Collaboration Between FTAs & the WTO for the Development of Global Value Chains

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Global Value Chains & International Trade Rules

There has been growing debate on global value chains (GVCs) and international trade rules as a foundation for their development. The facilitation of value chain development is of vital importance for companies seeking to expand their business activities across national borders. In reality, however, multinational companies often find their business activities subject to various institutional and regulatory constraints imposed by national governments. Although some regulatory rules are applied uniformly to all companies regardless of their nationality, many national laws and regulations favor domestic companies over foreign ones.

How can we create a favorable economic environment for business? Needless to say, companies need to make their own respective efforts. At the same time, however, government-to-government negotiations are also important as a means to bring about institutional reform in other countries. In terms of intergovernmental rulemaking efforts, such negotiations can take place under bilateral, plurilateral, and multilateral (or global) frameworks.

The environment in which value chains operate is extremely multidimensional, and thus creating rules governing value chains involves all sorts of trade-related factors. When we focus on the transfer of production factors across national borders, value chains involve the transfer of goods, labor, money, technology, and so forth. It is necessary therefore to consider rules concerning the transfer of various factors, such as export and import control, import tariffs, immigration controls, investment rules, and intellectual property protection. In order to facilitate the expansion of overseas business activities, it is extremely important to identify and address constraints in value chains from the viewpoint of businesses. Furthermore, in order to accommodate properly the growing complexity and expansion of value chains, it is becoming increasingly important to improve the overall domestic business environment, going beyond border measures such as tariff reductions and elimination. Addressing regulatory issues concerning behind-the-border measures — such as technical barriers to trade (TBTs) and problems in domestic laws and regulations on competition and trade in services — is becoming vitally important.

In the light of this perspective, a holistic approach is needed to address the problems in GVCs as pointed out in the World Economic Forum's (WEF) Enabling Trade Report 2013.

WTO & Value Chains

The General Agreement on Tariffs and Trade (GATT) has been a global forum for rulemaking on those regulations and constraints. Since its establishment in 1947, GATT has set out the basic principles of trade rules. Rounds of comprehensive negotiations under the GATT framework resulted in more than just reductions in import tariffs, and have led to the creation of rules for border measures such as antidumping measures and import licenses and promoted the development of cross-border rules for TBTs, subsidies, and so forth.

In particular, the Uruguay Round, which was concluded in 1994, resulted in the formation of the World Trade Organization (WTO) as well as the establishment of the General Agreement on Trade in Services (GATS) and the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) that govern intellectual property protection, altogether marking a significant enhancement of the rules for behind-the-border measures. It is noteworthy that the Uruguay Round also resulted in the Agreement on Safeguards, the prohibition of unilateral retaliatory measures, and the creation of a very powerful dispute settlement mechanism that provides a binding resolution.

Efficiency of the WTO

Given the multidimensional nature of trade rules for value chains, the WTO should not be considered as the sole forum for rulemaking. Indeed, GATT/WTO has developed together with other international organizations through collaboration and competition, for instance, with the World Customs Organization (WCO) in the area of tariff classification and customs clearance procedures, with the International Organization for Standardization (ISO) and the International Telecommunication Union (ITU) in setting international standards, and with the World Intellectual Property Organization (WIPO) in making rules for intellectual property protection. However, in the area of trade, there is a significant advantage to supporting and utilizing the WTO, which, unlike other international organizations, has the capacity to play the principal role because of the following characteristics.

The first characteristic is the universality of its membership. With nearly 160 members, the WTO covers almost all major economies in the world. Thus, rules established by the WTO are truly global in nature.

Second, the presence of a mechanism for binding dispute settlement established under the WTO ensures the enforcement of rules. This is a characteristic that no other international organization

offers. Although the legislative functions of the WTO are seriously paralyzed, its judicial functions are working properly and effectively.

The third characteristic is the comprehensiveness of the WTO rules. Having evolved through rounds of negotiations, the WTO rules cover not only border measures but also a significant part of behind-the-border measures, though not to the fullest extent. It is an extremely welcome development that trade facilitation was included, for the first time, as part of a multilateral agreement at the WTO Ministerial Conference held in December 2013 in Bali, Indonesia.

Considering those characteristics, it is rational to support the WTO as an organization underpinning global trade rules and promote rulemaking with the WTO as its center. However, as discussed in the subsequent section, the WTO is facing enormous challenges.

Stagnation of the Doha Round

While the WTO was established in 1995, the Doha Round — the very first round of negotiations under its auspices — was heavy going and launched only in 2001. Subsequent developments are no less discouraging as the Doha Round became quickly bogged down and remains adrift.

In a nutshell, the Doha Round has two problems: slowness and narrowness.

