



Institute for International Trade

WHAT FUTURE FOR THE GLOBAL TRADING SYSTEM AMID TRADE, TECHNOLOGICAL AND GEOPOLITICAL CONFRONTATIONS?

Executive Summary

With trade conflicts, new technologies and geopolitical competition reshaping the global economy, the trade and investment policy landscape is rapidly changing. While different scenarios are playing out, managed trade is gaining traction, rules are increasingly fragmented in competing spheres of influence and global trade governance is weakening. The World Trade Organization (WTO) is under strain and the business environment is more uncertain, volatile and increasingly power-driven than before. Amid these conditions, a renewed global trading system is critical to support growth, technological progress and world stability.

The task at hand is difficult, not least because it takes stage against the backdrop of great power rivalry and systemic competition between the US and China¹. In moving towards WTO reform, countries face the challenge of reconciling three critical objectives; preserving the rules-based nature of the system; ensuring all major economies remain part of it; and improving the way it works. WTO Members are presenting proposals to unpack the issues. However traction is yet to be achieved in the negotiation of new rules on key topics underlying current tensions, the solution to the dispute settlement mechanism's imminent halt and the rebalancing of developed and developing countries' contributions to the system. WTO Members need to shift gears and speed up negotiating efforts if they are to reach agreement by the next WTO Ministerial Conference in June 2020. However this may prove elusive, in which case the alternative is not to pause, but to actively preserve the system and prepare the way to be ready to act post-November 2020.

Historical context

For the past 70 years, global trade has been governed by a set of rules based on non-discrimination, transparency, binding and enforceable commitments on tariffs and other policy instruments. These rules have brought greater certainty, stability and increased market openness. At the heart of the system, the WTO—and before it, the General Agreement on Tariffs and Trade (GATT)—ensures that trade flows as smoothly, predictably and freely as possible. This global framework has helped create an unprecedented extent of prosperity across the world.

Trade has long been a driver of global growth—increasing 27-fold between 1950 and 2008, three times more than the growth in global gross domestic product (GDP). The expansion of global value chains (GVCs) has facilitated the integration of developing countries into the world economy and has enabled a billion people to move out of poverty. And during the global financial crisis, the WTO helped prevent the Great Recession from becoming another Great Depression as by and large, WTO Members continued to mostly comply with their obligations despite resorting to some protectionist measures². The system has worked overall because countries have seen the need for the WTO to function as being in their own self-interest “rightly understood”³.

The current state of play

Today, in the wake of longer-run trends of diminished trade opening since the 2000s, prospects for trade and investment liberalisation at the global level have weakened. In fact, they are going in different directions, with increasing trade and investment confrontations.

¹ Bergsten, C 2018. ‘With eyes on China, EU agrees investment screening rules’, *Business News*, November 20

² Evenett, S 2010. ‘Tensions Contained... For Now’, *The 8th Global Trade Alert Report*, November 8.

³ Bacchus, J 2018. *The Willing World: Shaping and Sharing a Sustainable Global Prosperity*, Cambridge University Press.



The US and China are at the centre of these high-stakes conflicts, but underlying systemic issues amplify the impact beyond the two countries. Other sources of tension, such as the threat of US tariff hikes on \$350 billion of cars, trucks and parts imports from the EU, Japan and others, loom on the horizon and further add to the concerns over escalation and retaliation⁴.

Current frictions are undermining confidence in the world economy, and global trade, investment and output remain under threat from policy uncertainty. The failure to resolve differences would not only increase costs for producers and consumers, but would lower business investment, disrupt supply chains, and slow productivity growth⁵, all while eroding the rules-based global trading system. Globalisation is at risk of rolling back due to the spill over effect into foreign direct investment, immigration and cross-border sharing of information and scientific data⁶.

The effect of new technologies

Meanwhile emerging technologies, such as artificial intelligence and robotics, the internet of things, virtual and augmented realities, additive manufacturing and blockchain, are spurring the development of new production techniques and business models that are fundamentally transforming global production systems⁷. They also have the potential to profoundly transform the way trade takes place, which countries trade and what is traded⁸.

