

G20: The WTO's future is at stake

The trade conflict between the US and China is unlikely to be resolved at this weekend's G20 summit. That's not just bad news for world trade and the global economy, it's bad for the World Trade Organization, whose future is now at risk



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It must have been a relief to Roberto Azevedo, Director General of the World Trade Organisation (WTO), when President Trump struck a dovish tone on China after talking to his Chinese counterpart, President Xi, on the phone earlier this month.

After months of tough talk and no sign of resolution to the trade conflict, Trump charmed Xi- and the markets- by saying that trade talks were "moving on nicely".

A de-escalation of the US-China trade war is what Azevedo badly needs at this weekend's G20 summit, where he already faces the difficult task of reconciling numerous proposals to reform the WTO. A further escalation of the trade war between the two largest trading nations could put the authority of his organisation at risk. Why?

Trump has criticised the WTO in his campaign to negotiate better terms of trade with the countries that run a surplus with the US. The President doesn't want to be impeded by a body that advocates multilateral, rather than bilateral, agreements. The WTO also takes action against protectionist measures, such as the tariff increases that are outside the rules of the WTO.

At times, Trump has threatened to leave the WTO if it doesn't reform. He wants the organisation to change its rules in such a way that it's easier for member states to take action against alleged unfair trade practises of other members (read: China).

Out of business

If the US-China trade war rages on, Trump will keep adding more trade restrictions on imports from China. This increases the chances of a standoff between the WTO and the US. The more trade-restrictive measures taken by the US, the more other WTO members are likely to complain. Given the questionable motives for these measures- such as 'national security' in the case of higher tariffs on steel and aluminium- cases against the US are likely to mount and the probability of the WTO ruling against the US will rise in tandem. This could mean the US administration decides to go it alone, potentially sending a bill to Congress to withdraw from the WTO or simply making the WTO ineffective in 2020 by continuing to block the appointment of new judges for the dispute settlement body.

It is hard to see how the WTO could function properly without the participation of the second largest trading nation in the world. After all, if the US decides to dispense with the rules, it becomes tempting for others to do so as well. The WTO could become a toothless tiger. Let's not forget that even within the current framework, WTO members have at times implemented significant trade-restrictive measures, with regular trade disputes as a consequence. This shows that the incentive to protect domestic industries is never far away in international trade.

If the role of the WTO as a global arbiter of trade is hollowed out by the withdrawal of the US or by a lack of sufficient judges to take decisions, the amount of trade-restrictive measures, which are already rising, could spiral out of control. So preventing a further escalation of the US-China conflict and thereby reducing the chance of a standoff between the WTO and the US, is of importance to preserve the WTO's authority. An escalation of the US-China trade war could trigger a dynamic that effectively puts the WTO out of business.

A positive surprise?

Although a positive surprise, like the deal that Trump struck with Jean-Claude Juncker last July, cannot be ruled out, Azevedo shouldn't count on it.

Trump is aware of the fact that in China, he is facing a much stronger opponent than in recent bilateral trade battles. The Chinese economy depends less on US demand for its products than, for example, Nafta countries. And if we take into account the fact that China is very important for the supply chains of American multinationals, it becomes clear that the trade war hurts both countries.

But the gap between what the US demands from the Chinese and what the Chinese are prepared to give seems too large for a deal to be agreed anytime soon. Trump wants China to adjust its structural plans to develop its economy and is also demanding that China cuts its bilateral trade surplus with the US in half by 2020. This would mean an extreme decline of \$190 billion within two years. Last spring, China offered to import \$70 billion. Even meeting each other half way (a reduction of \$130 billion) seems too far away from the current positions of both parties.

Moreover, the issue of China having to give up part of its economic development plans is an interference with domestic Chinese policy and therefore a 'no go' for the Chinese authorities.

Risky game

Trump is playing a risky game. If his strategy of strongarming trade partners with tariff hikes doesn't work with China, higher tariffs and other trade barriers will be around for an extended period of time. The mutual imposition of a 25% tariff on each other's imports would take 1% off the growth of world trade in 2019. We forecast that such a situation would contribute to 2019 being the worst year for trade since the trade collapse in 2009, with meagre growth of just 1.3%.

Both the Chinese and US economies would suffer GDP losses due to the negative effect on domestic demand from higher prices as well as less foreign demand for exports. Because China exports four times as much to the US as the other way around, China's economy would be hit harder, but the US won't walk away scot-free either. US companies could well become less competitive due to the higher prices they have to pay for Chinese goods that are used in the production process.

Cease Fire?

A temporary ceasefire, like the one that Trump struck with Juncker in July over the US-EU trade conflict, could be a way out. Surprises are always possible, but not very likely in this case. The harsh rhetoric towards China seems to be more than just a negotiating strategy. Trump's trade team is full of people who see China as the biggest danger to the future of the US trade advisor Peter Navarro, who is the author of the book 'Death by China', and US trade representative Robert Lighthizer, who has been accusing China of unfair trade practices for many years, have the President's ear while more moderate forces like Treasury Secretary Steve Mnuchin, have lost ground within the White House.

Since Lighthizer and Navarro have been calling for firm action against China for a long time, it's unlikely they will encourage Trump to take a large step back to make a compromise possible.

On Friday and during the weekend, the whole world will be watching the G20 meeting in Buenos Aires, but Azevedo will be one of the people most anxious to know the outcome of the meeting between Trump and Xi. The future of the WTO is at stake.