Valdai Papers

#23 | July 2015

The Future of the Global Trading System

Philip I. Levy

Valdai Discussion Club

valdaiclub.com

Two decades ago, in the mid-1990s, there was a moment of glory and satisfaction for those crafting the global trading system. The Uruguay Round of global trade talks, involving 123 countries, had come to a successful, if belated, conclusion. The participants erected the shiny new World Trade Organization (WTO) atop the makeshift structure of the General Agreement on Tariffs and Trade (GATT). This new edifice was meant to extend the rules-based global system into new domains, strengthen its ability to handle disputes, and provide a ready means to craft new rules. The hope was that a simpler approach to trade governance would avoid the impasses that had begun to characterize the grand rounds of negotiations.

There certainly seemed to be a need, since international trade was growing in both absolute terms and as a share of economic activity. Not only were trade volumes increasing, but the complexity of global commerce was increasing. More and more, trade moved beyond the simple shipping of crates back and forth. Trade in services was growing, often requiring investment to accompany trade. So was the use of global supply chains, in which products would be assembled from parts made all over the world.

In the decades since, the ebullience has faded away. Trade has continued to grow, but not as quickly as in the era before the global financial crisis. On the policy front, the successor talks to the Uruguay Round have stalled. In his most recent statement on their prospects, WTO Director General Roberto Azevêdo concluded, “it is hard to see a way forward.”

There have been accomplishments over the two decades, to be sure. The People’s Republic of China both emerged as an economic superpower and joined the membership of the WTO in 2001. Russia became the 156th member of the WTO in the summer of 2012. Yet the stalled round of WTO talks revealed a sharp divide among countries about the direction the global trading system should move. This split largely divided the major developed and developing nations of the world, with India and China standing in opposition to the United States and the European Union. After a failed attempt to conclude the negotiations in the summer of 2008, the major developed nations largely turned their attention to large regional trading agreements. While countries such as Brazil, Russia, India, and China are not officially excluded from such efforts, they are not currently participants, either. Even under the auspices of the WTO, new talks on trade in services include only a fraction of the membership, thereby challenging one of the signature accomplishments of the Uruguay Round – the application of most of its rules to all of its membership.

This paper explores the possibilities and prospects for the global trading system. It does so initially by tracing the roots of the schisms that have recently emerged out of the latest round of trade talks. Then it considers the new institutional approaches – mega-regional agreements and WTO plurilaterals – that followed the breakdown of global talks. Finally, the paper will consider where these trends are likely to lead and how major participants in the system can work to shape its future.

The Doha Derailment

From the early days of the post-war trading system, there had been a split within. Developing countries were treated differently from developed. In the parlance of trade, they received “special and differential treatment.” This approach had both philosophical and practical roots.

Philosophically, development theory of the 1950s and 1960s was skeptical that developing countries could make much progress if faced with full-on competition from developed countries. The popular view was that developing countries would need to be sheltered from the full brunt of the market if they were to flourish, if they were to nurture their infant industries to the point where they could be globally competitive.

Practically, developing countries constituted a relatively small fraction of the output and trade volume of the global economy in the immediate post-war era. The developed world placed relatively little commercial importance on access to their markets. Simultaneously, the participants in Cold War politics placed great importance on winning the allegiance of these countries, which was easier if they were not saddled with unwelcome market-opening obligations.

The result was a trading system, constructed through seven rounds of GATT talks, that imposed relatively few obligations on its less-developed member countries, but also did relatively little to address their needs.[1] The eighth round, launched in Uruguay, did take on issues of concern to developing countries and had a large number of developing-country participants. But when it concluded, many of those participants felt they had not fared well in the talks. They were required to undertake costly trade facilitation measures, for example, while many of the gains they cared most about – as in agriculture and textiles and apparel – amounted to promises of future liberalization (and the countries doubted the value of those promises).

This meant that when the powers of the new WTO attempted to launch new talks in the late 1990s, they were met with skepticism and protest. Some of this came from groups with concerns about the effects of globalization, but an important strain came from developing countries who felt they had yet to see the benefits of previous talks. A WTO Ministerial meeting in Seattle in 1999 devolved into a debacle of protest and discord. No new round was launched.