While some of these technologies are not new, their adoption is spreading faster than before. Competition to develop and implement of these new technologies is fierce. Governments and firms across the globe are engaging in legitimate—and illegitimate—acts to establish a foothold in a particular technology, to pioneer commercial application, and to gain share in new markets. Advanced economies, which for many decades have pushed the boundaries of technological development, are now joined by China and other emerging economies' growing presence in the cutting-edge technology scenario⁹.

In a 'multi-polar' technology world, commercial friction has increased and takes centre stage in the trade arena. While escalating unilateral actions to respond to such tensions are disrupting trade and investment flows, and straining the global trading system, they are also eroding the business environment for innovation progress and increased productive economic activity¹⁰.

Current trade and technology spats layer on geostrategic considerations, ranging from the military advantage that dominance in some of these technologies may bring about¹¹ to increasing cyber security-related trade conflicts at the global level¹². Moreover, a redistribution of global economic might has given rise to a new era of great power rivalry¹³, the use of economic tools to achieve strategic goals and the assertiveness of some governments in trying to unilaterally reduce or manage their exposure to the interdependence underlying the global economy¹⁴. One view is that current frictions run much deeper than the trade confrontations and have more to do with control of over technologies like artificial intelligence, key inputs such as energy sources for electric vehicles, and command over connectivity, both physical and digital¹⁵.

The future of trade and investment

The trade and investment policy scene is in flux as governments and firms try to cope with the challenges associated with current trade confrontations, disruptive technologies and geostrategic rivalry. There are several plausible scenarios for the future, depending on the interplay of key geopolitical and economic factors, in particular whether countries choose international cooperation or opt for a 'unilateral' path, and whether the world will move in the direction of higher or lower ease of cross-border movement of goods, services, capital and people. Four scenarios have been drawn in stark terms to sharpen the risks and trade-offs involved, while recognising that reality may end up somewhere in between or in a combination of parts.

⁴ Cohen-Setton, J 2019. 'Uncertainty over Auto Tariffs May Not End Soon', Peterson Institute for International Economics, April 24.

⁵ International Monetary Fund, 2019, World Economic Outlook Update, January.

⁶ McKinsey Global Institute, 2019, Globalization in transition: The future of trade and value chains.

⁷ World Economic Forum, 2018, Readiness for the Future of Production Report.

⁸ World Trade Organization, 2018, World Trade Report – The future of world trade: How digital technologies are transforming global commerce.

⁹ China Power Team, 2019, 'Is China a global leader in research and development?', Center for Strategic and International Studies, February 5.

¹⁰ González, A 2018. 'Strategic Brief on Trade Rules for the Tech Race, World Economic Forum Global Future Council on the Future of Trade and Investment'.

¹¹ Ciuriak, D 2018. 'The US-China Trade War: Costs, Causes and Potential Responses by Tier II Powers', 16th Korea-Canada Forum, Seoul, 13-15 December.

¹² Huang, K, Madnick, S, & Johnson, S 2018. 'Interactions Between Cybersecurity and International Trade: A Systematic Framework', MIT Sloan Research Paper, No 5727-18.

¹³ Bergsten, C 2018. 'With eyes on China, EU agrees investment screening rules', Business News, November 20

¹⁴ Roberts, A, Choer Moraes, H & Ferguson, V 2018. 'The Goeconomic World Order', Lawfare blog, November 19.

¹⁵ Choer Moraes, V 2018. 'The possibility of global economic governance in a period of great power rivalry', German Development Institute, November 14.

1. Open international rules – where countries cooperate to address issues through a revitalised WTO and complementary international frameworks.
2. Competing coalitions – where countries collaborate but are often drawn into competing spheres with regional blocks outside the WTO.
3. Technological disruption – where countries cannot cooperate and technological disruption races ahead of regulation, creating a borderless world for some but with great uncertainty and inefficiencies.
4. Sovereignty first – where in the absence of cooperation, prohibitive unilateral barriers lead to inefficiencies, high economic risks and a decline in productivity and innovation¹⁶.

