



THE TRANSFORMATION OF GLOBAL GOVERNANCE PROJECT

JUNE 19-20 SEMINAR

THE GOVERNANCE OF INTERNATIONAL TRADE: RESHAPE OR DEMISE?

Seminar insights – Bernard Hoekman, George Papaconstantinou and Jean Pisani-Ferry

- 1. The geopolitics of trade have changed.** Whilst free trade was once meant to create bonds, trade policy is now used confrontationally in a power struggle between the US and China with spillover effects for the rest of the world. Because of its enforceability, trade policy is increasingly used as a substitute for the lack of other instruments to promote issues that have little to do with it. There is danger in these developments.
- 2. Widespread dissatisfaction with the global trade system pre-dates Trump.** Most US grievances (about dispute resolution, the abuse of developing country status, weak rules for subsidies, China) pre-date the Trump administration. It's not only the US: there is widespread dissatisfaction with the outcome of past multilateral negotiations and the functioning of the world trading system. Sentiment of being treated unfairly is shared in both developed and developing countries.

Dissatisfaction stems from:

- In advanced countries, the rapid erosion of technology rents that benefitted all, including relatively unskilled employees (aggregate factor), and the lack of appropriate policies that could have tilted the sharing of trade gains between producers and consumers (distributional factor);
- Developing countries worry that manufacturing relocation away from advanced countries has benefitted a handful of EMs only and that insufficient market opening in advanced countries has prevented food-producing countries from benefiting;
- China feels it has been subject to discriminatory rules by advanced countries.

Future outcomes will hinge on:

- Whether, in advanced countries, the growing current challenge to the positive-sum game nature of international trade can be reversed or complemented with policies which convince (and compensate) an increasingly sceptical electorate;
- Whether, in certain developing countries, the values underpinning international trade can coexist with increasingly politically illiberal regimes.

- 3. Trade principles are sound but trade rules and institutions are outdated.** The nature of international trade has changed fundamentally with the development of global value chains (GVCs) and the blurring of the distinction between goods and services. It is bound to change further as a consequence of the digital revolution. Multilateralism, national treatment and the most favoured nation principle remain essential. But the trade negotiation architecture is increasingly outdated:
 - GVCs challenge traditional specialisations and trading interests;
 - The categorisation of participants in global trade on the basis of development level is at odds with growing heterogeneity within countries;
 - Increasingly important 'behind the border' issues (regulation, competition, taxes, intellectual property protection) are not properly addressed.
- 4. Clubs are the way forward, provided they abide by a set of strong principles.** Plurilateral agreements and critical mass agreements are nimble instruments that can be used in an open, non-discriminatory way. They can serve to fight the abuse of consensus and tackle the diversity in degrees/patterns of integration and national preferences/priorities. Their purpose remains ambiguous: Are they temporary patches, flexibility instruments, conduits for gradual emergence of new forms of multilateralisation or a basis for alternatives to existing multilateral arrangements? It is highly desirable that variable-geometry agreements be rooted in strong multilateral principles and be regarded as complements rather than substitutes to the multilateral order.
- 5. Trade is shifting to digital and trade policy and is increasingly linked to other policies.** As the economy and trade are increasingly digitalised, traditional trade governance norms and instruments have become increasingly ineffectual or irrelevant. With this trend set to continue, future governance outcomes will depend on the current system's ability to develop tools and governance formats which are more in tune with these new digital trade patterns and characteristics. The long-standing debate on

whether trade issues should be treated in isolation, or understood instead in conjunction with other policy areas (trade *and* environment, trade *and* labour standards,...) has decidedly shifted in favour of the latter. This is due both to the structural transformation of trade patterns but also to an understanding that this may be tactically the only way to save an open trade regime. The remaining question is whether this trade-*plus* policy stance will act to further destabilise open trade or instead help save it.

6. **The EU should address the Trump and China challenges simultaneously.** The EU shares some of the US grievances towards China but opposes its transactional approach. It should voice its concerns to both partners. It should position itself as an active proponent and, alongside the US and China, as one of the key potential architect of a reformed trade system. A “WTO 2.0” hinges on China-EU-US cooperation. The battle will be a hard-fought one as China and the US may share an interest in a purely transactional management of their rivalry.