The Doha Round, which remains directionless after more than 20 years since the effective conclusion of the Uruguay Round, is ill-fitted to the reality of rapidly changing supply chains and the business community in general. This slowness is the largest defect of the Doha Round and the WTO.

Narrowness is another serious problem. This is symbolized by the fact that three of the so-called Singapore issues — transparency in government procurement, investment, and competition — were completely dropped from the Doha Round agenda at the WTO Ministerial Conference held in Cancun, Mexico in 2003. Indeed, the scope of issues negotiated at the WTO is far too small compared to that of trade rules which the business community would like to see implemented so as to accommodate the operation and further expansion of their value chains.

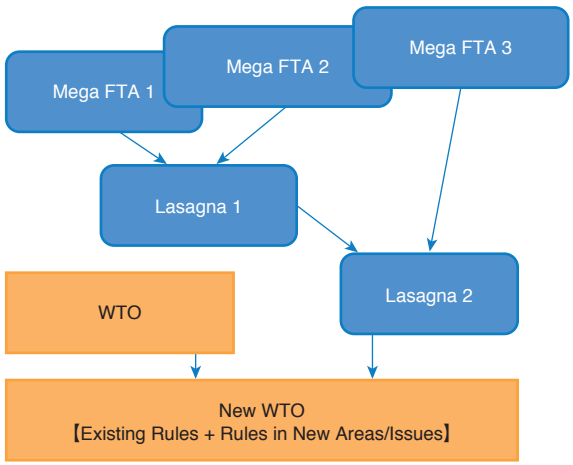
While it is a welcome accomplishment that WTO ministers clinched an agreement on trade facilitation at their meeting in Bali last year, the WTO and its Doha Round are far too slow and the scope of negotiations is far too narrow. There are various reasons, but rigidity in the WTO decision-making procedure, which is characterized by the uniform treatment of diverse members and based on the principle of consensus, and the WTO's nature as a forum for inter-governmental negotiations are the biggest factors.

Rise of Mega FTAs & Euphoric Scenario

Against this backdrop, the governments and business communities of many member economies are rapidly shifting their focus from the WTO to free trade agreements (FTAs) that allow for greater flexibility in the scope of issues to be dealt with and easier decision-making. Recent years have seen acceleration in the move toward concluding

CHART 1

Euphoric scenario



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mega FTAs such as the Trans-Pacific Partnership (TPP), the Regional Comprehensive Economic Partnership (RCEP), and the Transatlantic Trade and Investment Partnership (TTIP).

Subject to the provisions of GATT Article XXIV and GATS Article 5, participants in FTAs can push for liberalization and make trade and other rules. The effect of any accomplishments made under an FTA is confined to those countries that are party to the FTA. Even mega FTAs do not directly provide global solutions or rules for GVCs. The direct goal of mega FTAs is to provide regional solutions applicable to and within the respective geographic areas covered.

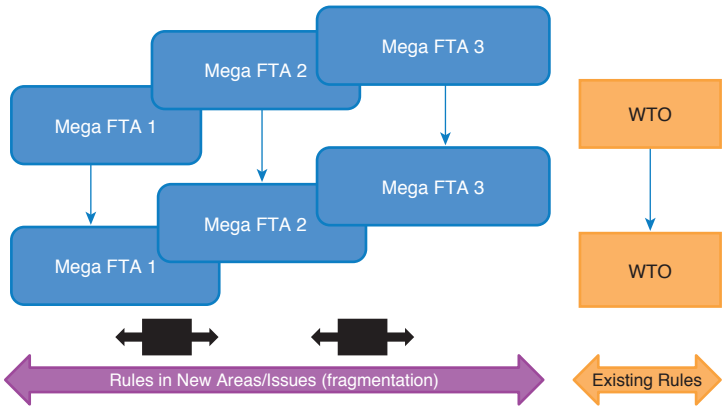
It is thus highly likely that emerging mega FTAs will culminate in multiple, mutually-conflicting sets of trade rules, and we should anticipate the possibility of those mega FTAs creating a "spaghetti bowl" of trade rules. A spaghetti bowl of rules of origin could possibly be tolerated, but a spaghetti bowl of trade rules would not. Indeed, in concluding FTAs with the European Union and the United States, South Korea has accepted different definitions of international standards in the areas of electrical products, electronics, and automobiles. As major economic powers contest for hegemony across mega FTAs, profound cases of the spaghetti bowl phenomenon may arise down the road, for instance, in the areas of competition (particularly regarding the treatment of state-owned enterprises), intellectual property protection, and cross-border data transfer (with respect to localization requirements and privacy protection).

FTAs — and mega FTAs in particular — are counted on to serve as a driving force, at least for some time to come, in promoting liberalization and rulemaking in the area of trade. At the same time, we should clearly recognize the limitations of FTAs.