Figure 1 summarises the defining features of each of the potential scenarios.

While the landing zone of current friction is still at play, from the perspective of trade and investment policy, three features are surfacing—managed trade, rules fragmentation and weakening of global trade governance¹⁷.

Managed trade

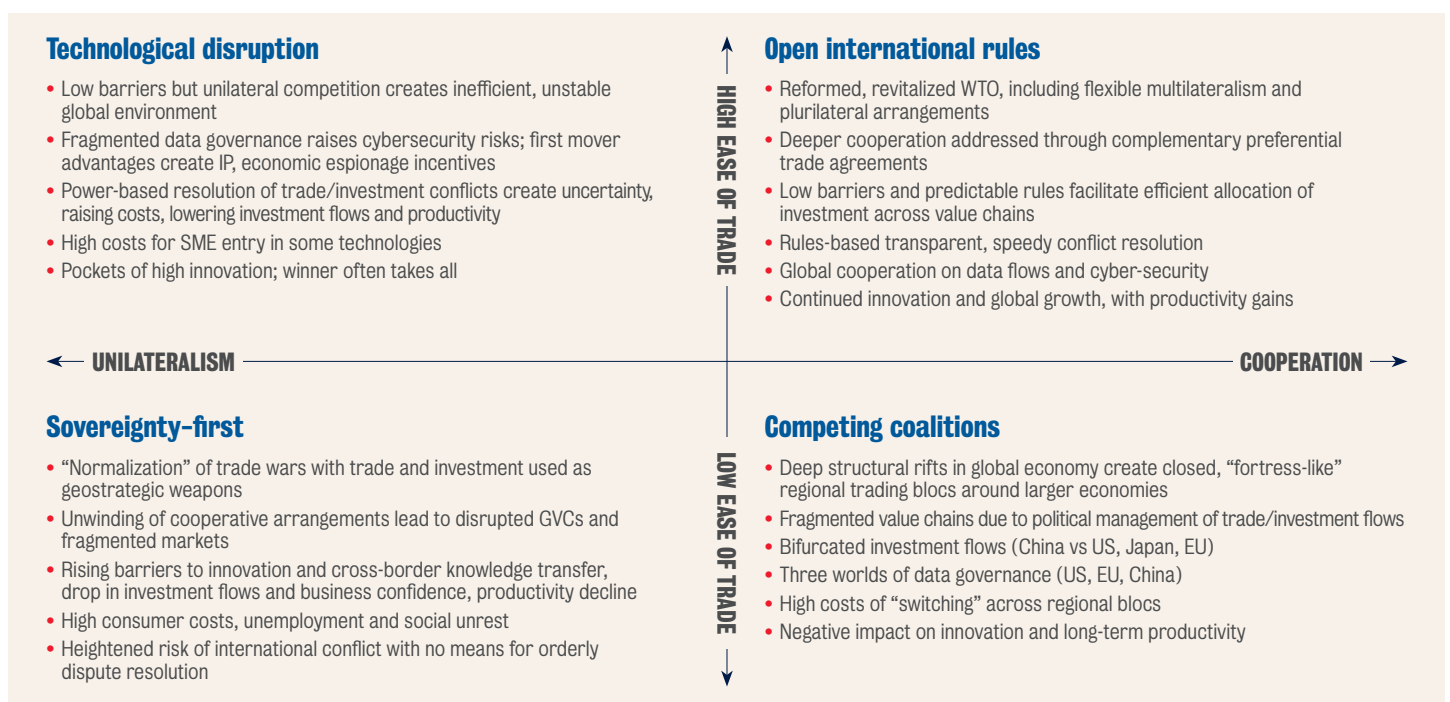
The revival of managed trade—a policy focused on achieving concrete outcomes through government intervention—includes the return of ‘the tariff’ and other measures such as voluntary export restraints, used to pursue national economic and security objectives. This is not minor—40 per cent of total US imports could be subject to new tariffs¹⁸. Duties are being used as a bargaining chip for a variety of purposes, one of which is to move manufacturing back to the US¹⁹,

in what is considered national economic security. Affected trading partners have activated the WTO dispute settlement mechanism to counter US tariff hikes and have unilaterally retaliated with tariffs of their own on imports of US products. In deals to suspend or avoid new US tariffs, commitments to import more natural gas, agricultural products and others are playing a role²⁰.

