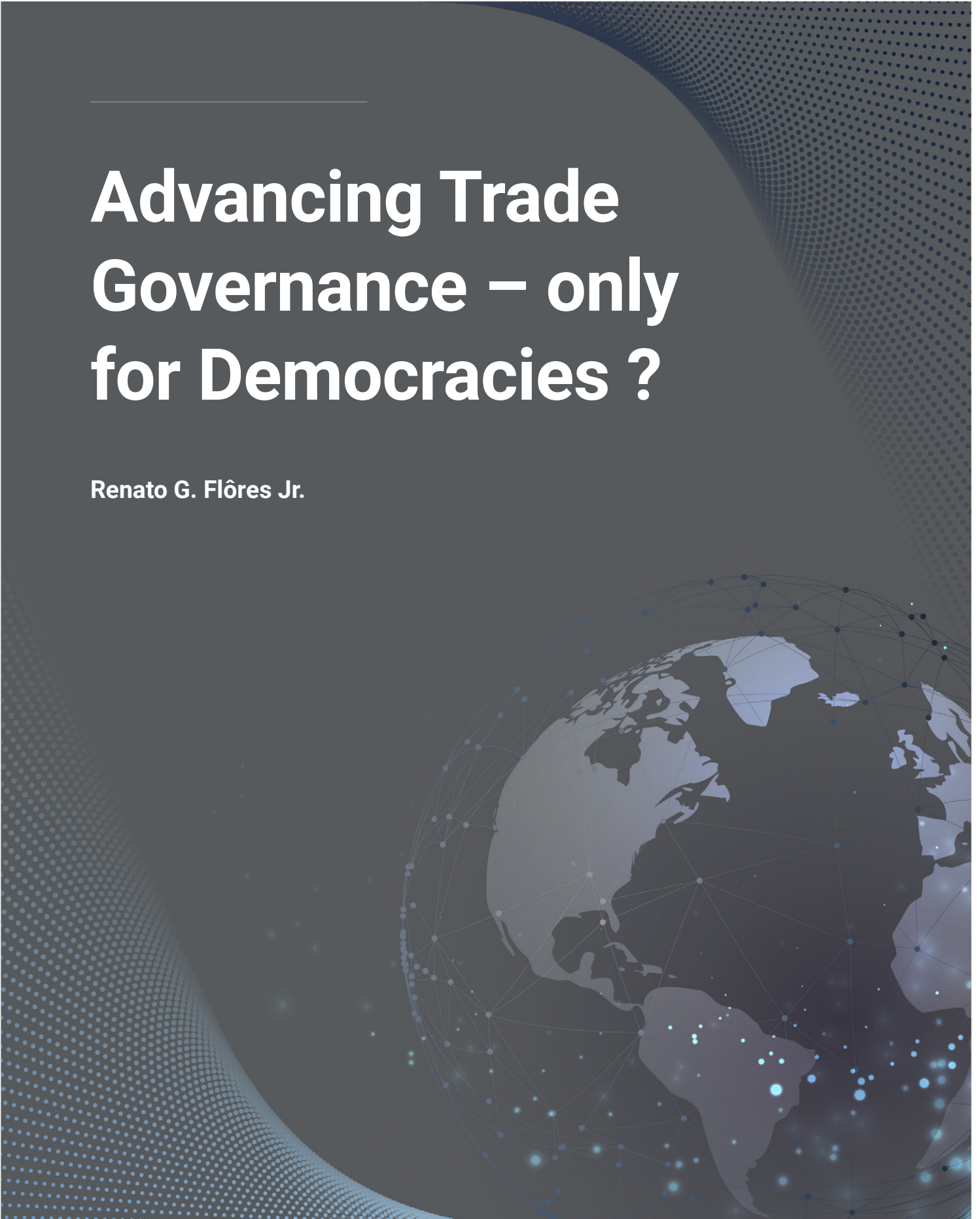


# Advancing Trade Governance – only for Democracies ?

Renato G. Flôres Jr.