The view that considers mega FTAs as the leading player in making trade rules is inferred to be based on the following premises:

1) Mega FTAs will be concluded before long.
2) There will be no or only a modest spaghetti bowl of rules.
3) Entangling rules can and will be harmonized.
4) Harmonization will not take much time.
5) Rules resulting from harmonization will serve as the basis for

CHART 2
Spaghetti bowl in rules



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rulemaking at the WTO.

6) Differences in rules applicable inside and outside of mega FTAs (members versus non-members) will not pose any major problems.

However, a critical examination of those premises suggest as follows:

Regarding premise 1), given the level of ambition and the diversity of countries involved, it is generally reasonable to assume that it takes quite some time to conclude a mega FTA.

Regarding premises 2) through 4), the harmonization of rules across mega FTAs, which tends to involve adjusting differences in economic systems, is prone to hitting a wall. As exemplified by the case of South Korea applying different definitions of international standards, it seems unavoidable that the emergence of mega FTAs will result in conflicting rules in various areas of trade in the coming years.

There is no guarantee that harmonization can be completed in a short period of time as stated in premise 4), and if no harmonization takes place, premise 5) fails, and there will be no basis for rulemaking at the WTO.

As to premise 6), differences in rules applicable inside and outside mega FTAs could pose a major problem as value chains are changing constantly in all aspects — i.e. procurement, production, and distribution — and in terms of countries concerned. (In this regard, "Trade Patterns and Global Value Chains in East Asia: From Trade in Goods to Trade in Tasks," a joint publication released in 2011 by the Institute of Developing Economies, Japan External Trade Organization (IDE-JETRO) and the WTO, pointed to the radical transformation of value chains in the Asia-Pacific region over the years in their shape and structure.)

Given the above observations, it is unlikely that rules negotiated and created in mega FTAs will automatically evolve into global trade rules in the future.

Era of Mega FTAs & GVCs: Prescription

So, what viewpoints and approaches are needed to enable mega FTAs to become the foundation for GVCs and the trade system?

First, we need to have a clear vision of the future trade system that we intend to build and design a global solution — not a regional solution. What the business community is looking for is not a regional solution by means of FTAs but a global solution. Inevitably, this requires a strategy developed with an eye on the future landscape of WTO rules. Governments and business communities around the world should negotiate mega FTAs from a global rulemaking perspective and from the viewpoint of creating future WTO rules.

Countries advocating mega FTAs should not try to impose their rules on other countries in a bid to contend for hegemony. We need to find a global solution. Seen in this light, major economies need to seek to achieve "norm attracting" — instead of "norm setting" — mega FTAs, as pointed out by Professor Patrick Messerlin regarding the TTIP.

Second, ensuring transparency, disclosure, and information sharing is critically important. Today, there is a compelling need to promote the multilateralization of FTAs and the localization of WTO rules. Transparency and the distribution of accurate information are what constitute the foundation of this endeavor. The formation of mega FTAs should involve adequate coordination with non-party stakeholders, relevant international organizations, and so forth. As mega FTAs are increasingly inclined to embrace elements that would significantly affect behind-the-border measures and domestic regulatory systems, ensuring appropriate dialogue with citizens and local communities is becoming all the more important.

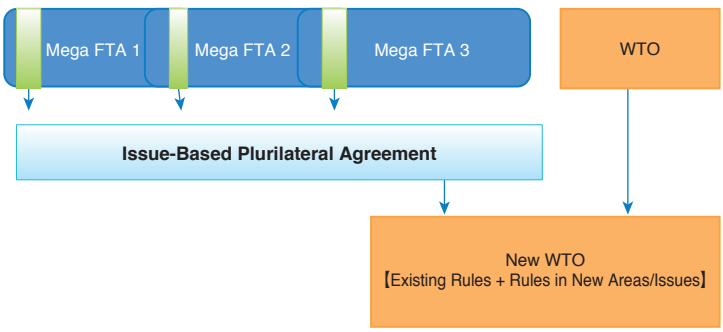
Third, the concept of GVCs and the viewpoint of the business community must be taken fully into consideration. The necessity of GVCs is now becoming a common view of business communities across the world. In creating a mega FTA, the governments of participating countries should not only collaborate closely among themselves but also accelerate government-business and business-business collaboration across national borders with the aim of facilitating the expansion and operation of GVCs. It is necessary to make every effort to prevent mega FTAs from becoming a process aimed at facilitating value chains at a regional level. We must change the process through which mega FTAs are formed, from one in which business communities accept a mega FTA as an outcome of negotiations between their governments to one in which the governments and business communities work together to create a mega FTA.

