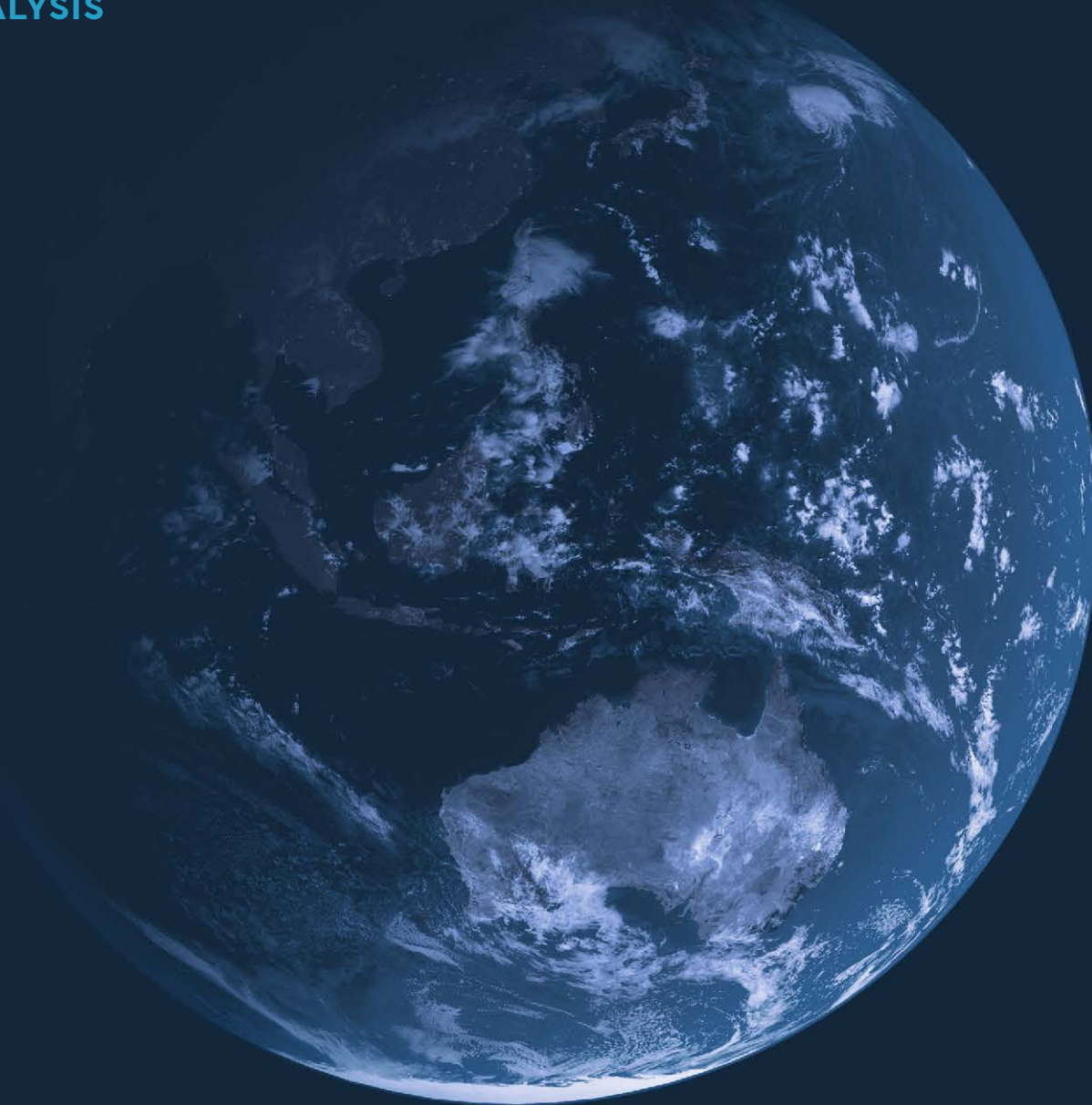


**LOWY
INSTITUTE
ANALYSIS**



The World Trade Organization: An Optimistic Pre-Mortem in Hopes of Resurrection

DMITRY GROZUBINSKI
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THE WORLD TRADE ORGANIZATION: AN OPTIMISTIC PRE-MORTEM IN HOPES OF RESURRECTION

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EXECUTIVE SUMMARY

For decades, multilateral trade rules operated to keep government protectionist impulses in check. They provided a foundation of openness for international commerce, as well as a framework for liberalisation and integration. With the trade rules as a guarantor, capital and value chains spread across the globe.

The creation of the World Trade Organization (WTO) in 1995 saw these law: binding and non-optional dispute settlement. For the first time, an international panel of legal experts would have the final say on the legality of trade measures, whether those implementing them liked it or not. On 10 December 2019, a procedural blockade by the world's largest economy, the United States, culminated in that 24-year experiment being put on hold, perhaps permanently.

The loss of the WTO's Appellate Body does not mean the global trading system is in anarchy, but it does move it a significant step closer to unilateralism and transactionalism in trade policy. Moreover, the Appellate Body crisis is just one of the areas where the WTO is bleeding, and the WTO is just one symptom of a global trading system besieged.

Policymakers looking to restore predictability and order must grapple with a WTO that has struggled to negotiate new rules and enforce and monitor existing ones; which civil society distrusts; and on which business has largely given up as a source of solutions. The global consensus, based on the underlying wisdom of sacrificing some sovereign policy space to allow predictable, rules-based trade, has never been weaker. There are no easy answers, but one thing is certain: technocratic fixes from Geneva and ministerial press releases bereft of specifics will not be enough.

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A BAD FEW MONTHS

Emerging economically from the other side of COVID-19 will not be easy. The pandemic has tilted the tectonic plates of the global economy, and countries are tumbling towards recession. It is hard to picture a less opportune moment to address the problems plaguing the WTO, with its woes escalating from paralysing to existential. At a time when the world needs stability and predictability, the institutional cornerstone of international rules-based trade is cracking.

The WTO stands on three pillars: the day-to-day work of monitoring compliance within existing rules; the negotiation of new and amended rules; and the formal adjudication of disputes. All three pillars are wobbly, and had been long before the Trump administration started taking a sledgehammer to them. Unquestionably however, the picture in 2020 is grim.

The Director-General of the Organization has resigned early, triggering a likely contentious succession process vulnerable to simple deadlock and deliberate sabotage by even a single member. The upcoming Ministerial Conference has been delayed until at least 2021. Negotiations to limit subsidies for illegal and overfished stocks, ongoing since 2001 and already months behind a target established in the UN Sustainable Development Goals, were suspended.¹

All three pillars are wobbly, and had been long before the Trump administration started taking a sledgehammer to them.



Director-General selection process 2020: Presentation to the General Council, Dr Liam Fox, United Kingdom (centre). Photo courtesy WTO.

The United States' blockade of the WTO Appellate Body has succeeded, rendering the Organization's highest dispute settlement arbiter impotent and unable to convene the required quorum of three panelists.² In effect, the once legally binding system of arbitration is now ultimately optional.

