once the European Commission has adopted the equivalence decision related to portfolio management (EU prudential requirements will still apply).

on trade, including “when appropriate, through greater convergence, mutual recognition, minimising the use of trade distorting regulatory instruments, and use of international standards,” but the activities listed in these articles focus on transparency and data and information sharing.

Even though CETA goes further than the TPP on regulatory cooperation, it arguably does too little to reflect the changes in the way international trade is organized. More rapid progress in attenuating the trade-cost effects of different regulatory policies might be realized by creating processes and institutional mechanisms that take a broader value chain perspective (Hoekman, 2015a). Concrete initiatives to reduce the costs of redundant regulatory requirements and processes must be policy specific – that is, they must involve the type of cooperation called for in CETA and that is being pursued in the Canada-US Regulatory Cooperation Council. But missing from current approaches are cross-cutting, supply chain-informed deliberative mechanisms that focus on a broad range of policies that affect trade costs and that provide a framework for regulatory cooperation to improve the competitiveness and efficiency of industry – two goals that Canada and the EU set for themselves in the CETA chapter on regulatory cooperation (CETA Article 21.2(4)(b)).

Reducing the negative trade effects of behind-the-border regulation

Regulatory measures generally fulfil a specific social or economic purpose, even if the effect is to restrict trade. Addressing possible trade-reducing (distorting) effects of regulation requires first an understanding of the effects of prevailing (proposed) policies. Many desirable reforms will not require actions by other governments (trading partners), but regulatory cooperation may help in identifying what such reforms should seek to do and increase the effectiveness and efficiency of regulation. Trade agreements may help by mobilizing and sustaining political attention and thereby address concerns by civil society groups opposing cooperation and incentivize regulatory bodies to give more of a priority to actions that reduce the negative trade impacts of regulation.

As already discussed, trade agreements are geared towards the negotiation of enforceable policy commitments. Binding disciplines reduce uncertainty for traders who know that the dispute settlement mechanism can be used to ensure that governments live up to what they sign on to. A precondition for agreement on binding international rules is a shared recognition that the negative spillovers associated with a policy (or set of policies) are significant and

that a proposed set of (enforceable) disciplines will result in greater efficiency (lower costs). Such an understanding exists when it comes to tariffs and related border barriers, but much less so when it comes to domestic regulatory policies.

It is important to recognize that trade agreements may not have a “comparative advantage” in supporting effective cooperation between regulators, even if trade negotiators have the best of intentions. The public backlash against TTIP in the EU was largely driven by concerns that greater integration of the transatlantic marketplace may result in an erosion of regulatory regimes in areas that are of great importance to significant segments of the EU population – such as the use of genetically modified organisms (GMOs) and specific food standards (Young, 2016). Regulatory cooperation is likely to be more easily pursued if it involves a bottom-up process that is driven by regulatory agencies, as opposed to being imposed top down as an element of a trade agreement. A useful prescription in this regard is to apply the principle “first, do no harm” and to concentrate on incorporating measures in trade agreements that can be defended as improving the ability of regulators to do their job better. That is, the aim should be empowerment of regulatory bodies rather than imposing restrictions on them (or being seen to be doing so even if that is not the intention).

From a trade perspective, international cooperation on regulation arguably should center on improving the transparency of applied policies, supporting analysis of the trade (and investment) effects of specific types of regulation, giving regulators a mandate that encourages (permits) them to design regulations that do not unnecessarily restrict trade, and doing more to ensure that the process of international standards-setting and norms-setting occurs with greater attention given to the potential trade impacts. Measures taken by the trade community to achieve these objectives should not affect the ability of regulators to achieve their mandates.

Transparency. This is a core feature and function of the WTO. The regular work of the TBT and SPS Committees, including notifications and the opportunity to raise specific concerns, can be emulated in other areas of regulation. Here, an obvious area to prioritize is services and regulations that impact on the ability of firms to supply and consumers to buy products that are connected to/use “the cloud” (data localization requirements, etc.) The relevant GATS bodies have not ignored issues of domestic regulation (see above), but much more could be done to map out the policies that WTO members are pursuing. The recent joint venture with the World Bank to maintain and update a database on services trade policies – the Services Trade Restrictiveness Indicators (STRI) – is a good first step, but this is mostly limited

to policies that are discriminatory and does not cover domestic regulation. It is unlikely that this can rely only on notifications – it will require a pro-active effort by the WTO Secretariat, working with other international organizations.

Much greater transparency is also needed as regards the operation and effects of PTAs. Insofar as PTAs give rise to innovative approaches to attenuate the market-segmenting effects of differences in regulatory policies, they can help all countries identify approaches that can usefully be emulated. All WTO members have a strong interest in understanding what PTAs end up doing and achieving, including their implementation, utilization and enforcement. Documenting and analyzing the approaches that are used in PTAs to reduce costs of regulatory heterogeneity would not only improve transparency per se, but can also inform a process of learning about what works and what does not and perhaps identify specific features of cooperation in PTAs that might be multilateralized. There have been some moves in this direction on an ad hoc basis; for example, the GATS Working Party on Domestic Regulation conducted a dedicated discussion on domestic regulation in regional trade agreements in 2014.

Learning: analysis and deliberation. As noted previously, there is often relatively little, if any, effort by national regulators and international standards-setting bodies to consider the trade impacts of regulatory requirements and alternative approaches that might have less negative effects while not impacting on the probability that regulatory objectives will be realized. There is also arguably more that can be done to understand how the universe of regulatory measures maps into the categories defined in Figure 1 and the potential efficacy of the different types of international regulatory cooperation summarized in Figure 2. There would appear to be significant scope to use the WTO bodies that already have a mandate to discuss regulatory policies (TBT, SPS, services, trade facilitation) to commission analysis of trade effects and to engage more regularly with the business community in discussions aimed at identifying where greater effort to pursue regulatory cooperation – which need not occur through the WTO – could have a significant impact on trade costs. Currently there is too little scope for engagement with the business community within WTO bodies. There is more attention to this in recent PTAs like CETA, but even there the extent to which business is part of regulatory deliberation arguably is too limited (Hoekman, 2015b).

Give regulators a mandate to consider trade effects. A simple, yet powerful change that WTO and PTA members could seek to achieve is to agree that regulatory processes include an assessment of trade effects – perhaps as part of broader regulatory impact assessments that are generally considered to be

an element of good practice. This is already “on the table” in the deliberations on a voluntary code of good practice in the WTO TBT Committee. If no consensus can be achieved there – and given that in other areas of regulation, this agenda is being pursued – one way proponents could consider moving forward is through plurilateral approaches (see below). In order to increase the prospects that trade impact assessments are made, regulatory agencies should be provided with the necessary (financial) resources so that such an effort would not crowd out (or be seen to crowd out) other activities. Incorporation of “trade effects assessment” language in trade agreements is in itself an instrument through which regulatory agencies can lay claim on additional resources from the government that are needed to fulfil the commitment.

Engaging with international standards-setting bodies. There is also a clear case for more regular interaction with international regulatory bodies. Again this is something that already occurs on an ad hoc basis. For example, representatives of the Basel Committee on Banking Supervision, the Financial Stability Board, the International Association of Insurance Supervisors and the International Organizations of Securities Commissions have been invited periodically by the GATS Committee on Trade and Financial Services to present recent developments in the area of international regulatory norms and initiatives in the financial sector and discuss possible implications for trade in financial services. However, this is largely limited to one-way information transmission. What would arguably make a difference is a greater effort by WTO members – who are all represented in international standards-setting bodies – to include a focus on the trade effects of new international norms and standards.

Club formation under the umbrella of the WTO?

Going beyond greater transparency, analysis and interacting with international standards-setting bodies, at the level of the WTO consideration should be given to facilitating more small-group cooperation on regulatory policies. Abstracting from informal discussion or working groups, there are two main alternative mechanisms for groups of WTO members to collaborate on an issue-specific agenda of common interest: conclusion of a Plurilateral Agreement (PA) under Article II.3 WTO, and so-called critical mass agreements (CMAs). CMAs are agreements in which negotiated disciplines apply to only a subset of countries, but benefits are extended on a most-favored nation (MFN) basis. Examples of CMAs include the Information Technology Agreement (ITA) and other “zero-for-zero” agreements in which a group of countries agree to eliminate tariffs for a specific set of products and inscribe these commitments into their WTO schedules. CMAs have also been concluded to facilitate trade in services.

Examples are agreements on basic telecommunications and on financial services that have been concluded under the General Agreement on Trade in Services and that apply only to signatories. PAs differ from CMAs in that they may be applied on a discriminatory basis – that is, benefits need not be extended to non-signatories. There are currently two PAs incorporated into the WTO: the Agreement on Civil Aircraft and the Agreement on Government Procurement.

PAs and CMAs differ from PTAs in important respects. WTO rules require that PTAs cover substantially all trade in goods and/or have substantial sectoral coverage of services. In contrast, CMAs and PAs can be issue specific. PTAs tend to be closed clubs – most PTAs do not include an accession clause. Those PTAs that do allow for accession often restrict it to countries in a specific geographic region. This helps explain the proliferation of PTAs – a new agreement often tends to be negotiated between members of any given PTA and a non-member, because it is not possible for a non-member to join an existing regional trade agreement. CMAs and PAs, in contrast, are open in the sense that in principle any WTO member can join if it wants to and is able to satisfy whatever disciplines are embodied in the agreement.

There are good reasons for WTO members to attempt to do more via CMAs and PAs (Lawrence, 2006). As discussed by Hoekman and Mavroidis (2015), CMAs and PAs cannot reduce the welfare of any country, including those that decide not to join, because CMAs apply on an MFN basis and PAs must be approved by the WTO membership as a whole. PTAs are reviewed by the WTO, but there is no sanctioning of their content; the process is limited to the supply of information. CMAs and PAs are more transparent as they involve formal scheduling of commitments by signatories and, in the case of PAs, regular reporting on activities to the WTO membership as a whole. They imply less dispersion in rules and approaches – and thus transactions costs and trade diversion – than PTAs. Indeed, they offer a way to multilateralize elements of what may be covered in PTAs. Multiple PTAs dealing with the same subject matter often do so in ways that imply that the rules of the game for firms differ depending on the PTA that applies for a given trade flow.

There is no formal constraint on the ability of a club of WTO members to pursue CMAs that involve deepening of disciplines on policies that are already subject to WTO rules, as long as they are willing to apply these on an MFN basis (Hoekman and Mavroidis, 2017). There is, however, a major constraint that impedes the feasibility of pursuing new PAs under WTO auspices: incorporation of a PA into the WTO requires unanimity “exclusively

by consensus.”¹⁸ This is a major disincentive for countries to pursue this type of cooperation. Hoekman and Mavroidis (2015) suggest that WTO members set up a task force on a code of conduct for new plurilateral agreements that apply to and benefit only signatories and consider replicating a GATS provision permitting WTO members to make additional commitments in the GATT, so as to facilitate the negotiation of new CMAs that deal with regulatory policies that affect trade in goods. Such codes would establish the basic principles that new club-based agreements should satisfy to be consistent with the principles of the multilateral trading system, as well as substantive criteria for the rejection of proposals to pursue such cooperation under WTO auspices.

Concluding remarks

The gradual reduction of tariffs as part of a more general process to open economies to international trade and investment flows, in conjunction with technological changes that are permitting the digitization of products and increasing the share of services in global production, have greatly increased the impacts of differences in domestic regulation of products and production processes. The future international trade agenda is likely to become largely a regulatory agenda, the challenge being to devise mechanisms to reduce the costs of differences in regulatory regimes while at the same time ensuring that this does not erode the likelihood of attaining the regulatory objectives that have been established by the politics of countries that engage in trade.

In principle, regulatory cooperation may bolster the ability of regulators to attain regulatory objectives if it is designed with that objective in mind. Indeed, in practice this is likely to be a necessary condition for cooperation to be feasible. A key question for governments is whether trade agreements are a useful instrument to guide regulatory cooperation and if so, how regulatory matters should be addressed in trade agreements. In some areas, such as technical regulation of products, there are now well-established and reasonably effective mechanisms in the WTO through which the potential negative externalities of differences in standards can be identified, discussed and attenuated. In many other areas of regulation – such as prudential regulation of services, “private standards” systems that apply to international production processes, or standards of protection of worker rights and the environment – WTO members have yet to put in place such mechanisms. The same is largely true of

18 See Article X.9 of the Agreement Establishing the WTO.

PTAs – while there is much discussion of new vintage PTAs as instruments for regulatory convergence, to date steps to address such matters have been limited.

Neither PTAs nor the WTO engage on the substance of regulatory norms – the focus is on the trade-impeding effects of differences in regulatory standards. Cooperation on substantive norms – international standardization – is left to specialized bodies in which regulators interact. These bodies tend to be technical and focused on defining the means to achieve specific regulatory objectives (health, safety, etc.). They generally do not consider the potential impacts on trade. One role that the WTO could play looking forward is doing more to ensure that international regulatory efforts consider trade effects when developing new international norms. More generally, the WTO (and PTAs) could be used as a focal point for encouraging regulators to interact with each other and to consider cooperation that enhances their joint ability to attain regulatory objectives at lower cost. The suggestions made above regarding the form this could take illustrate the potential positive role that trade agreements can play. Whether they will be pursued depends importantly on the stance taken by international business. A necessary condition is strong advocacy by international business for greater engagement by governments in the WTO to address negative regulatory spillovers.

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CHAPTER 8

The WTO's Next Work Program – As if the Global Economic Crisis Really Mattered

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Introduction

Typing the words “WTO stress test protectionism” into Google reveals that many in the official community claim that the WTO succeeded in preventing the widespread resort to protectionism since the onset of the global economic crisis. If, indeed, the multilateral trading system has done so well, then let’s open a bottle of champagne and the future work program of the WTO can address other matters.

Of course, there are reasons why certain officials find it convenient to downplay the significance of crisis-era distortions to global commerce. Some may have been persuaded by the findings of the limited WTO monitoring exercise on protectionism. This is not the place to detail the flaws in such official monitoring (see the relevant chapters in the 16th and 18th reports of the Global Trade Alert). Others may suspect that beggar-thy-neighbor activity is far greater than officially admitted, but fear that public recognition of this fact could trigger a wave of retaliation. What such fears say about the robustness of the current WTO system is worth pondering.

1 The authors of this paper are associated with the Global Trade Alert (GTA) initiative, the independent trade policy monitoring initiative that is run under the auspices of the Centre for Economic Policy Research (CEPR). The reports of the GTA, which provide far more data than is presented here, can be accessed at <http://www.globaltradealert.org/reports>. Comments received at a session of the Evian Group in December 2015 were much appreciated. This is a revised version of a document first prepared in March 2016. We thank Piotr Lukaszuk for helping in assembling the data for this version.

With the election of President Donald J. Trump, however, the notion that all is well in trade policy is no longer possible to sustain. The threat posed to the world trading system by the implementation of potentially far-reaching “America First” policies has been widely commented upon, even by officials that in the past have asserted that multilateral trade rules work. Confidence that those rules will restrain the present incumbent of the White House appears thin on the ground. The silver lining to the election of President Trump is that it may induce hitherto complacent officials to revisit their assumptions about just how well multilateral trading system has performed in recent years.

Some business associations – such as the International Chamber of Commerce and the B20 – have spoken out against crisis-era protectionism and, if their reports are anything to go by, are less sanguine than official assessments. In recent years particular attention has been given to significant export restrictions (recall the Chinese Rare Earth case), to state-owned and state-controlled firms, and to the spread of “localization” measures, the latter not just relating to trade in goods but also cross-border data flows. That many business associations have supported the negotiation of disciplines in mega-trade deals that go beyond those found in WTO rules says something about the contemporary commercial relevance of the latter. After all, the last major update of the WTO rulebook was negotiated almost a quarter of a century ago and many business models have changed markedly since then.

For the most part, when it comes to crisis-era protectionism, academics have been sorely behind the curve. In an age when data are downloaded rather than collected, most academic studies have confined themselves to datasets that were available before the crisis. In effect, this has meant that many studies examine only the impact of tariff increases and trade defense and safeguard measures. Other distortions to 21st century commerce tend not to be considered. Given that trade defense measures are the minnows of international trade policy, it is not terribly surprising that these measures have been shown to have cut trade by little during the crisis era.² Much theoretical analysis of the WTO makes little reference to actual policy choice – indeed, it is almost as if the crisis never happened. If much academic writing is anything to go by, there is little to learn from the crisis era for the next work program of the WTO.

If, indeed, policymakers conclude that the crisis era has few implications for the future development of the multilateral trading system, then this will represent a departure from the pattern observed after previous global economic contractions. The formation of the GATT was said to have been

2 In this chapter, we will confirm that the trade covered by trade defence and safeguard measures is a tiny percentage of world trade. No disagreement on this particular matter.

influenced by the beggar-thy-neighbor activity witnessed during the Great Depression. Similarly, the pervasive use of voluntary export restraints during the sharp global downturn of the early 1980s led to their banning as part of the Uruguay Round agreements. In both instances, there were enough analysts and policymakers that recognized the deficiencies in existing multilateral trading arrangements. Will this time be different?

In this chapter, we make the case that discrimination is rife in international trade relations and that the notion should be set aside that the spirit or the letter of multilateral trade rules held the line against government resort to trade distortions since the onset of the global economic crisis. That world trade flows did not collapse like the 1930s does not imply that all is well – contemporary trade distortions have done much to reshuffle world trade flows (Evenett and Fritz, 2017a). The best that can be said about existing WTO rules is that they have channeled protectionist pressure into policy instruments subject to weaker or no multilateral disciplines.

We support our case with evidence on the resort to discrimination against foreign commercial interests that has been collected by the Global Trade Alert (GTA) initiative, with which we are associated. Furthermore, in preparing this chapter we have computed the share of the G20's exports that face different types of discriminatory policies. We discuss the evolution of these trade coverage ratios since 2009 and identify policies that affect relatively more of global commerce.

What does this mean for the WTO going forward? It is said that, in two speeches in 1959 and 1960, President Kennedy noted that in Chinese the word “crisis” is represented by two symbols, one for danger and another for opportunity. Having spelt out the former, we conclude our chapter with the latter – describing how a future WTO work program could be influenced by what has been learnt about government policy choice since 2008.

We should be clear about what this chapter is not about. It does not provide an explanation to account for the timing and form of crisis-era discrimination against foreign commercial interests. Readers interested in this matter are referred to Evenett (2015). Nor does this chapter estimate the impact of crisis-era protectionism. For an analysis of the impact of such protectionism on the exports of the Least Developed Countries, see Evenett and Fritz (2015). Estimates of the extent to which the growth of the European Union's exports has been held back by trade distortions imposed since the crisis began can be found in Evenett and Fritz (2017a). For more information on national resort to protectionism and liberalisation during the crisis era, readers are referred to the reports of the Global Trade Alert.

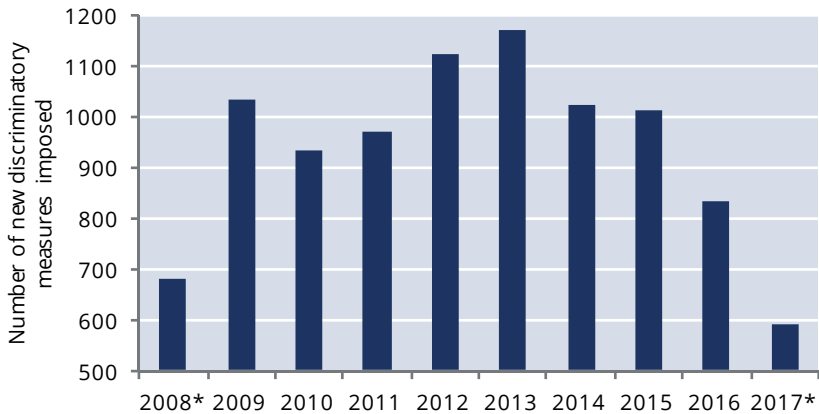
Monitoring discrimination

Several considerations need to be borne in mind when monitoring the resort to discrimination against foreign commercial interests by governments during a systemic economic crisis. First, governments have many policy instruments available to them, including those not subject to WTO rules. Second, the rationale for crisis-era policy initiatives may on paper have nothing to do with seeking commercial advantage yet, inadvertently or by design, these initiatives may discriminate against foreign commercial interests.

Third, governments can obscure, hide, or delay the publication of the details of discriminatory measures, not least to avoid being labelled “protectionist.” Fourth, in the 21st century, there are many more forms of cross-border commerce than traditional trade in goods, widening the range of policies of relevance to any monitoring exercise. Fifth, the financial origins of the most recent global economic crisis raises the possibility that the allocation of finance became another tool for state discrimination against foreign commercial interests.

For all of these reasons, when monitoring discrimination by governments it makes sense to focus on changes in the relative treatment of domestic versus foreign rivals rather than confine information collection to a pre-specified set of policy instruments. History shows that the most prominent form of discrimination changes with each global economic crisis (tariff increases and competitive devaluations in the 1930s, voluntary export restraints in the 1980s). So best to keep an open mind as to what form discrimination may take.

Figure 1: Discrimination in the world trading system is alive and kicking



Note: *implies annualized total.

Another implication of the foregoing considerations is that much information about the incidence and extent of discrimination against foreign commercial interests is available with a lag. Consequently, although the Global Trade Alert team looks for current instances of discrimination (and, for that matter, liberalization), when information about government initiatives from earlier years becomes available then this is added to our database. At this writing, a total of 13,002 government policy interventions that have been announced or implemented since November 2008 have been documented by the GTA team.³ In the past three years, over 2,200 measures have been documented per annum, substantially expanding the database. The GTA's coverage is global.⁴ In its October 2016 *World Economic Outlook*, the International Monetary Fund stated: "The Global Trade Alert database has the most comprehensive coverage of all types of trade-discriminatory and trade-liberalizing measures, although it only begins in 2008" (IMF, 2016: 79).

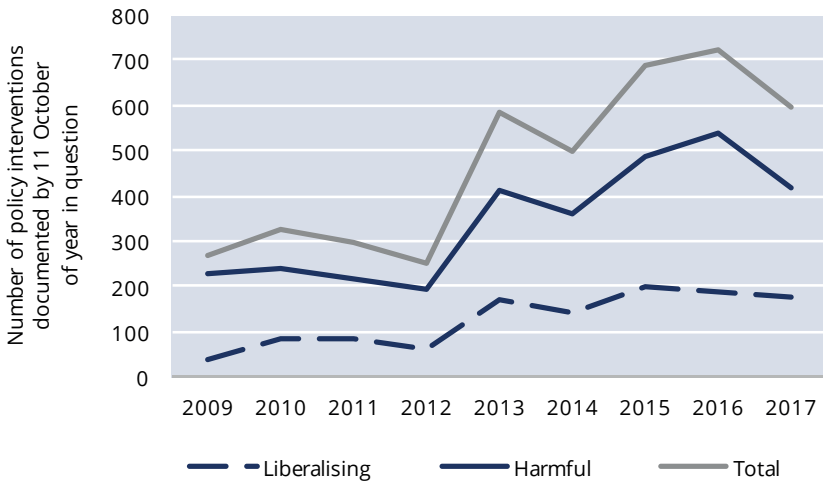
Taken together, Figures 1 and 2 highlight the perils of ignoring publication lags. Figure 1 is based on the data available as of the end of 11 October 2017. Consequently, the GTA team has had over eight years to document discrimination undertaken in 2009 and only ten months to document policies undertaken during 2017. Without knowing this, one might erroneously conclude that resort to beggar-thy-neighbor activity has fallen after its 2013

3 In comparison, the WTO's Trade Monitoring Database has at present 4,177 entries. That database can be accessed at <http://tmdb.wto.org>.