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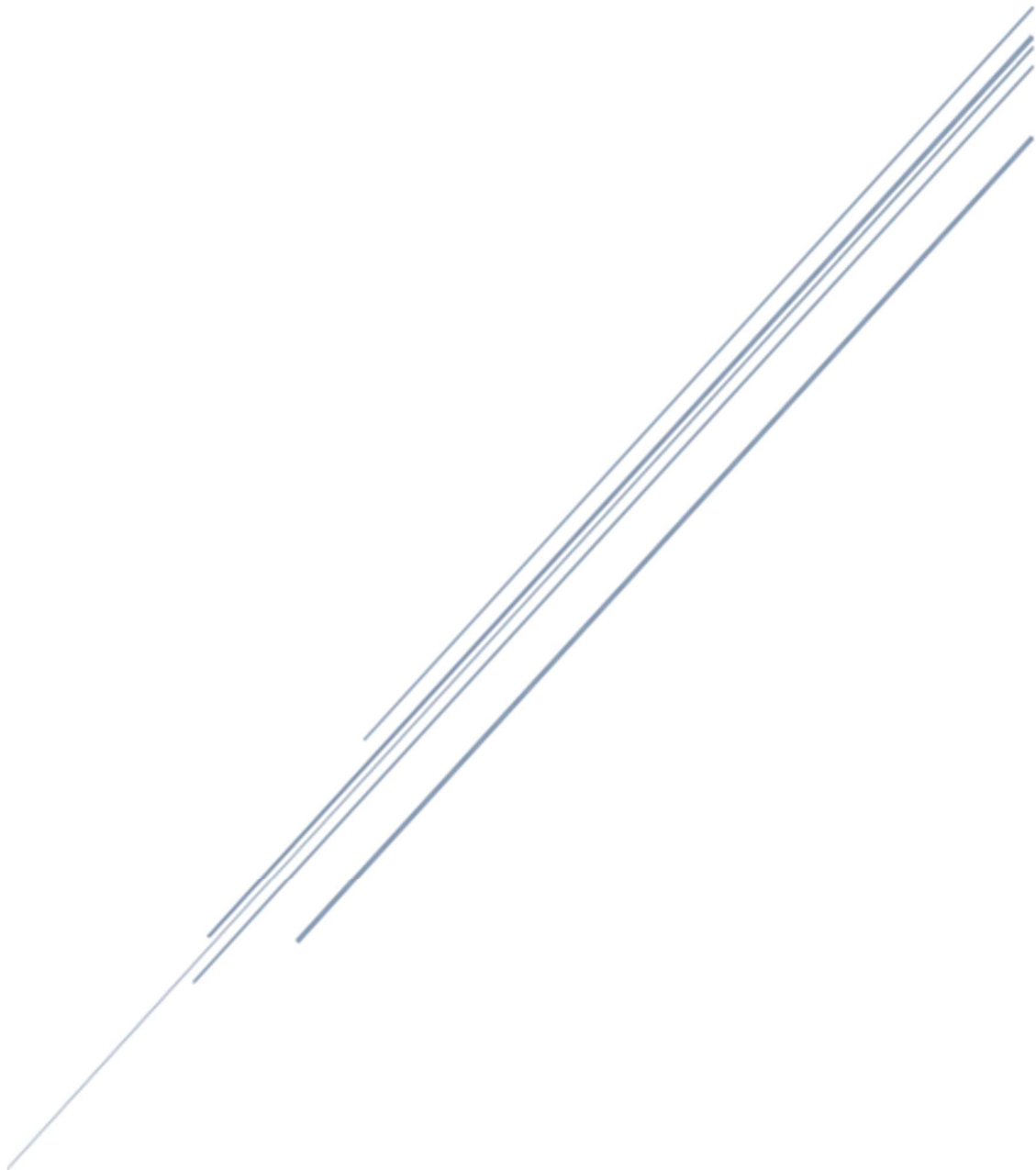
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## **Advancing Trade Governance – only for Democracies ?**

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**FGV IIU International Intelligence Unit**

Rio, April 25, 2022

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# Advancing Trade Governance – only for Democracies ? \*

## 1. Introduction.

Following Ikenberry (2020), it is easy to accept that, in the present state of growing anarchy in the world (dis)order<sup>1</sup>, big and main middle powers remain fully occupied by the “problems of anarchy”, such as hegemonic struggles, competition for security and spheres of influence, or reactionary nationalism. However, he continues, they are much more threatened by ‘emergent, interconnected, cascading transnational dangers’: pandemic diseases, financial crises, dangerously encompassing pollution threats and widespread nuclear proliferation, to mention a few.