Managed trade is complemented by other policies in the areas of investment and export controls, the combination of which may lead to ‘decoupling’ the US from the Chinese economy²¹. Strengthened revised investment screening mechanisms, in the case of the US by the Committee on Foreign Investment in the United States (CFIUS), are discouraging the acquisition of US firms in sectors deemed sensitive from the national security perspective. Investment screening rules have also been adopted by the EU²² and other countries²³.

In some countries expanded export controls to address concerns regarding the release of critical technologies to end uses, end users and destinations of concern, are also part of the package²⁴.

FIGURE 1: FOUR SCENARIOS FOR THE FUTURE OF TRADE AND INVESTMENT



¹⁶ Tan, Y & González, 2019. ‘Four Scenarios for the Future of Trade and Investment’, World Economic Forum Global Future Council on the Future of Trade and Investment.
¹⁷ González, A 2019. ‘Confrontation, disruptive technologies, and geostrategic rivalry: The quest for renewed global trade governance’, *Women Shaping Global Economic Governance*, International Trade Centre.
¹⁸ Bown, C 2018. ‘For Trump, it was a summer of tariffs and more tariffs. Here’s where things stand’, *Washington Post*, September 2017.
¹⁹ Draper, P 2018. ‘Where is Global Trade Governance Headed? A Tour D’Horizon’, German Development Institute, October 4. Lawrence, R 2018. ‘Five Reasons Why the Focus on Trade Deficits is Misleading’, Peterson Institute for International Economics, Policy Brief 18-6, March.
²⁰ Elliott, K 2018. ‘Trump’s Tariffs Herald the Return of “Managed Trade”’, *World Politics Review*, August 7.
²¹ Lee, J 2018. ‘Decoupling from China: Cutting the Gordian Knot’, Lowy Institute, November 9.
²² Blenkinsop, P 2018. ‘With eyes on China, EU agrees investment screening rules’, *Business News*, November 20.
²³ United Nations Conference on Trade and Development, 2018. World Investment Report – Investment and New Industrial Policies.

Rules Fragmentation

Greater fragmentation of trade rules has also emerged, with a flurry of activity leading to new or revised agreements and potential competing spheres of influence. The number of preferential trade agreements (PTAs) in force has more than doubled from less than 150 in 2005 to more than 300 in 2017²⁵. This upward trend is accelerating, as countries are redoubling efforts to negotiate or renegotiate regional and bilateral agreements as an offensive strategy in some cases, to secure market access and rules-based frameworks, and for defensive reasons in others, to restrict trade or expand spheres of influence (see **box 1**). While WTO-consistent PTAs provide a strong underpinning for GVCs, competing visions in areas like the digital economy risk bringing in differentiated standards and further consolidating emerging divisions in what has been dubbed a potential ‘splinternet’²⁶.

BOX 1. NEW OR REVISED PREFERENTIAL TRADE AGREEMENTS AND ONGOING NEGOTIATIONS

Most major countries and regions are actively engaged in trade negotiations. The US key decisions to date include the withdrawal from the Trans-Pacific Partnership (TPP) later renamed by the remaining members the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP), the suspension of negotiations of the Trans-Atlantic Trade and Investment Partnership (TTIP), the renegotiation of the Korea-US Free Trade Agreement, the renegotiation of the North American Free Trade Agreement (NAFTA) leading to the United States-Mexico-Canada Agreement (USMCA), and ongoing negotiations narrower in scope with Japan and potentially with the EU.

