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Seven Predictions About the World Without the WTO

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Summary

Imagining world trade without the WTO/GATT system. It was after all, the case through recorded history until around 1950. But today's economies are far more globally integrated than in the past, and information technologies which facilitate communication and coordination are clearly pointing to even more integration in the future. Under a no-WTO scenario, this brief formulates seven predictions.

The World Trade Organization is the essential institution underpinning the post-war liberal economic order, is under threat of extinction. The institution must be defended as if there were no alternative to it, but it is now necessary to think through the possibility that the WTO will sooner or later cease to exist as a functioning entity. To economists like me, and to most trade officials I know, contemplation of this possibility is beyond the pale; asking the question is a sure way to cut short a serious conversation. But world trade is the lifeline of the modern globalised economy and it would be irresponsible not to consider world trade without the WTO.

The danger to the WTO is clear and present, and it is on four fronts. First is the failure of the Doha Development Agenda and the inability of trade negotiators to move forward on the most important issues facing the institution's 164 members, including old issues such as agricultural subsidies and new issues such as digital trade. The second front is the Trump administration's decision to flout the WTO's rules, even as it pays lip service to the institution's importance and engages in legal hair-splitting to justify its unilateral actions (Dadush, 2018). A blatant example is the invocation of national security to tax steel and aluminium imports from its allies, and the threat to do the same on cars. The use of section 301 to retaliate broadly against perceived infractions by China is also clearly not in compliance with the WTO which requires that all retaliatory measures be sanctioned through its dispute settlement mechanism. Third, and most immediate is the United States' challenge to the legitimacy of that mechanism, exercised in direct

fashion by refusing to renew the mandate of members of its Appellate Body. Fourth, China – together with the EU, now the world's largest exporter – engages in various forms of obscure subsidisation and forced intellectual property transfer. But at least, unlike the present United States administration, China recognises that it is a major beneficiary of the multilateral rules-based trading system and officially supports it.

It is important to note that the damage that the recent US policies have already wrought on the WTO is immense. Indeed, veteran trade officials will say – though only in private – that the US has already left the WTO. Even if a future administration reverses course, the system of international trade laws the US has promoted will have lost credibility, perhaps irreversibly. The effects of trade uncertainty are not a distant possibility, they are already evident in the sharp downward revisions to the growth forecasts, especially in investment, in the manufacturing sector, and especially in Europe, which is the region most dependent on trade and which is affected not only by global trade tensions but also by the Brexit divisions. Trade uncertainties have become a major source of volatility in financial markets, whereas just a couple of years ago trade disputes were a non-issue on Wall Street.

Though there is much focus on the actions of the present US administrations, it should be very clear by now that the problems confronting the trading system run much deeper than one political cycle in a very important country. I would rank the causes of the present tensions in rough order of importance as follows: 1. Rising inequality – the uneven gains from trade and growth –made worse by the financial crisis, and its profound effect on domestic politics across the world, including most importantly the rise of national populism. Rising inequality owes more to skill-biased technological change than it does to trade (although the two are clearly linked) but it is much easier to attack machines than to attack workers. 2. The fading of the Soviet/Communist threat which kept the US vitally involved in the liberal democratic order it built post WW2. At the same time, hugely expensive and unsuccessful interventions in Afghanistan and Iraq have made the United States wary of foreign entanglements. 3. Economic migration pressures and large refugee flows have scared electorates and populists have capitalized on these fears. 4. The rise of China and of several other competitive low-wage economies with very different economic systems have disrupted many communities and called into question the appropriateness of WTO rules in governing disparate systems. 5. A major bone of contention is the ability of nations to "self-designate" as developing countries in the WTO, allowing them to receive special treatment, even though some of these countries are world powers or rich economies.

It is true that the WTO has to deal with a far more complex trade agenda than did the GATT, whose focus was mainly on tariffs in manufactures, and the WTO's membership is far larger and more disparate than that of the GATT. It is also true that the insistence to proceed only based on a single-undertaking consensus norm (everybody has to agree on everything before anything is agreed) has hobbled the institution. However, the structural changes that have occurred in the world economy over the last three decades are remarkable, as has the rebalancing of power across nations. These epochal shifts would almost certainly have led to the present trade tensions even if the WTO's institutional arrangements had been more flexible and in tune with the times.

The policy response thus must go far beyond WTO reforms. One implication, which is my main purpose here is to take the possibility of a WTO collapse seriously and to prepare for it. The other implications, which are sketched in a publication I co-authored recently in the context of a G20 task-force relate to the need to step up the fight against inequality (Akman et al. 2019). As important, the body politic in the US, China and many other WTO members need to carry out a profound reappraisal of their geopolitical and economic policies so as to find ways to deal cooperatively with the new configuration of world power. Hopefully the present China-US negotiations will mark a first step in that direction.

Now to the main task: imagining world trade without the WTO/GATT system – that is, world trade without an overarching set of rules. This scenario is today far from implausible. It was after all, the case through recorded history until around 1950. But today's economies are far more globally integrated than in the past, and information technologies which facilitate communication and coordination are clearly pointing to even more integration in the future. Under a no-WTO scenario, I am lead to formulate seven predictions.