4 Further details on the approach used by the GTA team to identify, investigate, and document crisis-era policy change can be found on pages 17-19 of Evenett and Fritz (2015).

surge. In fact, if our experience is anything to go by, the first published totals for a particular year are revised upward significantly over time.

Figure 2: Correcting for publication lags matters – since 2012 there has been a surge in discriminatory measures implemented



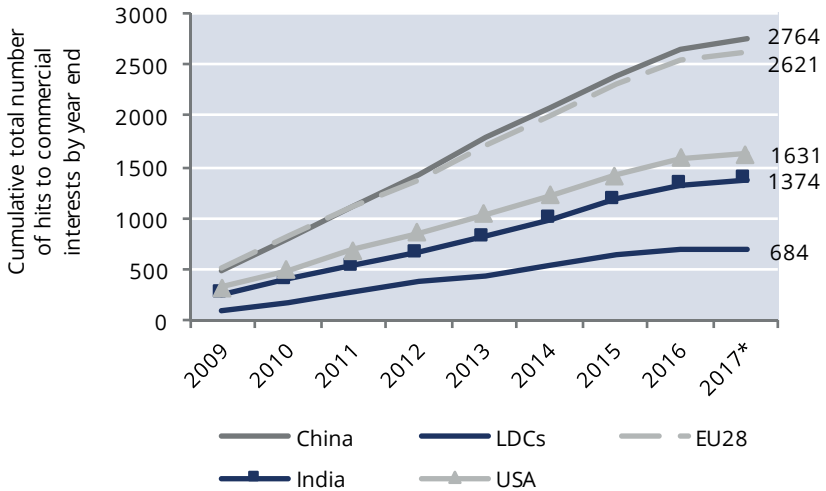
Source: Global Trade Alert. 11 October 2017.

In addition to tracking the annual totals, it is also helpful to report the total number of measures documented for each year at the same point in the reporting cycle. Figure 2 reports the total number of liberalizing and discriminatory measures implemented in a given year that were documented by 11 October of that year.⁵

The worrying finding in Figure 2 is that there has been a surge in the number of discriminatory measures implemented and documented from 2012 on. Some observers have wondered if that surge is the result of better monitoring on the part of the GTA team. Flattering as that may be, it is unlikely that the team has improved its productivity by over 150% since 2012. The implication being that the uptick in resort to discrimination since 2012 is real. While the number of liberalizing measures has grown too in recent years, the gap between the totals for discriminatory measures and liberalizing measures has grown. Any notion that beggar-thy-neighbor action has been tamed or was confined to earlier in the crisis should be set aside. Best not put that champagne on ice.

5 The findings in Figure 2 do not depend on the choice of cut-off date of 11 October. That date was chosen given the timetable for the preparation of this chapter.

Figure 3: No sign that harm to commercial interests is abating



Note: * year to date.

Source: Global Trade Alert. 11 October 2017.

It is probably too soon to draw too many conclusions concerning the data for 2017. As Figure 2 shows, the total has fallen somewhat (but is still above the 2014 level). In light of President Trump's frequent accusations of protectionism by trading partners, could this fall reflect foreign governments resorting less to protectionism that harms US interests? Our July 2017 report examined this matter in some detail and, to our surprise, found evidence in favor of this proposition. As we put it then, it would seem that "awe" rather than "rules" may have, for the time being at least, slowed down the resort to protectionism (Evenett and Fritz, 2017b).

Using a conservative methodology for each measure, the GTA team identifies the trading partners affected, should the measure in question be implemented. It is then possible to track over time how frequently a jurisdiction's commercial interests have been harmed by the discriminatory measures implemented by its trading partners. These totals have been plotted in Figure 3 for China, the 28 members of the European Union, the United States, India, and the Least Developed Countries (LDCs). With the exception of the latter, in every other case the cumulative number of hits to their commercial interests keeps rising. Ministers may want to bear this in mind should they receive advice from officials and international organizations to discount crisis-era protectionism. These hits to commercial interests harm firms, employees, shareholders, owners of intellectual property, and (where relevant) nationals working abroad.

Having reported the frequency of harm to commercial interests and, contrary to some, having shown that discrimination against foreign commercial interests wasn't a spasm at the beginning of the crisis that was successfully contained, we now turn to identifying the most prevalent forms of crisis-era protectionism.

The most prevalent forms of protectionism used since the beginning of the global economic crisis

Before the recent global economic crisis, the stylized fact was that trade defense and safeguard measures were the principal form of discrimination used by governments (mainly in industrialized countries) to manage pressures for relief from global competition. Also, many developing countries still had plenty of leeway to raise tariffs without breaching WTO bindings.

As a result of the frequent use of these particular policy instruments, datasets on their use were collected and analyzed. In the light of this, perhaps unsurprisingly, when the crisis hit the initial instinct of many analysts was to check if resort to these relatively more transparent and traditional policy instruments increased.

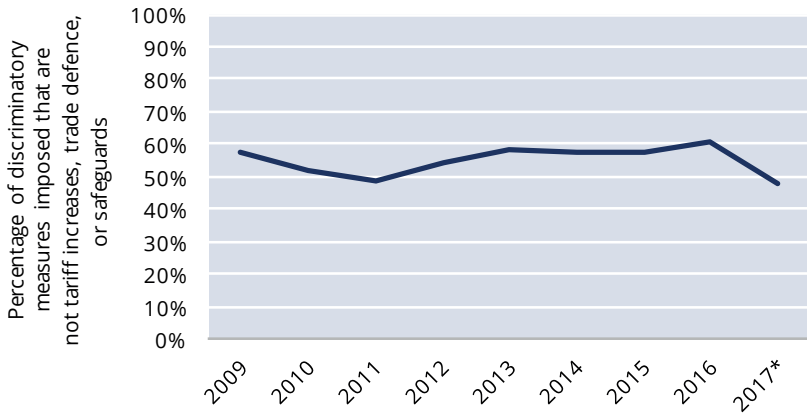
It turns out, however, that at least half of the discrimination against foreign commercial interests undertaken by governments during the crisis era did not involve resort to trade defense or tariffs (see Figure 4 and Table 1). Therefore, a full understanding of protectionism since the onset of the global economic crisis is not possible without recognizing the murkier – that is, less transparent or lower-profile – forms of discrimination against foreign commercial interests.

Table 1 groups the discriminatory policy instruments into the chapters proposed by the Multi-Agency Support Team (MAST), which comprises experts from several international organizations. This MAST classification is likely to define the new standard for recording non-tariff measures and consequently we have aligned our reporting of crisis-era discrimination with this approach. On this classification, different forms of subsidy (other than export subsidies which are covered in the “export measures” chapter) are the most frequent form of trade distortion imposed since November 2008. Coupled with the wide range of state-provided export incentives, the total number of state subventions granted since the onset of the global economic crisis exceeds 3,500.⁶ This total exceeds the sum of the number of tariff increases and duties associated

⁶ Let us quickly dismiss one red herring typically raised at this point in the argument, namely, that the subsidies and bailouts are in the financial sector and, therefore, of limited interest to international trade in goods. In fact, only 177 of the 2,226 subsidies recorded in the GTA database relate to firms in the financial sector.

with trade defense. Another 542 government procurement-related measures, such as the Buy American provisions enacted in 2009, round out the top five most frequently used measures.

Figure 4: Murkier forms of protectionism accounted for half of crisis-era trade distortions



Note: * year to date

Source: Global Trade Alert, 11 October 2017.

The mix of contemporary protectionism implies that it is a mistake to focus only on tariff increases, trade defence actions, and safeguards. Fewer than half of the 8,600 or so harmful measures imposed by governments since November 2008 involved resort to such duties. Therefore, it would be premature to declare victory just because this time around no government imposed across-the-board Smoot Hawley-like tariffs.

As the final three columns of Table 1 indicate, there is variation across the G20 in the resort to different forms of trade distortion. G7 nations are responsible for implementing just under half of the (non-export) subsidies worldwide, whereas the BRICS (Brazil, Russia, India, China, and South Africa) are together responsible for implementing a third of the export incentives, half of the restrictive trade-related investment measures worldwide, and a quarter of the import tariff increases. The BRICS and G7 nations are responsible for each implementing 30% of the worldwide totals of trade defence duties and safeguards. Non-G20 countries are responsible for half of tariff increases worldwide.

Table 1: Policy instruments employed against foreign commercial interests, organized by MAST chapter and listed in descending order

MAST chapter	MAST chapter name	Number of discriminatory measures implemented since November 2008	Number of discriminatory measures still in force	Number implemented by...			Percentage of global total implemented by...		
				G7	BRICS	G20	G7	BRICS	G20
L	Subsidies (except export subsidies)	2226	1802	1039	398	1681	46.7	17.9	75.5
D	Contingent trade protection	1560	1284	456	442	1296	29.2	28.3	83.1
	Import tariff measures	1548	1083	108	359	784	7.0	23.2	50.6
P	Export measures	1289	899	252	437	951	19.6	33.9	73.8
M	Government procurement	542	267	365	110	506	67.3	20.3	93.4
I	Trade-related Investment measures	363	333	52	186	315	14.3	51.2	86.8
E	Non-automatic licensing, quotas	325	186	42	57	185	12.9	17.5	56.9
	FDI entry-related measures	266	253	31	45	143	11.7	16.9	53.8
	Migration measures	183	158	49	28	108	26.8	15.3	59.0
	Instrument unclassified	175	132	22	60	132	12.6	34.3	75.4

MAST chapter	MAST chapter name	Number of discriminatory measures implemented since November 2008	Number of discriminatory measures still in force	Number implemented by...			Percentage of global total implemented by...		
				G7	BRICS	G20	G7	BRICS	G20
	Capital control measures	49	38	0	8	25	0	16.3	51.0
F	Price control measures	42	36	2	17	32	4.8	40.5	76.2
A	Sanitary and phytosanitary measure	18	16	2	2	10	11.1	11.1	55.6
G	Finance measures	17	15	0	1	3	0	5.9	17.6
B	Technical barriers to trade	13	8	1	3	7	7.7	23.1	53.8
N	Intellectual Property	2	2	0	0	1	0	0	50.0

Source: Global Trade Alert, 11 October 2017.

These statistics give a sense of the different protectionist mixes adopted by governments, suggesting there is no single template for contemporary protectionism. Moreover, this is not the protectionism that our fathers or grandfathers would recognize – it is a mistake to look at the current era solely through the lens of the 1930s. As Mark Twain noted, “history doesn’t repeat itself but it often rhymes.” The rhyme here is the resort to discrimination, not the form of such discrimination.

Since the next work program for the WTO could involve revising existing multilateral rules, then it is appropriate to ask what these statistics imply about the current WTO rule book. The extensive resort to subsidies calls into question the “discipline” provided by the Agreement on Subsidies and Countervailing Measures. If the 2,226 subsidies implemented since November 2008 were consistent with this Agreement, then one wonders what “bite” this accord has. If these subsidies were illegal, then why are so few subsidy cases brought to WTO Dispute Settlement?

Similar questions might be asked about the import tariff increases. In this regard, it is worth noting that when the global economic crisis hit, no fewer than 85 WTO members could have raised their average tariff rate by the Smoot-Hawley increase without violating their WTO disciplines. Even for those policy instruments for which the WTO has rules, there are legitimate questions about the extent to which they really restrained government action during the crisis.

It is worth recalling that the WTO rulebook is incomplete, that is, it does not cover every form of discrimination against foreign commercial interests. As a result, the failure to observe outright violations of WTO rules does not settle the debate about the effectiveness of those rules. Another possibility worth considering is whether the incomplete rulebook channeled protectionist pressures to allowed loopholes, to policy intervention where the existing rulebook is ambiguous, or to government measures for which there are no WTO rules in the first place.

The extent of G20 exports facing crisis-era protectionism

One reaction to the evidence in the previous two sections has been to dismiss it as merely referring to counts of measures. What about the scale of commerce potentially affected? As noted earlier, it is well known that the amounts of trade subject to trade defense investigations are typically small (although the 2012-3 dispute between the European Union and China over solar panels was a notable, €20 billion exception). In the absence of any Smoot-Hawley tariff increases by any of the major trading powers, so the argument goes, surely the amount of trade affected is trivial?

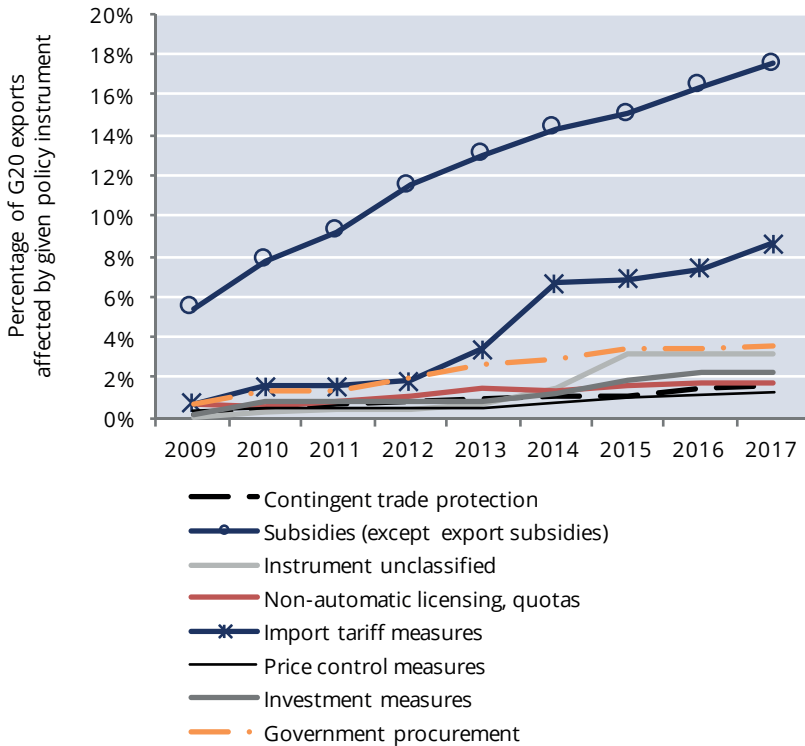
In preparing this chapter, we calculated the share of G20 exports that face either a discriminatory policy instrument in a foreign market, compete with a subsidized foreign rival that is based in that third market, or compete with a foreign rival that has received state incentives to export to that third market. We only considered measures that have been implemented since November 2008.

In 2016, the G20 nations exported just under \$9.3 trillion of goods, covering a substantial share of world trade. In gauging the results that follow, while a 2% trade coverage ratio may look small, it does imply that \$185 billion of trade was potentially affected in 2016. Of course, the G20 is not the world and trade in goods is only one form of cross-border commerce. Both limitations imply that the scale of trade affected by crisis-era protectionism presented here will be underestimates.

We used product-level (technically, six-digit HS codes) data on trade flows in preparing these calculations. For every discriminatory measure, we took account of the products implicated by that measure, the government responsible for that measure, and the known trading partners for the product in question. As trade flows tend to react to discriminatory measures, we used pre-crisis trade data (for 2005-7) to weight each trade flow once the crisis began. We also took account of when measures were enacted in a year. For example, if a measure lasted for only two months during a year, we discounted the annual trade flow affected by 10/12ths to reflect the fact that for ten months the measure was not in force.

Figure 5 reports the percentage of G20 exports that faced import tariff increases, trade defense and safeguard actions, localization requirements, and discriminatory public procurement measures during the years 2009 to 2017. In addition, the figure shows the percentage of G20 exports that had to compete in the home market of a foreign firm that had been bailed out.

Figure 5: The shares of G20 exports facing tariff increases and having to compete with bailed-out firms in their home markets has risen markedly



Source: Global Trade Alert, 11 October 2017.

The initial crisis response witnessed in 2009 resulted in over 5% of G20 exports competing against a bailed-out firm in its home market. Smaller percentages of G20 exports faced higher tariffs in 2009. These totals were to rise, however. By 2017, over 17% of G20 exports, an amount that exceeds \$1.4 trillion in trade, competed with firms that have been bailed out during the crisis or whose domestic operations have been subsidized. Furthermore, more than 8% of G-0 exports faced a tariff increase, covering at least \$740 billion of exports. In line with the WTO monitoring reports,⁷ we find the amount of trade covered by trade defense and safeguard measures to be small, relatively speaking. We estimate that localization requirements affected \$213 billion of trade in 2017,

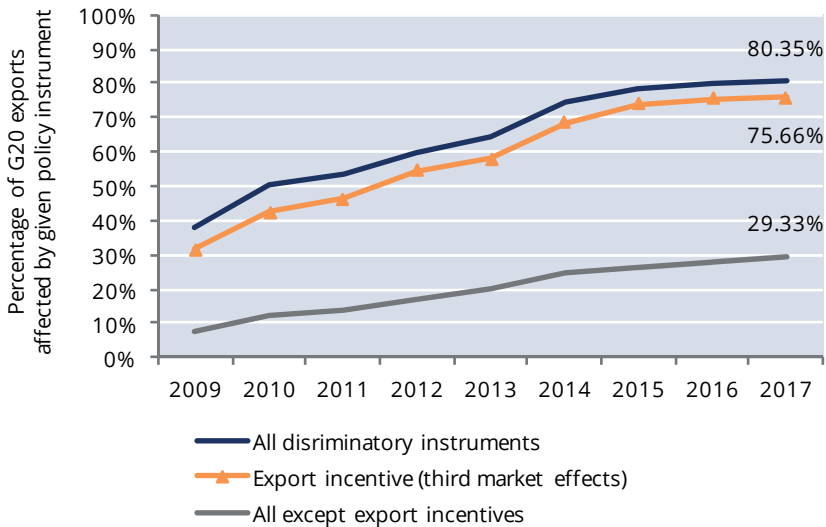
7 The “headline” trade coverage ratios that are found in the WTO’s monitoring reports cover only a narrow range of *import* restrictions. The WTO computes these ratios for the new measures in each reporting period implemented by G20 countries and does not present cumulative totals of the trade affected by all measures still in effect at a point in time, as we do.

a sizeable amount for a measure that in the eyes of many analysts had been banned by the Agreement on Trade-Related Investment Measures (TRIMs).

The amount of trade covered by the trade restrictions identified in Figure 5 and that competes in the home markets of bailed-out firms, however, pales in significance to that covered by state-provided export incentives. As Table 1 shows, the BRICS nations made frequent use of export incentives. Most of these incentives operate through national tax systems (some of the most far-reaching are related to value added taxes, but some are not.) Such incentives can force rivals to lower prices, shrinking profit margins and diminishing the incentive to export in the first place. Moreover, uncertainty over the size of such export incentives can deter foreign rivals.

The full extent of G20 exports facing subsidized competitors is revealed in Figure 6. As nations have progressively expanded the range of products eligible for export incentives, the percentage of G20 exports competing against subsidized rivals in third markets has expanded to 80% in 2017, rising 42 percentage points in eight years.

Figure 6: The percentage of G20 exports that face competition from subsidized rivals in third markets has risen 40 points in just six years



Source: Global Trade Alert, 11 October 2017.

In sum, in terms of scale, crisis-era discrimination against foreign commercial interests is more about export expansion than import contraction. Having said that, even if export incentives are excluded, 29% of G20 exports currently face some type of trade distortion introduced since the crisis began. The long-held principle of non-discrimination has taken a battering during the crisis era, and the latest data available suggest that there is no end in sight (Evenett and Fritz, 2015).

In recent years, more evidence has come to light of the importance of state competition in the provision of export incentives. The prolonged haggling in the US Congress concerning the reauthorization of the US Export-Import Bank is well known. It should not be forgotten too that France and the United Kingdom took advantage of this situation to lure production and jobs by US multinational General Electric. The then-CEO of General Electric, Mr. Jeff Immelt, went on record with the following statement:⁸

“In today’s competitive environment, countries that have a functional Export Credit Agency (ECA) will attract investment...Export finance is a critical tool we use to support our customers. Without it, we can’t compete against foreign competitors who enjoy ECA financing from their governments. We are fortunate to have the support of UK Export Finance (UKEF), one of the most flexible ECAs in the world. The UK is pro-export and pro-manufacturing.”

The expansion in recent years in various forms of support for exporters has been documented in a report in the *Financial Times*.⁹ Given the range of support documented in that article, the assumption that export finance merely corrects for market failures ought to be revisited.

In the interest of balance, it should be noted that certain developing countries have not just been expanding their export incentives, but also “improving” the implementation of existing schemes so as to pay exporters more. A leading example comes from China. At a press conference at the State Council on 17 July 2015, Mr. Wang Shouwen, Vice-Minister of Commerce for China, stated:

“During January to June, China’s volume of export tax rebates has increased 12.4 percent over the same period last year, which is far higher than the growth of export volumes and has greatly boosted the growth of foreign trade exports.”¹⁰

8 See <http://www.reuters.com/article/2015/09/24/ct-ge-idUSnBw245620a+100+BSW20150924>; see also <https://www.gov.uk/government/news/prime-minister-welcomes-export-framework-with-general-electric>.

9 See <http://www.ft.com/intl/cms/s/0/fe1a26be-1be1-11e5-8201-cbdb03d71480.html>.

10 See http://english.gov.cn/news/policy_briefings/2015/07/17/content_281475148824853.htm.

Practitioners and analysts of the world trading system who are committed to the principle of non-discrimination ought to be critical of every deviation from this norm. It is unfortunate that the term “protectionism” has long been associated with reducing imports. This may well have created a blind spot towards measures that artificially favor domestic firms when they export products to third markets.

Ironically, this evidence comes to the fore after WTO members at their Ministerial Conference in December 2015 agreed to eliminate, once and for all, agricultural export subsidies. If one accepts the argument that subsidy wars in agriculture are wasteful, then what makes rivalry over other export incentives different? Having written this, it would be wrong to infer that revising the WTO's subsidy code is the only trade policy-related lesson from the global economic crisis.

Implications for the future work program of the WTO

Coming on top of the decade-and-a-half long struggle over the Doha Round, the global economic crisis has exposed further deficiencies in the operation of the WTO. Since this is a member-driven organization, it would not be appropriate for the WTO Secretariat to shoulder all of the blame. The latter is not immune, however, from criticism. Its weak monitoring of protectionism has provided cover for those diplomats and government officials who ultimately are not committed to upholding the principle of non-discrimination in international commerce. From the point of view of global governance, if the WTO Secretariat is unable to effectively monitor its member governments, then consideration should be given to assigning this role to another official institution.

Moreover, the mismatch between the extensive resort to discrimination against foreign commercial interests and the limited number of disputes brought to the WTO for settlement begs further questions. If the discrimination is legal, then do existing WTO rules provide for such little constraint on government behavior? If the discrimination is illegal, why are so few cases brought? Could a “glass houses syndrome” exist whereby “people who live in glass houses don't throw stones”? Is the counterpart to the mutual indiscipline over protectionism mutual restraint in bringing dispute settlement cases? If so, a key weakness of the WTO Dispute Settlement Understanding – namely, that only WTO

members can bring cases – needs to be addressed.¹¹ Otherwise, even with the best possible rulebook, WTO obligations could be effectively suspended when a systemic crisis motivates major trading powers to simultaneously introduce discrimination against foreign commercial interests.¹²

The finding that another global economic crisis has brought to the fore prominent forms of protectionism not seen much in previous crises reflects the incentives created by an incomplete WTO rulebook. Tighter rules on subsidies, localization requirements, and trade finance are needed. An ambitious WTO work program would also include negotiating new rules on export taxes and expanding the reach of the Agreement on Government Procurement. The considerable leeway many governments have to raise tariffs without breaking their WTO obligations is another matter that could be addressed as part of a package of reforms.