Future outcomes will hinge on:

- whether the US will go “all the way” in rejecting the multilateral system of rules, or instead will stay within it, all the while challenging its individual tenets and pushing for reforms;
- whether the EU will be willing or able to assume the mantle of the main defender of this system, or be bogged down by its internal contradictions and weaknesses;
- whether China will be convinced to “play by the rules”, or instead veer towards an illiberal regional and confrontational solution;
- whether the WTO membership will support and implement reform efforts, or instead the WTO will be pushed to irrelevance.

7. **Broadly speaking, there are three ways forward for trade governance:**

- Attempting to **salvage the multilateral system**, by rewriting some rules, buttressing its institutions, and generating political support for it. In the current circumstances, this not only seems like an unlikely outcome, but also one at odds with the structural transformation of international trade under way.
- **Further breakdown**, with countries increasingly opting for unilateral action or pursuing bilateral deals, in essence destroying the current system in all but name. This is currently perhaps the most realistic scenario, but also one with the most downside for trade, growth and more generally the future of global governance.
- **A new plurilateral system** which draws and builds on the characteristics of the current multilateral system, but also recognises the need to amend and complement it in way that reflects the diversity of trade patterns and actors. This would be by far the most desirable – and probably also relatively likely – outcome; as a hybrid however, much will depend on its specific characteristics, i.e. on how far it will deviate from current multilateral rules.

Keynote – Trade governance today

The trade governance system no longer reflects current geopolitical and business situations. Paralysis within the WTO makes it necessary to develop new rules for the new economy. Nevertheless, it would be wrong to break with the Doha Development Agenda, and unilateral action is not useful. Bypasses exist within the current framework, and issues may be discussed in other fora (OECD, G7/20, APEC). These can be opportunities to set rules in areas currently not dealt with. This is particularly salient regarding China, which needs to be involved constructively and induced to lead.

The election and actions of President Trump are a shock mandating adjustment, but on a deeper level, he represents a backlash against free trade and a rules-based governance system. While it may be true that by some measures the US is quite open, the perception of unfairness towards it is more important. Complacency in explaining the benefits of trade liberalisation and globalisation, as well as insufficient adjustment policies have soured the political base in developed countries. While some argue for such policies to be equally multilateral, it may be preferable to develop them domestically.

It is becoming less pertinent to analyse trade on an international basis. Competition is no longer really between states, but between companies, between cities. Major developed and developing states should recognise this, not expect special and differential treatment, and focus on writing rules for the 21st century.

Seminar minutes

▪ Session 1: Has global trade governance broken down?

Multilateral trade governance has not broken down completely yet — but collapse is threatening. Optimists argue that trade continues to grow and trade facilitation agreements are still being agreed upon (both within the WTO framework and plurilaterally), while none of the threatened massive trade disruptions have occurred yet. Pessimists argue that the agreements being struck are stopgap at best, while the WTO and the multilateral trading regime face an existential crisis.

There is consensus to observe that many of the challenges the WTO face predate the current US President and his outright rejection of the multilateral system. While President Trump's unilateral actions and offensive rhetoric have been baffling, the grievances they express are not new. US complaints about China, the categorisation of emerging powers as developing countries of power-grabbing by the WTO's arbitration system were already expressed by previous administrations. What has changed is that Trump appears to prioritise above all else outcomes rather than rules, procedures or alliances with like-minded states. Tackling the stalemate therefore requires being "tough on Trump but also tough on the cause of Trump".

The WTO functions according to several principles that now contribute to paralyse it and to fuel these grievances.

- It is member-driven: rather than propose initiatives or make decisions, it has more of a convening or facilitating function.
- It is incomplete in terms of coverage (e.g. services and investment).
- It has no independent monitoring and verification capacities, relying instead on state notification.

The single undertaking principle makes it easy for one issue to derail an agreement; the consensus principle makes it easy for one country to do the same. Now, the long paralysis of the Doha round has, in all likelihood, made a single undertaking unrealistic to pursue for the future.

Bypassing the consensus principle remains a possibility, provided for by art. IX of the WTO agreement itself. But it is an unattractive option for member states, as they fear that departure from unanimity might end up putting them in the minority someday.