If this were not enough, the United States has already held hostage the approval of the Organization's budget in December of 2019, and seems poised to do so again in 2020.³ Two bills in the US Congress, including legislation in the House of Representatives by Democrats⁴ and a Senate Joint Resolution by a Republican⁵, would withdraw the United States from the Organization. Though it seems unlikely either bill will pass, that they are being debated at all is a harrowing sign, inviting obvious comparisons with the recent withdrawal of the United States from the World Health Organization (WHO).

US sentiments are not the only troubling news for the embattled Organization. COVID-19 saw the introduction of a flurry of protectionist measures, temporary and otherwise, as countries around the world sought to keep medical equipment at home, prevent shortages, or simply demonstrate aggressive action.⁶ While legally defensible under WTO rules, these responses illustrated the fragility of global consensus on the need for liberalisation, and often came with calls for a broader, and probably unrealistic, onshoring of supply chains.⁷

The current surge of tension, though 'born of a thousand fathers', is closely tied to the United States' loss of faith in the international order it helped forge. Faced for the first time since the Cold War with a true economic and geostrategic adversary, the United States regards the existing system as doing little to tame the Chinese dragon, while simultaneously constraining its own ability to fight back.

To make matters worse from the US perspective, the shield of trade defence instruments it thought to be fully legal has repeatedly been found overbroad.⁸ Despite a very positive win-loss record in dispute settlement, US losses in this critical area have undermined what it considers its right to defend itself against unfair competition.⁹

Unsurprisingly, China does not share this view. From its perspective, China paid an exorbitant price to join the WTO: its 'accession package' consisted of commitments on market access, regulation, and subsidies well beyond what would have been asked of any other country at the same stage of development. China maintains its practices are central to continued economic development, compliant with the rules as written, and that the United States and European Union have been protectionist in using trade defence instruments aggressively and illegally to keep certain Chinese products such as steel out of their markets.¹⁰

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Shi Guangshen, Minister of Foreign Trade and Economic Cooperation of China, signing China's Protocol on the Accession to the WTO at the 4th Ministerial Conference in Doha in November 2001. Photo courtesy WTO.

For policymakers elsewhere, focused on preserving the rules-based system, the outlook seems bleak. China is an increasingly assertive power, with a 2030 vision to be a high income, technologically advanced, and internally 'harmonious' country.¹¹ The heavy involvement of the Chinese state in the economy appears, for the moment, integral to that vision. While this remains the case, China is unlikely to acquiesce to new rules in areas such as state-owned enterprises (SOEs) or intellectual property.

Chinese Subsidy Blues

The WTO rules aim to keep a level competitive playing field through limits on industrial subsidies. However, when it comes to constricting Chinese state capitalism, the rules and the remedies available under them may be too narrow, too blunt, and too situational.¹²

The subsidy rules themselves are designed to curb advantages flowing to private industry from action by public bodies, such as ministries or agencies. However, in the Chinese case, things are rarely so simple. SOEs and large private companies, whose precise relationship with the state is opaque, can and do deliberately provide local firms better than market treatment.¹³ Complex central government programs involving tax rebates and export restrictions keep input prices down.¹⁴ Local and provincial governments, competing to meet centrally set targets for industrial growth, provide financing, land, and inputs to drive investment.¹⁵

Traditional remedies are also limited. Most trade defence tools exist to protect a country's domestic producers from competition in their own market, and can do little for firms finding themselves uncompetitive against subsidised rivals in third country markets. Even WTO disputes, which can directly challenge a country's policies, offer at best partial solutions. A dispute requires evidentiary demonstration of harm, can

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take years to resolve, and can only change a country's policy, not compensate for damage inflicted while the policy was in place.¹⁶ By the time such a policy change arrives, the competing businesses abroad may well have folded or pivoted elsewhere.

WTO Dispute Settlement Process



Concerns about the adequacy of existing rules in addressing Chinese subsidies are not a uniquely US preoccupation. The trilateral meeting of trade ministers for the United States, European Union, and Japan issued a joint statement presenting a solid front of concern on the subject.¹⁷ However, China's size and the consensus-based nature of the WTO means that ultimately, the rules will not change to limit Chinese actions until China decides it is ready to forswear such policies permanently. Clearly it is not yet ready to take this step.

While that remains the case, the United States is likely to continue using the trade tools at its disposal to fight back, and to keep baulking at trade law restrictions on its ability to do so.

Today's crisis is a product of rising geopolitical tension, global philosophical divergence, and emergent populism. However, it is also the result of years of benign neglect. An increasingly dysfunctional WTO has slipped to the back of ministerial minds, the bottom of departmental priority lists, and the margins of business' lobbying papers.

To break the impasse and preserve this crucial element of the rules-based system, policymakers will need to make a clear-eyed appraisal of what the system offers and why it is imperilled. It also requires a recognition that while the WTO's founding vision — of a world moving inexorably and in unison towards trade liberalisation — proved a fantasy, its core function as a consolidation of openness and consensus-rule remains critical.

Why Did We Bother with Rules-Based Trade in the First Place?

Governments agreed to enforceable and explicit limits on their own trade policymaking for good reason — to cure the 'protectionist itch' that has been so damaging in the past.

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“A tax on cars made by Johnny Foreigner to keep good, high paying jobs here at home,” is a protectionist proposal that can always count on a cheer. It also invites retaliation, escalation, and ultimately impoverishment for all sides; it encourages industry to focus on better lobbyists, not better offerings. The inter-war period of protectionism in the 1930s offers a chilling lesson in where such policies lead.

Trade rules are a recognition of protectionism's inherent appeal, and implicit danger. They are mutual disarmament treaties: the voluntary relinquishment and binding limitation by governments of tools they find tempting, but do not wish to see deployed on a mass scale.

One benefit of quelling protectionism is that it enables networked production. The period between 2005 and 2015 saw a surge in industries sourcing components and production across multiple countries.¹⁸ By spreading production chains abroad, firms utilised economies of scale and supplier specialisation to cut costs and create more competitive offerings.

This approach reduces costs for consumers, rewards the most competitive suppliers globally, and encourages investment and the establishment of affiliates in countries that may have otherwise struggled to attract capital. For countries participating in such value chains it can drive development and economic empowerment, provided that the right domestic policy settings are in place to channel the benefits.¹⁹

The trade war and WTO crisis (as well as the coronavirus pandemic) may not unpick global supply chains entirely, but uncertainty is already making investment more conservative and more domestic, thereby imposing significant economic costs.

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THE WTO — CHALLENGED ACROSS ALL THREE PILLARS

Of the WTO's three pillars, transparency and monitoring have traditionally been viewed as working adequately; negotiations as hopelessly stalled; and the dispute resolution system as working well, the "jewel in the Organization's crown". The reality was always more complex.