Of course, it is always possible to put together a wish list of items for the WTO membership to work on. However, the purpose of this exercise was to demonstrate that the recent global economic crisis has revealed significant deficiencies in the edifice of WTO rules. Making an effort to remedy their weaknesses – and bearing in mind the different types of cross-border commerce witnessed in the first quarter of the 21st century – ought to be a priority for the WTO membership. There is plenty to be getting on with.¹³

In sum, once one accepts that there has been considerable resort to discrimination against foreign commercial interests during the crisis era, then a series of awkward questions arise concerning the effectiveness of the multilateral trading system. These questions relate to the full range of the WTO's functions – going well beyond a minor tidying up exercise. Many national and international institutions have been thoroughly overhauled after their deficiencies were exposed during the global economic crisis – the World Trade Organization should be no exception.

11 In the European Union, for example, the European Commission – acting in its role as “guardian of the treaties” – can bring legal cases against member states before the European Court of Justice.

12 This may be the most significant lesson from the global economic crisis for the governance of world trade. There are strong complementarities between fixing the WTO rulebook and strengthening its dispute settlement function. Put differently, the benefits from improving one are conditional in part on improving the other.

13 Of course, it must be conceded that incremental improvements in the WTO rule set that result in an incomplete set of rules will still offer opportunities for circumvention whenever the next global economic crisis hits. Practically speaking the process of filling in the WTO rule set will take decades, if it ever comes to pass. These observations may qualify expectations about what a rules-based trading system could ever accomplish in taming the resort to protectionism during global economic crises.

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CHAPTER 9

Regional Trade Agreements and the WTO

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Introduction

Regional trade agreements (RTAs) are negotiated modalities for trade between two or more customs territories,² to the exclusion of others.³ By their nature, members of RTAs seek to grant trade preferences to each other, usually in the form of access to their markets, thus discriminating against non-members. Members of RTAs need not be geographically contiguous, or even close to each other; all that is needed is that they agree on arrangements for trade between themselves. RTAs have always dealt with reciprocal tariff reductions, but they are now increasingly complex, often with provisions for, *inter alia*, customs administration, standards, safeguards, services regulations, intellectual property and dispute settlement; some extend to competition, investment, labor and environment policies.

RTAs are a sub-set of preferential trade agreements (PTAs). These also include arrangements under which countries or customs territories *unilaterally* grant non-reciprocal trade preferences to other trading partners. Chief amongst these is the Generalized System of Preferences (GSP), under which (mainly developed) countries grant preferential tariff access for imports from developing countries,

1 I thank staff of the RTA Section at the WTO, led by Rohini Acharya; their advice was invaluable but the mistakes are mine

2 Normally these are countries, but I have used the phrase “customs territories” to include entities such as Hong Kong, China, and Macao, China – which are separate customs areas from China, each with their own trade policies – and to include a set of nations that collectively have a single trading identity, such as the European Union.

3 The term “regional trade agreement” is a bit of a misnomer, in that they are often not regional; traditionally, the WTO uses the term for such arrangements.

with each GSP “donor” maintaining its own list of preferences and conditions under which the “recipients” are eligible for the more favorable treatment of their exports to the territory of the GSP provider. Other non-reciprocal preference-granting initiatives include i) the European Union’s Everything But Arms (EBA) initiative, under which all imports – except armaments – from all Least Developed Countries (LDCs) to the European Union are tariff-free and quota-free; and ii) the African Growth and Opportunity Act (AGOA), under which imports of certain goods – mainly textiles and clothing – to the United States from eligible African countries are duty-free and quota-free.

This chapter deals essentially with RTAs and their status in the World Trade Organization (WTO), referring only in passing to the WTO coverage of unilateral, non-reciprocal initiatives.

RTAs have proliferated since the early 1990s, with just under 360 now in force compared to fewer than 100 in 1994, the year before the formation of the WTO. They also have their own terminology, with terms such as “free trade area”, “customs union”, the more prosaic “spaghetti bowl” and, more recently, “mega-RTAs.” The next section will deal with the present landscape and definitional framework of RTAs, including their coverage. Following this the chapter will turn, in the third section, to the possible reasons for negotiating RTAs and the rapid growth in their number. The fourth section in a sense gets to the heart of the matter, examining the provisions under which members of RTAs are authorized under WTO rules to provide preferential treatment in their trade relations with each other, thus departing from the cornerstone principle of the WTO of *non-discrimination*. The intent, or economic rationale, of these provisions is to ensure that an RTA strengthens – or at least does not weaken – the multilateral trading system, but it is not always an easy matter to know whether this is indeed the case. The section therefore also looks at the relatively recent RTA Transparency Mechanism, which is a peer review exercise to improve the understanding of individual RTAs and, it is hoped, their abidance of WTO disciplines. The chapter then goes on to question, in the fifth section, whether RTAs, through their departure from non-discrimination, undermine the role of the WTO as the guardian of the multilateral trading system, particularly in light of the putative move towards very large RTAs such as the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP), which, although they may now not come to fruition, nevertheless merit some mention. The final section briefly concludes.

The RTA Landscape

RTAs come in many shapes and forms, but generically they are either free trade agreements (FTAs) or customs unions (CUs). The two or more members of an FTA reduce the barriers to trade between themselves but retain independent trade policies; thus, for example, tariffs on imports from FTA partners will be lowered (normally to zero), but each member of the FTA will maintain its own tariffs vis-à-vis imports from non-members. Such an FTA may cover both goods and services, though technically a services FTA is known as an “economic integration agreement.” An FTA may also cover less than substantially all of the trade in goods between partners, and is then called a “partial scope” agreement.

As members of an FTA retain their own tariffs for trade with non-members, *rules of origin* are needed to identify products from members that are eligible for the lower duties and restrictions that apply to trade between members. In the absence of such rules of origin, non-members could divert their product to the member of the FTA with the lowest duty on that product and then tranship it to the final destination in the FTA. For example, if FTA members *A* and *B*, with zero duties on trade between themselves, imposed duties on imports of motor vehicles from non-members of 10% and 5%, respectively, then a non-member exporting motor vehicles to *B* could initially ship them to *A* and then tranship duty-free to *B*, thus saving 5%; rules of origin prevent such diversion.

One of the largest FTAs is the North American Free Trade Agreement (NAFTA). With Canada, Mexico and the United States as members, NAFTA accounts for some 14% of world exports. It provides duty-free treatment for virtually all goods originating in the members, has an extensive services component, deals also with non-tariff barriers, standards, competition, investment, intellectual property and trade disputes between members, and has supplemental agreements to handle labor and environmental issues. In trade parlance, it is known as a *deep* agreement, as opposed to a *shallow* agreement that would cover border measures but little else. Other large FTAs include the agreement between the Association of Southeast Asian Nations (ASEAN)⁴ and Japan, which applies only to goods and is thus a “true” FTA as compared to one – like NAFTA – that also has a services component, with this component then being known as an “economic integration agreement” (see above); the ASEAN Free Trade Agreement (AFTA), which applies to goods

4 The members of ASEAN are Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam; Papua New Guinea is an observer.

and is relatively unusual in that its members are all developing countries, a self-designation in the WTO; agreements between ASEAN and, respectively, China, India and the Republic of Korea, all of which are goods and services agreements; and the European Free Trade Association (EFTA),⁵ which is also a goods and services agreement. These FTAs were to be joined by a mega-FTA, the Trans-Pacific Partnership (TPP), which was signed in February 2016 but from which the United States has now withdrawn and which has not come into force; its membership would have accounted for around 40% of the global economy.⁶ Eventually, although it is also starting to look unlikely, the Transatlantic Trade and Investment Partnership (TTIP) which is currently being negotiated between the European Union and the United States may also join the ranks of FTAs. In addition, negotiations are underway for the Regional Comprehensive Economic Partnership (RCEP) between the 10 members of ASEAN, Australia, China, India, Korea and New Zealand.

Examples of smaller FTAs include agreements between Georgia and Armenia (goods); Guatemala and Chinese Taipei (goods and services); Hong Kong, China and Chile (goods and services); and India and Nepal (goods), which has rather limited coverage and is thus also known as a “partial scope agreement.”

To date, some 250 FTAs with substantial goods coverage have been notified to the WTO.⁷ In addition, the WTO Secretariat is aware of about 70 such agreements that have not (yet) been notified.⁸ Over 150 FTAs with a services (“economic integration agreement”) component have been notified to the WTO, although a limited number of these are part of customs unions (see below); there are probably about five such agreements that remain un-notified. Finally, there are in the order of 23 partial scope agreements.

The second generic category of RTAs is customs unions, of which some 30 have been notified to the WTO. The defining feature of a CU is that its members have a common external tariff. There is therefore no need for rules of origin between the members; once products are in the territory of the CU, they are technically free to move to any part of the CU, albeit subject to the regulatory, non-tariff provisions of each member of the CU.

The largest CU is the European Union, with a share of some 16.7% of the world’s exports of goods and services (not including intra-EU trade). Intra-EU trade, underpinned by the free flow of goods and services within the European Union, is very significant and accounts for some 50% of the

5 EFTA members are Iceland, Liechtenstein, Norway and Switzerland.

6 The 12 members of TPP are Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Vietnam.

7 Source: <https://rtais.wto.org/UI/publicsummarytable.aspx>.

8 Source: WTO document WT/REG/W/119, 12 September 2017.

exports of almost each of the members. As an indication, in 2015 total EU merchandise exports accounted for 33.7% of world exports, whereas extra-EU exports accounted for just 15.2%.⁹ This rather remarkable degree of integration reflects¹⁰ the comprehensiveness of the agreement, which has provisions on not just tariffs but virtually all aspects of trade in goods and services between the members, including competition, domestic regulation, environment, government procurement, intellectual property, labor, mutual recognition (services), standards and subsidies. Indeed, the EU has a single trade policy and, unlike all other RTAs, speaks with one voice at the WTO.

The EU is also an example of an *open* RTA. If a country is able to accept and implement the *acquis communautaire* (EU law) and the existing members agree, it can apply and/or be invited to accede to the EU. Since the Treaty of Rome of March 1957, the original six members (Belgium, France, Italy, Luxembourg, the Netherlands and West Germany) have increased to 28.¹¹

Other examples of CUs include the Central American Common Market (CACM),¹² which is for goods only; the East African Community (EAC),¹³ which is for both goods and services; EU–Turkey, which is for goods only (and is emblematic of the fact that the EU has RTAs with each of its neighbors among its total of 37 RTAs, making it the WTO member with the largest number of RTAs);¹⁴ the Southern African Customs Union (SACU),¹⁵ which is for goods and is arguably the oldest CU, having been founded in 1910; and the Southern Common Market (MERCUSOR),¹⁶ for both goods and services.

In all, as noted, 30 CUs have been notified to the WTO.¹⁷ The question arises as to why there are so few CUs compared to FTAs. The answer is reasonably straight-forward: there is a larger cession of sovereignty in adopting a common external tariff (as in a CU) than in retaining national tariffs vis-à-vis third countries (as in FTAs).

The lexicon of RTAs contains some cute terms, which nevertheless point to real phenomena. Most prominent among these is the phrase “spaghetti bowl.”¹⁸

9 Source: https://www.wto.org/english/res_e/statis_e/wts2016_e/wts2016_e.pdf.

10 I use the word “reflects” advisably because causation is not clear.

11 The members are Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovak Republic, Slovenia, Spain, Sweden and the United Kingdom.

12 The members are Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.

13 The EAC’s members are Burundi, Kenya, Rwanda, Tanzania and Uganda.

14 Alone among RTAs, the European Union is a WTO member in its own right, as are each of the Union’s 28 members.

15 SACU’s membership consists of Botswana, Lesotho, Namibia, South Africa and Swaziland

16 Its original members were Argentina, Brazil, Paraguay and Uruguay.

17 Source: <https://rtais.wto.org/UI/publicsummarytable.aspx>.

18 The term was first used by Jagdish Bhagwati in his 1995 paper “U.S. Trade Policy: The Infatuation with Free Trade Agreements” (Bhagwati, 1995).

This refers to a complex network of RTAs (Annex 1) and the complications that may then arise. For example, through various arrangements, a country may be party to more than one RTA with another trading partner, as is the case for Singapore, which at present has three separate RTA links with New Zealand¹⁹ and would have had a fourth had TPP come into force. The same Singapore product may thus be subject to three different rules of origin to qualify for preferential tariff access to New Zealand; similarly, as RTAs are normally phased in such that the preferential tariff may not be zero, the same product may face three different tariffs into New Zealand. This could certainly increase “search costs,” although in the case of Singapore the authorities have put in place a superb website to keep its exporters fully informed and to facilitate decisions. Moreover, if the producer seeks preferential access for the product elsewhere under another FTA, the rules of origin may again be different. This might require a number of distinct production processes for the same product, potentially reducing the benefits of economies of scale. When referred specifically to trade among Asian countries, the spaghetti bowl becomes the “noodle bowl.” Note that these spaghetti/noodle bowl effects could apply not just to tariffs and/or rules of origin, but also to all other arrangements between the members of an RTA (the regulatory environment, intellectual property rights protection, etc.).

An associated word is “lasagnas,” which refers to a consolidation among RTAs such that the spaghetti/noodle bowl becomes less complex. An example of this is the Mexico–Central America agreement, which replaced bilateral agreements between Mexico and Central American countries.

Figure 1, compiled by the WTO Secretariat, shows the evolution and stock of RTAs notified to the WTO up to late 2017. In all, there were 284 RTAs in force; in addition, as noted above, the Secretariat knew of at least 70 RTAs that had not been notified.

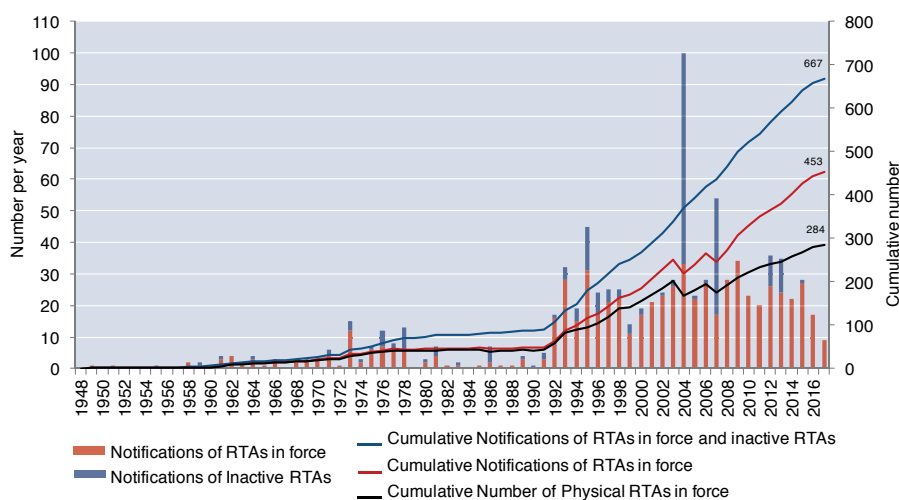
The cumulative total of notifications of RTAs in the period from 1948 to late 2017 is over 650, of which over 450 were notifications of RTAs still in force. The reason why the number of notifications exceeds the physical number of RTAs in force is that, under WTO procedures, the goods and the services components of RTAs are notified separately, as are accessions to existing RTAs.

Total notifications include both notifications of RTAs currently in force and past notifications of RTAs that are now no longer active or in place, mainly reflecting both the evolution of agreements as they are superseded by “deeper

19 These are the ASAEN—Australia/New Zealand FTA, the Agreement between New Zealand and Singapore on a Closer Economic Partnership (ANZSCEP) and the Trans-Pacific Strategic Economic Partnership (TPP/ETA) between Brunei Darussalam, Chile, New Zealand and Singapore.

integration” agreements among the same members²⁰ and the “lasagna” effect, sometimes as a result of EU enlargement. Thus there is a spike in the deactivation of RTAs in 2004, when 12 new members acceded to the European Union. Prior to accession, each new member had an RTA with at least one other new member and also with the European Union, all of which were then replaced by membership of the European Union.

Figure 1: Evolution of regional trade agreements in the world, 1948-2017



Note: Notifications of RTAs: goods, services & accessions to an RTA are counted separately. Physical RTAs: goods, services & accessions to an RTA are counted together.

Source: WTO Secretariat.

In summary, in force in late 2017 were 141 RTAs in goods only, 142 RTAs in goods and services and one RTA in services only (the latter being the European Economic Area, or EEA, with the 28 EU and four EFTA countries as its members). Three other points are worth noting: i) the prevalence of RTAs is such that all WTO members are now party to at least one RTA, with Mongolia, for a long time the only member without RTA links, entering into an agreement with Japan in June 2016; (ii) the vast majority of the RTAs are bilateral, essentially because they are easier to negotiate; and (iii) the “deeper” agreements are invariably between the more developed economies. Indeed, there are as yet few RTAs between developed countries and LDCs, an aspect that is dealt with in more detail below

20 For example, bilateral agreements between the European Economic Communities (EEC) –the forerunner of the European Union– and a number of Mediterranean countries were later replaced by “deeper” agreements among the same parties to include, for instance, competition, investment and intellectual property.

Figure 1 also shows the growth in the number of RTAs. Following some 40 years of relative calm after 1948, the number of RTAs has grown almost exponentially since the early 1990s. This has made the trading system more complicated, probably reducing transparency and predictability, and introducing considerable discrimination among trading partners. These factors could contribute to making it more difficult for individual traders to arrive at decisions, thus possibly increasing contract-costs and prices. The obvious question, and the subject of the next section, is: “Why so many RTAs?”

The “Whys?” and “Why Nots?” of RTAs

Governments are not confused about the gains from trade; by and large, they agree on the possibility of such gains. National administrations understand that a more liberal trade regime is likely to result in less bias in the transmission of international price signals, thus fostering more efficient resource allocation and improving a country’s consumer, and even, production potential. The composition of output is likely to shift towards internationally competitive sectors, increasing the exports, employment and wages in those sectors, and away from import- competing activities, which will shed employment. Thus, while the price of, say, a t-shirt may decline – due to t-shirts now being sourced from competitive external producers – there could be noisy protests from the unemployed in the shrinking sectors. Although (and this is well established in economic theory) the “winners” could compensate the “losers,” resulting in a net overall gain, this could require changes in social and fiscal policy that may be politically difficult to achieve. In short, if economies are to reap the benefits of a more liberal trading regime, there needs to be adjustment, and this can be painful.

Governments seeking to liberalize their external trade regimes would often prefer to do so in the context of comprehensive multilateral negotiations, such as the WTO’s Doha Development Agenda (DDA). This would strengthen – or at least not weaken – the non-discrimination, transparency and predictability characteristics of the WTO-led multilateral trading system, which is widely regarded economically as the first-best option for achieving the gains from trade. Also, and very importantly, it would offer significant trade-offs that, from a political point of view, would allow the export sectors in a country to “buy off” the import-competing producers (“yes we may be opening our markets to import competition, but our export opportunities will increase substantially, making us better off”). Note that this is a purely mercantilist argument (“exports are good, imports are bad”), whereas in fact it can be shown, as above, that

liberalization can be its own reward.²¹ Unfortunately, or otherwise, the politics of liberalization work in this manner – trade agreements are treaties and they need to be ratified!

The ideal is difficult to achieve. The Uruguay Round was launched in 1986 and was concluded successfully in 1994. Since then success has been much more difficult to find. The DDA was initiated in 2001, but to date progress has been extremely sluggish at best, with few results except for the notable exceptions of the Trade Facilitation Agreement, the RTA Transparency Mechanism (which is being provisionally applied), and decisions related to food security and export competition. The reasons are clear – the WTO has 164 members (as of end-November 2015), each with its own agenda and red-lines, which can and do change over time. It is therefore extremely difficult to find consensus, which is the way the WTO makes decisions,²² especially since an agreement establishes obligations that are legally binding. Given this reality, and the fact that governments will continue to seek the benefits that trade can bring, they are likely to look elsewhere for partners. This also brings the advantage that they can extend their potential agreements into areas not covered by the multilateral trade negotiations, such as competition and investment.²³ These factors were certainly influential when TPP and TTIP were mooted. And indeed Figure 1 shows that there has been a bit of an acceleration in the number of RTAs notified and brought into force since 2008, when it became evident that the already slow progress on the DDA, which arguably had already contributed to the growth in the number of RTAs, was going to falter even more, perhaps leading to the agreement's demise.

There are many other reasons, both economic and/or political, for entering into a particular RTA. Important among these is better *access* to a large market than that provided under that country's membership of the WTO. This was certainly a consideration for New Zealand when it entered into China's first country-to-country, bilateral RTA in October 2008.²⁴ The agreement was *procedurally* important for China also, because New Zealand denoted China as

21 As a corollary, and from the consumer perspective (and we are all consumers), imports are good because they improve consumer choice, and exports are bad because they reduce domestic consumption possibilities, with their role then being to pay for imports.

22 There is provision for voting, but it has not been used.

23 At the outset of the DDA, the negotiating mandate included competition, investment, government procurement and trade facilitation, known as the "Singapore issues" because they were first brought onto the WTO agenda at the 1st WTO Ministerial Conference in December 1996. All but trade facilitation were subsequently dropped, not least because many developing countries were not comfortable with their inclusion and it was thought that this might be slowing progress on the DDA.

24 At that point China was already part of the Asia Pacific Trade Agreement (APTA), a partial scope RTA to which it acceded in 2002, and had goods and services FTAs with ASEAN (2005) and with Hong Kong, China and Macao, China (both 2003).

a “market economy,” which is a status that provides somewhat more favorable treatment in the application of the WTO’s trade remedy provisions.

Countries have sensitive sectors – ones they would like to protect – such as agriculture in many countries (both developed and developing), textiles and clothing, and steel (mainly in developed countries). This could facilitate negotiations with *like-minded partners* for RTAs, or at least those that are less likely to pressure them on the sensitive sectors. Thus, for example, EU bilateral RTAs are generally very light on agriculture (indeed, the European Union’s customs union with Turkey excludes agriculture), those of Japan and Korea tend to avoid rice, and those of the United States are careful to retain special provisions for clothing, usually through the retention of high tariffs and rules of origin that may in fact be “fiber forward” (the raw material needing to be grown in the exporting country). “Like-minded” can also apply, of course, to those who seek partners to agreements that go beyond the normal WTO disciplines, such as the US–Australia RTA (2005), which includes provisions on competition, environment and labor and is WTO-plus on matters such as trade-related intellectual property rights.