Only after the terrorist attacks of September, 2001, did a new round of trade talks commence. Eager to do something to restore confidence in the economy, the members of the WTO gathered in Doha, Qatar in November 2001 to launch the “Doha Development Agenda.” The name was no accident. It embodied both the promise to address the concerns of developing countries and the intention to be different from previous GATT ‘rounds.’ Importantly, it also papered over some critical differences between the developed and developing nations. The major developed parties saw it as a commitment

[1] See Srinivasan, T.N. (1999), Developing Countries and the Multilateral Trading System: From the GATT to the Uruguay Round and the Future, Westview Press.

to engage in reciprocal negotiations on issues of importance to the developing world. At least some major developing nations saw it as a unilateral commitment on the part of developed countries to redress past imbalances in WTO obligations.

While the diplomatic double entendre was useful for launching the Doha round, it led to problems in the negotiations very quickly. In the fall of 2003, a Ministerial meeting in Cancun that was supposed to mark the midpoint of the negotiations dissolved into demands and recriminations. The first notional deadline of January 2005 came and went, as did a fallback deadline of end-2006. In the summer of 2008, an major push in Geneva to conclude the round ultimately proved fruitless. At the heart of the impasse were different conceptions of the minimal level of obligations that major developing nations would need to take.

The early permissive attitude toward developing nation trade barriers had faded significantly in the major developed nations, particularly in the United States. In part, this was because the major developing nations – especially China – were becoming far too economically important to ignore. In part, it was because the evolving complexity of modern commerce had increased the urgency felt by the business sectors in the developed world to pursue “high standards” agreements. These agreements not only addressed traditional border barriers, but also topics such as investment, services, intellectual property, and regulation. That shifted emphasis reflected both the evolution of trade and also the fact that, at least among developed countries, tariff barriers had dropped dramatically over the decades of GATT rounds.

The net result was that, in the summer of 2008, the multilateral process had ground to a standstill.

The Regional Roundabout

The United States and Europe were both determined to seek progress in trade liberalization through regional or plurilateral agreements. In September 2008, the United States announced its intention to join negotiations with four smaller nations in the Asia-Pacific Region (Brunei, Chile, New Zealand, and Singapore).[2] The grouping might have seemed odd, particularly given that the United States already had free trade agreements with Chile and Singapore. But the four countries had already built a framework based on two appealing principles: high standards and openness to new members. The effort became known as the Transpacific Partnership (TPP). Over years of negotiation, the number of participants grew to 12, including such major economies as Japan and Canada and would cover a significant fraction of world trade. It also grew to include important developing nations such as Malaysia, Mexico, and Vietnam. Thus, it served as a de facto rejoinder to those countries who advocated for reduced obligations for developing countries. Here were notable developing countries explicitly opting in favor of higher standards. While these higher standards imposed greater obligations on developing participants, they also provided an opportunity for those countries to make

[2] See Barfield, Claude and Philip I. Levy (2009), “Tales of the South Pacific: President Obama and the Transpacific Partnership,” AEI International Economic Outlook No. 2, December.

a public and credible commitment to investor-friendly economic policies in a way they could not do at the more permissive WTO.[3]

One of the emerging difficulties with the WTO was that it operated on the basis of consensus. As the number of WTO members reached 160, this meant a daunting number of potential veto players. While tiny nations were unlikely, in practice, to be able to single-handedly block a WTO agreement, this was well within the power of the major developing nations. That placed an effective check on 'top down' efforts to advance governance of the global trading system. Efforts such as the TPP represented a 'bottom up' alternative. If a nation such as China was recalcitrant at the WTO, the TPP could build a new set of trade rules all around it. When asked whether China could join the TPP, the U.S. Trade Representative responded that China would be welcome to join when it was ready.[4] The clear implication was that the TPP would set the new rules of trade in the Asia-Pacific and China would be presented with a high-standards fait accompli.

The potential network of free trade agreements embodying the high standards approach has grown steadily. The European Union sought its own agreements with Japan and Canada. The United States and Europe also began talks to create a Trans-Atlantic Trade and Investment Partnership (TTIP).