Inadequate transparency denies others the data required to challenge questionably compliant practices. Stalled negotiations leave ambiguities in the agreements, and entire areas of trade policy and modern international commerce loosely or entirely uncovered. Disputes are thus limited and the risk of panellists expanding laws from 'the bench' increases, undermining confidence in the Appellate Body that is supposed to strictly interpret the trade rules that countries agreed to, and nothing more.

The current US administration has also demonstrated WTO rules will not prevent it employing strategic denial of access to its market as a policy lever.

Compliance, Transparency, and Monitoring

Much of the day-to-day work at the WTO concerns monitoring the compliance of Members with their obligations. Under the treaties that the Organization brings together, Members are obliged to observe certain limits on their spending and policymaking, share notifications outlining domestic policies and regulations, and attend committees where their compliance can be interrogated by other Members.

The system relies on international peer pressure for the bulk of its enforcement, but also feeds into dispute settlement. Raising an issue in the relevant committee is the first step on the road to convening a panel, and Member notifications are a key piece of evidence in some disputes.

COMPLIANCE: A CASUALTY OF TRADE WAR

The world is in the grip of a trade war. Whether you believe the cause to be a US-China geostrategic rivalry predestined for confrontation, Chinese state capitalism exploiting loopholes within WTO agreements, or simply a US president who is a mercantilist obsessed with redressing trade balances, it is clear that trade is and will continue to be a major battlefield.

The current US administration has also demonstrated WTO rules will not prevent it employing strategic denial of access to its market as a policy lever. Some of those targeted have retaliated in kind.

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It is a point in favour of the continued relevance of the WTO rules that even the superpowers sidestepping them have generally attempted to find legal justifications for such derogations within the rules they are flaunting.

The Trump administration, in applying steel and aluminum tariffs (and threatening automotive tariffs), argued that these were permitted under the WTO national security exemption.²⁰ This clause specifies that WTO agreements shall not prevent a government from taking steps to defend its national security.²¹ There is ample room to question whether freely purchased imports of metal represent a threat to the national security of the world's most powerful nation. Yet even under a president hostile to multilateralism and international rules in general, the United States still sought a WTO legal justification for its actions.

This put the European Union (EU) in a quandary. On the one hand, US steel and aluminum tariffs were hurting EU businesses in a strategically significant sector, and the Trump administration seemed intent on further escalation. On the other, the EU considers due process and legal procedure as core principles. For the EU to retaliate before a WTO dispute could run its course, invoking the same national security exemption they accused the United States of abusing, would be to conclusively demonstrate the primacy of expediency over process.

Caught between wanting to punch back well beyond the spirit of the rules, and defending their integrity, the EU's lawyers invoked a complex rationale for retaliation under the WTO Agreement on Safeguards. They argued that the US measures, by making imported steel and aluminum less competitive, had pushed the products into the EU market in a surge against which the WTO rules allowed the EU to defend itself.²²

China also relied on this justification, at least in retaliating against the tariffs levied by the United States on steel and aluminum under the national security grounds of Section 232 of the US Trade Act.

OPTIONAL COMPULSORY TRANSPARENCY

While Members have a legal obligation under several agreements to submit regular reports about their policies, timely compliance is unenforceable, as is honesty. Other Members can grouse to committees about the absence, methodology, or veracity of notifications, but beyond that have little recourse, because the dispute settlement system is designed to address breaches that directly harm Member export interests, not the institution.²³

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Roundtable on Transparency in Applied Tariffs, January 2020. Photo courtesy WTO.

Notifications chronically lag behind obligations.²⁴ Even for G20 Members, WTO notifications of new trade-distorting measures consistently fall well short of those documented by independent checkers such as Global Trade Alert.²⁵

In a new development, the last two years saw the first wave of ‘counter-notifications’ in the Organization’s history. Australia, Canada, and the United States submitted notifications on India’s programs, which listed them as sufficiently more extensive and trade-distorting than the information reported in India’s own notifications.²⁶ Whether this is a new way forward for the Organization or a sign of its death throes remains to be seen.

REGULAR COMMITTEES — VITAL AND UNDERUTILISED

Much of the routine work of the WTO, including reviewing notifications, takes place in so-called Regular Committees. These do not have a negotiating mandate, but rather serve as fora to query and challenge how others are implementing the rules.

Take one example. Over the course of 14 years and 37 meetings between 2003 and 2017, WTO Members raised concerns about the EU’s regulation governing registration, evaluation, authorisation, and restriction of chemicals (REACH). Through this process they successfully influenced the regulation’s design and implementation. For instance, the European Union adopted additional measures to make engaging with REACH simpler for small and medium-sized businesses.²⁷

In some ways, the REACH example represents the platonic ideal of the process working as it should. A regulatory measure is contemplated

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and notified. Members raise concerns about its implications for their exporters. The regulation and its implementation are adjusted, taking some of the concerns on board. A victory for the system and for harmonious trade — but a protracted one.

Proper engagement in the difficult technical areas addressed by the Regular Committees requires dedicated and informed engagement from industry. That is badly lacking. Starved of inputs, the committees too often rehash the same issues, from the same few vocal industries, with the same few Members. The wasted potential for real reform and progress on regulatory, implementation, and policy areas of genuine concern to business is enormous. In the 25-year history of the WTO, the Technical Barriers to Trade (TBT) Committee has seen only 638 specific trade concerns formally raised.²⁸

Negotiations — Stuck, Wheels Spinning

There is an agonising moment at the end of many of the Special Sessions of the WTO's Committee on Agriculture. These sessions are supposed to make substantive progress towards negotiating new rules on agricultural subsidies and tariffs. The chair, always an ambassador of considerable gravitas, takes the floor to summarise recent progress. The moment is agonising because there has been no progress to report. In the face of this inescapable reality, the chair is forced to deploy a legion of platitudes about efforts made and mutual positions clarified. It can be painful to sit through, and is far from a problem unique to the agriculture negotiations.

Since 2001, the WTO has been operating under a Ministers' mandate established in the so-called Doha Round. Negotiators were instructed to focus on three areas: agriculture, tariffs on non-agricultural goods, and services, and to place development at the heart of the Organization's edict. Members have found have found unique and interesting ways to turn each of these areas into a quagmire.

AGRICULTURE — DISTORTED AND STAYING THAT WAY

International trade policy is about government interference in global markets, and trade in agricultural products and processed foods is certainly the subject of such interference. In 2018, average tariffs levied on food were almost double those on non-agricultural goods.²⁹ Subsidies for agriculture are also often more direct and extensive than in other sectors. The Organisation for Economic Co-operation and Development (OECD) calculates its members alone spent more than US\$238 billion in agricultural support in 2016, a staggering figure

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equivalent in value to 8 per cent of the world's agricultural production.³⁰

This level of market interference, the sector's strategic importance and cultural significance, and its centrality to the livelihoods of a disproportionate amount of the world's poor all combine to make agriculture a linchpin issue. Reforming the Agreement on Agriculture (AoA) has repeatedly been identified by major Members as the central objective of their engagement, and substantive discussion of other issues is frequently conditioned on movement in agriculture talks. Unfortunately, progress is elusive.