RTAs are also used to *lock in* reforms. A telling example of this is Chile, which since its first RTA (with Mexico in 1991) has used an RTA strategy to systematically lower its applied tariffs, with a view, *inter alia*, to improving domestic resource allocation. It also serves as an example of using RTAs for *learning by doing*. When first setting out to enter into the trading system, a country’s traders need to learn how to do so, and this is perhaps best done by encouraging contracts with those with a similar culture, language, and so on. Such RTAs can be instrumental in informing how to negotiate and can subsequently lead to deeper RTAs, as was the case for both Chile and Mexico. A more recent example of this is the Japan–Mongolia Economic Partnership Agreement, signed in February 2015. This agreement also serves as an example of the “defensive” or, closely related, “bandwagon” and “domino” reasons behind RTAs. If *A* negotiates an RTA with *B*, a close trading partner *C* is likely to be close behind in seeking RTAs with both *A* and *B*; thus the Chile–Korea Agreement was relatively closely followed by the Chile–Japan Agreement. More generally, when the United States joined the European Union in adopting “regionalism,” side by side with “multilateralism”, as a trade policy track (with US–Israel, US–Canada and then NAFTA), it became clearer, indeed indisputable, that RTAs were a permanent feature of the trade landscape. Others quickly sought to follow the trend – not least Japan and Korea, which had hitherto been adherents of “multilateralism” only – and began to consider/request RTAs either with major traders or with each other as a defensive action.

Politics also plays an important role. In fact, trade policy is integral to the foreign policy of many countries, with RTAs a possible element for strengthening diplomatic ties. The Treaty of Rome, establishing the EEC, was not without a certain political motive, with the idea in the background that “those who trade with each other do not go to war with each other.” Equally, the recent enlargements of the European Union to include Central and Eastern European countries was motivated at least in part by the notion that integration into a democratic, market-oriented system would provide those countries with a stable platform for their reforms. Also, it is difficult to credit that the United States’ agreements with Israel and Jordan were motivated only by economic factors, nor indeed its agreement with Panama. There are many more such examples, probably including TPP. In fact a look at Figure 1 shows that the surge in RTAs coincided roughly with the dissolution of the USSR. Many of the newly emerged countries, and those previously in the sphere of influence of the former USSR, sought RTAs as a step or “building block” towards their fuller integration into the multilateral trading system. Indeed, as with any country entering into an RTA, they may have acquired valuable technical and negotiating skills, as well as important allies, for their role in the WTO system. Also, on a slightly cynical note, trade ministers are politicians and need to demonstrate achievements to retain their portfolios; the signing of an RTA is a marvelous photo opportunity!

But RTAs have downsides. These include, as already noted, the beclouding of the trading environment with discrimination and complexity – the “spaghetti bowl” is real. Also important among the negative aspects of RTAs is that they tend to *divert* trade – imports are sourced from preferential partners rather than from the world’s low-cost suppliers, resulting in losses in efficiency and to consumers. Moreover, RTAs have *holes* that reduce their benefits. It is, for example, very difficult (if not impossible) to agree bilaterally, or even in a larger grouping, on effective measures to limit trade-distorting domestic support for agriculture; this can probably only be done in a multilateral setting. However, RTAs also can and do *create* trade – this is in fact their purpose – although this benefit can be reduced, inter alia, by exclusions from the coverage of an RTA. The trade-off between trade creation and diversion is central to WTO provisions on RTAs, and its discussion leads in the next section.

An RTA entails costs for traders. The additional search costs have already been noted. Compliance with the rules of origin, and the paper work involved, can also be expensive, sometimes to the point of eliminating an RTA’s margin of preference for the product. This can be exacerbated by the fact that the production process might need to be changed to meet the rules of origin. Anecdotal evidence suggests that a margin of preference of up to six percentage

points may at times not be enough to compensate for the additional costs; traders may then choose to access the market using the “most favored nation” (MFN) tariff, applicable to imports from non-preferential sources.

RTAs can attract attention and resources of even the largest national administrations away from the multilateral trading system. They then become a *stumbling block* to improvements in the acknowledged “first best” for the conduct of trade. And this can happen in other ways. A country with preferential access to an important market for its main exports may block a multilateral tariff deal to prevent its preference margin being reduced; in effect, it would seek to limit competition.

As a final point in this section, RTAs can marginalize smaller trading nations, including LDCs. The fostering of freer trade through RTAs may help accustom countries to competitive pressures and to sophisticated regulatory regimes, and thus may promote wider agreement on – i.e. be a building block towards – a stronger, more liberal multilateral trading system. But the smaller traders, and African LDCs in particular, are rarely partners to an RTA with major, competitive traders, which may place them at a disadvantage in the constantly changing trading environment. These countries invariably do have access to the preference schemes of their partners, but these are unilateral and can be changed or withdrawn – there is more than one example of foreign direct investment leaving a country as the latter’s preferences into a particular market (or markets) are altered.

RTAs now pervade the trading environment and, as noted, there are arguments both for and against their continued presence and growth. The question is urgent, therefore, as to how they are accommodated in the WTO, as the anchor and guardian and of the multilateral trading system.

RTAs in the WTO

The WTO is an economic organization encased in law. The rights and obligations of members are designed to help them reap the gains from trade, but they are written in legally binding form, with a legal contract then underpinning economic intent. So too with RTAs: the economic concept of net trade creation provides a possible rationale for the WTO to allow the discrimination of RTAs as an exception to its cornerstone tenet of non-discrimination.

Table 1 may help to explain the concept. Consider three separate cases:

1. Home produces a good at 35, Partner at 25, and the Rest of the World (RoW) at 20. Home maintains a zero tariff on imports. Home will then import the product from RoW for the maximum gain for consumers – it is the optimal outcome.
2. Home has a tariff of 100%, raising the prices of Partner’s and RoW’s products to 50 and 40, respectively. It buys the Home product; there is no trade. Then it enters into an RTA with Partner, such that there is a zero tariff on Partner’s product. It imports from Partner at 25, which is better than the Home price of 35; this is *trade creation*.

Table 1: Trade creation/diversion

	Home	Partner	Rest of world
Price	35	25	20
Tariff of 100%	35	50	40
Tariff of 50%	35	37.5	30

3. Home has a tariff of 50%, raising the price of the good from Partner and RoW to 37.5 and 30, respectively. Home imports from RoW at 30 and it collects 10 in tariff revenue – the net cost to Home is actually 20. It then enters into an RTA with Partner. It switches (“diverts”) its source of imports from RoW to its RTA – imports now cost 25 rather than 30, but the tariff revenue of 10 is no longer collected, for a net cost of 5. Thus, *trade diversion* is costly.

The economic position that follows from this is that if an RTA is *net trade creating*, the system as a whole will benefit. But this is what economists call a “comparative–static” result as nothing else has changed; the dynamics of a situation, such as changing tastes, could alter the outcome. That is, it is very difficult to know whether an RTA is or will be net trade creating, or otherwise.

The WTO’s disciplines on RTAs reflect this difficulty. Article XXIV of the WTO’s General Agreement on Tariffs and Trade (GATT), complemented by its Understanding as agreed in the Uruguay Round, provides the legal framework for RTAs in trade in goods. Article V of the WTO’s General Agreement on Trade in Services (GATS) does the same for RTAs in trade in services. The 1979 Enabling Clause provides for the mutual, preferential

reduction of tariffs and non-tariff measures among developing countries.²⁵ These provisions represent the “permission” for WTO members to enter into RTAs. But there are conditions.

GATT Article XXIV requires, *inter alia*, that in forming an RTA, the duties and other restrictive regulations of commerce, except those permitted under WTO rules, be eliminated with respect to *substantially all the trade* between the parties. GATS Article V requires *substantial sectoral coverage* and the absence or elimination of *substantially all discrimination*. The Enabling Clause does not have such requirements. Article XXIV also stipulates that the duties and other regulations of commerce (note the absence of the word “restrictive” in comparison to the earlier language) applied by the parties to an RTA shall not be higher or more restrictive with respect to third parties than those prior to the formation of the RTA – the so-called “general incidence” clause, in the case of customs unions.²⁶ In the case of the Enabling Clause, members to an RTA are admonished not to raise barriers to, or to create *undue* difficulties for, the trade of other WTO members. That is, RTAs are expected to be at least neutral with respect to their trade with third parties. Nor is there agreement in the WTO on important lacunae, such as preferential rules of origin, which could bring uniformity to how such measures are to be evaluated.

The intention of the above phrases is clear: an RTA should be to the benefit of the system – it should be net trade-creating. The problem is also clear: how is any of this to be measured? These are normative matters that defy obvious quantification. And what is the difference between “other restrictive regulations” and “other regulations”? Some have suggested that 95% would be a “good” measure for “substantially all the trade,” but even at 100% there could be net diversion, for example, as a result of preferential investment rules or WTO-plus trade in intellectual property requirements. The point is that conditions evolve – a non-restrictive regulation may be changed to become restrictive for non-preferential partners, as could be the case for the recognition of professional standards. In short, it is very difficult for members to assess whether an RTA complies with WTO rules. It is not surprising then that only one RTA has ever been found to be compliant, namely the customs union between the Czech Republic and the Slovak Republic, which was established when Czechoslovakia became the two republics and which “disappeared” when both states acceded to the EU in 2004. Nor does WTO Dispute Settlement

25 Its full name is the 1979 Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries. The Enabling Clause also provides the necessary waiver from non-discrimination for GSP schemes; programmes such as AGOA require a separate waiver from the members, and such a waiver is usually time-bound whereas the Enabling Clause is permanent.

26 The Understanding brought some clarity to this in the case of tariffs, but it remains an awkward, point-in-time calculation.

provide precedents. No RTA in its own right has been subject to a legal complaint at the WTO;²⁷ indeed, given the uncertainty about compliance, that would be almost like “people in glass houses throwing stones.”

Members have not been idle on the matter, being very aware that it is of systemic importance to the WTO. The Committee on Regional Trade Agreements (CRTA) was established in 1996 to oversee RTAs, but no reports have been issued on the compliance of an RTA. Besides the difficulty in determining compliance, no party will normally agree that its RTA is non-compliant, if only for fear of being drawn into dispute settlement, with the result that the compliance exercise has essentially fallen by the wayside.²⁸

In 2001, the clarification and improvement of RTA disciplines was entrusted to negotiators in the DDA. However, agreement has escaped them in the matter of rules, including guidance on the term “substantially”, coverage (whether, for example, all goods RTAs should include agriculture) and uniformity of rules or origin. Nevertheless, there has been considerable progress in the area of transparency.

Members decided at an early stage of the negotiations that they needed to know more about the facts and figures of the RTAs in force. This could lead to a better appreciation of the impact of RTAs on the multilateral system, could bring understanding to elusive concepts such as “substantially,” and, under peer review, might lead to an improvement in the nature and structure of RTAs, to the benefit of the system. This led, in December 2006, to the WTO General Council’s decision to apply, on a provisional basis, the Transparency Mechanism for Regional Trade Agreements.²⁹

The Mechanism provides for the early notification of RTAs. They are subsequently considered by the WTO membership on the basis of a *factual presentation* prepared by the WTO Secretariat under its own responsibility but in close consultation with the parties involved.³⁰ The factual presentations, minutes and questions and answers are published, but no report is issued. To date somewhat over 250 factual presentations have been distributed, providing a wealth of verified data. This information feeds into an RTA database, mandated by the Mechanism, maintained by the Secretariat and made available to the public and, hence, for purposes of research.

27 In two disputes RTAs have been an issue, essentially concerning whether they can be used as a legal defence for perceived discrepancies between some of their provisions and existing WTO rules.

28 Prior to the CRTA, individual Working Parties examined RTAs.

29 See WTO document WT/L/671 (18 December 2006) for the text of the decision. The Mechanism is also described in some detail on the WTO’s website at https://www.wto.org/english/tratop_c/region_c/trans_mecha_c.htm.

30 The consideration in the CRTA if the agreement is notified under GATT Article XXIV or under GATS Article V; if it is notified under the Enabling Clause, the discussion takes place in WTO’s Committee on Trade and Development.

The consideration of an RTA under the Mechanism does not include an assessment of its consistency with WTO provisions, and it is precluded from being used for purposes of dispute settlement. This is intentional, obviating a discussion of normative issues and encouraging a frank exchange on the facts of the RTA.

The Mechanism has certainly improved transparency with respect to RTAs. However, there is no escaping the fact that the WTO's legal provisions on RTAs remain very difficult – essentially impossible – to enforce. Thus, it is up to members to ensure that their RTAs meet the *spirit* of the WTO's legal provisions – to benefit, or at least complement, the system, supporting the WTO.

RTAs: Do They Help or Hurt?

The question is seemingly of some importance. After 16 years of negotiations the DDA has yielded few results, appears moribund, and is unlikely to be completed, at least as a single package. This leaves many with the perception that the WTO has lost some credibility as the mainstay of the multilateral trading system, with an agenda that may not reflect the realities of the trading environment, particularly the very significant sway of China and the maturing of “new” technologies such as the Internet. The continued growth in the number of RTAs adds to – and is perhaps influenced by – the notion of a WTO on the wane, with RTAs then arguably more in tune with the trading needs of their parties.

A rebuttal could come in two intertwined parts: i) the WTO is about a great deal more than just the DDA; and ii) it is not clear that RTAs have seriously undermined the WTO, although the jury might still be out on the possible new mega-RTAs, which after all are not yet in place.

The WTO remains a valuable global public good. The important day-to-day work will continue in the WTO Committees that implement its various agreements such as that on agriculture, contributing to freer, more predictable trade flows. So too will its significant work on transparency, including the trade policy reviews of member countries, the monitoring reports on protectionism that feed into the G20, and the discussion of RTAs; these functions fruitfully inform both members and the public. And the dispute settlement mechanism continues to provide sterling service in ruling on disagreements between members in their use of trade measures, fostering abidance by the rule-of-

law between parties. The WTO also curbed protectionism³¹ and kept markets open during the recent financial crisis, thus helping to contain contagion and perhaps a global depression.

Moreover, despite the DDA and intense RTA activity, the WTO remains an impressive negotiating forum for global trade rules, as evidenced by the recent Trade Facilitation Agreement. And, as noted, it is probably only in the WTO that disciplines in areas such as agricultural support could be agreed. Nor is it clearly the case that the WTO's ability to negotiate on market access has been impaired by RTAs, where the gains and trade-offs might already have been made. For example, the Information Technology Agreement (ITA), which eliminates tariffs on a large number of high-tech goods, has grown to 82 members, compared to fewer than 30 when it was first signed in December 1996, and covers some 97% of trade in the products concerned, with the liberalization applied also on a non-discriminatory, MFN basis to non-members.

In a like manner, precisely during the time when RTAs were showing spectacular growth in numbers, the number of WTO members also grew rapidly. The WTO now has 164 members, compared to the 128 members of the GATT, the WTO's predecessor. And, in fact, when the WTO was founded on January 1st, 1995, its 100 members accepted a considerably higher level of multilateral obligations than they had under the GATT. Those agreeing and acceding to the WTO clearly sought to ground their trade policies in a non-discriminatory, stable environment. By this interpretation, the WTO has remained a firm anchor of the system.

The anchor could be firmer still if there were multilateral trade agreements in areas like competition and investment, and if progress could be made in services and preferential rules of origin. For their part, RTA parties might think about steps such as cumulating origin across their various agreements – as in the Pan-Euro-Mediterranean preferential rules of origin – and the mutual recognition of standards; these could certainly promote deeper integration within the RTAs but, as always with discriminatory measures, the net benefit is uncertain. Parties to RTAs might also consider extending their tariff preferences on a non-discriminatory basis in the case of products where the MFN rates are already low, say at a “nuisance” level, thus both obviating the need for rules of origin on these products and enhancing competition.

31 This point is not beyond debate. In their chapter in this volume, Simon Evenett and Johannes Fritz argue rather persuasively that there was a surge in protectionism early in the financial crisis, although not in the main through resort to “traditional” measures, such as tariffs and trade defense.

The question remains as to whether the situation could be significantly changed by the emergence of new potential mega-RTAs, such as the once possible TPP (with the United States as a member), the unlikely but still possible TTIP (with the U.S. Secretary of Commerce indicating openness to resuming talks) and also RCEP. It should be noted that this would not be the system's first experience with mega-RTAs, with the European Union and NAFTA (see below) already forming part of the landscape. Both have often played positive leadership roles in the WTO; indeed, critical work and compromises by the European Union and the United States led to the founding of the WTO, significantly strengthening the multilateral trading order.

In this context, the US withdrawal from TTP in January 2017 has the touch of a lost opportunity for the system, particularly if TTIP comes to fruition. One might envisage a situation in which TPP and TTIP shared the same template for their RTAs, granted each other cumulation in origin, agreed on the mutual recognition of standards and applied each other's dispute settlement rulings. This would create, *de facto*, a new trade regime for some 50% of world output, possibly providing momentum for progress in the multilateral arena – with others not wanting to be left behind – including frameworks, for example, in investment and e-commerce, for updating the WTO.

However, such an arrangement would exclude major traders such as Brazil, China and India. In this context, the decision to negotiate RCEP might well have been defensive, at least in part. Moreover, the economic impact of these agreements might have been less than overwhelming, with zero MFN rates already in place – due to the Uruguay Round and ITA – on a wide range of products (particularly manufactures) and most other rates low. Also, they might have led to significant diversion in some areas, particularly agriculture in TPP, and perhaps regulations and investment. Thus, as is often the case with RTAs, it would have been difficult to gauge the actual impact of the agreements on the multilateral system. Nevertheless, there can be no doubt that the US withdrawal from TPP helped to feed concerns about the commitment of the United States to the trading system.

Such concerns are augmented by the ongoing renegotiations of NAFTA. Reciprocity, as noted above, has always been a negotiating tool. The present suspicion that the United States is seeking to equilibrate, completely or in part, bilateral imbalances with its partners in these negotiations would raise reciprocity to a policy objective, essentially then viewing trade as a zero-sum game rather than one with net benefits. This is the road to market sharing, undermining the very market mechanisms that have facilitated the considerable

benefits that the trading system has brought to its participants. In short, the United States is playing a dangerous game.

Conclusion

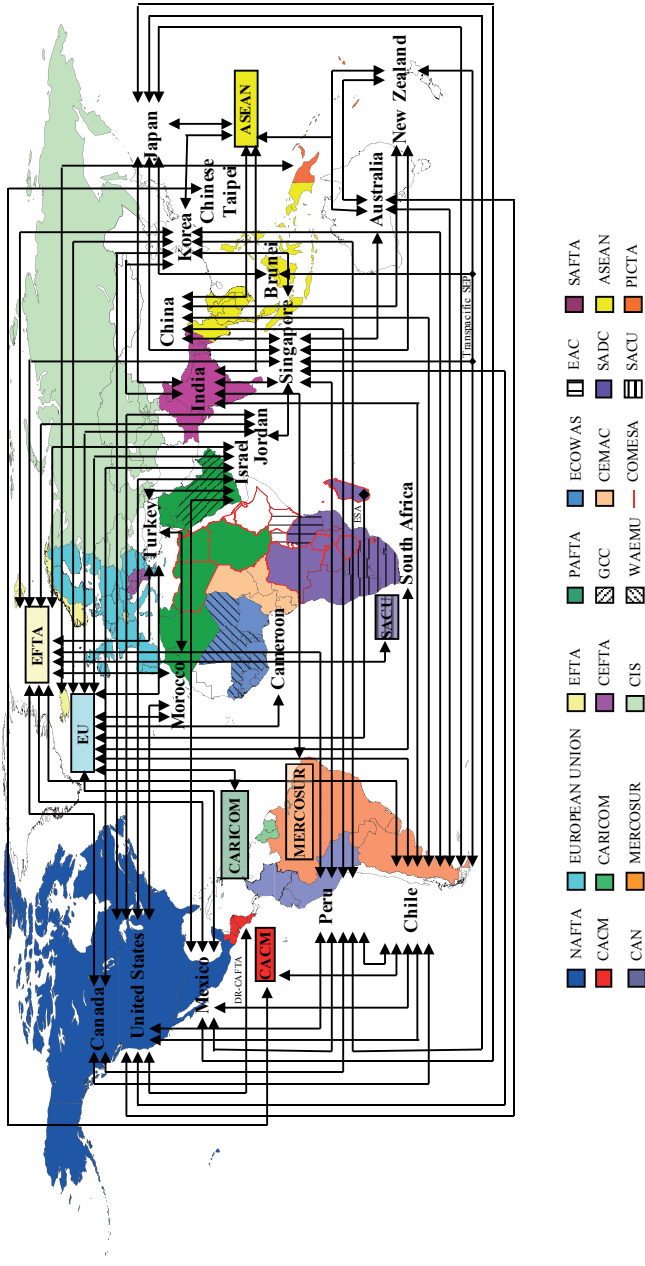
RTAs certainly have complicated the trading environment but it is not clear that they have undermined the WTO; they may have supported integration into the multilateral system. This system has provided significant benefits, including – and perhaps in particular – for the major traders. It is in their self-interest to safeguard the integrity of this global public good. Given the past record, hiccups and the DDA notwithstanding, it is to be hoped that they will continue doing precisely that.

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Annex 1

The “Spaghetti Bowl”: What a complex web we weave when first we set out to ... negotiate RTAs



This chart is an example of the complexity that arises—it still leaves out quite a lot as otherwise it would become completely unreadable
 Source: Acharya (2015).

CHAPTER 10

Addressing the Networked Economy in Trade Policy

Nick Ashton-Hart

When most people think of the Internet, they think of the services they use online in daily life – search engines, social media, streamed video and audio services, and email. That’s not a good definition for the digital economy – in fact, it is a particularly poor one, yet policymakers frequently work on that flawed assumption.

The best definition for the Internet – or digital – economy actually goes back to the 2008 OECD Ministerial: it is “... the full range of our economic, social and cultural activities supported by the Internet and related information and communications technologies” (OECD, 2008).

Let’s unpack the elements for viewing through the trade lens – starting with services.

First, and perhaps most fundamentally, the “business-to-consumer” (B2C) services like those we use daily are only about 10% of the economic value proposition of services with a digital dimension. The other 90%¹ is business-to-business services (B2B), such as “cloud” and supply chain management systems and “industrial Internet”² applications. UNCTAD estimates that cross-border B2C e-commerce was worth about \$189 billion in 2015 (UNCTAD, 2017).

The Internet has made many services exportable in a way that was previously impossible. While outsourcing may be controversial, it is a good example of this phenomenon, as technology has made distance and geography irrelevant to the competitiveness of payroll services, legal discovery services and customer relationship management, including, famously, call centers. This has contributed to making services the largest segment of the world economy

1 There are various sources for this figure, but perhaps the most useful reference is the UN Conference on Trade and Development’s *Information Economy Report 2015* (UNCTAD, 2015).

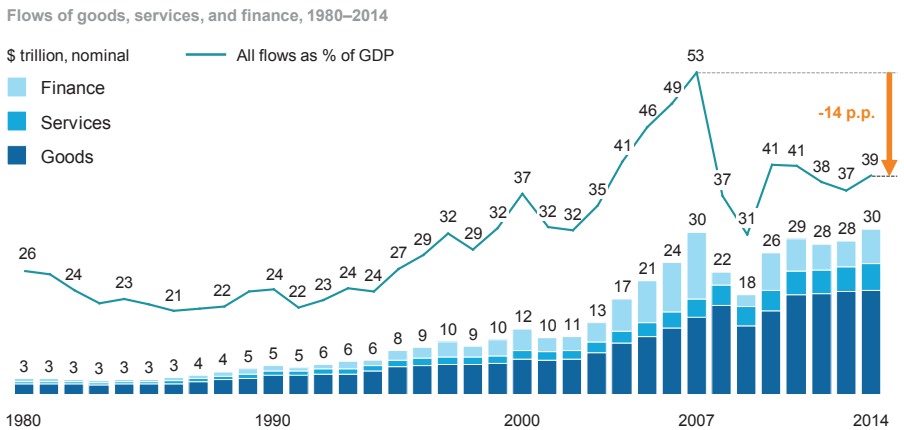
2 For a good overview that is layman friendly, see Bruner (2013).

in GDP terms (Lanz and Maurer, 2015) and the largest employer even in developing countries since the turn of this century, 20 years after it became true for OECD countries.³ The ICT services component, while small as a proportion of all services, is the fastest growing: up 40% between 2010 and 2015 (UNCTAD, 2017).