Loss of the ability to keep and secure stable and intensive international trade flows is a major transnational threat. Such activity is crucial for harmonious progress among democracies and an encompassing welfare-enhancing goal that should include a plurality of regimes.

While abuse of the panacea of free trade has been progressively giving way to more realistic views towards fair or fairer trade, other objectives to trade gained voice. Job creation led the growing set of discontents with globalisation; it is now evident that securing employment for the less qualified and those displaced by the international efficiency mantra should not be left to half-baked adaptation policies. The environment needs care, the digital must be tackled, and politics and special interests—ever present—must be kept, more often than not, at bay.

Though not yet in profound hibernation, the related international institution, the World Trade Organisation (WTO), has been vilified and bypassed, sometimes becoming a puppet institution. The present state of fairly generalised un-governance is a preliminary step to chaos. Exclusion and creation of different, autonomous trade circles would be a move backwards, with evolving serious consequences.

How to reconcile the aggressive, disruptive and footloose aspects of present-day trade with a better, minimally fairer and more welfare-improving international version of the same practice, under the aegis of a modern and flexible international institution—appealing to all—that would assure an adequate level of governance?

This Note addresses this ambitious challenge by proposing deep changes in the present system of trade governance. The next section briefly describes the modern issues that have transformed the standard pattern and uses of trade, and then the problems with the WTO. It works as a building block for the proposal presented in section 3. Section 4 concludes with a somewhat enlarged view.

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<sup>1</sup> Throughout the text use is made of the expression ‘world (dis)order’, following Tharoor and Saran (2020). See also Flôres (2021).

## 2. Trade problems and institutional troubles

### 2.1. The trade dimension

Economies may display a variety of state and market arrangements, operating with more or less imperfect markets and more or less state intervention, usually being plagued by monopolies and oligopolies, whether visible or not. In more than a few countries—and often independently of the regime—states are significant partners in key enterprises. Interactions among these structures may produce harsh competition and Schumpeterian destruction; trade can be either a tool for imposing uniformity or for spurring rapid, sometimes undesired, globalisation rather than a means to foster diversity<sup>2</sup>.

In the present (dis)order, the experiences accrued in the post-WWII years oblige to highlight problems or realities that have been poorly considered in the recent debates on trade regulation:

#### *The value chains phenomenon*

Value chains have ultimately changed the logic of several classical tariff and trade barriers systems while also creating serious dependencies and calling attention to the importance of specific materials and components. It enhances labour problems—by displacing significant contingents of less efficient producers in the chain—and creates ticklish property rights issues.

Thanks to the fragmentation of production and the forging of international value chains, around 80% of trade in goods takes place among fewer than 1000 big world manufacturers. A much broader and more modern economic logic than the familiar (localised) comparative advantages setting imagined by David Ricardo<sup>3</sup>.

Globalised world competition no longer centres on supplying competitive versions of a specific good. Although the latter still exists, the main focus today is on rules, norms, and standards embodied in technological decisions and innovations, which *ease the creation of multi-country value chains*.

#### *The digital galaxy*

This has introduced new forms of exchange, from internet sales platforms to 3D printers, that have transformed elusive concepts like tariffs and even classical competitive settings, disrupting existing practices and posing questions not yet addressed by the current regulations. Five constellations—Alphabet/Google, Amazon, Apple, Facebook and Microsoft—are prominent in the galaxy and are powerful enough to dictate (unwritten) rules and practices that either circumvent or apply outside the traditional trade

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<sup>2</sup> On the multiple features of the trade activity, and the false causality trade → peace, see, among others, Flôres (2013).

