

Can the WTO be fixed?

The world trade organisation faces three major problems. Can there be a solution before time runs out?



Donald Trump speaks on trade in Illinois, July 2018

As a negotiation platform for multilateral trade deals, the World Trade Organisation (WTO) has long lost its authority because the last round of trade negotiations, i.e., the Doha Development Agenda, aimed at further liberalising trade hasn't been progressing for many years. Now, the WTO faces two, even more, pressing problems.

1. Tensions between developed and developing countries

Advanced economies are objecting to the 'developing country' status of China and other fast-growing G20 countries because of the privileges that come with this status. Also, developed economies are concerned about some country's (read Chinese) barriers to imports and market access as well as market interventions through state-owned companies and forced technology transfers.

2. The US is unhappy with the dispute settlement mechanism

President Trump's administration has threatened to withdraw the United States from the WTO if it doesn't change the way it settles disputes and doesn't reform to address its other concerns.

To force this issue to the negotiation table, the US has been blocking the appointment of new judges to the Appellate Body - the highest court of the dispute settlement system. If this doesn't change, there won't be enough judges available to settle disputes by the end of next

year. Countries may then bypass the WTO and resort to unilateral actions to solve conflicts, raising the risk of having more bilateral trade wars. This would not only undermine the authority of the institution and hollow out its pivotal function but could also potentially put its survival at risk.

Due to the differing opinions of developed and developing countries, there is little chance of a big overhaul reform of the WTO that can solve all complaints at once. After all, the WTO is used to making decisions through consensus, and individual countries then have the right to veto.

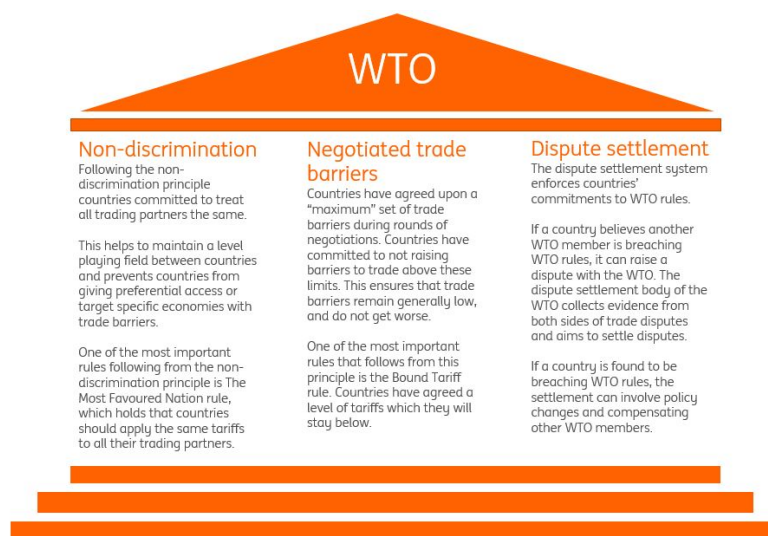
A deal on just the issue of the dispute settlement system has more chances of succeeding. In particular, since the EU and 11 other countries have reached out to the US this week proposing reforms addressing US' concerns about dispute settlement. This could avert the acute danger of the WTO's function as an arbitrator falling apart. However, it's worth noting that the US rejected similar reform EU proposals a month ago.

But despite all of this, we still think there are a few reasons to be optimistic.

What is the WTO

The World Trade Organisation was created in 1995 and is made up of 197 countries including member and observer states. If there is no specific trade agreement between two member countries, trade takes place based on WTO rules, and if disputes cannot be resolved through bilateral negotiations, the WTO steps in for mediation and, if needed, settles them too.

The WTO is also the platform for multilateral negotiations directed at further liberalisation of trade in goods and services.



Source: ING

The figure below shows the basic WTO rules and most important exceptions. The rules allow for some trade barriers and don't necessarily follow the principles of free trade.

Basic trade rules for WTO countries

	Allowed	Allowed on condition that...	Not allowed	Not allowed with specific exception
1 Subsidies (that subsidise exports or import substitution) Measures to counter distortions caused by subsidies (remedies)		...there is significant damage to local producer and may normally not be implied longer than 5 years		...for agricultural products* as long as they are on the list of tariff concessions
2 Dumping (exporting products at a price below normal price (read: cost price)) Anti-dumping remedy measure	YES YES			
3 Import tariffs on goods Import tariffs on services		...a country applies the same import tariff to all WTO countries: MFN rule ...if it regards services that are not on one of the specific lists of agreements on MFN trade in services or when it regards services demanded by the government of that country		
4 Other tariffs				...for products or services are part of the "list of tariff concessions"
5 Quotas				...for quotas that are equally damaging to all: the damage must be in accordance with their share in the trade flow
6 Different treatment of domestic and foreign goods once on domestic soil (ie, regarding rules and taxes) Different treatment of domestic and foreign services once on domestic soil (ie, regarding rules and taxes)			NO	...for different treatment of services that are not on one of the specific lists of agreements on MFN trade in services or when it regards services demanded by the government of that country

General exceptions to basic WTO rules are allowed when...