Beyond services, 75% of the economic value of the digital economy benefits traditional bricks and mortar businesses of all kinds (McKinsey Global Institute, 2011a,b). Think for a moment about the economic consequences of that fact, given that the size of the digital economy is estimated at up to 4.3% of GDP worldwide (UNCTAD, 2017).⁴

At the same time, the latest studies we have show that while flows of non-digital goods and services have actually declined relative to GDP, data flows have expanded 45-fold, with an estimated positive contribution to GDP of 10% (McKinsey Global Institute, 2016).

Figure 1: After 20 years of rapid growth, traditional flows of goods, services and finance have declined relative to GDP



Source: Exhibit E1 from McKinsey Global Institute (2016); IMF Balance of Payments; World Bank; McKinsey Global Institute analysis.

A key objective of “offline” trade policy is to progressively reduce tariffs and other barriers to trade between countries, with an ideal objective of “free” and fair, frictionless trade worldwide. The Internet is by nature friction- and barrier-free – it makes any company that uses it a global business from the

3 See the supporting datasets for the International Labour Organization’s Global Employment Trends 2014, at http://www.ilo.org/global/research/global-reports/global-employment-trends/2014/WCMS_234879/lang--en/index.htm.
 4 See table II.1 and Figure II.7 at page 23.

moment it goes online. That remarkable facility is at the heart of why research has repeatedly found that for each 10% increase in broadband penetration, GDP rises by between 0.25% and 1.38% (ITU, 2012: 17).

You will notice considerable variability in these statistics; that's because measuring the digital economy holistically is famously difficult. Perhaps the best approach from an economist's perspective is that of the OECD (2013: 7), which divides the Gordian knot into three elements:

1. The “direct impact”: the value added generated by Internet-related activities
2. The “dynamic impact”: net GDP growth generated by all activities related to Internet-related activities
3. The “indirect impact”: consumer surplus and welfare gains generated by Internet-related activities.

Rather than presenting an economic theory view of the networked economy, this chapter will relate it to how networks actually work and explain how world trade rules relate to that “real world” paradigm; this also corresponds to the way trade rules are structured. The hope is that this will aid both trade policy practitioners and those more familiar with the Internet in forging a common understanding.

Finally, the networked economy is important for all countries, not just for a few; it is at the heart of economic activity. Despite that fact, countries are increasingly implementing measures that add friction in online trade – this chapter will explore several. Understanding these measures is a key and pressing challenge for trade policymakers.⁵ The chapter ends with some ideas of policy options that can help trade and non-trade specialists understand the subject better and explore some trade policy options that would facilitate commercial activity, but also create more trust in digitally enabled trade, acknowledging that in several areas there are significant complexities and political sensitivities.

5 There have been many efforts to quantify the elements that prepare a country to take maximum advantage of networked technologies for economic benefit; perhaps one of the more interesting is the Digital Evolution Index developed by the Fletcher School at Tufts University, with participation by many private- and public-sector stakeholders (see <http://insights.mastercard.com/digitalevolution/>).

The Network and the Data It Carries: Two Different Things

To understand the Internet in a trade context is a challenge. This is partly because trade specialists are confronting a subject that is new to them, but also because those who advocate for networked economy provisions in trade often don't explain the fundamentals so that policymakers can relate the unfamiliar to the existing trading system they know.

The starting place is that the Internet from a trade perspective is really two different things:

1. The network that makes communications between any connected devices possible (in this chapter, the “network as a platform”). This most closely corresponds to ‘basic telecommunications services’ in the General Agreement on Trade in Services (“GATS”).
2. The data and associated services that use that network as a communications platform (or “everything else”). From a GATS perspective again, these would be value-added telecommunications services but also many others where the service delivered electronically is functionally the same as an offline service.

It is important to look more closely at these though; where to draw the line between them is crucial, so let's use the “digital holiday” scenario to illustrate that boundary.

Let's say every person who uses the Internet took a “digital holiday” on the same day, and every single online application service provider (search engines, video services, email providers, etc.) did the same thing. The network itself would still continue exchanging addresses and related information. The next morning when people go online, everything would work as normal.

The data that the network carries are the applications and services that people use and the data that those applications and services create. The network is the hardware, interconnections and essential communications between them.⁶

6 For the technically minded, the network as a platform corresponds to the lowest four layers of the OSI model and the lowest three of the TCP/IP (RFC 1122) model.

The Network

The network is an interrelated web of hardware and software that utilize common standards to ensure each component is interchangeable with others performing the same function. This concept – “interoperability”⁷ – is important because it allows maximum flexibility in designing networks and related systems. It is a close functional cousin to the concept of technology neutrality that is so fundamental to trade policy.

The grouping of standards that make communications in the network possible are known as the “Internet protocol (IP) stack.” IP-based networks are designed to operate with maximum efficiency, and a continuous process of evolution of these standards responds to the need for greater performance, interoperability, resilience, trust and security over time.

What we call the public Internet is actually a “network of networks.” The large majority are privately owned and managed by corporations, whether for the use of their employees or, in the case of Internet service providers (ISPs), for the public to connect to the rest of the Internet.

Keeping things simple, there are three types of entity that collectively make basic connectivity, and therefore the public Internet, possible:

- Internet service providers (ISPs): entities that provide connectivity for end-users (ranging from single mobile devices to the largest corporations), of which most countries have from several to dozens;
- Backbone providers: entities that connect ISPs to one another but that do not have end-users as customers. These entities are often responsible for making connections between countries and continents possible.
- The processes and institutions that manage allocation of unique identifiers, such as IP addressing and the domain name system (DNS). These are analogous to telephone numbers or postal addresses in that they allow any “node” on the network to be identified and reached from any other node, and ensure that worldwide every single unique address is used only once. If you’re wondering what a ‘node’ is, your mobile phone and your PC or laptop are examples.

7 For a user-friendly overview of the Internet and the “network of networks” that it is comprised of, the Internet Society’s “An Introduction to Internet Interconnection Concepts and Actors” (Internet Society, 2012) is recommended (see www.Internetsociety.org/sites/default/files/bp-interconnection.pdf).

Each ISP or backbone provider must do two things aside from connecting to its customers:

- Connect to other ISPs so their respective customers may exchange data and connect to backbone providers (either directly or indirectly) to allow international traffic exchange. Without these agreements (often known as “peering” or “interconnection” agreements), the Internet would cease to be a global platform and would exist solely as ISP-specific “islands” that would only allow users to connect to the other customers of their own ISP.
- Acquire the various types of technical addresses necessary for its equipment and that of its customers to connect to others, and implement the related services (like DNS servers) that allow every single device on the public Internet to have a unique address.

The result? Networks (if left to themselves and the web of stakeholders who operate and maintain them) can:

- **Automatically find the optimal (which is not necessarily the most *direct*) route between any two points at any given time.**⁸ The route between any two points may traverse third countries, and that route may pass through different third countries at different times of the same day. This is especially common in border areas where two countries have dense populations in close proximity to a shared border.
- **Create a communications connection between any two points in a way that optimizes *performance* in the networks through which that communication passes.** This can result in communications taking a route that is *geographically* complex to ensure the communication “performs” better.
- **Ensure that anyone may extend the public Internet** simply by connecting a device called a router⁹ to the “edge” of the network and applying for a unique address for it. Acquiring that address is often

8 Throughout this chapter illustrations refer to connections between two points (“point to point”) in order to make key points easy to follow. There certainly are communications where a single origin is connecting to multiple endpoints simultaneously and each of these endpoints may be in different countries from one another.

9 A router is a device that “talks” to other such devices to figure out how to forward requests from any device connected to it to any other part of the network. The standards used ensure that this can happen automatically, and as the network topology changes in real time these changes are “learnt” by those devices that need to know about them. Pretty much every business and residence has a router, in the latter case generally provided by the Internet service provider.

automatic, though public Internet addresses are ultimately assigned by regional Internet registries (RIRs)¹⁰ to ensure every single device on the public Internet has a unique address.

The public Internet as a platform is inherently blind to geography in a way that the “offline” world is not. Goods trade, for example, would generally be biased against shipping via third countries to deliver a package sent from, and bound for, destinations in the same country to avoid the potential “friction” of border measures such as customs, tax compliance and other formalities. The digital world by design doesn’t care about borders.

The Objectives of Trade Agreements Related to the Network as a Platform

Looking at the network as a platform suggests several policy objectives to pursue in trade agreements (and public policy in general):

- **Avoid actions that impede or distort basic functions such as addressing and traffic routing.** Where a country needs to prevent some communication from taking place, or prevent access to certain information that the network carries for whatever reason (such as to block child pornography), it must do so in a way that does not affect the operation of the network that carries those communications.
- **Avoid actions that might impact upon “transit traffic.”** As we have seen, traffic often – for very good reasons – transits a country for which it is neither the destination nor the source. This argues strongly for such transit traffic to remain untouched and unhindered – after all, failing to respect transit traffic of others could lead to reciprocal lack of respect for your own. More about transit traffic later.
- **Avoid obligations that distort private-sector choices about how equipment or services integral to the functioning of the network as a platform are made.** Measures of this type – often called “local hosting” obligations – can refer to elements of the network as a platform (like submarine cables, routers or related equipment), but they are most often intended to influence where applications, data, and related services are hosted. Obligations that distort investment choices that would otherwise seek to optimize performance, resilience, and cost in the network everyone uses could be trade-distorting (a “non-tariff measure”, or NTM, in trade

¹⁰ These organizations are responsible for managing the key forms of addressing on the Internet, which are akin to the various types of addresses in the worldwide postal system in the functions they perform. All of them are ultimately linked to the Internet Assigned Numbers Authority (IANA), managed by the Internet Corporation for Assigned Names and Numbers (ICANN). IANA and the RIRs work together (more information is available at <http://www.iana.org/numbers>).

parlance). An example from the offline world is roads: we want roads to be well maintained and with enough lanes to handle peak traffic, and ideally to have multiple connections between locations so that when traffic congestion affects one road we have alternative routes to take.

How Existing Trade Agreements Relate to the Network as a Platform

Thanks to the principle of technology neutrality in trade agreements like GATS the network as a platform has been subject to extensive coverage in WTO members' commitments (as 'basic telecommunications services') since GATS entered into force. International commitments in this area are anchored to the WTO Agreement on Basic Telecommunications Services.¹¹ Part of the problem is that this agreement is an annex of GATS, and GATS is a "positive list"¹² agreement – meaning that the only obligations countries have are those they specifically commit to.¹³

There are 108 WTO member countries with commitments in telecommunications, though the commitments are worded differently¹⁴ so the only way to determine what common commitments exist is through laborious searching and comparison of the wording of each commitment. What the Internet really needs is not a "positive list" approach to commitments but the opposite – a "negative list" approach coupled with the political will to agree upon robust framing of the obligations themselves.

The concepts in the WTO Agreements are sound and have been improved upon by bilateral and regional free trade agreements in the intervening decades,¹⁵ the most comprehensive treatment being that of the Trans-Pacific Partnership finalized in 2015, now in the process of being amended and renamed the Comprehensive and Progressive Agreement for Trans-Pacific Partnership.¹⁶

11 https://www.wto.org/english/tratop_e/serv_e/12-tel_e.htm.

12 For those unfamiliar with some of the trade terms used in this chapter a good glossary, provided by the Organization of American States' SICE project, may be found at http://www.sice.oas.org/dictionary/SV_e.asp.

13 A layman-friendly description of the flavor of existing commitments may be found at https://www.wto.org/english/tratop_e/serv_e/telecom_e/telecom_highlights_commit_exempt_e.htm#country.

14 Commitments may be found by searching the WTO's 'i-Tip' database at <http://i-tip.wto.org/>.

15 For a good history of GATS and international services negotiations at the WTO and in regional trade agreements, see Adlung and Mamdouh (2013).

16 For the relevant provisions, see Chapter 13 of the Trans-Pacific Partnership (inter alia, Articles 13.4.3 and 13.4.5.6) at <http://tpp.mfat.govt.nz/text>. While the TPP is being amended due to the withdrawal of the United States, the provisions referenced in this chapter have not been changed as of the time of writing.

Data Flows (or “Everything Else”)

The term “data flows” or the “free flow of data” in a trade context refers to the exchange of any and all information in electronic form unrelated to maintenance of the network connectivity that makes those data exchanges possible.¹⁷

Data flows, not surprisingly, are where everything becomes complicated as data can and does relate to any activity that can be conducted electronically at distance.

In order to understand the flow of data, one must start by understanding two key facts about the fundamentals of IP-based networks:

- Each and **every communication is broken into little pieces called “packets” and sent to its destination independently**, and then reassembled on reception; if (and this often happens) a packet goes “missing” along the way, the receiver asks the sender to send it again.
- The result of this “packetizing” of data is that **only the sender and receiver of any online communication know what is being communicated**.¹⁸

These two facts are critical, as they show that data flows operate pretty much opposite to offline trade, where transactions require a package bound for international destinations to clearly indicate what it contains; packages may be opened to verify that the contents are as stated. The Internet’s fundamental approach cannot really change; there are hundreds of billions of communications taking place simultaneously 24x7. To make the contents of all communications transparent would not only require a complete redesign of the network, it would create such overheads throughout the transmission path of every communication as to render the network unusable or unaffordable, or both.

Keeping this in mind, there are ways to break the monolith of “data flows” down in a rules-based trading context and below is a résumé of the principles that should apply:

¹⁷ Again for the technical, this essentially corresponds to the application layers of both the OSI and TCP/IP models.

¹⁸ This is a slight simplification – it is possible to “inspect” packets to divine information about what each contains to a certain degree, but doing this is technically burdensome and necessarily imperfect, and where a communication is encrypted (as an increasing number of communications are) inspection is rendered useless.

1. The principle of technology neutrality of trade agreements means that **any online activity should be treated the same as its offline equivalent**. This principle actually provides substantial coverage today as regards many economically significant activities online, from the purchase of goods of every variety via online storefronts to services of many kinds. The data associated with these activities are covered to the same extent as the activity that produces them, as they are integral to covered activities.
2. Entirely **Internet-based services should receive the benefit of national treatment and market access commitments related to their offline equivalents**. In practical application, this has been disputed when it is inconvenient for WTO members in certain circumstances. For example, countries have alleged foreign search services to be purveyors of pornography even where domestic equivalent services allow users to legally link to similar adult content (Elegant, 2009). Numerous other foreign Internet-based services, including social networks, blogging and photo sharing sites, have over time been blocked for varying lengths of time or severely restricted by government action while domestic versions of the same services are permitted to operate.¹⁹ There is also very little transparency about what material is removed from online services, when, for what purpose, and at whose instruction. Even where companies would like to release details of these requests, they are routinely legally prevented from doing so in many jurisdictions. Companies have increasingly begun unilaterally publishing information about this.²⁰ In the trade context, voluntary measures that must accommodate unharmonized, nationally specific legal restrictions on disclosure do not produce the certainty or transparency that a rules-based international regime can.
3. As a corollary to national treatment, competing **equivalent lawful economic activities online should be treated the same by the network wherever any part of an economic transaction is in another country**. In national and regional debates this is often referred to as “network neutrality” and is hotly debated. Net neutrality is discussed in more detail below.

19 The OpenNet Initiative compiles information on the types of blocking, monitoring, and filtering that countries engage in (see <http://map.opennet.net/>). A layman-friendly explanation of the different types of interference that exist is at <https://opennet.net/about-filtering>.

20 Transparency reporting has greatly increased globally in the wake of the Snowden disclosures; the Global Network Initiative is an example of an Internet industry initiative to promote disclosure of such requests (see <http://www.globalnetworkinitiative.org/>).

- 4. Any data not bound for, or coming from, the territory they are passing through shall not be subject to any impediment.** This is a corollary to the rule on the network as a platform and for the same reasons.

Existing Protection of Data Flows

The level and scope of existing coverage of data flows per se is a subject of considerable debate.

At least 60 countries have undertaken commitments on “data processing” and 76 on “on-line information and/or data processing” (Berry and Reisman, 2012) under the WTO agreements. Given the latitude that countries have in the wording of their commitments, of course there is considerable variation. More definitively, a moratorium on customs duties on “electronic transmissions” covers all WTO members and while it is not permanent, it has been renewed at each WTO Ministerial, and many countries have included it as a permanent feature of bilateral and plurilateral agreements.

With respect to services themselves, where there is little functional difference between their online and offline versions the market access and national treatment obligations should apply. Again, commitments may be read in different ways depending upon the interests of the reader – or more to the point, the country the reader represents if he or she is a trade negotiator.

Many books have been written about the extent to which existing CPC classifications cover the digital equivalents of offline activities and the problems associated with the trading system’s dependence upon classifications last revised in 1991.²¹ Because commitments often refer to these classifications, given their generality it can make commitments even more subject to interpretation depending upon how they’re worded.

This does argue for straightforward commitments on data flows as a policy object and the TPP is the most substantive step in this direction of any trade agreement to date.²²

ICT Hardware: The Common Thread

The focus of this chapter is the networked economy as a wider phenomenon rather than its specific impacts on the ICT sector. Of course, the Internet exists

21 The “current” classification list for services trade is online at https://www.wto.org/english/tratop_c/serv_c/mtn_gns_w_120_e.doc.

22 See the Electronic Commerce Chapter of the TPP (inter alia Article 14.11) at <http://tpp.mfat.govt.nz/text>.

in physical form not just as wireless signals. The data the platform carries are generated by people using the multitude of network enabled devices, from cloud services' server farms to your smartphone.

Goods trade in these forms of ICT-related hardware is economically significant – reaching US\$4 trillion in 2014. One of the crown jewels of the WTO system relates to ICT hardware like this – the Information Technology Agreement (ITA), concluded as a plurilateral agreement in 1996, removed all tariffs on the products it covers.

The rapid advance of technology increasingly made revision of the agreement a priority (as the original agreement covered only items specifically listed, rather than product families), and this was agreed in December 2015 at the 10th Nairobi WTO Ministerial. It is at least arguable that the ITA is the greatest achievement of the WTO in normative terms after the WTO agreements themselves, and it is understood to be profoundly beneficial to developed and developing countries alike.²³ It is estimated that the expansion alone may add \$1 trillion in annual global trade benefits in covered goods and increase global GDP by \$190 billion.²⁴

Digital Issues and their Trade Dimensions

It has always been the case that public policy issues that arise in a non-trade context can have profound trade implications, and the networked economy is not exempt from this reality. Here are several of the most topical.

Network Neutrality

“Network neutrality” has been debated for a decade in a few advanced economies, but is now being discussed by regulators in many countries as the Internet's impact spreads.

The debate about net neutrality is a struggle that is both economic and political and has enormous consequences in three respects:

- Who gets to decide how the value generated by product and service providers is apportioned – application providers themselves, or ISPs?

23 There are many studies of the application of the ITA to developing countries, but a particularly good one is Ezell (2012).

24 See, *inter alia*, United States Trade Representative, *Supporting Economic Growth at Home and Abroad by Eliminating Trade Barriers on Information Technology Products*, July 2015, at <https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2014/November/Supporting-Economic-Growth-Home-Abroad-Eliminating-Trade-Barriers-on-IT-Products>.

- How much control should each part of the value chain of digital commerce have over the public Internet in each country?
- Who controls the power position of each part of that chain – shareholders and markets, or regulators?

Boiled down to the essentials (there are considerable nuances, especially in markets where competition between ISPs is impaired), the main question is this:

- **If network neutrality is obligatory**, then ISPs must treat all applications or services the same as *any other that is functionally similar*. In other words, YouTube could not pay ISPs in order to make it perform better for the user than a similar startup video service.
- **If network neutrality is not obligatory**, then ISPs can charge service and application providers fees to prioritize paying services over those of competitors.

An additional dimension relates to peering and whether these agreements are entirely private or regulated by the same kinds of rules.

The trade policy community has yet to engage with this discussion much. Aside from the European Union (where a Regulation for the Union as a whole was finalized in 2015 but with important definitional elements left to the member states), net neutrality debates have focused on how they will apply within countries.

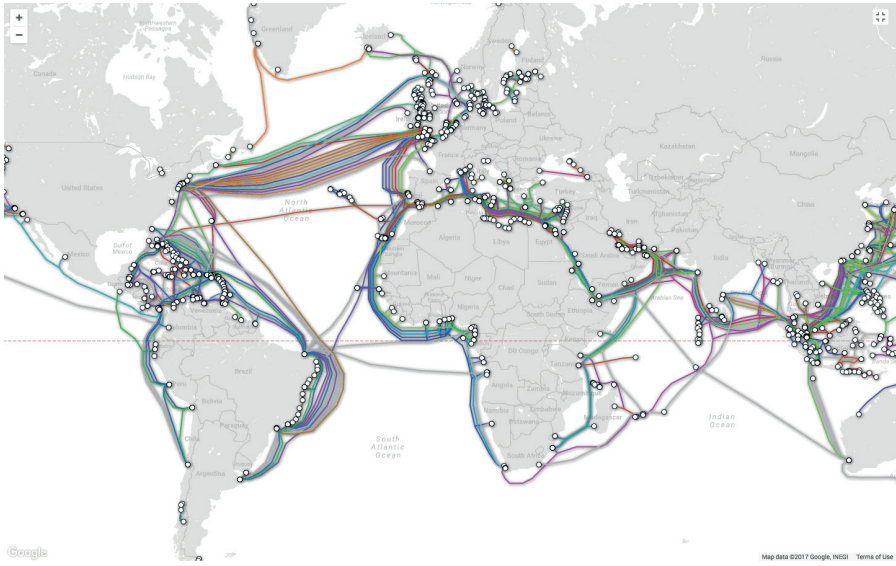
These national debates miss the impacts these decisions have on the Internet as a globalized trading platform. Since the private sector owns and controls the international links between countries, net neutrality rules that impact international peering arrangements could have profound impacts.

This is magnified when you realize that a few backbone providers handle the vast majority of international Internet traffic. Many of these so-called “Tier 1” (Zmijeuski, 2016) providers are actively lobbying on network neutrality in key economies.²⁵

In addition, all countries are not created equal with respect to the flow of data – just like offline trade, some generate far more data than they take in. As a consequence, national decisions about net neutrality may well have consequences far beyond their borders.

Figure 2: Submarine cable map

25 With respect to lobbying spend in the United States on its net neutrality decision, three of the biggest backbone providers were active: Verizon and AT&T opposed, and Level3 was in favor (Furmas and Drutman, 2014). European-headquartered Tier 1 providers are active participants in the net neutrality debate at the European Union as well.



Source: TeleGeography (<https://www.telegeography.com/telecom-resources/submarine-cable-map/index.html>).