Elsewhere, the UK’s post-Brexit repositioning involves the dismantling of deep integration ties with the EU and agreeing on new rules of engagement. The EU, Japan, China and others are also moving ahead with bilateral or regional agreements, of which the EU-Japan Economic Partnership Agreement and CPTPP, as well as the negotiations to conclude the Regional Comprehensive Economic Partnership (RCEP) among the Southeast Association of Asian Nations (ASEAN) and China, Japan, Korea, India, Australia and New Zealand are particularly important, by virtue of their scale and political relevance, as is the African Continental Free Trade Agreement (AfCFTA). The Chinese-led Belt and Road Initiative (BRI) is the most ambitious initiative to promote deeper regional economic integration, beyond trade and investment.

Weakening of global trade governance

Two immediate actions have brought the WTO to confront its most fundamental crisis since coming into force in 1995: the adoption of the national security tariffs by the US on imports from several trading partners, and the responses in kind of those countries²⁷, and the US blockage of the nomination of members of the WTO’s Appellate Body²⁸. While these actions risk the system’s breakdown, problems in all three WTO functions—negotiations, dispute settlement and monitoring—have been brewing for some time, impairing its ability to keep up with the challenges of the evolving trade landscape, technological change, and the role of emerging countries in the global

economy. Unless WTO Members take decisive action to reform it, it is only a matter of time before the uncertainty about the future of the organisation and increasing antagonism amongst the major players brings it to a halt, spurring commercial chaos at the time when GVCs and the digital economy require more, not less, policy cooperation.

Trading system challenges

Three complex concerns underline current tensions in the multilateral trading system. The first and most significant plays out in the sphere of market versus state capitalism. The key question centres on whether and how to redefine the level playing field to better address market-distorting state intervention in the economy, through subsidies, state-owned enterprises, technology transfer measures and others. China’s rapid rise, state-dominated economic system and sheer size have brought heightened attention to its industrial and trade policies. While one may question the uniqueness of China’s trade policies or the extent of its non-compliance with trade rules²⁹, it has undeniably strained the global trading system. Concerns were first centred on the challenges faced by foreign firms competing in the Chinese market, but they now extend to competition with Chinese firms in developed and third-country markets, and expanding Chinese investments and acquisitions of advanced technologies—all of which also intertwine with strategic considerations.

Against the backdrop of the digital economy and technological innovation, a second point is the need to reform existing arrangements and develop a multilateral framework that is fit for the digital age, including on issues such as cyber security and cross-border e-commerce and data flow³⁰.

The launch of WTO plurilateral negotiations on trade-related aspects of e-commerce is an important step to address these issues.

And third, as developing countries have become central players in the global economy, with their share in world merchandise exports reaching almost half (see **figure 2**), the issue of whether all developing countries should continue to claim special and differential treatment (SDT) in trade negotiations is a critical point confronting the world trading system. The question is particularly relevant in the context of the larger developing countries—the 15 largest of which account for some three quarters of that trade share—as their actions can have sizeable economic effects in international market³¹.

Towards renewed global trade governance

The need to act in order to sustain a global trading system that continues to support global growth, enable continued technological advancement and temper escalating power confrontations is pressing. The urgency is greater in a context in which managing and mitigating tensions associated with changing patterns of globalisation and the move towards the digital economy require more, not less, global policy cooperation.

²⁴ Akin Gump, 2018. ‘The Export Control Reform Act and Possible New Controls on Emerging and Foundational Technologies’, International Trade Alert, September 12.

²⁵ United Nations Conference on Trade and Development, 2019. ‘Key Statistics and Trends in Trade Policy 2018 – Trade Tensions, Implications for Development Countries’.

²⁶ Kharpal, A 2019. ‘The ‘splinternet’: How China and the US could divide the interest for the rest of the world’, *CNBC*, February 3.