<sup>3</sup> This is true despite the fact that the very concept of “comparative advantage” is quite elusive and not correctly understood by many, who easily confuse it with “absolute advantage”. Paul Samuelson, to his credit, liked to say that Ricardian comparative advantage remained one of the most subtle and difficult-to-grasp economic concepts.



flows realm. Trade-related intellectual property rights acquire novel, challenging and unsolved, shapes.

#### *New (and powerful) actors*

Adding to the previous five giants, with the likes of Walmart, Benetton or Zara, Bayer, the top five pharmaceutical industries<sup>4</sup>, Samsung, Huawei, Siemens, Tencent and Ali Baba, among others, it becomes apparent that large companies, rather than nations, are those actually fighting for greater international sales and market share, even if the parent country usually offers some support. This undercuts many of the traditional findings and theories about how markets should work, and forces any given nation—democratic or not—to confront not only economic but also complex juridical and geostrategic policy choices.

#### *The surge of political motivations*

The (dis)order resulting from a weakening hegemon and the growth of serious alternatives, along with the assertiveness of quite a few middle powers, have, of late, brought forward additional problems, such as:

- i) The quest for self-sufficiency: Concerns over a nation's autonomy to produce specific, supposedly strategic, goods have always existed, but the COVID-19 pandemic has enhanced them as well as zeroed in focus on protectionist policies when it comes to key raw materials and components, together with the redesign of the related value chains;
- ii) Sanctions: Use of economic sanctions, of which trade restrictions are, perhaps, first and foremost, has consistently increased since the early years of this century, and is becoming widespread. Sanctions, besides being rather debatable—both in humanitarian terms and in causing effective damage—disrupt patterns of trade and often disregard basic trade regulations; their widespread use, irrespective of sensible restraint, eventually damages the whole system and many other partners beyond those at the core of the conflict;
- iii) Technological protectionism: What is often, and wrongly, called the US-China trade war is a struggle over technological supremacy, with its most prominent axes of contention being the 5G technology, in which—to the great surprise of the US—China so far has developed a better product<sup>5</sup>, and the advancements in super and quantum computing, that may bring forth game-changing civil and military applications. This war then extends to trade restrictions—many illegal—as goods and services embody crucial technology, and induces distorting industrial policies.

#### *The social-environmental priorities*

Social and environmental priorities reflect a greater awareness of the global commons on how the control of trade activities cannot be restricted merely to the economic realm. The carbon footprint of the traded goods and services, the diversified labour concerns,

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<sup>4</sup> Respectively, in terms of revenue, as of 2020: Johnson & Johnson, Pfizer, Roche, Novartis and Merck & Co; the next two -GlaxoSmithKline and Sanofi- also posted revenues above 40 bn US\$.

<sup>5</sup> One of the reasons for this is that US companies focused on individual components, as handsets or routers, and disregarded the network dimension needed to build any end-to-end 5G system, like that offered by Huawei. See, for instance, Darby and Seawall (2021).

and even the inclusion of issues related to the animal kingdom are gaining ever more space. Certain countries and blocs already impose (or envisage to impose) extra tariffs on the grounds of how “green” the purchased good or service is purported to be.

## **2.2. The trouble with the WTO**

Tracing when the ongoing crisis at the WTO started is not easy. A clear sign that things were seriously awry may be found in early December 2019, when the institution’s Appellate Body was closed for lack of a quorum, and many of its functions and attributes came in for questioning and criticism.

At the core of the crisis lies the US–China rivalry, with the former complaining about China’s actions since the country joined the WTO on 11 December 2001. The American side broadly charges that China betrayed the hopes of those who facilitated its accession, while China firmly denies it and explicitly preaches in favour of the WTO and the multilateral approach to trade. The paralysis in the Appellate Body is solely due to the US systematically using its veto power to block the nominations of new judges.

Within this context, it is almost inevitable that the actions taken by many members start to cross the limits of what is allowed by WTO rules, if not to violate them outright.

The new realities in the world trade arena previously discussed have contributed to its deterioration. The digital complex and its multiple trade-related aspects are a blatant void in the Organisation. A serious updating and rethinking of intellectual property rights—to be made more flexible in socially sensitive sectors like pharma, or more modern in brand-new ones such as the digital galaxy—are dearly needed. This must be done in tandem with a new vision as regards trade and investment, where the balance between the micro-economic objectives and the broad social benefits will be even harder to achieve than in the past. The vexed question of state trading firms needs to begin with a clear, widely accepted definition of this animal.