Local Hosting Requirements

Local hosting obligations are widely discussed in the trade community, in part because they are easy to relate to offline trade. There are few measures more disruptive to the networked economy – that’s a broad statement, but justifiably so since we know that the largest beneficiary of the networked economy is traditional businesses.

We know that all commercial activity depends upon access to a wide variety of products and services available at competitive prices as inputs. If your competitor is allowed to choose the inputs he or she wants based solely upon price and suitability for the purpose at hand and you are not, you are at a disadvantage. This is just as true for inputs related to the Internet.

For example, let’s say you manufacture hats and sell them online as well as in shops. If you’re obliged to host all records of customers in your country on local servers, that will limit the services that you can choose to take credit cards for payment to those willing to follow your local data localization rules. If you are from a smaller or developing country and you have data localization requirements, the major online marketplaces may not make their service available to you or your countrymen. If that happens, you lose incredibly valuable opportunities for marketing and selling your goods to a global market of buyers.

One of the most authoritative studies of data localization (Bauer et al., 2014) found that the impact of rules being planned or implemented in several countries (Brazil, China, the European Union, India, Indonesia, Korea, and Vietnam) were expected to reduce GDP from 0.1% to 1.7% depending upon the country.

Given all this, you might ask: why are countries considering these rules in the first place? They are suggested as being the answer to all manner of ills, from protecting access to nationals' personal information by foreign national security agencies, to providing greater protection of personal information in commerce, to creating jobs by incentivizing the development of more data-hosting centers. Data localization is at best a poor instrument, and at worst entirely ineffective, in pursuit of these policy objectives. In the first two cases, the perception that geography has anything to do with data access is a holdover from the analogue world. In reality, it is the measures taken to protect data, and not the location where it is stored that matters.²⁶ With respect to access by foreign powers' national security services, these organizations are not known for respecting borders and localizing data may simply make it easier for the country creating these obligations to surveil its *own* citizens under the guise of protecting them from others. Finally, there are few jobs in data centers – even very large ones are automated and require only a literal handful of people to run them, and those are largely lower-wage jobs to manage the physical security of the buildings.

In a trade context, presence requirements generally relate to business presence (i.e. registration) and other “offline world” requirements. The most comprehensive local hosting provisions relating to the digital economy are to be found in the TPP – and they prevent TPP parties from creating these obligations:

“No Party shall require a covered person to use or locate computing facilities in that Party’s territory as a condition for conducting business in that territory.”²⁷

The Industrial Internet of Things

The industrial Internet of things (IIoT) is fascinating for many reasons, one being that it relates to solely machine-to-machine communications in

26 For those interested, the standard reference for best practices in securing information is the ISF's Standard of Good Practice for Information Security; more information is available at <https://www.securityforum.org/tool/the-standard-of-good-practice-for-information-security/>.

27 See the Electronic Commerce Chapter (Article 14.13.2) and the Telecommunications Services Chapter (inter alia Articles 13.4.3 and 13.4.5.6) of the TPP at <http://tpp.mfat.govt.nz/text>.

manufacturing, agriculture, and many other market segments. Since these are communications between machines about their activities, the IIoT is largely devoid of personal information of individuals.

As an example of the IIoT in application, imagine if every machine associated with a car factory were networked and reported on everything that it does. This would allow operators to know when any aspect of manufacturing was deviating from design tolerances – or even if a specific part being installed in a specific car was damaged during the installation process or couldn't be installed because it deviated from design tolerances. Clearly, this would greatly increase both the value of automation and also the quality of finished goods.

Major manufacturers have banded together to create standards for how devices and processes can interoperate with one another. A report by Accenture suggests that the GDP value that the industrial Internet may unlock is in the trillions of adjusted US dollars just for the G20 countries by 2020, and up to \$14 trillion by 2030 (Purdy and Davarzani, 2015).

There are of course profound trade dimensions to the industrial Internet, such as:

- How can trade policy ensure that standards impacting such massive economic effects remain open and not subject to capture by a few powerful interests? The Technical Barriers to Trade (TBT) process has been successful in ensuring that standards are not used for trade-distorting objectives, but will evolutions of that process be necessary to deal with the transformative impact of IIoT standards? Certainly, the list of international standards bodies recognized by the TBT should be revised.
- How will small and medium-sized enterprises (SMEs) that are part of global value chains be impacted by, for example, the much lower tolerance to deviation from design specifications that IIoT manufacturing and assembly processes will likely require of them?

Data Protection and Privacy

Trade agreements provide for exceptions so that signatories may deviate from normal treaty obligations in order to deal with key policy priorities.²⁸ The general exceptions of GATS are the de facto standard by which data protection and privacy are handled in trade agreements – directly and by transposition into bilateral and regional trade agreements. That said, the increasing political

²⁸ Contained in Article XIV and available at https://www.wto.org/english/docs_e/legal_c/26-gats_01_e.htm#articleXIV

importance of data protection in key economies is straining continued reliance on exceptions-based privacy regimes. At a practical level, measures related to personal information are a key consideration since we know that online data routinely crosses borders. The simple act of tracking visits to a website²⁹ can reveal who that visitor is, at least to the level of an IP address.³⁰ This differs from the offline world where the commercial use of personal information across borders is less routine and often far less detailed.³¹

It is also the case that measures taken to protect national security in the online environment can create barriers to efficient network operation and introduce legal uncertainty that is damaging to commerce.³² An early example of this from the “pre-Snowden” period is the US Patriot Act.³³ Provisions of this act have resulted in reluctance by other countries to allow storage of their nationals’ data in the United States.³⁴ The Snowden disclosures greatly aggravated this situation to the point where several heads of state announced national plans to build submarine links to other continents specifically to avoid their traffic entering the United States’ territory.³⁵ More recently, the US government is pursuing Microsoft in US courts to force it to hand over personal data of a non-US-based customer that are held in Ireland simply because Microsoft is headquartered in the United States. This despite the fact that should the government prevail, it will instantly make all US-headquartered technology firms lose competitiveness to the tune of billions in annual revenue and undermine international law.³⁶ The case is of such significance that the European Union itself has filed an amicus brief asking the US government to drop it. Microsoft has taken the extraordinary step of designing a cloud service offering through Deutsche Telecom that both companies believe will withstand any attempt by US authorities to force Microsoft to hand over data held in those data centers – despite Microsoft being a US-headquartered company (Ribeiro, 2015).

29 Website usage tracking tools (“web analytics”) are used by many, if not most, public websites as, amongst other uses, they help web designers understand how sites are used and when.

30 As an example of how fundamental the differences are in what constitutes “personally identifying information” (PII), IP addresses are considered PII in some countries but not in others.

31 While the volume of literature on the subject is considerable, for those in the trade community we recommend the February 2013 WEF report, *Unlocking the Value of Personal Data: From Collection to Usage*, available at <https://www.weforum.org/reports/unlocking-value-personal-data-collection-usage> (WEF, 2013).

32 Cloud services are particularly susceptible to this; for an example of the harms, see “Dutch government to ban U.S. providers over Patriot Act concerns,” Zdnet, 19 September 2011 (at <http://www.zdnet.com/blog/btl/dutch-government-to-ban-u-s-providers-over-patriot-act-concerns/58342>). This decision was subsequently reversed.

33 An accessible summary of the Act and subsequent amendments may be found on Wikipedia at http://en.wikipedia.org/wiki/Section_summary_of_the_Patriot_Act,_Title_II.

34 Perhaps the most well-known being Canada (Clement and Obar, 2013).

35 Just one of the many examples is Brazil and the European Union (Emmott, 2014).

36 For an accessible resume of the case, see Endler (2014).

The US is far from alone – China has promulgated rules which went into (partial) effect in 2016³⁷ that create obligations on foreign businesses related to personal information that have very clear trade impacts, arguing that to do otherwise risks Chinese nationals’ exposure to foreign secret services and privacy violations by foreign companies (McDougall, 2015).

At a macro level, there is increasing evidence of filtering of content available online driven by governmental action (World Bank, 2016),³⁸ and while there is frequent attention paid to this from a human rights perspective (Freedom House, 2017), the economic impact needs further analysis.

The debate about privacy and trade generally focuses heavily on business-to-consumer (B2C) services, as by their nature these generate and use large amounts of personal information. Since we know that these services are only a small fraction of the total economic value proposition even of networked economy services, it is easy to argue that the debate we are having is deeply unbalanced. This is not to suggest that data privacy is not important – put simply, people count – but having a debate almost exclusively focused on that isn’t balanced or sensible.

However, given that there is personal information in many sectors, there is a need for developing countries in particular to invest the time and energy to better understand how data protection law in advanced economies will impact their services exports and to consider both its potential to inhibit services exports but also how a strong data protection regime might make them a more competitive destination for certain kinds of foreign inward investment by personal data-intensive multinationals (Yakovleva & Irion, 2016).

If you are a policymaker (especially one concerned with economic affairs) in one of the more than 100 countries that have no data protection legislation at all (UNCTAD, 2016), these are not minor issues. Until you have a data protection regime, your citizens must rely upon the protections of the services they use – and your services firms may find they are effectively unable to offer services in many developed markets.

Who Owns User Data?

There are other economic questions about data generated by (and about) individuals in one country that are aggregated by companies in other countries and then used to generate further income. Does the user (and generator) of

37 For a good discussion of the law and issues discussed in this paragraph see <https://qz.com/999613/a-key-question-at-the-heart-of-chinas-cybersecurity-law-where-should-data-live/>

38 See in particular “Map 4.1 Evidence of internet content filtering” at page 222.

personal information “own” the information about them and generated by their use of a service, or is the question of ownership to be left to private contract law – specifically, the service provider’s end-user license agreement (EULA) users agree to when beginning to use a service? Does the value that services that are free at the point of use provide their users fairly compensate them for the use of the service *and* de facto ownership of the data about them which are generated as the service is used?

The trade community is beginning to look more closely at these issues in part because the debate is easily exploited by populists claiming that “Western” services are exploiting developing country users and generating profits which do not leave economic benefits in the countries those individuals live in and are from. The debate is also topical because some end-user services are spectacularly successful financially,³⁹ yet maintain a physical presence in a minority of the world’s countries even though users in any country can and do use them.

The imminent widespread advent of the “Internet of things” (IoT), where devices as mundane as refrigerators and home fire alarms are connected to the Internet and report on use of these devices, will further complicate such concerns; there are additional issues with respect to product safety.⁴⁰

These issues will trouble trade negotiators, partly because they are complex – especially jurisdictionally – and also because many countries are in the throes of national debates about interrelated questions that impact the networked economy, such as:

- What is the balance between the privacy of individuals in the networked environment and the commercial or government use of information about them?
- How does each country ensure that key information needed for regulators
- – such as that related to financial transactions and institutions – is protected and remains accessible to them when it leaves national boundaries?
- How can we create rules to protect users against online fraud and abuse and use of public networks for criminal activity without undue consequences to fundamental freedoms (or commercial activity)?
- Where is the dividing line between national security issues and everyday commercial and end-user security?

39 See <https://www.statista.com/statistics/277483/market-value-of-the-largest-internet-companies-worldwide/>.

40 A good overview for the non-specialist may be found in Wiesman (2015).

Ideas for Future Work

It is certainly true that the WTO's normative processes are currently under stress. That said, there are many things that WTO members can do, short of negotiations related to the networked economy, which would help them collectively understand the state of their current economic dependence upon it and the competitive advantages (and disadvantages) they have. In order to have a successful negotiation, you need negotiators with sufficient knowledge of the subject matter to be confident of the choices they make as well as a shared base of understanding of the objects they're discussing.

Given that the capital of the trade community is Geneva, the WTO community is a good forum to begin discussing issues in a low-risk way and the flexibility in the Electronic Commerce Work Programme means that any country can propose relevant discussions and make contributions – and if the membership as a whole doesn't choose to take them up, those who are willing can always do that in smaller groups. After all, that's how the Trade in Services Agreement (TISA) negotiations on services began. More recently, the grouping of 14 WTO members known as the Friends of Ecommerce for Development (FEDs)⁴¹ have added greatly to the discussion of electronic commerce over the last biennium, not least by helping developing country members see the value proposition the digital economy has for them.

A Development Agenda for Digital Trade?

In October 2017, one of the countries of the FEDs grouping, Costa Rica, proposed to WTO members that the outcome of the WTO's 11th Ministerial (MC11) in Buenos Aires in December 2017 should include a discussion on how trade could help to achieve several existing public policy objectives across six areas (WTO, 2017). This is the first time a WTO member has explicitly proposed a development-centric agenda on how trade policy can help to achieve the Sustainable Development Goals (SDGs). In early November, Bangladesh became the first LDC to make a similar proposal, broadly congruent with that of Costa Rica.

Whether or not these proposals are reflected in the MC11 outcome, it is a watershed as it frames the discussion of networked economy trade in the form of questions that will be hard for other WTO members to resist for long on political grounds alone. Several of the six areas are very high-priority policy objectives in the majority of developing economies, especially those who have

41 As of the time of writing the FEDs membership is Argentina, Chile, China, Colombia, Costa Rica, Kazakhstan, Kenya, Mexico, Moldova, Montenegro, Nigeria, Pakistan, Sri Lanka and Uruguay.

been most resistant to increasing the activity level on digital trade discussions at the WTO.

For example, the first item, a focus on how trade policy can accelerate reducing the digital divide, ties directly to SDG 9(c). It also ties directly to India's Digital India initiative, which is a legacy objective of Prime Minister Narendra Modi with financial commitments from the Government of India and private-sector partners in the trillions of US dollars.⁴² Others tie to digital financial inclusion – something even most LDCs have set a high priority on – and SME trade export financing.

If the traditional opponents of a greater focus of WTO work on “e-commerce” oppose such an obviously development-focused trade agenda, it will increase calls to begin negotiations on a plurilateral basis – and give political cover to developing countries interested in normative work in this area that have national priorities related to the subjects Costa Rica has raised. The argument against a focus on electronic commerce that countries like South Africa and India have made in the past – that unfinished work from the Doha Round should be the WTO's overriding priority – will not be seen as credible if used to try to prevent even a discussion of how digital technology's trade dimensions can foster delivery on the SDGs. There has to be room to discuss – and ultimately to reach agreement – on both.

Better Understanding of How ICT Services Act as a Multiplier, or Facilitator, of the Traditional Economy

Below are just a few areas where WTO members could ask the Geneva-based institutions with trade or statistical gathering activities to collaborate on reporting or symposia organization or both.

- **There is a great deal we don't know about how traditional services leverage the digital environment to compete, innovate and export, and the role ICT services play in making this happen.** To illustrate the stakes, European services overall account for 73% of the Eurozone economy (ECB, 2016), while those related to ICT-specific services represent just over 3%. In a trading context understanding these interrelationships is not optional, it's essential – for both developed and developing countries.

⁴² “Industry hails 'Digital India' move, top CEOs commit to invest Rs 4.5 trillion”, *India Times*, 2 July 2015 (<https://economictimes.indiatimes.com/news/company/corporate-trends/industry-hails-digital-india-move-top-ceos-commit-to-invest-rs-4-5-trillion/articleshow/47901803.cms>).

- **Understanding how traditional non-services industries leverage the digital economy to compete and the trade rules that apply needs more research.** Just one aspect of this is how after-market services that leverage networked technologies impact the competitiveness of manufactured goods. An example of this is Volvo, the world's largest manufacturer of commercial diesel engines. Volvo offers a 100% uptime guarantee for their commercial vehicles made possible by networking technology reporting when parts need servicing before they fail.⁴³ What trade rules apply in these circumstances – and what barriers apply too – and how can developing economies compete in the value chain of products such as these?
- **Understanding how so-called Mode 5 services interrelate with, and depend on, the digital economy in their multiplier of goods trade.** Estimates suggest that global GDP gains from liberalizing Mode 5 services multilaterally could reach €300 billion by 2025 (Cernat & Antimiani, 2017). Given that even in developing countries services are, on average, the largest sector of the economy, all members should want to participate in benefits from this – and should better understand how they relate to their economies.
- **Analyzing the extent of trade-related data flows and what they consist of.** If digitally connected commerce between businesses is ten times that between businesses and consumers, it is logical that much of that data flowing across borders do not consist of personal information. You would think that this a question about which we have a lot of information, but sadly the opposite is true. Remedying this deficiency will require a concerted effort across public and private organizations, as much of the base data needed for analysis are in private-sector hands.

Improving the Quality of Statistical Information on Networked Economy Transactions

Measuring the economic impact of the networked economy, as well as ICTs more generally, is notoriously difficult.⁴⁴ It is equally true that acquiring better data is widely accepted as desirable and necessary – and the trade community should be at the forefront of that effort given the trade impacts of these technologies. The WTO has recently convened various public-sector institutions – from UN agencies to multilateral and regional development

43 See http://www.volvotrucks.com/trucks/uk-market/en-gb/parts_service/Genuine-Volvo-Service/service-contracts/volvo-gold-contract/Pages/gold-contract.aspx.

44 For an excellent tour d'horizon of the issues with measurement accessible to non-specialists, see OECD (2013).

banks – along with the private sector to see what data exists and where. At the same time, the first session of UNCTAD’s Intergovernmental Expert Group on Ecommerce and the Digital Economy has recognized the need for greater action in this area (UNCTAD, 2017). Finally, the United Nations as a whole has acknowledged that better information about the impact of technology is a priority.⁴⁵ It is important that the trade dimension of technology’s impacts are seen as central to the implementation of the Sustainable Development Goals, to ensure that the link between development and the economic impact of technology on development are better understood. The trade community should take a leading role in ensuring that both these processes are informed by the community’s needs – doing so will pay dividends for decades to come.

Data Protection and Privacy in International Trade

Data protection and privacy issues are already a thorny subject in trade negotiations – the controversies around the TPP negotiations were evidence of this.⁴⁶ The reality is that the global nature of data flows in the networked economy raises issues that will be the subject of debate at the national level for some time, and laws made nationally in response will continue to evolve. Trade negotiators will be wary of agreeing to binding international obligations where national discussions are not mature.

A first step would be for a group of interested WTO members to convene a few meetings of their data protection and trade officials to compare notes on how different countries’ legal systems handle personally identifying information. That conversation could also ask experts to consider how interoperable (or otherwise) different approaches are in a trading context.

An informal discussion like this regularly in Geneva would allow these charged issues to be discussed outside of negotiations but still involve negotiators – removing political risk from an already fraught subject. It is hoped that over time, meetings could at least periodically include other stakeholders to build understanding.

At the same time, the WTO, UNCTAD and the ITC should collaborate on the **extent to which data protection legislation enables – and lack**

⁴⁵ There are many examples, but the most significant is to be found in the Addis Ababa Action Agenda for financing of the Sustainable Development Goals, where an entire chapter is dedicated to measures on how data and data analysis are integral to the achievement of the goals (see the “Addis Ababa Action Agenda of the Third International Conference on Financing for Development” (Addis Ababa Action Agenda), adopted by the United Nations General Assembly on July 27th, 2015, (A/RES/69/313, Section III, page 35, at http://www.un.org/en/ga/search/view_doc.asp?symbol=A/RES/69/313).

⁴⁶ There are literally thousands of articles discussing different views on this subject.

of such legislation limits – market access to developed economies.

There are many dimensions to data protection, and while human rights are absolutely key, that doesn't mean looking at the trade-related aspects of data protection should be avoided due to reluctance to provoke criticism from those more concerned with the human rights aspects. We may find that the economic arguments, far from creating arguments against robust data protection, actually end up making a compelling argument for it.

Creating Greater Certainty for the Network as a Platform

While it is true that issues with data and their use in sectoral trade applications can rapidly become very complex, that should not be true with the network as a platform.

A group of WTO members could make unilateral most-favored nation (MFN) commitments to some of the principles articulated above without any “free-riding” problem. A commitment that traffic that is only transiting a member's territory would not be subject to interruption or delay would make a political and practically important statement without a downside, since it is not practical to know what the contents of transit traffic is in any case.⁴⁷

Second, **a group of WTO members could commit to making the moratorium on customs duties on electronic transmissions permanent on an MFN basis.** This is now a commitment in enough bilateral and regional agreements⁴⁸ that, for many countries, it would be difficult to derogate from in any case – and it would send a very strong signal, especially if the group were large enough and cross-regional.

Finally, this discussion could have very positive ancillary effects beyond the trade community – **too little is known about the economic impacts of content filtering, site blocking, and large-scale blocking of the Internet at the country level.** As with data protection, we may find that the economic consequences from these actions, if better known, would help to argue against the behaviours justified by national public policy priorities yet so objectionable to civil society non-governmental organizations (NGOs) and human rights advocates.

47 For textual inspiration, see the Telecommunications Chapter of the Trans-Pacific Partnership (Articles 13.4.3 and 13.4.6.5) at <http://tpp.mfat.govt.nz/text>.

48 Including all TPP Parties; see the Electronic Commerce Chapter of the Trans-Pacific Partnership (inter alia Articles 14.15 and 14.8.5) at <http://tpp.mfat.govt.nz/text>.

Creating Better Clarity on Existing Commitments for the Platform and the Data It Carries

There are existing commitments across a large proportion of WTO members on key aspects of the networked economy, but no authoritative comparison of how different commitments interoperate with one another. Surfacing this information in a neutral way that simply compares how commitments are worded and how congruent those are with others is essential information. The meaning would then be argued by some, but at least the argument would be taking place based upon a reasonable foundation. **A group of WTO members should jointly ask the WTO Secretariat for such a report** – if the sensitivity were seen to be too great for this to be published as an official WTO Secretariat product, it could be commissioned as part of the WTO Working Papers series.⁴⁹

Exploring Issues like Network Neutrality in a Global Trading Context

As outlined above, the debate about network neutrality being confined to national (or inter-regional) dynamics is far from optimal. **A dialogue between trade officials, backbone operators and ISPs, and other stakeholders in Geneva to explore the international dimensions would be valuable.** It would expose very different views on the subject, but it would also help create a shared understanding of the impacts of different policy choices that are being made. It would also help expose any analysis that is needed to better understand the market landscape. These conversations could (and should) be held at least partly in public, and other Geneva-based institutions' stakeholders invited to participate, given that the impacts of these choices have profound implications beyond trade.

Discussing, and Creating, a Disclosure Process for Digital Information Blocking, Filtering, and Removals

While undoubtedly controversial, countries are increasingly blocking and filtering content and monitoring what their citizens do online. These activities have an inherent risk – and in some cases the certainty – of trade-distorting effects. **A disclosure process that would ensure a basic minimum of information on when content online may be blocked by a member would be of great benefit.** The WTO notifications process in other areas of trade law has been very successful, and future agreements that incorporate digital issues should build upon this legacy.

49 WTO Working Papers that presently exist are to be found at https://www.wto.org/english/res_e/reser_e/wpaps_e.htm.

The starting place is a conversation amongst willing WTO members to compare experiences and practices. Far more studies on the economic impacts of measures for blocking connectivity or reducing access to online resources are needed to complement the many that exist on how such measures can impact on freedom of expression.

Governance and Inclusion Challenges

Historically, trade agreements have been negotiated almost entirely behind closed doors. This has been challenged by civil society groups, and even industry, in direct proportion to the extent that agreements have broadened to include more and more areas of regulatory harmonization.

Given that the Internet is a general purpose technology (Jovanovich and Rousseau, 2005) – only a handful of which have existed in human history – it is no surprise that the networked economy that leverages it impacts horizontally across the entire economy. The principle of network effects (and in this context, Metcalfe’s Law and its corollaries)⁵⁰ ensures that its impact grows with each person connecting for the first time not additively but as a multiplier, just as we saw with the advent of the telephone – each person getting their own phone made the network as a whole more useful for everyone already connected.