- ...the WTO rules are at odds with the environment, national security, national health, consumer protection, intellectual property protection or national morals
- ...imports lead to serious damage of domestic industry. Protectionist measures with this motive may be applied for a maximum period of four years if disadvantaged countries are compensated.
- ...the deviation is due to a Free Trade Agreement with other countries
- ...the deviation is applied by developing countries
- ...beneficial deviations are granted to trading partners that are developing countries.

This figure provides information on some WTO rules based on the source (see below). It is not a complete list. The rules presented here are a selection made by the authors and the description of the rules is according to the interpretation of the rules by the authors.

Source: Peter van den Bossche en Erik Denters, in Handboek Internationaal Recht, 2007, Nathalie Horbach, René Lefeber, Olivier Ribbelink

Source: ING

The rules and the current trade war

The WTO rules are embedded in national regulation and to raise tariffs beyond the upper rate allowed, countries have to utilise the exceptions part of the trade laws.

For example, the US argues that its tariff elevations on steel and aluminium are justified by the exception in the WTO law that states that domestic industries can be protected in case of a threat to national security. In response to this action from the US, the EU, China and other countries imposed tariffs on US imports referring to similar provisions in WTO laws. In the end, the WTO has to speak justice on the legitimacy of these actions.

What is wrong with the WTO?

Trade negotiations at an impasse

Since the WTO was created, few multilateral trade negotiations have been concluded. The current wide-ranging round of trade negotiations including the Doha Development Agenda faces deadlock. The unresolved topics are trade barriers and subsidies in agriculture, intellectual property and services trade and dispute settlement.

One of the reasons why WTO negotiations are extremely difficult is that new agreements or rules can only be adopted by the principle of consensus where individual members have the right to

veto. Since 2001, only in two cases, sufficient agreement was reached for trade agreements on trade facilitation and export subsidies in 2013 and 2015.

Developing versus developed economies

Tensions between developed and developing countries are a roadblock in the WTO reform agenda as developed countries no longer see the need for larger economies such as Brazil, India, and China to be classified as 'developing economies' which gives them benefits not granted to 'developed economies'. There is also discontent about WTO rules not forbidding aggressive economic policies and not being reprimanding enough for not complying to the rules. And finally, there is tension over if China should be granted 'market economy' status.

- *Developing economy status*

The WTO doesn't specify a clear definition of developing or developed country. Therefore, countries can decide for themselves and claim to be a developing economy, which gives them extra time for lowering tariffs and subsidies to the agreed levels. This often makes advanced economies increasingly frustrated that large emerging economies, such as China, who have a profound influence on global markets continue to claim the protection of a developing economy.

- *Aggressive economic policies*

Many developing countries, but in particular China, maintain discriminatory barriers against foreign imports and market access for foreign firms. According to the [European IPR SME](#), a business helpdesk by the European Commission, market access in China is often restricted, and technology transfers are sometimes demanded of foreign companies to gain access to the Chinese market.

Another concern is interventions in markets through state-owned enterprises in a non-transparent way and the frequent failure to comply with the WTO obligations regarding the notification of subsidies. Many consider these policies to be out of line from the spirit of the WTO; however, current rules offer few tools to prevent such misdemeanours or to discipline countries that practise them. In some cases, the WTO rules even explicitly allow these types of policies.

- *China's market economy status*

When China entered the WTO, it was granted a 'non-market economy' status, which means in trade disputes about alleged Chinese dumping - exporting a product below domestic market prices, Chinese export prices were compared to prices from a country with 'market economy' status. Given the considerable influence from state-owned companies in China, it becomes somewhat easier to manipulate (cost) prices but if China was given the status of 'market economy', then it would become much more difficult to build a case of dumping practices.

China was promised to be granted 'market economy' status after 15 years of membership; however, the EU, US, Canada, Japan, Mexico, and India still consider China a 'non-market economy' and negotiations on this issue are still ongoing.

US discontent with the dispute settlement mechanism

The current but also the previous White House administration expressed major concerns with the dispute settlement system. Its position is first of all that the Appellate Body - the highest court of the dispute settlement system that handles country appeals against adverse rulings has

appropriated too much power beyond its original mandate. Secondly, the US believes that the Appellate Body changes the rules of the game with its reinterpretation of WTO agreements and national laws. And finally, the US complains that the Body doesn't stick to its 90-day deadline for handling disputes.

To pressure the WTO and its members, the US is blocking the appointment of new Appellate Body judges. If the US keeps doing this, there won't be enough 'judges' to settle disputes by the end of next year. Also, the US has said that it could veto appeal rulings by the Appellate Body if they exceed the 90-day deadline. Although other WTO members are unlikely to accept this interpretation, the US could seriously challenge the authority of the institution by flaunting the rules.