²⁷ Bown, C & Kolk, M 2019. ‘Trump’s Trade War Timeline: An Up-to-date Guide’, Peterson Institute for International Economics, August 1.

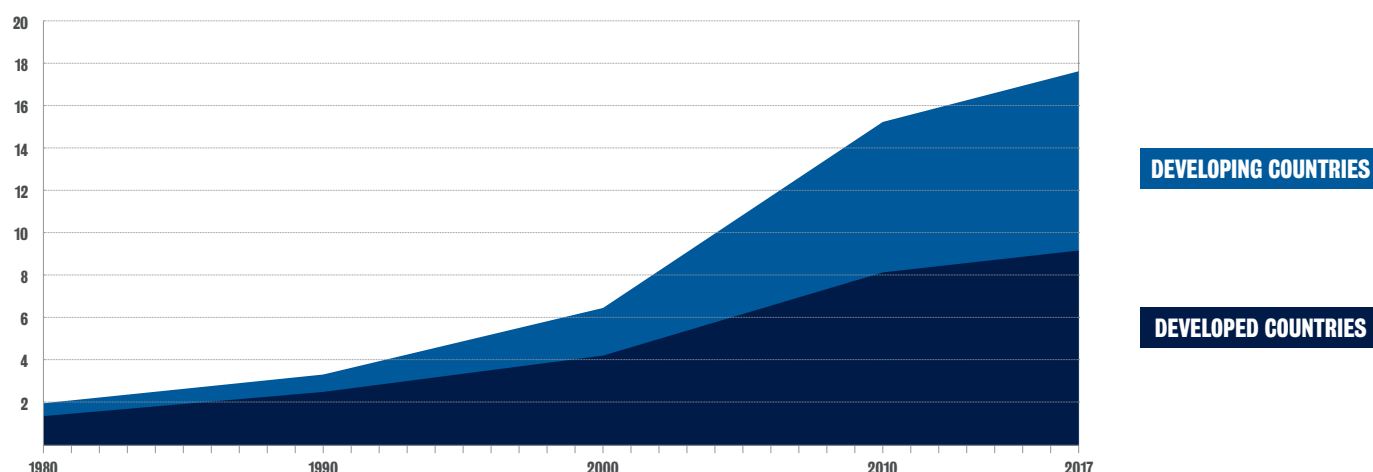
²⁸ Stoler, A 2019. ‘Crisis in the WTO Appellate Body and the Need for Wider WTO Reform Negotiations’, The University of Adelaide Institute for International Trade, Policy Brief 01, March.

²⁹ Beinart, P 2019. ‘U.S. Trade Hawks Exaggerate China’s Threat’, *The Atlantic*, April 21.

³⁰ Ciuriak, D 2019. ‘World Trade Organization 2.0: Reforming Multilateral Trade Rules for the Digital Age’, Centre for International Governance Innovation, Policy Brief No. 152, July.

³¹ González, A 2019. ‘Bridging the Divide Between Developed and Developing Countries in WTO Negotiations’, Peterson Institute for International Economics, March 12.

FIGURE 2: MERCHANDISE EXPORTS (MILLION US\$)³²



WTO reform is challenging. The fact that it will take place in the charged context of the broader US-China confrontations adds complexity to the task. Unfortunately, the crisis at the WTO limits an important channel for resolving conflicts between the two countries, one that has been effectively used by each of them to address trade controversies against the other. The US has activated the system to solve 23 trade conflicts with China, whereas China has brought 15 cases against the US³³.

Three objectives are critical in guiding WTO modernisation; the rules-based nature of the system must be preserved; all major economies must remain part of the system; and the way in which the system works must be improved. Failure to achieve any of these goals would significantly limit the role of a multilateral trade organisation that supports growth, innovation and stability. The crux of the challenge is precisely to reconcile this triad of objectives.

