



PIIE PETERSON INSTITUTE FOR
INTERNATIONAL ECONOMICS

Trade Policy, Industrial Policy, and Economic Security: Why WTO reform is so difficult and increasingly needed!

Jeffrey J. Schott

Senior Fellow, Peterson Institute for International Economics

Presented at RIETI-CEPR symposium: The Future of the Global Trade Order and Economic Security

Tokyo

April 16, 2024

1750 Massachusetts Avenue, NW | Washington, DC 20036 | www.piie.com

Overview of the Presentation

- Trade/Industrial Policy/Security goals are interwoven in postwar GATT system.
- New and disruptive geopolitical and commercial conflicts over the past decade threaten to unravel rules-based trading system.
- Concerns about Economic Security increasingly compromise open trade and investment policies.
- Trade and industrial policy interventions have been revamped to meet commercial and security challenges.
- WTO initiatives have been ineffective, but progress could be made if the “Big 5” regional trading powers work together on a plurilateral package covering trade enforcement and climate provisions.

Postwar trading system designed to balance commercial and security interests

- Trade, industrial policy, and security interwoven in GATT system:
 - Designed to promote export-led growth;
 - Allowed subsidies/tariffs to support economic reconstruction;
 - Provided large-scale exemptions from trade obligations for developing countries.
- GATT/WTO rules impose limited constraints on industrial policy:
 - Domestic subsidies largely unfettered for agriculture and industry;
 - Limited coverage of government procurement;
 - Article XXIV on RTAs abets WTO-illegal discrimination;
 - Article XXI security exceptions unbounded and undisciplined.

Recent geopolitical/commercial conflicts threaten the multilateral trading system

- Hot and cold wars forced reassessment of critical security needs and more trade/investment interventions.
- Disabling of WTO Appellate Body and abuse of national security exemption allow big powers to skirt WTO obligations.
- Technological advances affecting production, demand for resources, data usage and cyber activities have created new interdependencies and security risks.
- Climate and global health crises complicated the production and distribution of goods and services, raising new national security concerns.

Economic Security now covers a broader range of government interventions

- Access to natural resources and industrial components;
- Access to finance and/or the denial or confiscation of official/private assets;
- Protection of intellectual property;
- Protection of data, privacy, and cyber security;
- Security of transport and distribution networks;
- Stockpiles of food, medicines, critical minerals, war materiel;
- Insurance against climatic events affecting farm and industrial production and power generation.

Trade/industrial policy interventions revamped to meet commercial and security challenges

- WTO rules often ignored in new competition for investment or to protect domestic employment from import competition.
- Increased use of subsidies, regulatory barriers, export controls, and new border restrictions for national security and labor/environmental reasons.
- Discriminatory investment incentives and local content requirements.
- Sharper focus on indigenous development of critical resources/products and strategic stockpiles of fuels and armaments.
- Growing resort to financial sanctions targeting rogue nations and abusers of human rights.

WTO initiatives have failed to address new challenges or curb new trade discrimination

- Track record of WTO negotiations has been very weak.
- Progress blocked by opposition of one or a few countries for both commercial and political reasons.
- Disabling Appellate Body allows countries to avoid WTO enforcement and discourages acceptance of new trade rules/obligations.
- WTO obligations evaded by increased resort to Article XXI security exemptions for self-proclaimed threats to economic and national security.

Plurilateral trade reforms could help update WTO provisions

- Regional trade agreements (RTAs) have promoted trade liberalization and new trading rules in areas like digital trade, environment, labor, investment.
- All the big trading nations participate in one or more RTAs... and major troublemakers in the WTO are absent from those deals.
- Plurilateral talks should draw on RTA outcomes to develop building blocks for WTO reforms; negotiations could start among select countries involved in the 5 major RTAs (USMCA, EU, CPTPP, RCEP, ASEAN).
- Key challenge will be to set a discrete agenda for the talks among countries that are key competitors and/or commercial adversaries.

Plurilateral talks need to improve enforcement and preclude large violations of WTO rules

- US-China-EU are essential participants in major trade reforms and should be joined by leaders of CPTPP (Japan) and ASEAN (Indonesia).
- New agreements possible among adversaries if each gains from cooperation, though mistrust between US and China is large and growing.
- Agenda should focus on dispute settlement reform and the most urgent area for new rulemaking, trade and climate, to govern the use of prospective new carbon border adjustment measures (CBAMs).
- The 5 countries recommended to participate in the plurilateral are the largest economies in their respective RTAs, large carbon-emitters, and large users of WTO dispute settlement.

The Big 5 are big economies, emitters, and users of WTO dispute settlement

Table 1: Comparing 2022 GDP, 2022 carbon emissions, and WTO dispute petitions since 1995

	2022 GDP (in billions USD)	2022 CO2 emissions (in millions ton)	WTO dispute petitions (since 1995)
US	25439.7	5057.3	124
China	17963.2	11396.8	24
EU	16746.5	2761.9	110
Japan	4256.4	1053.8	28
Indonesia	1319.1	728.9	15

Source: World Bank, Our World In Data, WTO

An initial Big 5 agenda to deal with key trade and security issues

- Start with important but limited objectives to rebuild trust among major trading nations: fixing the holes in WTO dispute settlement and enforcement; and preempting trade disputes over green subsidies and border measures.
- On dispute settlement, the key task is to (1) revive the Appellate Body and/or allow WTO panel rulings to be finalized without further review; and (2) encourage the responsible use of national security exemptions under Article XXI.
- On climate, develop agreed accounting standards for crediting carbon-mitigation tax and regulatory policies; green box subsidies for R&D in renewables; reduced emissions in steelmaking; accelerated reductions in methane emissions.
- Agree to a 2-year moratorium on CBAMs to prevent/delay new US and EU restrictions that could undercut the Big 5 negotiations.



PIIE PETERSON INSTITUTE FOR
INTERNATIONAL ECONOMICS

Trade Policy, Industrial Policy, and Economic Security:

Why WTO reform is so difficult and increasingly needed!

Jeffrey J. Schott

jschott@piie.com

1750 Massachusetts Avenue, NW | Washington, DC 20036 | www.piie.com