First, the system will be based on a combination of power, bilateral deals, and (unenforceable) norms or practices from the days of the WTO. Without WTO disciplines, the balance of power within nations will shift from export interests to import-competing interests, probably entailing an escalation of protectionist measures across the world, adding to the recent problems (Global Trade Alert, 2019). To some degree this trend will be moderated by the fact that some 75% of world trade consists of raw materials (UNCTAD), parts and machinery which are needed for domestic and export production, but not in instances where import competing interests are powerful, as the case of steel producers in the United States has shown most recently.

Second, trade-related power – as distinguished from military power - will be equally distributed among three major actors, namely the US, the European Union, and China (dadush and Wolff, 2019). To contain the uncertainty, the major trade powers will almost certainly try to strike bilateral deals with each other, as is already happening (negotiations are ongoing between the United States, China, the EU and Japan, for example). But such deals will not have the high ambitions of, say, the now discarded Trans-Atlantic Trade and Investment Partnership which attempted to deal with regulatory and other non-tariff barriers to trade. Instead, they will be largely defensive; they will aim to preserve as much as possible of the rules and disciplines presently enshrined in the WTO, which mainly relate to tariffs in manufactures and agriculture, while recreating a bilateral mechanism for dispute settlement. However, in practice, striking even a minimal US-EU, US-China or EU-China trade deal may prove impossible. In that case, there will be a sequence of continuous and unmanageable disputes that will make the business and trade environment of even the largest players far less predictable than it is today. Because so much trade takes the form of inputs, such as machinery, the effects of this uncertainty will be felt far beyond the sectors which are directly open to international competition.

Third, faced with the choice of chaos or a trade deal, many smaller nations will be forced into vastly asymmetric deals with China, the EU and the US. The point is that smaller nations currently have a choice of reaching a trade deal or relying on WTO disciplines, which include Most Favored Nation Treatment, etc. When that alternative is no longer available, negotiations will become even more unbalanced in favour of the major trade powers.

Fourth, the trading system will naturally then tend to splinter into three blocks around the three giants. With the US, EU and China holding different interests, traditions and views about the trade rules and disciplines that are most important to them, the likelihood of developing a common set of obligations to govern e-commerce, intellectual property protection, industrial and agricultural subsidies, carbon taxes, and investment will be close to zero. Insofar as the blocks turn hostile to each other, smaller nations may be forced to choose between these blocks on account not only of economic but security considerations as well.

Fourth, the new non-system of bilateral deals and unilateral action, discrimination possibilities will be endless. There will be little to stop national security establishments from pressing to use trade policy against nations seen as a threat, and more lenient treatment of allies. Corporate interests will press for higher tariffs on nations most competitive in their sectors. Human rights and environmental activist will press for retaliation against nations they see, rightly or wrongly, as violators of their values. Bilateral deals will routinely include discrimination against third parties – examples of which can be seen in the more restrictive rules-of-origin, export restraints, managed trade, and geopolitically motivated exclusions sought most recently by US negotiators.

Fifth, nations that are currently part of established trade agreements will fare much better than nations that are not, assuming that the agreements hold in the face of a protectionist wave. For example, individual EU nations currently can count on a combination of the Single Market and numerous EU partnership agreements such as that with Japan to cover about 75% of their trade. Developing nations such as Chile, Mexico, and Morocco, will be more sheltered from a trade storm than nations such as Brazil and India. But while trade agreements will protect nations from the direct effects of protectionism, they will still be affected by second round effects. For example, Mexico's exports of auto parts to the United States will be penalized if the United States can no longer export BMWs manufactured in North Carolina to China.

Sixth, all sectors will be hit, but sectors such as autos and electronics which rely on global value chains will suffer disproportionately as will sectors such as soybeans and corn which rely heavily on export markets and which can easily become the object of retaliation. Utilities, such as electricity generation, and services such as finance and

health-care which are less affected by import competition and less dependent on exports will be less affected directly but will suffer indirectly as the purchasing power of consumers is squeezed by higher prices and the price of imported machinery and raw materials increases.

In short, world trade without the WTO would be a very bad outcome for the world economy as a whole, even if the effect will be disparate across countries and sectors. Things could get worse still when the business cycle deteriorates, leading to the seventh prediction. When the next international financial crisis hits = as it has infrequently but with distressing regularity over the centuries -- the trade picture is far more likely to resemble the protectionism and competitive currency devaluation of the 1930's than the restraint shown in 2008-2009. Undoubtedly, such a scenario would contribute to a downward spiral that may result in profound depression and mass unemployment.

The purpose of thinking about a world absent a multilateral trading system is not to promote such an outcome – on the contrary. It is to encourage all to prepare for the worst. What does that mean? For example, it means accelerating negotiation of bilateral trade agreements to "lock in" as much trade openness as possible. It means preparing contingency plans based on careful analysis of which sectors are most exposed. It means strengthening safety nets in preparation of workers becoming displaced because of a combination of tariffs on exports and tariffs on imported inputs. The contingency plans currently being developed for a no-deal Brexit can provide a model, although a very incomplete one since EU-UK trade is expected to revert to WTO rules, whereas in the scenario we envisage, there will be no WTO to revert to.

The main purpose here is to instil greater clarity in the mind of policymakers as to what happens if compromise fails. By thinking about the consequences of a world without the WTO, policy makers will achieve greater clarity about the steps necessary to prevent that outcome.

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