The most pressing problem is the threat to the Appellate Body, where the Trump administration is blocking the nomination of new judges due to a perceived mission creep that constraints the scope for transaction with trade partners, and more generally to a perceived unfairness of its decisions towards the US. This heightens the risk of an all-out trade war. Only two reactions could reverse the dynamic of punitive measures and counter-measures: a high-level initiative, or untenable market pressure.

Perceived unfairness towards the trade governance system, however, lies much more widely than with just the US government: China's perception is that it has paid a steep price to accede to the WTO, has been subject to discriminatory and disadvantageous rules, and has still managed to succeed while remaining very polite to boot. In the EU and the US, citizens are anxious about the distributional consequences of trade liberalisation, which are not being compensated for by domestic policies. Governments in both the US and Europe point to persistent distortionary Chinese practices (intellectual property infringement, state aid, direct or indirect control of commercial companies). Large emerging economies which might have an important role to play in upholding the system are in fact a heterogeneous group, requiring different incentives to buy into it.

Despite this crisis there is a systematic abandonment of leadership due to a lack of both willingness and capacity. Governments remain silent, but so does business. Scant progress can be observed on the issues of tomorrow (e-commerce, data), while older issues remain undealt with. It is possible that China and the US might strike a bilateral deal which would seal the irrelevance of the WTO and undermine the whole trade governance system as it currently exists.

A better alternative would be for the US, the EU and China (each accounting for roughly equal shares of global trade) to stop blaming each other for free-riding, and to reaffirm their common commitment to a system of multilateral trade principles. This system should be designed so as to provide a level playing field. Some suggest that since the US is suffering decline, while China is cautiously ascendant, the EU, by default, should lead the way. It may, however, have to focus on solving its own internal problems with the Single Market and EMU first.

▪ **Session 2: Trade structures and trade institutions**

While the rules and institutions governing trade have remained largely static for 20 years, the structure of trade has been changing. After Baldwin's Second Unbundling (which, by disaggregating knowledge from location, triggered the global value chain revolution) we are witnessing the incipient Third Unbundling (disaggregating service from location, through telepresence and telerobotics). Companies and cities now play a far more important role than when the rules were designed. This has made pre-existing gaps between rules and reality yawn wider, threatening to dissolve the already fragile consensus over the principles underpinning those rules.

Three problems arise. First, that of multipolarity. The high noon of multilateralism of the 1990s is being relegated to a distant past by the advent of a much more multipolar world. Against this background, the definition and mechanics of multilateralism are increasingly contested. The system requires some good will for consistent application, but strategic competition is creeping back in: trade is never just a tool, but can be an objective per se. The US exemplifies this currently. There is also scope for opportunity, as multilateralism was launched precisely in a multipolar context.

Second is the problem of late joiners to the system. The special and differentiated treatment they benefit from fuels resentment towards the multilateral system: while they feel they have made significant concessions and benefited little, incumbent trading countries feel the opposite. This has led to the rise of status quo-prone or garrulous new powers, like China or India.

China presents a particular problem as it seeks to reshape its trade environment through its Belt-and-Road Initiative (BRI) and promotion of the RCEP as alternative or complement to the CPTPP/TPP-11. The BRI can be seen as China's alternative to creating a parallel WTO. Support for it in the region should not be underestimated as China provides badly needed infrastructure. On one hand, it can be argued that China understands its weight and seeks to be modestly constructive both regionally and globally, and that space should be made for it understanding its internal dynamics. On the other hand, it can be argued that China has "emerged without having converged", and is simply playing veiled power politics. An important question is how to involve China in a constructive governance agenda, and on which issues: connectivity and the environment may be suitable.

Third, technological advancement is leading the world into a zero marginal cost knowledge economy with the potential to radically shift comparative advantages (though it is debatable whether this takes place more predominantly on a geographic basis due to legacy issues or a functional one). With only loose, difficult to enforce disciplines, the current rules over intellectual property rights and state subsidies cannot prevent a brutal erosion of technological rents enjoyed by developed countries to the benefit of countries capitalising on this gap between rules and reality. This is a major concern vis-à-vis China.

The question is how to (re)establish and maintain core principles. Fast-changing trade structures call for distinguishing the foundational principles of trade, which should remain invariant, from the operational rules, which need to be adapted as trade patterns evolve. Since it is easier to create new rules than to reform existing ones, recent practice has been to bypass WTO blockage through club arrangements, which often explore deeper regulatory policy coordination.