The Internet poses a real challenge for policymaking generally (Ashton-Hart, 2015) and this is particularly so for trade, given the historical model of trade negotiations being limited to a very small group of policymakers, advised in general by a small subset of almost exclusively private-sector stakeholders. That may have made sense in political economy terms in the 20th century, but increasingly it looks like a mistake; by limiting those with a voice to such an extent, you make negotiations easier to conduct but you make the case for the benefits of the agreements harder to sell – and leave the results vulnerable to populist claims about the negative externalities.

Continuing with this historical model of closed negotiations with few advisors able to meaningfully affect the outcome would be a strategic mistake; in the age of transparency, ironically made possible by the Internet, it cannot be politically justified. Aside from that, the advice and expertise required to make good policy on the broad areas of regulatory interoperability (if not harmonization) requires broader engagement – the trade ministry alone simply

50 For a description of Metcalfe’s Law on Wikipedia, see https://en.wikipedia.org/wiki/Metcalfe%27s_law; for a discussion of its shortcomings and corollaries, see https://www.spectrum.ieee.org/tech-talk/semiconductors/devices/was_metcalf_wrong.

won't have the expertise, and other government departments will have the leading roles in the execution of outcomes. They are hardly likely to consent to binding norms they had no role in formulating, and their stakeholders, used to much more open consultation processes, will demand a role in the results, too. The European Union has recently announced that it will considerably increase the consultation processes and stakeholders involved in its trade negotiation processes (European Commission 2017), but the extent to which the reality will match the narrative remains to be seen. That said, this is the direction that all democratic societies should endorse.

In Conclusion

The networked economy presently only connects about half of humanity. We are only at the beginning of its transformation of society and of our economies. Its inherent nature is frictionless to an extent that the “bricks and mortar” trade community can only dream of for the traditional economy.

If for no other reason, it is long past time for the international trade community to make a priority of better understanding the networked economy. The Internet as a globalized medium really needs basic “rules of the road.” Trade rules related to the network and its functions that facilitate all sectoral-trade-related activities should move beyond those of basic telecommunications commitments to create a foundation from which all economies can “branch out” to tailor their national economic policy, while being able to rely on the foundation to provide interoperability with their trading partners.

For global rules to evolve, leadership from WTO members will be required. If they are unable to muster the political will to overcome the political stalemate that affects so many other areas of multilateral trade policy, the discussion will still happen, but it will happen in a fragmented way via bilateral and plurilateral negotiations, and the foundational rules will be made by a subset of economies. Almost certainly, that subset will be those with the greatest stakes in the present digital economy. Ultimately, these agreements would need to be “stitched together” or at least be interoperable somehow, and given the time frames involved, such an approach would be far from ideal.

All countries need to be a part of the conversation, as trade agreements will inevitably incorporate more and more provisions related to the networked economy. Trade negotiators of all countries – including those from developed countries – will need to understand the impacts and opportunities better to negotiate the future agreements that will bind them.

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CHAPTER 11

International Trade and Competition Policy: Working Together for the Global Economy

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Introduction

International trade and competition policy are closely related and mutually complementary in nature. However, it has long been recognized that competition enforcement issues can hinder international trade, whether through anticompetitive practices committed by companies or through different mechanisms of competition enforcement or a lack of coordination between competition agencies. This problem has led to a variety of efforts and initiatives to set disciplines on competition enforcement via international trade instruments, aiming to ensure that such issues would not harm commerce.

In the international trade system, efforts to regulate competition first took place on a multilateral basis, going back to the earliest predecessors of the World Trade Organization (WTO). On a bilateral and regional basis, such attempts materialized in the form of competition provisions in free trade agreements (FTAs) and in further forms of integration.

At the same time, relevant initiatives have been taking place outside the international trade system, in forums such as the OECD, UNCTAD and the International Competition Network (ICN). These institutions, while not specifically focused on the intersection between trade and competition but in competition policy and enforcement *per se*, have nevertheless had a positive indirect impact on the dynamics of international trade. Through extensive

development of best competition practices, the effects of the ICN on trade may probably be the furthest reaching.

The relationship between trade and competition is without doubt complex, but it has traditionally been analysed in one sense: how trade rules can influence competition enforcement to prevent competition problems from undermining trade. This chapter aims to further contribute to this discussion and, perhaps more importantly, to put forth an innovative approach to analysing such relationship, asking in what ways competition policy can positively influence trade.

What follows aims to provide a portrait of the current state of the interface between trade and competition, as well as a series of proposals and ideas for further reflection on possible ways forward. These ideas will flow in two directions, exploring how the international trade system can influence competition enforcement on the one hand, and how the competition system and principles can influence trade policy on the other.

A Glance at the Interface between Trade and Competition

Trade liberalization and competition law and policy are complementary since they pursue similar objectives. They both aim to foster a more efficient allocation of resources in the economy and to promote market efficiency and economic growth, which ultimately lead to an increase in total welfare.

In an ideal world, trade liberalization would be the most powerful tool of competition policy. Free trade intensifies competition by opening markets to foreign competitors. By increasing the size of relevant markets, trade liberalization reduces market concentration. This in turn reduces the probability of abuse of dominance, although space for cartelization remains. At the same time, trade liberalization gives companies access to a wider range of goods and services and the possibility to harness economies of scale. In sum, free trade exerts competitive pressure and simultaneously renders businesses better suited to competing. Moreover, consumers and the economy in general benefit from healthy competition driving businesses to innovate to offer better products and services at the best possible prices.

Anticompetitive Practices Can Frustrate the Gains from Trade Liberalization

However, efforts to liberalize trade through lowering or eliminating tariff and non-tariff barriers can be defeated by anticompetitive practices, especially cartels.

For example, in 2016 the Antitrust Division of the US Department of Justice fined Nishikawa Rubber Co. (a Japanese automotive parts company with manufacturing plants in the United States) for participating in bid-rigging conspiracies with other suppliers of car body sealing products. Nishikawa and its co-conspirators sold overpriced products (made in the United States) for installation in Honda, Toyota, and Subaru vehicles manufactured throughout the United States, Canada, and Mexico. Many of those vehicles were then exported to the United States and sold there.^{1,2} Therefore, savings that consumers should have benefited from, thanks to free trade in auto parts under NAFTA and the Mexico–Japan FTA, were canceled out by the incorporation of components at collusive prices.

The auto parts industry has been under rigorous antitrust investigations over the last several years across multiple jurisdictions (including in the United States, the European Union, Germany, France, Brazil, and South Korea). More than 46 companies have been investigated in the United States alone. While this is only one example in a particular industry, international cartels are a pervasive problem: more than 1,300 international cartels were discovered worldwide between 1990-2015 (Connor, 2016).

The Need for Mutually Reinforcing Implementation of Trade and Competition Policy

In an increasingly globalized economy, cases of conduct having cross-border effects as well as mergers being reviewed in several jurisdictions are becoming more and more common. However, there are additional circumstances that accentuate the need for a complementary implementation of trade and competition policy. Today, almost ten years after the start of the 2008 financial crisis and global recession, some economies have yet to recover their pre-crisis dynamism and growth momentum. In particular, global trade growth has not fully bounced back (Prasad and Foda, 2017; WTO, 2017).

1 <https://www.justice.gov/opa/pr/nishikawa-agrees-plead-guilty-and-pay-130-million-criminal-fine-fixing-prices-automotive>

2 <http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/agreements/Nishikawa.pdf>

Furthermore, we have witnessed a backlash against free trade and globalization in some countries through the rise of nationalist and populist forces that call for protectionist policies. Some of those countries, like the United States and some EU member states, have traditionally played an important role in the globalization process. This puts stable policymaking at stake and plagues the international system with uncertainty. In this context, there are latent risks to the future of free trade and competitive markets, and consequently, to economic efficiency. This makes the interface between trade and competition even more relevant today than when it was first incorporated into the WTO agenda.

Evolution of the Interface Between Trade and Competition

Discussions about the interface between trade and competition policy have taken place in the international arena for decades. There have been several attempts to develop competition-related trade rules at the multilateral level as well as at the bilateral and regional levels. While earlier efforts aimed to combat international anticompetitive business practices, they later expanded to address impacts on the competitive process caused by competition authorities' enforcement of competition legislation, state engagement in commercial activities, and states' exercise of their regulatory attributions.

The Multilateral Approach

League of Nations

Perhaps one of the earliest accounts of international discussions around trade and competition can be traced back to the League of Nations, which in May 1927 celebrated a World Economic Conference in Geneva (League of Nations, 1927). Representatives from 50 countries attended the conference with the main purpose of identifying and eliminating obstacles to international trade. At the time, there was a recently raised awareness about the need to address international cartelization, a phenomenon that had become widespread following the First World War.

This issue was debated among much controversy, and adopting ambitious recommendations regarding cartels proved too difficult. The official report of the conference acknowledged that it was impossible to establish a common international regime against cartels at the time because countries had divergent views about them (Hollman and Kovacic, 2011).

Shortly after, the Great Depression and Second World War interrupted international efforts to find a solution to cartels and to build an international competition law. During the War, the United States and its allies envisioned the Bretton Woods system with the objective of setting a new framework for the global economy. The system provided for the establishment of institutions including the World Bank, the International Monetary Fund (IMF) and the International Trade Organization (ITO).

Havana Charter

In the late 1940s, liberalizing and revamping trade was considered fundamental for global economic recovery. Similarly, in order to combat international cartels hampering trade, the United States aimed to include competition principles as part of a new international trade order. In this vein, United Nations member states negotiated the Havana Charter, which proposed the creation of the ITO and intended to establish common rules on trade and competition. At that time, only ten of the parties had national competition laws, all of them developed countries.

The Havana Charter covered a broad array of disciplines, including subsidies, export taxes, and tariff reduction. A chapter on “Restrictive Business Practices” was specifically dedicated to measures against anticompetitive practices. However, the Havana Charter was never ratified by the US Congress. Although the ITO failed to come into existence, the Charter did establish a precedent for the inclusion of competition principles in international trade agreements.

GATT-WTO

Parallel to the Havana Charter discussions, the General Agreement on Tariffs and Trade (GATT) was negotiated and entered into force in 1948, containing most of the commercial policy clauses of the Havana Charter. Several multilateral negotiation rounds followed under GATT auspices, focusing on the progressive reduction of tariffs and other trade barriers. Even though international competition law was at a very early stage at that time and competition policy was not included in the GATT texts, it did figure in its deliberations.

Singapore Issues

With the conclusion of the Uruguay Round, the WTO superseded GATT in 1995. At its first Ministerial Conference, celebrated in Singapore in 1996, four topics were included for further discussion. These topics, known as

the “Singapore issues”, were competition policy, government procurement, investment, and trade facilitation. Accordingly, a Working Group on the Interaction between Trade and Competition Policy (WGITC) was created with the mandate of studying the topic and identifying areas that required further consideration.

The Doha Declaration of 2001 formally incorporated the interaction between trade and competition policy into the negotiating round with the objective of concluding a multilateral agreement by 2015. Points to be addressed included core principles, due process, and capacity building for developing countries, among others. However, negotiations quickly stalled due to incompatible positions between developed and developing countries.

Soon after, at the Cancun Ministerial Meeting of 2003, talks broke down because of strong disagreements between members on diverse issues of the agenda, including the Singapore issues. The following year, the General Council decided to erase the interaction between trade and competition policy from the Doha agenda. Following that decision, the WGITC became inactive and remains so to date.

The bilateral and regional approach

In addition to the multilateral initiatives described above, trade and competition have been addressed on a bilateral and regional basis through FTAs and further forms of integration. Competition policy has increasingly figured as one of the non-tariff disciplines contained in trade agreements. The purpose of including competition enforcement principles and cooperation provisions in trade agreements is to ensure that parties have in place laws to sanction anticompetitive practices that may distort trade, and to improve coordination mechanisms between competition agencies.

There are also cooperation agreements between competition agencies, some of which derive from competition commitments or chapters in FTAs. Although specifically addressing the interface between trade and competition is not the central purpose of FTAs or of further integration schemes, they are useful instruments thereto, as they aim to establish the grounds for the functioning of progressively integrated markets. A brief overview of existing mechanisms at the bilateral and regional levels is provided below.

Free Trade Agreements

FTAs have proliferated in recent years, and an increasing number of FTAs include a competition chapter. An extensive screening exercise of 232 FTAs

contained in the WTO database, conducted in 2015, found that 88% had competition provisions. While some had only a few provisions, others had chapters specifically dedicated to competition with varying degrees of ambition. In contrast, of the FTAs concluded before 1990, only about 60% contained competition provisions.³

The competition content of FTAs ranges from vague obligations to deep commitments. At one end of the spectrum, there are provisions that lay out basic or ambiguous obligations, such as promoting competition in the parties' markets. As we move to the other end of the spectrum, FTA obligations are more clearly defined and involve adopting or maintaining competition laws, addressing anticompetitive practices, establishing mechanisms to facilitate and promote competition policy, considering the impact of regulation on competition, ensuring some sort of competitive neutrality regarding state-owned enterprises, and promoting a competition culture. At the lower-to-middle end of the spectrum are FTAs such as EFTA–Canada, NAFTA, and EU–Chile.

Although less common, provisions can go further and define the design of competition regimes to be maintained by the parties or the types of anticompetitive practices they should address, and may even commit to abolishing trade remedies (mostly antidumping measures) between them, opting to address such practices through the implementation of competition legislation. At the top end of the spectrum we find Australia–New Zealand, as well as the European Union, both of which merit further elaboration.

Australia–New Zealand

The Australia–New Zealand Closer Economic Relations Trade Agreement (ANZCERTA, or the CER Agreement) warrants special mention because it is one of the most comprehensive bilateral FTAs. Moreover, it is an umbrella for a series of agreements and initiatives in other areas of policy and business law, as both countries progress towards a single economic market. In the field of competition, they have developed an exemplary cooperative relation among their respective authorities (the Australian Competition and Consumer Commission, or ACCC, and the New Zealand Commerce Commission, or NZCC).

The ACCC and the NZCC have in place various instruments on competition issues, including a broad cooperation agreement that provides for the development of subsidiary protocols in areas where they may wish to

3 This exercise was performed in the framework of the E15Initiative, a project conducted under the auspices of the International Centre for Trade and Sustainable Development and the World Economic Forum. For further details, see Lapr evote et al. (2015).

undertake further cooperation and establish more detailed provisions. In this vein, the ACCC and the NZCC have a Cooperation Protocol for Merger Review, as well as a cooperation arrangement in relation to the provision of compulsorily acquired information and investigative assistance.⁴ The latter is a highly advanced form of cooperation that allows the sharing of confidential information, often referred to as second generation agreements.

European Union

It can be argued that the highest level of cooperation and convergence in competition law and policy is found in the European Union, thanks to its *sui generis* nature as an economic and political union. In the field of competition, the European Union has in place a sophisticated system of parallel competences across the European Commission, the European Court of Justice, and the member states' national competition authorities and tribunals.⁵

This system, established by Council Regulation 1/2003 and related regulations, provides that all enforcers have the power to apply the European Community law on competition.⁶ The system's purpose is to enhance enforcement efficiency by allowing the best placed agency to manage the case in question.⁷ In order to achieve this, the European Competition Network was created as a platform for close coordination and cooperation among the Commission and national competition authorities.

In general terms, the system works by competition authorities informing each other about their intentions for dealing with a case so that they can decide on the optimal way to allocate resources. Although the rules are flexible rather than rigid, national authorities most frequently deal with cases that are relevant to their national market, while the Commission deals with the most important, largest cases or those affecting more than three member states (Bonnecarrere, 2016).

4 See <http://www.comcom.govt.nz/the-commission/about-us/international-relations/agreements-with-australia/>

5 COUNCIL REGULATION (EC) No 1/2003. <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32003R0001&from=ES>

6 Articles 81 and 82 of the Treaty Establishing the European Community

7 An authority is well placed to deal with a case if three conditions are fulfilled: (1) the behavior of the parties has substantial effects for the territory in which the authority is based, (2) the authority can effectively gather all relevant information, and (3) the authority can effectively bring the infringement to an end.

Other Developments in Competition Policy and Enforcement

As explained above, the interface between trade and competition was eliminated from the WTO agenda while parallel work continued at the bilateral and regional levels. Within the international trade system, initiatives had focused on establishing basic rules on competition enforcement principles, aiming to prevent anticompetitive practices from hindering trade. On another note, and independently from trade-driven initiatives, enormous progress has been made in forums such as the OECD, ICN and UNCTAD.

Recognizing the international dimension of competition issues, these bodies have advanced the development of best practices, criterion, and methodologies; fostered inter-agency cooperation; provided technical assistance, and so on. Even though international trade is not their primary objective, they still exert an effect over it. By promoting convergence in competition enforcement principles that have proved successful, fair, and effective, institutions like the OECD, ICN and UNCTAD help prevent jurisdictions from enforcing competition legislation in discriminatory and trade-distorting ways.

Given this background, a brief description of these institutions' essential features and most important contributions to the world of competition is provided below.

OECD

Competition law and policy have been an important part of the OECD's work since its establishment in 1961. The OECD Competition Committee gathers representatives of the members' and observers' competition authorities, holding in-depth technical discussions on different areas of competition law and policy. Non-OECD members, as well as international organizations like the World Bank and the WTO, can also participate in the Competition Committee and the Global Forum on Competition. Additionally, there is a specialized Competition Division within the OECD's Secretariat which assists the work of the Competition Committee.

The OECD Council has adopted various recommendations on competition law and policy covering a wide range of topics, such as merger control, competition assessment, bid rigging, and hard-core cartels. Of particular relevance to the interface between trade and competition is the 2014 "Recommendation concerning International Co-operation on Competition Investigations and

Proceedings”,⁸ which replaced the 1995 “Recommendation on Cooperation between Member Countries on Anti-Competitive Practices affecting International Trade”. The 2014 recommendation establishes a cooperation framework for OECD members and adhering countries on the notification of investigations and consultation regarding competition law enforcement. Accordingly, it has inspired cooperation provisions for competition chapters in recently negotiated FTAs.

Furthermore, since 1998 the OECD Secretariat has conducted peer reviews of several member and non-member states’ competition regimes, a relevant tool for fostering public dialogue and convergence.

UNCTAD

UNCTAD developed the “Set of Multilaterally Agreed Equitable Principles and Rules for the Control of the Restrictive Business Practices on International Trade” (commonly known as the UN Set), with the objective of enhancing economic policy in developing countries. The UN Set, adopted by consensus in 1980, recognized that restrictive business practices limit market access and undermine international trade. Despite its non-binding nature, the UN Set promoted further international cooperation on competition issues. Every five years, it is reviewed by several experts from different countries, with its most recent revision taking place in July of 2015.

Another contribution of UNCTAD is its Model Competition Law, which has guided some developing countries in their drafting and adoption of national competition laws. The Model Law encourages convergence on general principles and best practices and provides for cooperation on the implementation of legislation against transnational restrictive business practices. The Model Law is also periodically revised.

UNCTAD also hosts an annual Intergovernmental Group of Experts on Competition Law and Policy for consultations on competition issues and informal exchange of experiences and best practices, including a voluntary peer review of competition law and policy. Overall, UNCTAD is remarkable at providing technical assistance and capacity-building, helping create sustainable competition regimes at the national level.

8 “Recommendation of the OECD Council concerning International Co-operation on Competition Investigations and Proceedings” as approved by Council on 16 September 2014 [C(2014)108], <https://www.oecd.org/daf/competition/2014-rec-internat-coop-competition.pdf>

International Competition Network

Founded by 15 agencies in 2001,⁹ when trade and competition was treated within the WTO, the ICN is a network of competition authorities with the objective of addressing cross-border issues of competition law and policy. It is currently composed of 135 national and regional competition agencies from 122 jurisdictions spanning all continents. The ICN's work is guided by its Steering Group, which is composed of 18 representatives of member agencies working as the network's driving force.

Although the ICN hosts an annual conference as well as other face-to-face events such as workshops, most of its work is carried out via teleconferences or other electronic means. The ICN does not have headquarters or any permanent staff, which is why it is often described as a virtual network.

The ICN further distinguishes itself in two aspects: it is the only international body devoted exclusively to competition law and policy, and, unlike in most international bodies, its members participate in their individual capacity as competition authorities, as opposed to representing their governments.

The ICN has developed a series of recommended practices which are consensus driven, non-binding policy recommendations created by and for the ICN members to inspire greater global convergence of the most effective practices. Recommendations cover areas such as merger notification and review procedures, merger analysis, assessment of dominance, and state-created monopolies, among others. It has also produced an Anti-Cartel Enforcement Manual, which compiles the diverse investigative approaches used by member agencies with varying experience levels. The manual serves as a reference tool for agencies to use according to their respective jurisdiction's enforcement regime. In this sense, while the ICN is not a forum for case-specific cooperation, it does explore mechanisms for agency cooperation and interoperability to make competition systems more compatible.

The standards and recommended practices developed through the ICN platform have had a great impact on the development of national competition regimes. It has been estimated that approximately 25% of ICN members have undertaken a major legislative overhaul according to ICN recommendations. In fact, countries including Mexico, Brazil, Italy, Germany, and South Africa have undertaken reforms inspired by the ICN's recommended practices.

Thanks to its broad membership and guidance on several areas of competition law and policy, the ICN has influenced the practice and performance of

9 Australia, Canada, European Union, France, Germany, Israel, Italy, Japan, Korea, Mexico, South Africa, United Kingdom, United States (with two competition authorities), and Zambia.

competition agencies in cases with indirect impacts on trade, thereby helping to bridge the gap between the worlds of trade and competition.

Intersection between Trade and Competition: Possible Ways Forward

When properly implemented, trade and competition policy are mutually reinforcing in the pursuit of market efficiency, the promotion of economic growth, and increases in welfare. However, appropriate implementation cannot be taken for granted. Despite the progress made via the mechanisms discussed above, international trade, and hence competition, can be restricted through the misuse of existing flexibilities in trade rules. This potential misuse includes the imposition of quotas, arbitrary or unnecessary technical standards or sanitary and phytosanitary measures, market-distorting subsidies, unjustified resort to trade remedies, as well as in discriminatory government procurement practices.

Although an open trade policy is meant to remove government barriers to trade and investment, it is sometimes used as a tool to open foreign markets for exports while protecting domestic companies (national champions) from imports, by maintaining or establishing selective obstacles to the entry of potential foreign competitors. Such obstacles are found both in the form of tariffs and non-tariff measures (NTMs), with the latter having an increasingly important impact in the context of tariff-binding processes both multilaterally and through FTAs (Abbott and Singham, 2013). Against this background, obstacles to trade and restraints to international competition are both understood as harmful.

Consequently, and particularly in a context of rising protectionism, special attention to the complementary implementation of trade and competition policies is required in order to prevent their strategic implementation to the detriment of economic efficiency.

Given this background, it is worth reflecting on two questions. How can the legal framework of trade agreements be leveraged to influence competition enforcement in a way that promotes seamless trade and market efficiency? And how can competition principles be effectively embedded into trade policy and decisions? What follows is a series of proposals and ideas for further reflection.

How can the legal framework of trade agreements be leveraged to influence competition enforcement in way that promotes seamless trade and market efficiency?

