

# The Future of the World Trading System

Uri Dadush

Senior Fellow, Policy Center for the New South and  
Non-Resident Scholar, Bruegel

RIETI BBL Seminar  
Tokyo, January 2019

# Purpose

- To describe the present crisis in world trade and to identify its causes.
- To explore good and bad scenarios for the next 10-20 years
- To suggest how countries should respond

# Sources

This presentation is based partly on my distributed paper “The Future of the World Trading System” Atlantic Dialogues, December 2018

It draws partly on my forthcoming RIETI Policy Brief “The Crisis in World Trade” with Professor Kimura et al.

...and on my recent writings on trade which contain the relevant bibliographic references and can be found on the sites of the Policy Center of the New South and of Bruegel <http://www.ocppc.ma/experts/dadush> and <http://bruegel.org/author/uri-dadush/>

All views in this presentation are my own and only my own.

# Key Messages

1. The Trading System has been remarkably successful but is now under unprecedented attack
2. The causes of the present crisis run deep and will not be quickly resolved
3. Globalization will not stop even if the trading system is in crisis
4. The future of the trading system depends on the answer to three questions – what happens in the WTO? In the US? In China?
5. Policy-makers must develop a plan for the good scenario, Plan A, but also prepare for the bad scenario where the WTO is no longer fully (or even partly) functional, Plan B.

# World Trade Is Governed by an Overarching System of Laws, Norms and Agreements which extend well beyond the WTO

- The WTO
- Preferential Agreements
- Domestic Institutions

# This System Has Been Remarkably Successful

- Globalization Indicators, well known
- MFN applied tariffs have been cut to a fraction and Effectively applied tariffs even more so
- WTO and PTA rules govern many aspects of trade
- Developing countries have evolved from import substitution to export-orientation
- Investments by the private and public sector have been undertaken on the implicit assumption that the system will continue.

# But the Trading System is Now in Crisis

It is under unprecedented attack, on three fronts

- . Widespread questioning of the WTO's worth in negotiations
- . United States' unilateral actions and challenge of the WTO DSU
- . Trade Conflict between China and the United States (and others)

# The Crisis in World Trade is Quite Recent but its Causes Run Deep

- 1. Inequality and disruption
- 2. Macroeconomic crisis, terrorism, etc.
- 3. Global Imbalances
- 4. The Rise of China
- 5. Limits of Multilateralism

*...these problems are not new and they are not easily resolved*



# Economic Theory Teaches that Protectionism is not the right answer

- The Community gains from trade but some lose
- The gains must be shared for all to gain
- Sharing the gains requires ....
  1. ex ante policies that boost productivity (education, health-care, mobility, infrastructure and competitiveness)
  2. ex post policies that share the gains (progressive tax structure, targeted transfers, etc.)

...but the politics of redistribution is thorny...

# The Future of the System Hinges on the Answer to Three Hard Questions

1. Can the WTO's Dispute Settlement be Reinvigorated?

2. Are the Trump Administration's trade policies an aberration, or the start of a new trend of US isolationism and withdrawal?

3. Does and will China fit in the WTO?

# Reinvigorating WTO negotiations?

Good Scenario : WTO members drop single undertaking/consensus approach and adopt plurilaterals which may be restricted to participants (not MFN) but require assent of all members or they can be MFN among a critical mass of members. They then move forward selectively on specific issues – e.g. services and on disciplines governing SOEs.

Bad Scenario: Even if DSU remains, inability to move forward on key issues renders the organization less relevant and eventually key players find that the cost of membership (i.e. limits on what can be negotiated and with whom) outweigh the benefits (MFN treatment, etc.).

# United States Isolationism?

Good Scenario: The US body politic is not supportive of power-based, unpredictable trade relations. Business, Consumers and the National Security establishment do not favor this approach. The next administration takes a softer line. However, even in this scenario, tensions with China remain as does dissatisfaction with the WTO, especially on the front of negotiations.

Bad Scenario: The US reverts to the protectionism and isolationism of the 19<sup>th</sup> and early 20<sup>th</sup> century. Countries need to cope with a WTO without the US. That also means dealing with the US on the basis of power and/or on the basis of bilateral agreements on less favorable terms than in the past. All aspects of international relations (global public goods, etc.) become more complicated.

# Chinese Exceptionalism?

Good Scenario : China benefits greatly from the WTO and continues to support it. China lowers tariffs and agrees to downplay its developing country status. China strengthens IPR disciplines and is more rigorous and transparent in its governance of SOEs so they do not distort trade. It is transparent in its plans to support private sector firms active in the industries of the future and agrees to avoid trade distortions. Even in the best case, these reforms will take time and continuous effort to implement.

Bad Scenario: China turns inwards and hostile. Countries are forced to choose between economic ties with China and those with its critics. All aspects of international relations (global public goods, etc.) become more complicated.

There are no definitive answers, but we need to think about the implications of good and bad scenarios

What's for sure is that this is not business as usual

# How should Major Players (e.g. The EU, Japan) react? Start with Three Important Assumptions for the next decade or two ....

- 1. Globalization may become disorderly but it will not stop even if the trading system is in trouble. No economy, however big, can isolate itself without incurring big costs.
- 2. The United States will remain the pre-eminent world power even if it continues to withdraw and its influence gradually erodes
- 3. The Chinese system based on state capitalism will continue and China will rapidly rise in importance as a trading partner and global player

# Plan A: assume the good scenarios and work to make them happen

- Accelerate bilateral agreements and competitiveness reforms
- Share the gains domestically to buttress consensus in favor of trade
- Push for Plurilateral approaches to critical issues in the WTO
- Undertake Reform of DSU that improve it for all parties
- Use DSU to deter unilateral actions
- Reduce large current account surpluses
- Encourage China to “share the burden” without alienating them – best done in a multilateral setting when possible
- Encourage the US to work within the system



# Plan B: in case one or more of the bad scenarios materialize, prepare for a different kind of mixed power- and rules-based system

- If the WTO's negotiating arm is not revitalized, the WTO could falter even if the US tries to remain in the fold. For some players, the cost of the WTO becomes greater than its benefits. World trade relations tend to become power-based, to the detriment of all, especially smaller players.
- To minimize disruption, countries will accelerate and broaden their set of bilateral agreements and many will seek trade agreements with China, the US and the EU. That will often require a redrawing of their red lines and acceptance of less favorable terms.
- If negotiating a trade agreement with one or more of the big blocks is not possible, then countries may reach a "status quo" deal, i.e. trade based on preceding WTO conditions.
- Each block may establish a dedicated dispute settlement system - arbitration or an international court. Such a system could afford more flexibility in how damages are awarded and in allowing partial trade deals.

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