▪ **Session 3: Clubs and the new trade governance arrangements**

Wide differences in development levels and degrees of economic integration call for a differentiation of trading arrangements. Arms-length exchange of goods and deep integration within the framework of global value chains and bundles of goods and services cannot be governed in the same way. The latter especially do not require border provisions but also behind-the-border provisions. As the WTO is increasingly unfit for purpose, countries are bypassing it through club arrangements, with the more or less sincere hope of integrating the rules thus agreed upon into the WTO framework.

There are three main forms of club arrangements compatible with WTO principles: preferential trade agreements (PTAs); plurilateral agreements (PAs); and critical mass agreements (CMA). PTAs are exceptions, provided for by WTO rules, to the most-favoured nation (MFN) principle, and are generally concluded on a regional basis. PAs allow sub-sets of the WTO membership to agree to certain disciplines applying to signatories only; CMAs are agreements among a set of countries that have the greatest stake/interest in an issue, with the benefits of whatever is agreed extended to all WTO members, whether they join or not. They are all, primarily, responses to the abuse of the consensus requirement, put in place to tackle the differences in sectoral priorities and patterns of integration among states within the WTO.

PTAs, while to some extent discriminatory and trade-diverting, can extend to regulatory policy, allowing for the creation of harmonised rules and thus deeper economic integration, dealing with the gaps in WTO rules (although some argue they do not have a good track record in that respect). On the other hand, they generally do not address certain distortionary policies giving rise to large spill-overs, like state subsidies or production origin requirements. Excepting the CPTPP/TPP-11, they are generally closed clubs, lacking clauses allowing for third-party accession.

PAs and CMAs, as a form of “open plurilateralism”, may be useful to multilateralise some PTA elements within the WTO framework. However, it appears that they can only work for some issues and operate at a lower level of ambition, acting more as a focal point for good practices fostering regulatory convergence instead of actively mandating it. Nevertheless, relying on the WTO framework, they offer greater transparency and accession opportunities, lower administration costs, and a surer dispute settlement mechanism. Different trade instruments can be considered depending on the issue or objective at hand and the size of the set of countries involved.

At the end of the day, any system of clubs will have to build on basic trade principles, and will require institutional machinery that would be inefficient to re-create for each club. The WTO can provide the needed support functions and other machinery clubs will need. The MFN and national treatment principles, endowed with the necessary flexibility, ensure multilateral reciprocity. The WTO’s single undertaking principle, however, is a major constraint, and is arguably no longer realistically achievable due to the abuse of the consensus requirement. On the other hand, in negotiation there is a temptation to link issues, so as to pair gains and concessions and present a give-and-take narrative; though this may only be applicable if a country enjoys actual leverage.

An underlying issue is the purpose of the trade arrangement: trade per se, or trade as a vector to project influence. It is obvious that the latter is the case for the US and China, and less so for the EU. When this is the stake, incentives to participate must go beyond those of just trade. More generally, these arrangements can serve as patches to the trade governance system; alternatives to it, or a means to make it evolve.

▪ **Session 4: Governance implications of the interaction between trade and other policy areas**

Stimulating trade, at some point, begins to necessarily involve some regulatory coordination in order to maintain a level playing field, and turns into deepening economic integration. Four major policy areas interact with trade in this sense:

- First is currency. Countries may seek to benefit by manipulating the exchange rate to their advantage, and managed trade and managed exchange rates may be trade-offs. In a world of floating exchange rates,

however, prices adjust leading to short term gains only at best. In terms of governance, this issue is best managed by its proper institution, the IMF.