Fourth, we should embrace the concept of issue-based international rulemaking. Mega FTAs are, in substance, an aggregation of issue-based agreements such as those on investment, services, and trade facilitation. Then the next natural step is to have what has been discussed for mega FTAs multilateralized into global rules on an issue-by-issue basis by analyzing accomplishments in each area. In that context, utilizing the existing frameworks of issue-based plurilateral agreements is quite important.

Plurilateral frameworks that have been proven successful include

CHART 3

Utilization of issue-based plurilateral agreements (e.g. ISCA)



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the Information Technology Agreement (ITA), the Basic Telecommunication Services Agreement, and the Financial Services Agreement. It is quite possible and necessary to turn what has been discussed for mega FTAs into global rules, building on issue-by-issue and/or sector-by-sector initiatives by a cohort of interested countries.

In parallel with their efforts toward concluding mega FTAs, governments and business communities should also work together and seek to achieve plurilateral agreements on a single or multiple priority issues. This is an endeavor that is not only effective as a way to prevent a spaghetti bowl of different rules resulting from mega FTAs, but also quite meaningful from the viewpoint of promoting GVCs and global rulemaking ("Global value chain governance in the era of mega FTAs and a proposal of an international supply-chain agreement" by Michitaka Nakatomi, www.voxeu.org, Aug. 15, 2013).

The importance of such an issue-based approach was emphasized by Keidanren (Japan Business Federation). Its 2013 report entitled "Proposals for Redefining of Trade Strategy: Towards a Proactive New Trade Strategy that Takes the Initiative to Establish Global Rules" called for establishing a common approach as a "unified axis" on a sector-by-sector basis.

I am advocating the need to pursue an International Supply Chain Agreement, an initiative to negotiate a set of issues relating to value chains at the same time. Readers are advised to refer to my proposal as an option for promoting the development of GVCs ("Concept Paper for an International Supply Chain Agreement (ISCA)" by Michitaka Nakatomi, RIETI, 2012).

Fifth, GVCs require a holistic approach. Problems with the WTO and the Doha Round stem from failure to incorporate the viewpoints of the business community. Trade issues have been seen solely from the viewpoints of governments, and little, if any, effort was made to analyze the actual state of supply chains and consider what rules are needed from the viewpoints of the business community. While this deficiency is addressed to some extent with mega FTAs, it remains crucially important to review trade rules thoroughly to create a favorable environment for business activities and facilitate supply chain operations. Emphasizing this point, the WEF's Enabling Trade Report 2013 calls on governments around the world to "think supply chain". It is indeed about time to reexamine and rebuild trade rules from the viewpoint of facilitating value chain operations.

Importance of WTO Reform

As has been discussed above, mega FTAs will likely play the leading role in liberalization and trade rulemaking for some time to come. However, taking an excessively optimistic view of mega FTAs is dangerous, and it is necessary to understand their limitations and defects. Each country must bear in mind the notion of creating global trade rules for the future. And toward achieving this end, all countries are counted on to make the best use of the WTO (multilateral), FTAs (bilateral), and plurilateral agreements by fully understanding their respective characteristics as tools for trade rulemaking. We must not stop thinking.

At the WTO Ministerial Conference in Bali, it was decided that a work program on the remaining issues be considered and prepared within the next 12 months. It is hoped that substantive discussions on the reform of the WTO will take place in the course of this process. More specifically, it is necessary to address the key underlying problems that have long hampered progress in WTO rulemaking and the Doha Round thereby prompting a global race for FTAs, such as problems with the current decision-making mechanism and the rigidity in the rules governing the conclusion of plurilateral agreements (based on the principle of consensus). Difficult issues, such as the definition of a "developing country", must not be avoided. Furthermore, in order to ensure that the voices of the business community reach the WTO, we should consider establishing an advisory panel of business leaders, similar to the APEC Business Advisory Council (ABAC) for the Asia-Pacific Economic Cooperation (APEC) forum.

As countries around the world strive to build a new trade regime, it is strongly hoped that they will support the existing WTO regime and transform it into one that can function properly and accommodate the needs of the new era and emerging GVCs, instead of relying solely on mega FTAs. And now is the time to take collaborative actions toward achieving that end. Otherwise, the WTO is doomed to an eternal decline. We must foresee what would happen if that becomes reality. We would be living in an increasingly polarized world characterized by the overwhelming presence of mega FTAs. Such a world would not necessarily be desirable for governments and business communities concerned. It is strongly hoped that a full-blown discussion will be launched on the future course of the WTO based on an accurate understanding of the actual state of cross-border business activities and GVCs and involving not only governments but also business communities in their respective countries.

Constructive competition between mega FTAs and the WTO is the basis for creating desirable GVCs. JS

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