If all of these ambitious agreements are completed and somehow stitched together the result would be a new set of trade rules that created a high-standards system. Major developing nations such as Brazil, Russia, India, China, and South Africa would have been excluded from the discussions that shaped the system. While these nations all possessed seats at the WTO negotiating table, the real action has, for the moment, moved elsewhere.

There is nothing to stop the BRICS nations from forming their own alliance with whatever level of commitment made the members comfortable. The problem would be that the amount of trade between BRICS nations is a fraction of that between the countries pursuing high-standards agreements. Further, the presumably lower standards of such an agreement would offer developing countries little opportunity to use their membership to promote investment.

Yet the high standards network has not yet been realized. The key building bloc agreements are at varying stages of completion and each faces its own obstacles. Not only are the negotiations between countries difficult, but there has been increasing domestic political opposition to key facets of the agreements in both the United States and Europe. Even if this opposition can be overcome, significant obstacles remain, including the question of how the disparate agreement can be harmonized. This question of harmonization is not much of a problem for tariffs, where a country can readily apply different levels depending on the country of origin. It is a more difficult problem for issues such as regulation, government procurement, and transparency, which often dictate rules for government behavior; unless those rules align, it will be tough for a single government to comply with

[3] See Levy, Philip I. (2009), The United States-Peru Trade Promotion Agreement: What Did You Expect? Available at SSRN: http://ssrn.com/abstract=1501243.
[4] There is a subtlety to this stance. The TPP has sometimes been portrayed as an anti-China alliance. While this perception can play to those focused on strategic tensions between the United States and China, the real question is whether China could accept the high standards of the TPP.

multiple conflicting dictates. This is a problem that is inherently solved by a multilateral trade agreement.

Where do we go next?

The scenario of the previous section, in which a new, modernized trading system is constructed through a network of ambitious regional agreements, is but one potential direction in which the global trading system might head. This section presents three alternative scenarios.

Scenario 1: Carry on with existing institutions

What if the obstacles to Doha, the TPP, and TTIP all prove insurmountable? Are the existing global institutions governing trade sufficiently sturdy to meet the near-term demands of global trade?

There are at least two major problems with attempting to get by with the status quo. First, the governing set of trade rules for the WTO are twenty years old. They were crafted in the Uruguay Round and its immediate aftermath. There had been some hope that the World Trade Organization could take on something approaching a legislative role, but that has not happened. Thus, many of the issues that have emerged in international trade – global supply chains, the role of state-owned enterprises, electronic commerce and data privacy, agricultural export restrictions – were not on the agenda when the current rules were set. One sees this problem frequently in legal settings, as in the interpretation of constitutions. However, there is usually a judicial mechanism available to 'fill in the blanks,' to apply general principles to modern situations.

This raises the second problem with relying upon the status quo –it is not clear the Dispute Settlement Mechanism of the WTO is durable enough to stand on its own. It is the WTO's version of a judicial system and it was significantly strengthened in the Uruguay Round. However, it was not designed to have either the political backing or the precedential heft that characterize effective judicial systems. Furthermore, the core question of enforceability is very different in the WTO setting. Dispute Settlement rulings have no force of law. Instead, when a party is found to have violated its obligations under WTO trade agreements, the decision describes the sanctions that the complainant can legitimately apply in response. This poses a quandary when a small country has a complaint against a large one: if the small country can only muster meager retaliatory threats, why should the large country honor its obligations?

The standard answer to this quandary is that the large country will wish to remain in good standing at the WTO. Presumably, it wishes to retain its standing because the WTO is a useful forum for addressing new trade concerns through bargaining. But this motive disappears if the prospect for advancing WTO negotiations fades away. Thus, the viability of the existing structure can depend on hopes for future progress.

Scenario 2: Conclude Doha

The easiest way to envision such progress would be through a conclusion of the ongoing Doha round of talks. After a long dormant period, there were signs of life in the talks when a 2013 WTO Ministerial meeting in Bali concluded with an agreement on trade facilitation. The agreement was exceedingly modest, in comparison with the original Doha ambition, but observers rejoiced that there was some movement. The trade facilitation deal was coupled with calls for progress on the broader agenda. Such calls are nothing new – they were issued repeatedly in the wake of the global financial crisis. The problem, then and now, is that the calls have elicited little response.