- Second is tax policy. It is claimed by some in the US that the WTO ignores distortions caused by the fact that not all countries impose VAT. This is not necessarily discriminatory under WTO rules and can be addressed in its current framework, but could benefit from dialogue (with the OECD for example).
- Third is environmental policy. Trade policy has long ignored the negative externalities it entails which drive climate change. One way to address these could be Nordhaus' proposal of a Climate Club, a club arrangement imposing tariffs on non-members as a sort of carbon border tax; it appears difficult to craft one in a non-discriminatory fashion, however. Another way would be to negotiate an elimination of fossil fuel subsidies within the WTO framework, on a similar template to that of the agreement on agriculture. These subsidies could be redeployed to fund renewable energy projects or to alleviate energy poverty, but industry lobbying and lack of political will are serious obstacles to this scheme.
- Fourth is national security. Trump has recently alleged this reason as grounds to levy tariffs on steel and aluminium imports. It is held to be self-judging, as no country can credibly judge the national security interests of another, and until now has been seldom invoked: there is therefore little jurisprudence to turn to for guidance. Such a linkage is dangerous because of its inherent lack of justification and scope for unduly seeking to constrain a partner's foreign policy: the US threatening to impose sanctions on EU companies after withdrawing from the JCPOA, for example.

It is true that linkage of trade and other issues has at times been abusive, as special interest groups can wield influence to extract advantages. These special interest groups can have concerns at first glance far removed from trade. It is questionable whether trade agreements and the WTO are the proper fora for advancing and adjudicating these claims. However, deepening economic integration means that interaction of trade and other policies becomes inevitable. This involves going beyond minimal, relative standards mandated by national treatment, to advance harmonised standards. This can threaten democratically determined national preferences. These should be debated openly in top level discussions rather than being left solely within the WTO.

Trade is one of the rare fields of global governance where a binding dispute settlement system (still) exists. Since it is difficult to parse the degree to which trade can be dealt with as a standalone issue, linkage with other policy areas runs the risk of overburdening it. This is not necessarily the case, as WTO rules allow for forbearance and flexibility for measures which may be distortionary to trade but are informed by genuine national preferences, on labour or environmental standards for example. Some, even more optimistically, are confident that if restored to its proper functioning it can be used to impose genuine duties on states. Be that as it may, there is consensus that a narrow focus on trade may foreclose dealing with the "causes of Trump".

Adrien Bradley

Seminar programme

19 JUNE

20.00 - 22.00 Dinner
Guest Speaker: **Lim Hng Kiang** | Former Minister for Trade, Singapore

20 JUNE

09.00 - 09.10 Introduction by **Bernard Hoekman** | EUI and **Jean Pisani-Ferry** | EUI

09.10 - 11.00 **First session: Has global trade governance broken down?**

Introductory remarks: **Alan Wolff** | WTO and **Mark Wu** | Harvard

11.00 - 11.20 *Coffee break*

11.20 - 12.40 **Second session: Trade structures and trade institutions**

Introductory remarks: **Sébastien Jean** | CEPII

12.40 - 13.40 *Lunch*

13.40 - 15.00 **Third session: Clubs and the new trade governance arrangements**

Introductory remarks: **Bernard Hoekman** | EUI

15.00 - 15.20 *Coffee break*

15.20 - 16.40 **Fourth session: Governance implications of the interaction between trade and other policy areas**

Introductory remarks: **Robert Howse** | NYU

16.40 - 17.30 **Wrap-up session**

Introduction: **George Papaconstantinou** | EUI and **Jean Pisani-Ferry** | EUI

Seminar participants

Giorgio Barba Navaretti	Centro Studi Luca d'Agliano
Suman Bery	Bruegel
Emily Blanchard	Tuck School of Business
Adrien Bradley	Robert Schuman Centre, EUI
Bernard Hoekman	Global Governance Programme, Robert Schuman Centre, EUI
Robert Howse	New York University
Sébastien Jean	Centre d'Etudes Prospectives et d'Informations Internationales
Knud Erik Jørgenson	Aarhus University
Brigid Laffan	Robert Schuman Centre, EUI
Jean-Pierre Landau	Banque de France
Lim Hng Kiang	Former Singapore Minister for Trade
Doug Nelson	Tulane University
George Papaconstantinou	School of Transnational Governance, EUI
Ernst-Ulrich Petersmann	Law Department, EUI
Jean Pisani-Ferry	Tommaso Padoa-Schioppa Chair holder, Robert Schuman Centre, EUI
Miguel Poiares Maduro	School of Transnational Governance, EUI
Michael G. Plummer	Johns Hopkins University, School of Advanced International Studies
Stefan Profit	German Federal Ministry for Economic Affairs and Energy
Denis Redonnet	DG Trade, European Commission
André Sapir	Bruegel
Alan Wolff	WTO
Mark Wu	Harvard Law School