Using FTAs to foster convergence towards best practices in competition enforcement.

FTAs have the potential to drive jurisdictions to adapt their national competition regimes to best practices, thereby contributing to increase convergence. FTAs can foster the political will and private-sector support that might be necessary to undertake reforms when doing so is perceived as a prerequisite to a trade relationship from which important benefits are expected.

As discussed above, there is a wide spectrum of approaches to competition policy in FTAs, from those containing basic or ambiguous provisions to those containing specific competition chapters with disciplines of varying scope and degree. While competition provisions in their simplest form (such as requiring parties to promote market competition or to adopt or maintain a competition law and authority) may not provide much added value to countries with developed competition regimes, they have been a crucial first step for countries previously lacking any form of competition regime. This was the case for Mexico, which adopted its first competition law in 1992, in the context of the NAFTA negotiations, where parties committed to adopting or maintaining measures to proscribe anticompetitive business practices and proceeded accordingly.¹⁰

Nevertheless, there is a trend towards FTAs including competition chapters with more ambitious, further-reaching provisions, which is how they can help jurisdictions move progressively closer to best practices on competition enforcement. For example, despite TPP's uncertain future, its competition chapter was relevant because parties not only committed to applying their respective national competition law, but also to ensuring that their regime (law and regulations, procedures, tribunals, etc.) would comply with high standards of transparency and due process. This is critical for ensuring that competition law is not implemented discriminatorily or with protectionist purposes.

With a view to expanding and deepening convergence through FTAs, the development of a model competition chapter would be very beneficial. The model chapter could be achieved through work in the ICN, harnessing the OECD's expertise. While a model chapter would evidently be subject to adaptations, it should encompass provisions in areas like enforcement principles

¹⁰ Subsequently, Mexico underwent competition reforms in 2006, 2011, 2013 and 2014, leading to a legal and institutional framework comparable to the most advanced jurisdictions in the field and turning its experience into a point of reference for young competition agencies in Central America.

and due process, cartels, abuse of market power, and mergers, as well as the treatment of state-owned enterprises (SOEs) and designated monopolies under the principles of non-discrimination and transparency.

Using FTAs to establish comprehensive international cooperation and coordination mechanisms for effective competition enforcement.

Whether through FTAs or through cooperation agreements between competition authorities, establishing the grounds for international cooperation on competition enforcement means contributing to the well-functioning of markets and to the attainment of the benefits of trade liberalization.

Trade agreements have become important platforms for cooperation in competition enforcement. Similarly, including cooperation provisions may result in greater resources available to enforcers to support cooperative efforts. Common forms of cooperation provided for in FTAs include the reciprocal notification of relevant investigations, exchange of typically non-confidential information, provision of technical assistance, coordination of enforcement activities, consultations, as well as negative and positive comity.

Positive and Negative Comity

Comity is a principle in international public law whereby a country should take into consideration the important interests of other countries when enforcing its laws, in return for reciprocity. Negative comity (also known as traditional comity) means that a country will consider how to prevent its laws and law-enforcement activities from harming another country's important interests. Positive comity, on the other hand, means that a country may carry out enforcement actions against a practice taking place on its territory, upon request (case referral) from another country whose interests are also being affected by such practice.¹¹ In this sense, while the same conduct may harm both jurisdictions' markets, one agency would take enforcement action and apply a remedy that serves both. The effectiveness of positive comity is determined by several factors, such as the type of conduct taking place, the competition authorities' priorities and constraints, as well as the trust between them.

Some competition agencies have signed cooperation agreements establishing positive comity commitments, such as the "Agreement between the Government of the USA and the European Communities on the Application of Positive Comity Principles in the Enforcement of their Competition Laws", which was signed in 1991 and further clarified in 1998. The first formal referral

¹¹ See the OECD's Inventory of Cooperation Agreements at [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=daf/comp/wp3\(2015\)12/rev1&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=daf/comp/wp3(2015)12/rev1&docLanguage=En)

under this Agreement occurred in 1998, and involved computerised airline reservation systems. Upon request by the US antitrust authorities, the European Commission investigated specific discrimination allegations regarding the system's operation by European airlines within its jurisdiction. However, in many cases this type of cooperation takes place without a positive comity agreement being formally invoked.¹²

The OECD Competition Committee has concluded that positive comity's potential appears to be greatest in cases where anticompetitive actions in the requested country injure the requesting country's exporters but not its consumers. These types of cases would actively concern the requested country's competition authority because of the harm caused to consumers in their jurisdiction. From the point of view of the requesting country's competition authority, these cases would be understood as "export restraint cases"; and from the point of view of trade officials, as "market access cases" (OECD, 1999). Positive comity offers important potential benefits both in terms of efficiency and avoidance of jurisdiction conflicts; therefore, it is desirable for authorities to engage more actively in this kind of cooperation.

Information Exchange

Information exchange has been at the core of competition authorities' discussions of enforcement cooperation. It is common practice when information is non-confidential in nature. In contrast, the exchange of confidential information – including evidence compulsorily obtained through antitrust investigative powers – is a more advanced form of cooperation. Of course, strong mutual trust between parties is a prerequisite.

Confidential information can be exchanged according to confidentiality waivers or through "information gateways". While the former involves an explicit consent from the source that provided the information in question, the latter allows its exchange without such prior consent, as long as the exchanging authorities respect certain safeguards. Information gateways delimit the types of information that authorities can exchange, establish conditions on its usage, or further disclosure, among other terms of protection.

Cooperation agreements providing for the exchange of confidential information are commonly referred to as "second generation agreements", and are currently in place between Australia and New Zealand, Australia and the US, Australia and Japan, the European Union and Switzerland, and

12 "United States and European Communities Sign Agreement on 'Positive Comity' in Antitrust Enforcement", Federal Trade Commission press release, 4 June 1998 (<https://www.ftc.gov/news-events/press-releases/1998/06/united-states-and-european-communities-sign-agreement-positive>).

in the Nordic Cooperation Agreement between Denmark, Sweden, Norway and Iceland.¹³

Since some jurisdictions may face legal constraints to engaging in this scheme of cooperation, not every competition authority would be able to put it in place. However, when applicable, second generation agreements do offer important potential benefits – namely, more efficient proceedings, avoiding unnecessary work duplication, and reducing the burdens and costs for parties involved. In this regard, FTAs could leverage the experience learned from interagency cooperation agreements and, when suitable, serve as mechanism to promote the exchange of confidential information

Abolishing Antidumping Measures in FTAs

The elimination of antidumping measures in FTAs and other regional trade agreements (RTAs) should be a relevant prospect for enhancing competition enforcement. At present, antidumping measures have been abolished in only 11 trade agreements of diverse nature (some between countries, others between trade blocks, such as free trade areas and customs unions). In some of these agreements, the elimination of antidumping measures is explicitly linked to competition law (see Table 1).

In trade agreements that eliminate antidumping measures, the underlying rationale is that the effective enforcement of competition rules may adequately address the economic causes leading to trade defences. Specifically, dumping may result from the abuse of market power by protected firms that use their monopoly profits from home to dump products abroad. Trade agreements that facilitate cross-border cooperation for competition enforcement pave the way for combatting such practices through the application of predatory-pricing or anti-discrimination rules (National Board of Trade, 2013). In this vein, one could assume that eliminating antidumping measures between parties of an FTA would provide a strong incentive to improve coordination among their competition authorities, through mechanisms like positive comity or exchange of confidential information, among others.

Regarding the legal basis for the elimination of antidumping measures, it is worth observing that GATT Article XXIV, in its eighth paragraph, establishes that customs unions and free-trade areas shall be respectively understood as “*the substitution of a single customs territory for two or more customs territories*”, and “*a group of two or more customs territories*” where “*duties and other restrictive regulations of*

13 See the OECD's Inventory of Cooperation Agreements at [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=daf/comp/wp3\(2015\)12/rev1&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=daf/comp/wp3(2015)12/rev1&docLanguage=En)

commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories”.

Special attention is warranted to the fact that GATT Article VI on Antidumping and Countervailing Duties is not included in the list of trade restrictions that can be maintained in customs unions and free trade areas. Some analysts have argued that if the drafters intended to allow for the adoption of antidumping measures in RTAs, this would have been explicitly mentioned in Article XXIV, and that its absence should therefore be understood as implying that antidumping measures are incompatible with RTAs. Nevertheless, it has never been clarified whether that list is exhaustive or illustrative, as there is no consensus nor dispute settlement understanding on the matter.

It could be argued that eliminating antidumping measures in RTAs is not feasible for various reasons. First, from a political perspective, governments may find it difficult to obtain enough support from domestic industries to sign RTAs if antidumping measures were not included therein. Second, one could point out that so far, a majority of the RTAs that have eliminated antidumping measures have been signed by jurisdictions that do not use the antidumping system at all (such as the EFTA states), or between jurisdictions that rarely used it against each other (for example, Canada–Chile).

In agreements abolishing antidumping measures between countries that did have more intense trade flows (and hence a higher probability of resorting to antidumping), high degrees of economic integration and harmonization of standards and other conditions are also in place. The European Union and ANZCERTA are clear examples of this. Consequently, it may appear that high levels of integration and harmonization are a prerequisite to abolishing antidumping measures between trade partners, so as to ensure that such partnership develops on a level playing field. Despite these complexities, replacing antidumping measures with the application of competition legislation should be explored as a possible way forward for the promotion of market efficiency, especially between close trade partners.

Table 1: Trade agreements currently in force that have eliminated antidumping on intra-regional trade

		Type of Agreement	Antidumping measures prohibited	Anti-subsidy measures prohibited	Safeguard measures prohibited	Competition Chapter	Year the elimination of antidumping came into force
1	European Union	CU	x	x	x	x	1958
2	Australia-New Zealand (ANZCERTA)	FTA	x		x	x	1990
3	EU-Andorra	CU	x	x	x		1991
4	EU-San Marino	CU	x	x	x		2002
5	EU-EFTA (European Economic Area)	FTA	x	x		x	1994
6	Canada-Chile	FTA	x			x	1997
7	European Free Trade Association (EFTA)	FTA	x	x		x	2002
8	EFTA-Singapore	FTA	x			x	2003
9	EFTA-Chile	FTA	x	x		x	2004
10	China-Hong Kong	FTA	x	x			2004
11	China-Macau	FTA	x	x			2004

Source: National Board of Trade (2013).

Including Binding Dispute Settlement Mechanisms in Competition Chapters of FTAs

Notwithstanding the potential benefits of including competition provisions in FTAs, it could be argued that they are inherently limited by the fact that they are often not subject to dispute settlement mechanisms. The majority of FTAs exclude their competition provisions or competition chapter from the coverage of their general dispute settlement mechanism. The screening exercise referred to above found that 59% of the FTAs examined explicitly excluded competition issues from the dispute settlement mechanism. At the same time, 47% of FTAs reviewed established *ad hoc* dispute settlement mechanisms for competition matters, such as consultations or negotiations between authorities (Laprévôt et al., 2015). However, these *ad hoc* procedures lack the binding force of the general dispute settlement mechanism.

Consequently, exploring the possibility of including a binding dispute settlement mechanism in competition chapters would be an interesting prospect for further harnessing the strength of FTAs, or of the WTO if a competition agreement were to be established therein. Two types of mechanisms could be explored: (1) a state-to-state mechanism which would allow parties to challenge discriminatory provisions in the other party's law, guidelines, or consistent practices; and (2) an investor– or business–state mechanism allowing private companies concerned by an individual decision to seek redress at the international level. This is a complex topic, and would require governments to refrain from getting involved on behalf of a particular company, as the risk of politicizing competition enforcement should be avoided at all costs.

Of course, a binding dispute settlement mechanism for competition issues has never before been put in place within a trade agreement, and reluctance could be expected both at the level of competition agencies and central governments.

Striving for a Plurilateral Agreement under the WTO

As discussed above, efforts to develop a multilateral framework for trade and competition have failed to produce a binding agreement. This has occurred for several reasons, including a low prevalence of national competition regimes at times when negotiations were taking place, incompatible positions between developed and developing countries, resistance to reducing policy space, concerns about domestic capabilities and costs of implementation, and so on.

Despite past unfruitful attempts, the objective of achieving an agreement on trade and competition rules should not be dismissed. The relevance of the intersection between international trade and competition has been magnified by globalization and the increase of operations across national borders and of

international mergers, trends that are likely to continue. Therefore, we should seek ways to advance towards the aforementioned goal.

While some experts have suggested the creation of an independent multilateral competition system with a supranational authority, others have envisioned a plurilateral competition agreement within the WTO system (Hufbauer and Kim, 2008; Nakatomi, 2013). Given the complexity and multitude of factors involved, the latter is perhaps a better alternative, considering that the WTO is an already solid institution on which to build, as well as the natural framework in which to treat trade-related issues.

Nevertheless, it would not be a simple task by any means. The interaction between trade and competition policy was removed from the current WTO agenda. The Doha Round, under negotiation since 2001, has been extended in time due to the difficulty of successfully concluding its mandate on topics such as agriculture, non-agricultural market access, and antidumping and subsidies rules, among others. Despite these potentially discouraging facts, one should not lose hope in the potential of the WTO to produce meaningful results. The Trade Facilitation Agreement, which entered into force on February of 2017, offers an example of why the WTO is still relevant. Even if at a slow pace, things can still move forward, and some progress is preferable to no progress at all. In this context, a plurilateral agreement among like-minded countries might be a desirable option for the future, with a view to broadening its membership progressively.

Moreover, the enormous advances that have been achieved through ICN, OECD and UNCTAD should be leveraged as a cornerstone on which to build a plurilateral agreement under the WTO. Concretely, ICN could provide the strongest platform to harness international support on the issue, thanks to its broad membership and to the fact that its recommended practices have been effectively adopted and implemented by many of its member jurisdictions. For this initiative to flourish, a comprehensive advocacy strategy to raise awareness about its increasing relevance and inherent benefits is warranted.

How can Competition Principles be Effectively Embedded into Trade Policy and Trade Decisions?

The other side of the discussion about the trade and competition intersection ought to be how trade policy implementation can be positively influenced by competition policy and its core principles. Stronger embodiment of competition principles in trade policy can make globalization more inclusive. Moving towards a more inclusive globalization – where competitive markets extend the benefits among all stakeholders in developed and developing economies alike (Pérez Motta, 2016) – would help dissipate popular doubts or mistrust over market-oriented policies, as well as the appeal of populist forces that threaten the stability of the international trade system and of sound policymaking.

Competition principles can essentially be summed up as market efficiency, consumer welfare, and competitive neutrality – or a level playing field for all. These principles are designed to reach the full potential of a globalized economy by contributing to the realization of trade liberalization's goals of promoting lower prices to consumers in a better, broader range of products available thanks to increased competition, as well as stimulating innovation and economic growth. Therefore, exploring ways to proactively embed competition principles and advocacy by competition agencies into trade policy decision-making at the national level, so that such decisions foster market efficiency more effectively, should be a top priority.

In order to achieve this, the involvement of national competition authorities (NCAs) in trade decision-making is desirable. NCAs could positively influence decision-making regarding the application of trade rules and flexibilities by analysing the measures on the basis of competition merits, evaluating their potential impacts, and issuing recommendations accordingly. Of course, for this proposal to be feasible and successful, NCAs should be effectively independent from political pressure and economic interests.

National Competition Authorities Issuing Recommendations About Trade Measures

In the mechanism envisaged here, the NCA's recommendations would ideally be mandatory. If the government opposed the proposal, the trade minister or equivalent would be able to veto it, but would be required to disclose the criteria and arguments motivating the veto. In a similar vein, the competition authority's recommendation would be public and include its supporting reasoning.

The role of NCAs would involve the following:

1. *Tariff modification*: NCAs would make a comprehensive evaluation of the full cost-benefit analysis from the standpoint of domestic market efficiency of a proposed tariff increase.
2. *Government procurement*: NCAs should work closely with procurement officials to ensure tenders are designed and carried out in a pro-competitive manner, and to combat bid rigging by suppliers. NCAs should also work to raise awareness of the advantages of having open, competitive procurement processes in terms of getting the most value for the public resources put out. When applicable, they should also exhort their government to adhere to the WTO Agreement on Public Procurement.
3. *Services and investment regulation*: NCAs should evaluate proposed regulations which would have effects on trade and investment, to assess their impact over market efficiency and consumer welfare. Additionally, NCAs should make recommendations on areas where further liberalization would be beneficial. Ideally, those recommendations should be discussed and coordinated with sectorial regulators, with NCAs' recommendations and arguments made public even if disagreements between them and regulators persist.
4. *TBT and SPS measures*: While NCAs are in no way meant to substitute for the technical expertise of specialized regulators in the establishment of science-based regulations, they could provide a balanced, independent analysis of the broader market impact of a proposed measure, by taking into consideration both consumer and producer interests. This would be consistent with the principles enshrined in the WTO Agreements on Technical Barriers to Trade (TBT) and on the Application of Sanitary and Phytosanitary Measures (SPS), which establish that technical regulations shall not be more trade-restrictive than necessary to fulfil a legitimate objective,¹⁴ and that members should take into account the objective of minimizing negative trade effects when determining the appropriate level of SPS protection.¹⁵
5. *Trade defense instruments*: NCAs might be the best-placed agencies to assess the transversal market impact of measures such as antidumping duties. The competition authority should weigh their potential effects over consumers and intermediate users, in order to provide a view that is not limited to the

14 Article 2.2 of the WTO Agreement on Technical Barriers to Trade.

15 Article 5.4 of the WTO Agreement on the Application of Sanitary and Phytosanitary Measures.

interests of national producers, but encompasses wider economic efficiency and welfare.¹⁶ Accordingly, NCAs would issue recommendations regarding the imposition of antidumping duties, advocating for the use of the lesser duty rule when appropriate.¹⁷

Advantages of Empowering NCAs in Trade Decision Making

The proposed scheme whereby NCAs would make recommendations to national commercial authorities before trade decisions were made would have significant advantages. First, it would not be perceived as a foreign imposition, which was one of the reasons why previous discussions on trade and competition stalled. Second, it could be implemented as a national strategy in favor of market efficiency, seeking to reinforce the trade agenda. Third, by offering an *a priori* analysis, negative effects of unjustified trade barriers would be prevented, rather than remedied through an *ex post* intervention. Fourth, the scheme would foster transparency while still preserving trade authorities' ability to apply the proposed decisions, albeit at a higher political cost if anticompetitive consequences are known beforehand. Finally, the proposed mechanism could be implemented on a very wide scale, since more than 130 jurisdictions currently have an NCA.

National Competition Authorities Issuing Recommendations about the SOEs and Designated Monopolies Regime

Another relevant trade-related field where competition authorities could exert a positive influence is that of state-owned enterprises. SOEs have gained presence in the global marketplace. According to a report published by the OECD in December of 2016, approximately 22 of the world's biggest 100 firms are SOEs or are otherwise under state control (OECD, 2016). This is the highest level of state-ownership in decades, which raises concerns regarding the impact of SOEs in international trade and investment, and challenges

16 This consideration, often referred to as "public interest test", is not explicitly contained in the WTO Antidumping Agreement, but it is desirable for a balanced approach to the use of such trade defence instrument.

17 This would be consistent with the Antidumping Agreement, which in its Article 9.1 recognizes that imposing an antidumping measure is optional even when the required conditions are fulfilled, and that it is desirable to apply a duty below the dumping margin when that is sufficient to remove the injury to the domestic industry.

governments to guarantee competitive neutrality if unfair market distortions are to be avoided.

On Competitive Neutrality

Recognizing that SOEs have become global competitors with the potential to have effects on trade and investment across borders and beyond the mandate for which they were established, it is critical to ensure fair and competitive regulatory environments. In this sense, NCAs should analyze their country's national regulatory framework for SOEs and issue recommendations as necessary to guarantee that SOEs do not unjustly benefit from preferential treatment when performing commercial activities. Such preferential treatment (whether through subsidies, privileged regulatory, fiscal or financial regimes, etc.) would confer SOEs artificial advantages over their private counterparts, potentially deterring the latter from investing in a jurisdiction where they lack the certainty of a level playing field.

Mergers and Acquisitions involving SOEs

On a similar note, merger and acquisition (M&A) activity by SOEs has also increased, especially by enterprises owned by developing countries' governments (OECD, 2016). This is a source of concerns in some jurisdictions as takeovers by foreign companies tend to be perceived as potential threats to national sovereignty or security. This is especially the case when M&A transactions involve areas like high technology, infrastructure, satellite navigation, or sectors otherwise regarded as strategic. Hence, it is necessary to ensure that M&A analysis and approval respond to strict economic and legal facts, and that they are not deviated by political interests. A special responsibility falls on NCAs to guarantee this.

Conclusions

There is a naturally occurring intersection between international trade and competition, since both pursue similar objectives. Nevertheless, while international trade and competition are in essence complementary, the implementation of trade and competition policies in a truly reinforcing manner cannot be taken for granted. With worrying waves of protectionism in some countries threatening the stability and foundations of the global trade order, special attention is required to the implementation of such policies.

When it comes to the potential impact of competition issues over trade, it has been acknowledged that distortions to trade and investment can be generated by anticompetitive practices committed by private companies or SOEs, by a lack of coordination among NCAs, by competition enforcement decisions reached through methodologies that do not conform to best international practices, and by competition legislation or decisions responding to objectives other than economic efficiency. Due to the long-existing recognition of the fact that these issues can negate the benefits of trade, the international community has aimed to influence competition enforcement through international trade instances such as the WTO, and instruments such as bilateral and regional trade agreements. This chapter has analyzed possible steps for further progress in this sense.

However, while competition issues can undermine trade, trade policy and decisions can also deviate from its ultimate objectives to serve narrow interests, thereby hindering the competitive process. Better harnessing of the complementarity of trade and competition therefore requires observing this relationship in the opposite direction – namely, how to embed competition principles into trade policy and decisions. A series of innovative ideas aimed at achieving this has been put forth in this chapter. Further reflection and discussions should ensue in the hope of making trade and competition policy work together for the global economy.

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The world economy is going through major economic and geopolitical shifts, fostering tensions in the global economic governance structure centered on the IMF, World Bank and the WTO. The impacts of globalization are being questioned while disruptive technologies continue to change the economic landscape. Populist politicians advocating for greater sovereignty and policy autonomy are attracting increasing shares of the vote in many OECD countries. The election of Donald Trump on a protectionist platform and the UK referendum in favor of Brexit may signal that the peak of globalization has been reached.

This collection of papers focuses on one of the pillars of global governance: the multilateral trade system, anchored by the WTO. Membership of the WTO is now close to universal, with the accession of China in 2001 representing a landmark achievement. While the organization plays a major role in enhancing the transparency of trade policies and enforcing the rules of the game that have been agreed by members, it has not been successful at negotiating new rules. The private sector is frustrated with the WTO, as are civil society groups seeking to address issues of interest to them. There is a general perception that WTO disciplines and *modus operandi* are outdated and have not kept pace with globalization.

The chapters in this volume focus on key critical issues that confront the WTO membership. They review developments in trade policy and technology and regulation. They make clear there is an important global governance gap. The “internet of things”, e-commerce, cross-border services, digital trade and data flows all call for global rules of the road. They also make clear that pressures for old-fashioned protectionism are rising in some parts of the world. The future of the WTO is under serious threat. Safeguarding and bolstering the rules-based trading system is critical for the health and expansion of global trade in the 21st century.

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