There are two key problems with attempting now to bring the Doha talks to a successful conclusion. The first is that the agenda is now almost 14 years old. It reflects the pressing issues of 2001. While there is some ability to squeeze new issues in under old chapter headings, this does limit what can be done.

The second problem is the question of who will lead the effort? Traditionally, the United States and the European Union have taken leading roles. However, they have become sufficiently frustrated with the impasse at the WTO that their negotiating efforts have largely turned to regional projects.

An alternative source of leadership could be the BRICS countries. This would be a sharp switch from past practice, but there are reasons the countries might consider it. The WTO is now headed by a Brazilian and China has benefitted enormously from the rules-based system that the WTO embodies. None of the BRICS countries are party to the major regional trade agreements under negotiation; they would benefit from relocating the conversation back to Geneva where they are able to weigh in. Unlike free trade agreements, which require all-or-nothing commitments to deeper liberalization, the WTO provides a path for more gradual moves, which seems better suited to the preferences of the BRICS countries. But to take advantage of this opportunity, one or more of the BRICS countries would need to conclude that progress under Doha is preferable to the other alternatives on offer and decide to lead through a substantially more generous offer than we have seen in the talks so far.

Scenario 3: A new approach under the WTO

The final scenario involves working under the auspices of the WTO, but acknowledging the failure of the Doha talks and trying something different. This could be the launch of a new round with a fresh agenda, or it could be an approach that returns to the use of plurilateral agreements within the WTO.

As the GATT agenda grew more complex in the 1970s, plurilateral agreements proliferated. Subsets of the GATT membership would join “codes” on subsidies, government procurement, or antidumping. Countries that signed on would get the benefits of the agreement; countries that failed to sign might not (some practices do not lend themselves to exclusivity). This ran counter to the basic GATT “most favored nation” principle under which all participating nation would be treated equally, but it solved the problem of recalcitrant countries blocking agreements. One of the signature achievements of the Uruguay Round was to get every country to sign on to all of the codes, thereby unifying WTO commitments.[5] But Uruguay Round negotiators had special leverage to accomplish this feat: any holdout countries would not be founding members of the WTO. That proved a one-time trick.

Even now, in parallel with the laggardly WTO talks, there is a plurilateral effort to liberalize services: the Trade in Services Agreement (TISA), an intended extension of the General Agreement on Trade in Services (GATS). As described by the WTO, "The stated objective is to achieve an ambitious outcome, compatible with the GATS, that would attract broad participation and that could be multilateralized in the future." This approach has also been described as "variable geometry" – countries join in on some agreements and reserve the right to join others later, when they feel ready to adopt the higher standards.

Aside from the potential complexity that might result, the additional difficulty to this approach is that it relinquishes one of the key advantages of broad rounds. When a country is a demandeur on services but a demandee on agriculture, for example, a broad round allows cross-issue tradeoffs. Sectoral negotiations or complex variable geometry could make this substantially more difficult. However, in practice, it could be very much like bringing the TPP and TTIP under the oversight of the WTO.

Conclusion: Policy Levers

The world trading system has descended from a time of satisfaction to a time of persistent difficulties. Trade itself continues to grow, albeit at a slower pace. The accomplishments of the Uruguay Round were sufficiently impressive and the challenges ahead sufficiently daunting that there is a temptation to simply make do with the system as it stands. However, the unmet needs of an increasingly complex trading world and the underlying shakiness of the WTO system make this option unwise.

It is a situation that demands new leadership, both in global talks and in persuading skeptical publics about the gains from globalization. There are plenty of candidate countries who benefit from the global trading regime. It remains to be seen if any will step up.

About author:

Philip I. Levy, Senior Fellow on the Global Economy, The Chicago Council on Global Affairs; Adjunct Professor of Strategy, Northwestern University Kellogg School of Management.

[5] The exception was the Agreement on Government Procurement, which remains a plurilateral.