WTO Members are beginning to unpack priority issues for consideration, with proposals submitted to safeguard and strengthen the dispute settlement system and improve the monitoring of existing rules³⁴. While very valuable in fostering discussion and engagement in the WTO context, they have not yet gathered traction from all major economies, partly because solution to the dispute settlement eminent impasse cannot come without parallel efforts to address the concerns underlying current tensions, as specified above. This requires at a minimum the negotiation of new multilateral rules on industrial subsidies and SOEs, foreign investment, technology transfer and export controls. In this context, the ‘trilateral process’ launched in December 2017 between the US, the EU and Japan to draft new disciplines on these topics is critical—although, even if successful, results will not translate automatically into progress with other trading partners or in the WTO context. Much more work would be required, particularly to fully incorporate China and other key WTO Members in the conversation, and to define the format and enforcement mechanisms of potential agreements³⁵. It may also require adding other topics, such as agricultural subsidies, to the mix. Bringing the WTO out of the emergency room would also entail sorting out the increased tariffs adopted in contravention of the rules.

The next steps

To reach agreement by the next WTO Ministerial Conference scheduled for June 2020, WTO Members need to shift gears and speed up negotiating efforts. Intense and serious participation

from all players, particularly the largest among them, is crucial. For strategic considerations, timing factors or the sheer amount of work involved, this effort may nevertheless prove elusive. Furthermore, disengagement by the US gives little reason for hope³⁶. The alternative for members is not to just pause, but to preserve and prepare. In preserving the system as much as possible, interim arrangements to keep the dispute settlement system working without the Appellate Body will be required, such as the draft EU proposal on an interim appeal arbitration procedure for WTO Members to voluntarily arbitrate their WTO dispute rulings³⁷.

In parallel, continued engagement with text-based proposals among willing members to make progress on critical issues is necessary to be ready to ramp up work in the aftermath of the US elections. While the context may change one way or another after November 2020, the systemic and substantive issues outlined in this brief will continue to confront the global trading system. There is no escaping the need to reform the WTO to underpin the trade and investment landscape of the future.

ABOUT THE AUTHOR



Anabel González is an independent consultant on trade and investment, and nonresident senior fellow at the Peterson Institute for International Economics. She is former: Senior Director of the World Bank’s Global Practice on Trade & Competitiveness (2014–18), Minister of Trade of Costa Rica (2010–14), and Director of the World Trade Organization Agriculture Division (2006–09), among others. She is a member of the World Economic Forum Global Future Council on Trade and Investment.

³² González, A. 2019. ‘Should Developing Countries Get Preferential Treatment on Trade? Shooting the WTO will not level the playing field with emerging economies’, Peterson Institute for International Economics, August 27.

³³ Schott, J. 2019. ‘US-China Trade Friction: The WTO Dimension’, Presentation for the PIIE-CF40 Conference on China-US Relations and the Global Economic System, January 23.

³⁴ Van den Bossche, P. 2019. ‘The WTO in 2019: A Future Mired in Uncertainty’, *Society of International Law Newsletter*, Winter.

³⁵ Bown, C. 2018. ‘For Trump, it was a summer of tariffs and more tariffs. Here’s where things stand’, *Washington Post*, September 2017.

³⁶ Bown, C & Douglas A. 2019. ‘Trump’s Assault on the Global Trading System and Why Decoupling from China Will Change Everything’, *Foreign Affairs*, September/October.

³⁷ Lester, S. 2019. ‘The EU’s Interim Appeal Arbitration Proposal’, *International Economic Law and Policy Blog*, June 7.

FOR FURTHER ENQUIRIES

Institute for International Trade
The University of Adelaide
Level 5, 10 Pulteney Street SA 5005 Australia

TELEPHONE +61 8 8313 6900

EMAIL iit@adelaide.edu.au

WEB iit.adelaide.edu.au

© The University of Adelaide. Published October 2019
CRICOS 00123M

DISCLAIMER The information in this publication is current as at the date of printing and is subject to change. You can find updated information on our website at adelaide.edu.au or contact us on 1800 061 459. The University of Adelaide assumes no responsibility for the accuracy of information provided by third parties.