The blockage is primarily due to rules around agricultural subsidies. The AoA aims to restrict how much Members can spend on the types of subsidies it defines as most trade-distorting (i.e. most likely to impact markets). However, unlike most WTO agreements that provide developing countries with additional flexibilities, the AoA largely skews the other way. Reflecting the state of play at the time it was negotiated, it provides developed countries with permanent multi-billion dollar annual exemptions to these limits.³¹

This imbalance is compounded in the eyes of many developing countries by the types of subsidies defined in the Agreement as trade-distorting and thus subject to limits. For example, the European Union's direct payments program (whereby farmers are paid for the size of their holdings) is classed alongside research grants and disaster relief as a less-trade distorting (and thus unlimited) subsidy.

None of this is a coincidence. The negotiation of the AoA saw the United States and European Union – the agricultural subsidy giants of the time – ensure their existing programs would not become illegal upon signature. The theory was the Agreement would initially allow significant freedom for existing subsidisers, who would then be increasingly constrained by further disciplines negotiated in the future.³² The further disciplines never materialized.

Had the US, EU, and Japan, which generally use a fraction of their allowances, remained the only major agricultural subsidisers, some progress on AoA reform may have been possible. But that has not been the case. India, utilising government procurement and an exemption for 'resource poor farmers' now spends tens of billions a year on trade-distorting support. Meanwhile, a dispute settlement panel largely upheld a US accusation that Chinese agricultural support was being routinely subsidised to the tune of billions annually, well in excess of its AoA subsidy limits.³³

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The rules allow developed countries to deploy and concentrate subsidies to a far greater degree than their developing country competitors. However, confronted by developing countries spending in the billions, major developed economies such as the United States will not contemplate unilateral cuts. Developing countries such as China and India meanwhile refuse to contemplate cuts until developed countries significantly or entirely eliminate their 'overflow'. With contention over Indian and Chinese adherence to the rules, and the United States now fully utilising its 'bonus' entitlements to compensate farmers hurt by the trade war, progress seems more remote than ever.

TARIFFS — NO MAGIC FORMULA

Every WTO Member has a publicly accessible WTO Goods Schedule, outlining the maximum tariff they have committed to ever applying in each product category. These schedules are unique, arrived at through bespoke and painstaking negotiations with the Membership. Attempting to improve on these commitments through WTO negotiations requires one of two difficult paths: multilateral-multilateral or plurilateral-multilateral.

True multilateral tariff reduction, whether in agriculture or in other goods, requires agreement on a common approach, such as a formula, which would reduce tariffs across the entirety of the Membership. Trying to come up with a formula (and inevitably, a list of exemptions to it) covering 6,000-13,000-plus tariff lines acceptable to 164 Members is an endeavour of staggering complexity.

Any approach necessarily advantages some producers over others, insufficiently meeting the ambitions of liberalisers while threatening the sacred cows of protectionists. Since the 2008 collapse of negotiations on the so-called Rev.4 modalities,³⁴ the Membership has largely put this kind of tariff reduction in the 'too hard' basket and focused on achieving tariff reductions through bilateral or plurilateral trade agreements. Even in these, haggling over tariffs can last decades.

Plurilateral-multilateral paths are more modest in ambition. A self-selecting subsection of the Membership agree on a list of tariffs they will reduce, which they then extend to the entire Membership. This can be effective. Ninety-seven per cent of the world's trade in IT products has been liberalised under the Information Technology Agreements (ITA) I and II, which began with just 29 members and now have 82 signatories.³⁵

This approach also came close to successfully liberalising trade in dozens of sustainable goods under the Environmental Goods

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Agreement (EGA). The EGA saw 46 Members³⁶ negotiating tariff elimination on products such as wind turbines, solar panels, and bicycles. Unfortunately, talks ultimately collapsed in 2016, partly due to the EU and China failing to reach a compromise on the bike tariff.³⁷

The EGA was the closest the WTO came to tackling climate change as an issue. The WTO has a work stream on environment and there are environmental elements to various agreements. However, the WTO Committee on Trade and Environment is an information sharing and discussion body, and not in the business of negotiating new rules. With ever greater and commercially significant disparities in climate action between governments, the pressure on the Organization to achieve meaningful climate outcomes only promises to grow.

While the ITA and EGA were worthy initiatives, they were by their very nature self-selecting and limited. A single success liberalising trade in 201 products out of tens of thousands is hardly enough to declare the Organization's market access negotiation function operable, and the failure of the EGA at such a critical time for climate action is disheartening. The story in services is not much better.

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SERVICES — REGULATE YOUR EXPECTATIONS

Services trade rules are famously complex. Services are not subject to tariffs, but are heavily affected by regulation, from visas to investment screening. Therefore, international rules on trade in services take the form of commitments that governments make to one another on how they will allow, regulate, and administer the presence of foreign services providers in their markets. Capturing these undertakings requires a dense classification system with multiple modes of supply, services types, exemptions, reservations, and commitment levels.

Even in bilateral agreements, services liberalisation is marginal at best. Liberalising services means making commitments on some of the most sensitive regulatory areas, from temporary visas to professional accreditations. Governments are reticent and businesses insufficiently engaged to push.

After years of excruciating diplomacy and coalition building, 2019 saw some progress. Fifty-nine Members including the European Union³⁸, Australia, China, and South Korea, signed a joint statement welcoming the headway made on negotiations in Services Domestic regulation, and pledging to work towards substantive outcomes by the Twelfth WTO Ministerial Conference in June 2020.³⁹ The measures being considered are lowest common denominator commitments around basic transparency and procedure, and still face strong opposition.

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With the deadline missed and the Ministerial postponed, a near-term multilateral outcome looks unlikely.

Also unlikely is the imminent resurrection and conclusion of the Trade in Services Agreement (TiSA) talks. A plurilateral initiative negotiated physically at the WTO but not technically under its auspices, this was an ambitious attempt co-chaired by Australia, the EU, and the United States to make some real progress on services commitments among willing partners. The 23 Member trade pact made significant progress before talks were suspended at the end of 2016.⁴⁰ It will likely require a change in either posture or leadership in the United States before any reboot can be contemplated.

GLIMMERS OF HOPE

Largely deadlocked on the major negotiating fronts of the Doha Round, the WTO has managed to make some progress in other areas. The 10th Ministerial Conference in Nairobi in 2015 surprised many by phasing out and banning agricultural export subsidies — programs considered uniquely harmful to world markets. Although these export subsidies are not used by most economies, a binding agreement was nevertheless a much-needed win.⁴¹

In early 2019, the European Union and 48 other WTO Members including China, Brazil, and the United States, announced they would be commencing negotiations on the trade-related aspects of electronic commerce. Attempts to discuss new rules on e-commerce multilaterally at the WTO have been blocked repeatedly for years by an Indian-led coalition. They argue e-commerce is still too new an area to be making permanent trade commitments. They also contend that no mandate exists for such talks, and that new rules risk ‘distracting attention’ from the core Doha issues.