Moreover, the criticism originally raised by the US applies: the Appellate Body had slowly become a dual persona of the institution, setting decisions and procedures that, gradually and informally—though effectively—become codified as interpretations of, and additions or extensions to the established, hard negotiated treaties; hence, introducing an unacceptable amount of juridification to the Organisation.

The World Trade Organisation had, thus, been under intensive care since before the pandemic. It went out of tune with the new trade realities, and lost focus and became aimed at partial corrections, missing the larger picture. To think that topical remedies, like changes in the Dispute Settlement Understanding, may provide enough oxygen to its breathless body is illusory. After too many years in the hands of international bureaucrats—competent as they might have been—novel ideas and ways to cope with the new “trade shapes & forms” must be put to a full discussion, without prejudice and a hidden desire to ensure that things remain as they are.

Notwithstanding, the WTO has a precious cumulated value—knowledge of systems and procedures, embodied in its high-level staff—that should be preserved, and global trade in principle needs global rules.

Demands and disputes will surge as trade patterns resume and evolve in the coming (recession) post-pandemic years. Resorting to domestic subsidies will frequently

appear in multiple guises, adding to the protectionist measures still remaining from the 2008-2009 financial crisis.

A temptation to separately address individual issues like the ones above—under a pragmatic spirit of mending misdeeds, repairing damages and taking the WTO out of intensive care—will be strong. But this is not the right course of action. And who will lead it—a US wanting to be again conspicuously present everywhere? Will China be happy with this choice? What about the likely coalitions? Given the multiplicity of themes and damages to tackle, it is hard to expect middle powers to stick to the same leadership in all of them. Will a divide take place, with groups of faithful followers closing ranks behind either China or the US?

International institutions are foundational for guaranteeing the rule of law in a global society that wants to minimise its inherently anarchic trends. But for this to happen, a sizable number of countries must be willing, fighting for and supporting them: the WTO needs a rebirth out of a credible common effort. Moreover, at the heart of the previous statements lies a fundamental, preliminary question, inherent to the debate on any international organism: do the nations in this new world (dis)order still believe in and want multilateralism?

Multilateralism translates to communities of states the ideal format of democracy. Despite engaging with all kinds of countries, and having the desirable quality of equalising the weak to the powerful, it suffers from innate deficiencies.

While in the case of democratic nations, the monopoly of law enforcement and, if needed, violence is clearly in the hands of the state; in an international multilateral organisation, no police force is available, and the ways to ensure the due settlement of disputes assume different forms, none of which ideal or fully efficient. Additionally, the imposed *a priori* equality among parties may generate distortions, particularly as regards obligations. In the WTO treaties, to assume all members equally wealthy, developed and competitive is, sometimes, a cynical way to push them towards the model and interests of the powerful—in the original case, the advanced Western economies.

More powerful countries can always put pressure on smaller and weaker ones to accept their views, many times through bargaining the support against concessions in other areas, like a foreign debt or a military alliance. This kind of “corridor politics” is common in many multilateral organisations, and in the WTO, they are sometimes called Green Room meetings. Corridor politics do not invalidate the merits of multilateralism, but introducing mechanisms to curb them is a welcome though not easy advancement, as they should not impair one of the golden tools of the approach: coalitions of the weak at a level that is large enough to block the strong.

At the same time, muscular members can break the rules and refuse to join arrangements nevertheless supported by them. The refusal of the US to be a signatory to the International Convention of the Seas and, more crucially, of the International Criminal Court, then followed by China, Russia and—under the US shield—Israel, shows the limits of acceptance of this supposedly ideal design.

However, if the strategy of multilateralism, with its simplicity and elusive absolute fairness, is neither sufficient nor appealing any more to completely tame the rule of instincts akin to anarchy, other solutions need more elaboration and a clearer definition of responsibilities.

Multilateralism must remain, even if less widespread and more conditioned. It creates viable inter-state communities, provided there does not exist much disruption of the established power balance. It does not abolish the underlying jungle spirits; it is merely super-imposed on them.