Can there be a solution?

- **Can developed countries agree?**

In October, Canada organised a summit on WTO reform without the US and China. Both the EU and Canada presented discussion papers that outlined their positions and discussed the lack of a clear definition of 'developing countries', the need to strengthen rules against the lack of transparency and market distorting policies. The EU paper also addressed the issue of forced technology transfers. It's worth adding that these discussion papers are more or less in line with an earlier joint statement by the US, EU, and Japan.

Although advanced economies seem to be on the same page, differences remain. While many of the concerns are around stronger WTO rules and tools to discipline countries, the White House administration opposes giving the WTO more sovereignty. In July, a leaked draft bill by the Trump administration called the Fair, and Reciprocal Tariff Act (FART) said it would allow President Trump to abandon key WTO principles including the most-favoured-nation (MFN) and bound tariff rule. Although this piece of legislation is probably not even likely to make it to Congress, it fundamentally shows the conflicting stance of the US.

Although many exceptions in WTO rules allow member countries to impose tariffs or quantitative restrictions, developed member states haven't tried to exploit these loopholes, like the US currently does.

- **The position of developing countries and China**

Since new WTO rules will need to pass by full consensus vote, it will be challenging to pass any reforms that restrict the rights of developing countries. In earlier rounds of negotiations, developing countries, including India and China have vetoed rules that narrow the requirements for 'developing economy' status. Last week, the deputy minister of commerce of China said they would oppose any deal that stripped away China's status as a developing economy or included rules specifically addressing state-owned enterprises. He also said the WTO reforms should address agricultural subsidies by developed countries and China's status as a non-market economy.

- **No all-encompassing deal in Buenos Aires**

A large portion of the demands made by Canada, the EU, Japan, and the US are directed at restricting the rights of developing countries. But the problem is that developed countries don't

have much to give in return to developing countries, which makes a big overhaul very unlikely anytime soon, but there may be possibilities in the long-run.

Developing countries may play tough, but on the other hand, the WTO is very important to the development of these countries. Chinese trade has increased by more than threefolds since it joined WTO.

If no deal is reached, the US may leave the WTO but it's worth remembering that the WTO rules will still be embedded in US regulation, which means President Trump needs a majority in Congress to repeal that legislation

However, countries may be willing to give in to some of the US demands to make the US stop vetoing the appointment of new judges and lower the risk that the US Administration tries to withdraw from the WTO. This requires that the US concerns about the dispute settlement system are resolved at the very least. This involves narrowing the jurisdiction of the Appellate Body and new guidelines on how it should appoint (new) members.

This week, the EU and 11 other countries proposed reforms to address these concerns. The reforms aim to clarify and narrow the Appellate Body's mandate and increase the number of judges from seven part-time members to nine full-time members to speed up its capacity. However, the US has already rejected the EU's proposal in its concept phase and expressed scepticism about granting more resources.

What's next?

The EU's willingness to reach out to the US with the backing of 11 other WTO members gives hope of a deal. Negotiations on this issue have a chance of a positive outcome as it only touches on the US concerns with the dispute settlement system. Undoubtedly, these proposals will be discussed at the G20 meeting to try and secure support among other members.

At the WTO general council meeting on 12 December, the reforms could be brought for a vote. However, more time might be needed to get the White House administration on board. If an agreement can be reached in the coming months, the immediate threat to WTO's existence may just be avoided, but we can't really see any solution for the rest of WTO's problems.

If the US keeps on blocking the (re)appointment of judges, then, countries that don't agree with dispute rulings are (more) likely to ignore findings by the dispute settlement system instead of filing an appeal

If no deal is reached, the US may leave the WTO; however, WTO rules will still be embedded in US

regulation, which means the President needs a majority in Congress to repeal that legislation. After withdrawal, the remaining WTO members will no longer be obliged to grant the US benefits of a WTO member.

If the US keeps on blocking the (re)appointment of judges, then, countries that don't agree with dispute rulings are (more) likely to ignore findings by the dispute settlement system instead of filing an appeal. This could provoke bilateral trade wars and harms WTO law and would contribute to a new normal where non-compliance with WTO rules and rulings becomes the norm rather than the exception implying serious damage to the world's trade system as well.

Bottom line

Due to the split between WTO members and the habit of taking unanimous decisions, we think there is little chance of a big overhaul reform that addresses all of the objections.

But, it might be possible to strike a deal on the issue of the dispute settlement mechanism, thereby, averting the acute danger of the WTO falling apart. This week the EU and 11 other countries reached out to the US proposing reforms. Although the US rejected the idea of these specific reforms in the concept phase, they may be a good starting point at the negotiation table.

Having said this, the question remains whether or not the US will push it too far. The White House administration's current stance towards trade and the WTO may be unhelpful if compromises are needed. Despite this, other countries may be willing to give in to keep the WTO alive.

Author

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com