Still, the Joint Statement Initiative on e-commerce is a promising sign, with new disciplines being considered plurilaterally in areas such as electronic invoicing and the acceptance of digital signatures. Sensibly, the initiative’s latest draft text appears to be steering clear of the most sensitive issues in e-commerce, such as data localisation⁴² and privacy.

Ominously however, even as the Joint Statement Initiative raised the possibility of progress, one of the WTO’s only other achievements in e-commerce is floundering. Since 1998, WTO Members have maintained and periodically renewed an agreement not to apply customs duties on goods and services delivered electronically. Known colloquially as the ‘e-commerce moratorium’ it prohibits, for example, the charging of a tariff when a person purchases a movie online from a foreign company

The 10th Ministerial Conference in Nairobi in 2015 surprised many by phasing out and banning agricultural export subsidies ...

and downloads it (whereas shipment of a DVD with the same movie might encounter a tariff at the border).

This moratorium was up for another multi-year renewal in December 2019, but with a coalition of primarily developing countries contemplating blocking its extension, Members instead agreed to negotiate the issue at the next Ministerial Conference. These Members argued the moratorium shuts off a potential tax revenue source and prejudices the direction of a still emerging field, although research suggests the potential tax revenues are minor.⁴³ With the Ministerial Conference now postponed by at least a year because of COVID-19, the future of the moratorium is more uncertain than ever.

While the results on e-commerce are thus decidedly mixed, there did appear to be a glimmer of hope at the opposite end of the technological spectrum. Negotiators have been hard at work for the better part of a decade on new international rules to limit or eliminate government subsidies for certain forms of illegal or environmentally damaging fishing. This negotiation, specifically identified in the UN's Sustainable Development Goals⁴⁴ and cheered on by such luminaries as David Attenborough,⁴⁵ has now been suspended due to coronavirus, but was one of the great hopes for the now postponed June 2020 Ministerial Conference.

When talks restart, getting fisheries across the line could serve as a rare victory for the WTO. However, doing so will require navigating one of the toughest debates in international trade policy: special and differential treatment.

DEVELOPING COUNTRY — WHAT'S IN A DESIGNATION?

A stumbling block for virtually all the negotiations described above is so-called 'special and differential treatment'. Many multilateral trade agreements include at least some level of special treatment for poorer economies. This treatment takes the form of either a looser commitment or incremental stepping stones towards compliance, such as longer phase-in periods.

The debate about the commercial significance of most of these provisions is fiery and inconclusive, but it is probably fair to say that while additional flexibility in the rules for developing countries may have some situational uses, most are not economically transformational.⁴⁶ In fact, the most meaningful existing provisions are probably those allowing developed countries to extend tariff-free access unilaterally to poorer economies through schemes such as the EU's Everything But Arms initiative.

A stumbling block for virtually all the negotiations described above is so-called 'special and differential treatment'.

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However, debate becomes truly problematic for negotiations in three areas:

1. What is the purpose of special and differential treatment?
2. Who qualifies for developing country status?
3. What does 'Development' in the Doha Development Agenda imply?

What is the Purpose of Special and Differential Treatment?

Is Special and Differential Treatment about giving poorer countries a helping hand to bring themselves into compliance with international trade rules? Or is it about giving them exemptions from those rules to help them develop? Ideologically, this is tricky. For many developing countries, conceding the former would mean severely limiting the kind of derogations they could seek. Meanwhile, for many developed countries, conceding the latter would imply that liberalising trade rules is a hindrance to economic growth, rather than a driver of it.

Who Qualifies for Developing Country Status?

Existing WTO rules divide Members into three categories. The first of these, 'Least Developed Country' (LDC), has quantitative UN Identification Criteria and Indicators. The other two, 'Developed' and 'Developing' are entirely self-nominating. As might be imagined, the category for 'Developing' is broad indeed, encompassing the island of Samoa (GDP US\$850 million or \$4315 per capita), the sub-continent of India (GDP US\$2.875 trillion or \$2104 per capita), and the Kingdom of Bahrain (GDP US\$38.5 billion or \$23 500 per capita). It also includes China, the world's number one goods exporter, and the Maldives, the world's number 171.



Meeting of full WTO membership, 27 February 2019. Photo courtesy WTO.

Operating on these categories alone makes it impossible to include measures for poorer economies without simultaneously extending them to huge trading nations. Attempts at differentiation in the Developing category have been largely unsuccessful. China, India, and

a host of others categorically oppose the introduction of economic criteria for Developing, as there is for Least Developed. Unsurprisingly, a US proposal to that end in February 2019 was met with contempt from its targets.⁴⁷

Some limited progress has been made on the margins of this issue. A handful of wealthier countries in the Developing Country category, such as Singapore and South Korea, have forsworn using special and differential treatment entitlements either entirely, or in future agreements. In a similar self-designatory way, the 2013 Trade Facilitation Agreement allowed developing countries to set their own deadlines for commitments, allowing those with better advanced trade infrastructure to be more forward leaning than those without.

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The Purpose of the Doha Development Agenda

Complicating the differentiation puzzle are profound disagreements about just what the Doha Agenda is supposed to be. Multiple developing countries have argued that the Doha Round is a 'free round' for countries in their category, and should consist exclusively of commitments intended to close the inequality gap by developed economies, a view developed countries largely reject except when it comes to LDCs. Others have hung their hats on the concept of Doha as a 'single undertaking', which should not progress in any one area, or be considered a completed round, until progress has been made across the full breadth of its mandate.

The Dispute Settlement System —A Damaged Experiment

The creation of the WTO saw, for the first time, the role of law in multilateral trade evolve from advisory to adjudicatory. Prior to 1995, if two signatories to the General Agreement on Tariffs and Trade (GATT) had a dispute, they could by mutual agreement convene a panel of legal experts to consider the issue. When that panel reached a conclusion, the parties could, again by consensus, agree to adopt the result. This model worked well for decades, but began to break down in the 1980s as areas of dispute became more politicised and Members grew freer with their vetoes on the convening of panels and acceptance of reports.

The WTO evolved this model in a more legalistic direction. Members could no longer block the convening of a panel or refuse consensus on a panel report. Instead, the WTO would include a permanent body of legal scholars, composed of relevant experts for particular dispute types, to whom panel reports could be appealed for a final and binding ruling.

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THE 2019 CRISIS

To secure agreement for the creation of such a bold initiative, a number of concessions had to be made. Among these was the requirement that those on the Appellate Body would serve fixed terms and be approved only with full consensus.

To get nominees confirmed for these fixed Appellate Body terms, a complicated courtship ritual evolved. Members nominate candidates who come to Geneva and meet, one by one, the ambassadors of key WTO Members, as if being presented before the extended relatives of a prospective spouse. Like US Supreme Court nominees before the Senate, candidates are grilled on their judicial philosophy and probed for biases, real and imagined.

In time, unwritten rules emerged about 'geographic seats' on the Appellate Body, traditionally filled by jurists from a specific part of the world.