In the governance body proposed here, it is supposed to continue.

### 3. The design.

A multilateral organisation is proposed, as an evolution of the WTO; call it ITO – International Trade Organisation, the name envisaged in the 1947 Havana Charter.

Two main principles guide the proposal. The first is that the WTO moved to not only a heavy structure but (also and worse) a rigid framework where the parties' degrees of freedom have progressively been reduced, with all members—regardless of their own will and specificities—being obliged to fit into the same straitjacket. Flexibility, and an as lean as possible structure, must be brought back. The second is to accept that enforcement in an international institution is problematic and may easily lead to impasses like the one lived nowadays by the Organisation. This has bold implications as will be seen below.

A preliminary question is: What do we do with the present WTO? How do we tackle its *acquis* and, most crucially, the existing treaties and commitments? To answer, we must first describe membership.

Two kinds of members are possible: Members and Encompassing Members. The former adhere to a single basic treaty, which would be a modernised and somewhat larger version of GATT 1994<sup>6</sup> and all its Understandings, as well as some of the Agreements in Annex 1A<sup>7</sup>, together with Annex 1B on trade in services; the latter keep on subscribing to all texts of the Marrakesh Agreement, with the remark that Annex 2, on dispute settlement, would be reformulated as described below.

All parties would, thus, respect the foundational principles like the *most-favoured nation* or the *national treatment* ones, but further commitments, like TRIPS and the enforcement package (Annex 2) would be optional.

Any Member could, at any time, (re)adhere to a text outside its basic core, or even decide to acquire Encompassing Members status. Take, for instance, a developing country that does not want to commit itself to property rights constraints. It can live on, relying on the attractiveness of its market, which could even be supported by domestic legislation giving a minimum of protection to foreign investors. If, at a certain moment, it judges the existing situation unacceptable, investments and opportunities being lost because it has not adhered to TRIPS (Annex 1C), it can easily request its inclusion in the Agreement.

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<sup>6</sup> All GATT 1994 articles cited are according to the incorporation of GATT 1947 in the GATT 1994, as described in WTO (1995); a reference that also applies to all treaties mentioned in the text.

<sup>7</sup> With those on Trade Related Investment Measures and on Subsidies and Countervailing Measures most certainly not included.

Instead of imposing market regulations to parties as in the classical format—despite the fact that they were the outcome of negotiated treaties—they become free to join them, if deemed necessary. It is well known that, though helping, WTO rules, especially at the present times, are not a pre-requisite for foreign investments; these usually result out of a compromise between risks and opportunities. High though known risks—as, for instance, property rights ones—are usually tolerated, *because they have been part of the overall calculus of expected returns*.

This flexibility also eases the burden of developing countries in general, as they are not forced to sign more sophisticated regulations that may stifle their growth and innovation potential. The multiplicity of level playing fields allows advanced economies to trade among themselves at one level, while underdeveloped ones are subject to basic trade fairness requirements among them, and relations between representatives of both groups are regulated by constraints applying to the weakest one.

All parties discuss and negotiate any of the urgently needed revisions, updates and novel additions to the existing set of legal texts. All may engage in their formulation, though many may eventually opt out. This implies a different policy to approve a treaty, which can be set at a slight majority level, like 55 or 60% of all members.

More daring initiatives by select nations should not be restricted. A given group—even composed of less than half the parties—could at any time form a special-interests niche, advancing both liberalisation and regulation of a specific sector or activity. This implies a revamping of Article XXIV of GATT 1994, in which emphasis and encouragement should be given to the creation and formatting of such niches, rather than to the (nowadays) heavy and irrationally ambitious, time and resources consuming regional integrations.

The Dispute Settlement Understanding is where the greatest change would take place. The bold decision here is to abolish the existing framework in Annex 2, particularly the Appellate Body, replacing it by a much-streamlined version. The first phase of the panels would be maintained, and panel decisions could be appealed to the same panel, that could then be enlarged by one or two more panellists. The decision would judge which party(ies) was right, could call for the suspension or end of the illegal practice, *but would not estimate damage for purposes of compensation or retaliation*; . A party judged of wrongdoing a certain number of times, during a specified time interval, would have its rights suspended in the Organisation. Repetition could result in leaving the ITO.