While never apolitical, this process yielded consensus nominees to fill vacancies consistently until June 2017, when the United States began refusing consensus on any and all nominees. This effectively bled the body of jurists until 10 December, when it fell below the three-person quorum required to convene new panels.

This opened a potential legal void. Panel proceedings can still be appealed, but appeals cannot be heard. Without a hearing, any WTO Member appealing a ruling can credibly argue that no final legal determination on the matters at hand has been made. Beyond the damage to the system and to the predictability of international trade, there are real and immediate consequences. In the face of a legal-void veto, for example, the European Union cannot prove it has removed or changed the subsidies it was previously found to be offering in the Airbus case. This effectively means the tariffs the United States has been authorised to levy in retaliation for these subsidies, to the tune of US\$7.5 billion per annum, can be maintained permanently.⁴⁸

WHAT ARE THE US CONCERNS?

Displeasure with the Appellate Body is no new Trumpian phenomenon. The United States has long had issues with how it operates generally, and specifically with the frequent rulings against US measures to protect itself from what it sees as unfair foreign competition.⁴⁹

In refusing to consider candidates for the Appellate Body, the United States has pointed to a number of areas in which the Body is not performing in line with US expectations. Some of these are procedural,

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such as the Appellate Body almost always taking far longer than the prescribed 90 days to decide cases, or Body Members continuing to handle ongoing cases once their own terms have expired. Others are legalistic, focusing on what the United States sees as inappropriate reliance on precedent, consideration of issues not in the submission, and rulings on the substance of cases (not just the legalities).



US President Donald Trump at the White House on 10 December 2019, the day on which two of three remaining Appellate Body members' four-year terms came to an end. Photograph: Flickr/Official White House photograph Joyce N. Boghosian.

The sympathy that other Members have for these US complaints varies, but many accept at least some of the issues as valid. Yet at the same time, Members strongly suspect an underlying aversion to binding international dispute settlement.

Previously, under the GATT, the United States could leverage its tremendous market power in the negotiations to resolve any bilateral trade dispute. The introduction of an alternative to negotiations, whereby questions are decided on the merits and the law by an international tribunal, somewhat levels that playing field. Some Members believe that US concerns about procedure and function are merely a smokescreen for opposition to the system in principle.

WITH THE WTO STALLED, WHAT HAVE MEMBERS TRIED?

Recent events have increased the sense of urgency, but Members have been aware of the malaise gripping the Organization for some time. For years the outcome documents and communiqués from Ministerial meetings reaffirmed the system's importance and called for reform.

Sub-groups of Members have taken steps to put these sentiments into action, including the European Union's trilateral talks on WTO reform with the United States and Japan, and the dedicated working group with China. Though somewhat short on results, these processes have at least kept the lines of communication between major powers open.

Virtually everything that can be done at working level in Geneva is being done, but when mandates from capitals are in direct opposition, there is only so much that technical creativity and talks can achieve.

The New Zealand Permanent Representative, Dr David Walker, serving as a facilitator on the Appellate Body reform process, has worked with Members to create a 'Chair's text' outlining his view of where consensus might lie. This work is vital, even though the United States has been clear it opposes any technical fix to the Appellate Body, which it believes is fundamentally flawed. The Chair's text ensures work will not have to begin from a blank canvas should the US political calculus change.

Some Members have explored ways to resolve disputes among themselves during the period of Appellate Body paralysis. A temporary group, which includes 20 Members and the European Union, has gone farthest, notifying the WTO of a system called the Multiparty Interim Appeal Arbitration Arrangement (MPIA) to decide appeals in the absence of the Appellate Body quorum.⁵⁰ The EU has indicated it will treat as final and binding any WTO panel ruling in its favour against a Member that appeals into the void and refuses to partake in the MPIA. More WTO Members may join the MPIA in time, but it is clear that the United States — which threatened to block the WTO's 2020 budget if organisational resources supported this arbitration — won't be among them, meaning the MPIA can only ever be a strictly limited solution for a sub-section of the WTO Membership.

Beyond the Appellate Body crisis, Members have explored other avenues for negotiated outcomes. Towards the end of 2018 China, generally more of a reactive player at the WTO, made a significant

Some Members have explored ways to resolve disputes among themselves during the period of Appellate Body paralysis.

though largely thwarted push for formal negotiations on investment issues within the WTO. A consensus on the differentiated impacts of trade policy on two separate issues — women, and small and medium enterprises (SMEs) — has gained traction. Both gender and SMEs have achieved exponentially higher profiles at the WTO in parallel to their prominence within bilateral and plurilateral trade agreements.

Alongside all this, the last few years have seen a concerted effort to link the WTO's work into the broader multilateral system's efforts with the 2030 Agenda for Sustainable Development Goals. These initiatives are laudable, but have thus far yielded little multilateral consensus nor moved the needle on the market access, subsidisation, and services liberalisation questions still central to most Members' evaluation of the WTO.

Beyond the WTO, governments have looked to bilateral, regional, and plurilateral trade agreements to fill the liberalising void left by stagnation at the WTO.

Beyond the WTO, governments have looked to bilateral, regional, and plurilateral trade agreements to fill the liberalising void left by stagnation at the WTO. The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the Regional Comprehensive Economic Partnership (RCEP), and the European Union–Mercosur agreement each create binding trade rules between economies with collective GDPs in the tens of trillions. The African Continental Free Trade Area (AfCFTA) talks have established foundations for one of the largest free trade blocs in the world. The TiSA negotiations were an attempt at the world's first services plurilateral, and the Transatlantic Trade and Investment Partnership (TTIP) would have seen the two largest economies on earth united under one bilateral deal.

These initiatives moved (or in the case of TiSA and TTIP, tried to move) liberalisation forward, but in fragmented fashion. Unlike tariffs liberalised at the WTO, reduced tariffs from a trade agreement can only be accessed by proving goods are sufficiently regionally produced to meet Rules of Origin thresholds. Billions of dollars in lower tariffs are not being utilised at all, as traders are locked out through ignorance about their existence, the Rules of Origin thresholds, or the cost and hassle of evidentiary requirements.⁵¹

Bilateral and plurilateral deals also risk being more trade diversionary than trade liberalising. Eliminating tariffs between select WTO Members creates an uneven playing field not just between domestic and foreign producers, but between foreign producers in different countries. While recent research has cast doubt on whether diversion occurs on a commercially significant scale under deep agreements, it remains a concern, especially for 'shallower' deals.⁵²

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Finally, these agreements are bilateral or plurilateral, but built on a foundation of WTO law. Tariff commitments are negotiated from a common understanding that the two sides are otherwise bound by their WTO maximum tariffs and the most favoured nation principle. Regulatory chapters begin by reaffirming the commitment of the two sides to the relevant WTO provisions, and build up from there. A weakening of the WTO threatens the foundation of the agreements built atop its framework.

POLICY RECOMMENDATIONS

The first step to improving the perilous condition of the rules-based trading system is acknowledging its actual purpose, and the limitations of some of the tools policymakers have spent years reflexively reaching for.