This would save time and the somewhat hypocritical procedure of enforcing penalties and compensations often eluded or not complied with.

The hopefully leaner and more dynamic structure would be complemented and gain additional clout by the following two supplementary principles.

First, stop with the über-enthusiastic and encompassing view that trade deals and trade itself are a way to solve or tackle more effectively global-commons issues like environmental degradation or inhumane labour conditions. Such an approach crams the trade agenda with questions that, more often than not, may be handled better in another forum.

New mechanisms should be created to deal with transnational companies' trade flows, given their inherently asymmetric character and their weight in global trade in

goods. Joint, co-ordinated work with other multilateral agencies should be encouraged and given a dramatic boost. This is not exactly new, as successful earlier experiments like the association between Sanitary and Phytosanitary rules with the Food and Agriculture Organisation's Codex Alimentarius testifies. Telecommunications and internet issues overlap considerably with the International Telecommunications Union - ITU. A permanent joint task force on coupling and identifying basic general ITO-ITU rules seems a must.

Trade must cease to be taken as a proxy for the solution to all failures in the governance and regulation of common goods. Climate change and carbon footprints, unfair labour practices, potential violations of basic human rights, broad competitiveness gaps, and geo-strategic rivalries—all must be addressed in their proper fora.

Second, a collective effort should be pursued to curb the use of trade for other purposes than trade itself; a clear separation between trade and strategic security goals, including conflict (war), must be put forward, which will require modifications in Articles XX and, specially, XXI of GATT 1994. Use of trade as a tool of war should be banned, or at least greatly restricted.

The imposition of trade sanctions on specific states, though known to be usually inhuman, continues to proliferate despite its nefarious consequences. A Convention on Ordering the Use of Trade Sanctions in International Relations would be a step in the right direction. In principle, the United Nations would be the right venue to host the Convention.

A similar effort and attention should be given to the issue of arms trade—the heart and fuel of the “war & conflict business”—but the complexity of the solutions obliges us to just mention the point here.

#### **4. Conclusion.**

Trade is too basic and important to be restricted to democratic regimes only. It is neither a tool for regime change nor a sure vehicle to pass better and more equitable government values. Notwithstanding, it carries information that goes beyond the traded good or service. This is encouraging and justifies that its flows—provided key local features like labour, culture and minimal needs are preserved—should go round the planet, creating convergences and improving life for every world citizen.

Regulations are needed but should be kept to a minimum and not become a source for byzantine bureaucracy and artificial super-structures. As much as possible they should obey a multilateral, no-divisions format. The creation of excluding cleavages, as democracies x non-democracies, my allies x the others, is a shot in the foot of global trade, though it might have meaning and usefulness in other realms.

An outline in this direction has been proposed here. Improvements and details are needed, but the spirit of the design should be kept.

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## About the Project

The Jean Monnet Atlantic Network 2.0 is a small network of six members that keep intense communication and joint activities on the Atlantic Basin. The Network also serves as a central arena for discussing globalisation and key major trends in the several Atlantic microcosms. By combining the national with the regional perspective, its research and debates take into account the different foreign interests and pressures, as well as a critical view on the possible roles and future of the European Union (EU) in the area.

It is the present link of a long chain of projects. In 2016, the project that established the first Jean Monnet Network on Atlantic Studies ([jeanmonnetnetwork.com.br](http://jeanmonnetnetwork.com.br)) sought to foster knowledge and co-operation among scholars and researchers on topics of fundamental importance for Atlantic actors in general, and for the EU, in particular. It involved a greater number of centres and universities.

Seven years later, still focussed on the original three broad thematic axes -Energy/Sustainability, Trade/Economy (International Economic Flows) and Security/Inequality-, the Jean Monnet Atlantic Network 2.0 represents a continuation and a rupture with the previous undertakings.

It intends to offer a wide, innovative and sometimes controversial view on Atlantic problems and the expectations on and scope of the EU activities relative to them. The papers in this series are a sample of its achievements.







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