The WTO is about locking in a policy consensus, not creating one — every major agreement from the GATT to the AoA, and more recently the Trade Facilitation Agreement (TFA), was about taking a concept on which the major parties were broadly in alignment, hammering out the details, and then locking it in to prevent excessive backsliding or divergence. Expecting negotiations between comparatively low-level officials in Geneva or the occasional short Ministerial meeting to resolve differences as vast as those currently dividing major players, is a reversal of the causality chain. The WTO can enshrine a grand bargain between superpowers, but it cannot forge one.

No one believes the WTO is a flawless institution that could not benefit from reform and refinement.

Policymakers must accept that the issuing of ministerial statements, communiqués, press releases, and tweets calling for the system to be ‘reformed’ to work better in some unspecified way is insufficient. No one believes the WTO is a flawless institution that could not benefit from reform and refinement. But the problem lies, and has lain for years, in forging consensus on any one specific set of reforms that might actually satisfy major players.

Those same policymakers must also accept that no technical solution, no matter how innovative, will emerge to sidestep the political challenges. Technical discussions in Geneva and the outstanding work of scholars and experts can only complement, not replace, political progress.

On the Appellate Body alone there are sound, thoughtful proposals from eminent scholars that could readily form the technical foundation for a compromise solution.⁵³ This is equally true of agricultural domestic support, special and differential treatment, services, and goods market access. The practical ideas are there, but there is disagreement on the fundamentals and a lack of political will. The technical proposals are vital in identifying and proving the existence of paths forward should the political situation change, but they alone cannot shift it.

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1. Accept This is Not All Going Away

It is tempting to consider the current crisis a function exclusively of particular personalities in the White House, an inflection point in the Chinese transition away from low-end manufacturing, or a temporary global populist surge.

This is wishful at best.

A different US president may improve the tone of engagement and bring to the table less open hostility towards internationalism as a concept. They might be more consultative or balanced in their rhetoric. Yet, would fundamental US interests change?

Similarly, while future circumstances might see Chinese policy shift away from state market interference, it seems optimistic to expect such a move in the short to medium term. While China continues to intervene heavily in the market, frictions are inevitable.

If certain trade rules are incapable of co-existing with a world divided into US, EU, and Chinese spheres, they must be reconsidered before they drag down the entire system with them.

2. Plurilateralise and Coalesce

The WTO's precursor, the GATT, was negotiated in 1947 by just 23 countries. It was by any modern definition a plurilateral agreement, for example the Soviet Union was absent. Switzerland, where the negotiations took place, would not join for another 20 years.



The GATT enters into force on 1 January 1948. The 23 original members - 11 developed and 12 developing - hold one of their first sessions at the Palais des Nations, Geneva. Photo courtesy WTO.

Whether knowingly or not, the GATT parties began with a coalition of the willing, and trusted in momentum and magnetism to grow the project. That spirit has to be recaptured.

If properly designed, disciplines on investment and e-commerce should be inherently commercially attractive. The modern order is built on the theory that binding rules that reduce and make predictable any government intervention in the market should make countries more, not less, attractive as destinations for investment, entrepreneurship, and talent.

If governments still hold to that theory, then open plurilaterals and a continued commitment to existing rules remain the right move. If, on the other hand, governments are moving to a place where models like Chinese state capitalism, with its national champions, party-directed investment, and blurred lines between public and private, are more attractive in the long term, then a lot more than just the WTO needs to be reconsidered.

... ministers who already had political incentives to prefer the individual glory of an FTA signing ceremony over the comparative anonymity of a WTO Ministerial, pivoted to bilateral and plurilateral processes.

3. Rebuild the Domestic Foundation

Whatever comes next, governments have to invest the time, energy, resources, and political capital into rebuilding awareness and engagement with international trade policy. Even 'sexier' Free Trade Agreements (FTAs) struggle for useful and representative business input or a proper dialogue with civil society groups, and the WTO has not been sexy for quite some time.

The stakeholders that governments need to hear from and keep onside have limited bandwidth and focus energy where they perceive immediate threats or opportunities. The paralysis of WTO negotiations has led them to look elsewhere.

In response to business apathy and what is often civil society antipathy, ministers who already had political incentives to prefer the individual glory of an FTA signing ceremony over the comparative anonymity of a WTO Ministerial, pivoted to bilateral and plurilateral processes.

Trade ministries can afford to take a broader and longer view than the ministers they serve, but ultimately exist to deliver on ministerial priorities. As these priorities shifted away from the WTO, departmental resources were reallocated, with an ever-growing reliance on the conscientiousness and creative energy of individual officers and managers.

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For the WTO, this process has been triply debilitating. First, from a negotiation standpoint, business engagement is vital to identifying offensive interests beyond the obvious and traditional. Without such offensive interests to push and trade for, defensive interests only become more entrenched. Second, only an engaged and informed business community can highlight the technical regulatory issues the WTO's regular committees are designed to probe and address. Third, the disengagement and suspicion of civil society has left anaemic the efforts to achieve outcomes in progressive areas where WTO rules have fallen behind.

Efforts to rectify this challenge do not have to be grandiose, but they do have to be fully resourced, long term and practical. The New Zealand government's trade barrier website is a good example of a business-focused approach. The majority of businesses may not realise that the challenges they face are trade barriers addressable through the international system. Only through sustained, genuine outreach and engagement can governments even begin to demonstrate the benefits of the rules-based trading system.



The European Union's significantly increased transparency around trade following the TTIP protests in 2016 and the general trend towards increased consultation are both positive developments, but a huge amount more outreach and genuine engagement is needed before civil society groups develop any sense of ownership and investment in the trade policymaking process, or the WTO.

4. Ask the Difficult Questions

Resolutions to address the current landscape, while eventually needing to be expressed technically, are clearly political. The US Permanent Representative to the WTO, Ambassador Dennis Shea, said as much at the 12 December WTO General Council meeting.⁵⁴ If all WTO Members decide they like the Appellate Body in principle and decide to update

its guidebook, there is no shortage of detailed ideas on paths forward. Yet to begin walking this technical journey, political leaders must first agree a destination. That requires answering some tough questions.

What does the rules-based system look like if the United States never comes back? Will countries remain in a system that the world's largest economy does not consider binding? Is the response to Chinese state capitalism to wait until China swears off it unilaterally, confrontation, forbearance, or even an embrace of some of its elements to even the playing field? Is globalisation fragmenting into regionalisation, and what are the instruments required for emerging regional mega-blocs to continue trading in a predictable and mutually acceptable fashion?

To date, political leaders have largely sidestepped these questions in favour of repeating their views on the existing system, trying to manage its dysfunction in the short term, and encouraging technical solutions in the absence of political guidance. Unfortunately, that will not be enough.

CONCLUSION

This Appellate Body crisis may abate, and the impending budget crisis may be averted, but the WTO's challenges run deep. Unless the consensus on gradual liberalisation and rules-based trade can be rebuilt, the WTO will continue to fall short of the political will required to move beyond current impasses and inefficiencies. Ministerial calls for unspecified reforms, or reforms with no chance of securing consensus from the very players they target, will continue to sound hollow.

The United States has to be central to any future plan. No amount of technical work, statements of concern, or speeches in the General Council can fix a trading system to which the world's largest economy is uncommitted. US allies and trading partners with an interest in maintaining a rules-based multilateral trading system will need to use collective and creative diplomacy to pressure the United States to return to a productive member of the WTO, if not a leader as it has been in the past.

Whatever the future of the WTO, governments who believe in rules-based trade must look inwards and begin rebuilding the interest and engagement of business and civil society. Business must be convinced to devote the time and resources to shape and inform trade policy, and civil society actors must be brought, however sceptically, into the tent. That is not going to be easy, but the decades of economic growth and prosperity enabled by predictable, rules-based trade, show that it is worth it.

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- ⁴² Among the thorniest issues in international trade is the concept of data localisation. This refers to the rules governments implement regarding where their citizens' data can be stored, and how it can move across borders. It includes whether, for example, Facebook has to maintain physical data centres in a country in order to host the accounts of that country's citizens, or whether an accounting firm can outsource the more routine parts of a citizen's tax return preparation to a cheaper affiliate abroad.
- ⁴³ Hosuk Lee-Makiyama and Badri Narayanan, *The Economic Losses from Ending the WTO Moratorium on Electronic Transmissions*, European Centre for International Political Economy (ECIPE) Policy Brief No 3/2019, August 2019, <https://ecipe.org/publications/moratorium/>.
- ⁴⁴ Target 14.6 of the UN Sustainable Development Goals states: "By 2020, prohibit certain forms of fisheries subsidies which contribute to overcapacity and overfishing, eliminate subsidies that contribute to illegal, unreported and unregulated fishing and refrain from introducing new such subsidies, recognizing that appropriate and effective special and differential treatment for developing and least developed countries should be an integral part of the World Trade Organization fisheries subsidies negotiation", https://stats.unctad.org/Dgff2016/planet/goal14/target_14_6.html.
- ⁴⁵ "David Attenborough Explains What We Need to Do to Stop Over-Fishing", World Economic Forum, *YouTube*, 8 October 2019, <https://www.youtube.com/watch?v=og8N-EsIUPQ>.
- ⁴⁶ Bernard Hoekman, Constantine Michalopoulos, and L. Alan Winter, "Special and Differential Treatment of Developing Countries in the WTO: Moving Forward After Cancún", *The World Economy* Vol 27, No 4 (April 2004), 481–506; Nicolas Imboden, "Special and Differential Treatment: A New Approach May Be Required", *Bridges Africa* Vol 6, Iss 8 (November 2017), 21–24, <https://www.tralac.org/images/docs/12386/bridges-africa-november-2017-ictsd.pdf>; Alexander Keck and Patrick Low, *Special and Differential Treatment in the WTO: Why, When, and How?* World Trade Organization Staff Working Paper No ERSD-2004-03, (January 2004), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=901629.
- ⁴⁷ Tom Miles, "U.S. Drafts WTO Reform to Halt Handouts for Big and Rich States", Reuters, 16 February 2019,

- <https://www.reuters.com/article/us-usa-trade-wto/us-drafts-wto-reform-to-halt-handouts-for-big-and-rich-states-idUSKCN1Q426T>.
- ⁴⁸ Jakob Hanke, “WTO Allows U.S. to Hit EU With Tariffs Over Airbus Subsidies”, *Politico*, 14 September 2019, <https://www.politico.com/story/2019/09/14/wto-tariffs-airbus-subsidies-1496170>.
- ⁴⁹ The US win–loss record at the Appellate Body is good, except in the area of its trade remedies regime.
- ⁵⁰ European Commission, *EU and Norway Agree on Interim Appeal System in Wake of World Trade Organization Appellate Body Blockage*, European Commission, Brussels, 19 October 2019, <https://trade.ec.europa.eu/doclib/press/index.cfm?id=2074>.
- ⁵¹ United Nations Conference on Trade and Development (UNCTAD), *The Use of the EU’s Free Trade Agreements*, National Board of Trade Sweden, (Geneva: United Nations Conference on Trade and Development, 2018), https://unctad.org/en/PublicationsLibrary/EU_2017d1_en.pdf.
- ⁵² Depth in trade agreements is generally measured by a combination of the number of product types covered, and the range of policy areas addressed. See Aaditya Mattoo, Alen Mulabdic, and Michele Ruta, *Trade Creation and Trade Diversion in Deep Agreements*, World Bank Policy Research Working Paper (Washington DC: The World Bank, 2017), <http://documents1.worldbank.org/curated/en/208101506520778449/pdf/WPS8206.pdf>.
- ⁵³ Robert McDougall, *Crisis in the WTO: Restoring the WTO Dispute Settlement Function*, CIGI Papers No 194 (Waterloo: Centre for International Governance Innovation, October 2018), <https://www.cigionline.org/sites/default/files/documents/Paper%20no.194.pdf>; Jennifer Hillman, *Three Approaches to Fixing the World Trade Organization’s Appellate Body: The Good, The Bad and the Ugly*, (Washington DC: Institute of International Economic Law Georgetown University Law Center, 2018), <https://www.law.georgetown.edu/wp-content/uploads/2018/12/Hillman-Good-Bad-Ugly-Fix-to-WTO-AB.pdf>.
- ⁵⁴ For Ambassador Shea’s full remarks see: *Ambassador Shea: Matters Related to the Functioning of the Appellate Body*, U.S. Mission to International Organizations in Geneva, WTO General Council Meeting, 9 December 2019,

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[https://geneva.usmission.gov/2019/12/09/ambassador-shea-statement-at-the-wto-general-council-meeting/.](https://geneva.usmission.gov/2019/12/09/ambassador-shea-statement-at-the-wto-general-council-meeting/)

ABOUT THE AUTHOR



Dmitry Grozoubinski

Dmitry Grozoubinski is a former Australian trade negotiator and diplomat, now based in Geneva where he serves as the Executive Director of the Geneva Trade Platform and founder of the consultancy ExplainTrade. He has negotiated complex agreements in Geneva at the World Trade Organization (WTO), at UN Ministerial Conferences in Kenya, and as part of the MH17 taskforce in Kyiv, Ukraine. Before joining the Australian Department of Foreign Affairs and Trade, Dmitry was an academic at the Monash Graduate School of Business, and with the Australian trade consultancy TradeWorthy. He is now a trade consultant and visiting professor at the University of Strathclyde's School of Law. Dmitry holds a BA in Political Science from the University of Melbourne and a Masters of Diplomacy and Trade from the Graduate School of Business at Monash University.

@DmitryOpines

LOWY INSTITUTE

31 Bligh Street
Sydney NSW 2000

Tel. +61 2 8238 9000
Fax +61 2 8238 9005

lowyinstitute.org
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