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**Article**

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*Bernard Hoekman and Robert Wolfe*

## WTO Reform As a Triangular Problem among China, the EU and the US

Although structural weaknesses and gaps in its rules were evident right from the start,<sup>1</sup> the impetus for current talk of reform of the World Trade Organization (WTO) largely stems from the tension among the three major trade powers—the EU, the United States and China. The three-way dynamic can be seen clearly in the commentary on the EU-China Comprehensive Agreement on Investment announced at the end of 2020. Is it a political win for China alongside the Regional Comprehensive Economic Partnership (RCEP)? Does the deal complicate US efforts to negotiate with China? Will it undermine US efforts to work with the EU and other allies to address level playing field concerns?

When people identify the aspects of the WTO that need reform—no progress on negotiation of important new issues, the Appellate Body in crisis, inadequate notifications of applied trade policies, working practices no longer fit for purpose—a concern with the impact of China on the trading system is often in the background. The US especially has raised a series of complaints before the WTO, mostly dealing with the role of the state in the workings of the economy. Lurking behind the US push for reform of the WTO is its frustration, shared by others, that integration into the trading system has not changed China into a liberal market economy. Frustration with China's state capitalism model was behind the initiation of Trilateral meetings of the trade ministers of the US, Japan and the EU, who have met four times since May 2018, when they “reiterated their concern with the non-market-oriented policies of third countries and discussed actions being taken and possible measures that could be undertaken in the near future.” After

many inconclusive discussions in the General Council, the US submitted a draft resolution on its own proposing that the Council express its serious concerns with non-market-oriented policies and practices “that have resulted in damage to the world trading system and lead to severe overcapacity, create unfair competitive conditions for workers and businesses, hinder the development and use of innovative technologies, and undermine the proper functioning of international trade” (WTO 2020a).

China's attitude to WTO reform is essentially conservative and reactive. China claims to support WTO reform as long as it preserves such core values of the multilateral trading system as non-discrimination and openness, safeguards the development interests of developing members, and follows the practice of decision-making by consensus (WTO 2019). Meanwhile, China is adapting its economic strategy, reflected in the “dual circulation” concept enunciated by President Xi Jinping in 2020 (Sandhu 2020). Insofar as the domestic market is thought to be big enough to sustain further growth, China may be less concerned about the policies of its trading partners that limit access to global markets. That puts China on the same footing as the US, for whom giving or restricting access to its vast internal market helped it shape the postwar trading system, and the EU, which leverages the single market to influence the increasingly important domains of product, sustainability and data privacy standards (Rühlig 2020).

All three trade powers need the WTO. All three have a big stake in reinforcing a multilateral system of rules to manage the inevitable frictions among interdependent economies organized on different principles. This applies as much to transatlantic regulatory cooperation as to challenges across the Pacific. In this paper, we draw on the findings of a recent research project on WTO reform<sup>2</sup> to discuss elements of the WTO reform agenda through the lens of the triangular tensions among the three major powers. Reforming the WTO will not solve China-US conflict nor will it settle outstanding transatlantic disputes, but it can enhance the salience of the organization as a forum for the large economies to agree on rules of the road on matters that have been causing trade conflicts,

<sup>1</sup> For a compelling case for institutional reform by one of the architects of the WTO, see Ostry (1999).



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<sup>2</sup> For all of our papers on WTO reform in a project supported by the Bertelsmann Stiftung, see <https://globalgovernanceprogramme.eui.eu/research-project/revitalizing-multilateral-governance-at-the-wto-2-0/>.

in the process helping to resolve the problems of the WTO. All three major trade powers, but particularly China, have to accept that progress on some issues will require leaving some obstructionist members behind—i.e., to negotiate on a plurilateral basis.

The plan of the paper is as follows: in the first section, we consider the problems created by the WTO consensus working practice and the approach towards recognizing economic development differences—“special and differential treatment” for developing nations; the second section moves from negotiations to problems with WTO transparency, which are especially marked in the domain of industrial subsidies; we then consider reforms to WTO working practices in the third section before coming in the fourth section to the Appellate Body crisis; the final section concludes with implications of our analysis for the design of trade cooperation between the three major powers.

### **WORKING PRACTICES: CONSENSUS AND SPECIAL AND DIFFERENTIAL TREATMENT**

A key reason for the difficulties experienced in using the WTO as a negotiation platform was the backward-looking Doha Round agenda, notably the decision by WTO members to prioritize tariffs on manufactured products and agricultural support policies as opposed to twenty-first century policy priorities such as trade in services, regulation of the digital economy, investment, and using trade policy to combat climate change. The consensus working practice impeded the ability of members to adjust the agenda. After almost 10 years of deadlock, in 2017 many countries decided to shift gears and launch talks on a plurilateral basis.

The associated “joint statement initiatives (JSI)” span e-commerce, domestic regulation of services, investment facilitation, and measures to enhance the ability of micro and small and medium enterprises (MSMEs) to utilize the opportunities offered by the rules-based trading system. Most address coordination failures and/or entail joint efforts to identify good regulatory practices. The EU participates in all four groups, as does China, but the US only participates in one JSI.

The EU objective in the e-commerce negotiations is to negotiate a set of provisions that will become a reference paper that participants could include in their GATT and GATS schedules, which would ensure that these commitments apply on an MFN basis. As this plurilateral includes the EU, China and the US, the outcome could be de facto critical mass, whether or not all Members choose to participate. Plurilateral approaches are not a panacea, but they offer a mechanism for large trade powers to cooperate without engaging in negotiations on trade agreements that liberalize substantially all trade (Hoekman and Sabel 2021). But the results will not be worth having if large

traders claim that they need special and differential treatment. Here too the focus of US concern is China.

Special treatment for developing countries is now part of WTO theology, to the point that it was baked in to the 2001 Doha Development Agenda. In the negotiations on non-agricultural market access, it did not matter if small developing countries wanted less than full reciprocity in reduction commitments (paragraph 16 of the Doha declaration), but unwillingness on the part of larger developing countries to make real commitments did matter. Whether existing special and differential treatment provisions make sense is one thing but asking for it in new negotiations is problematic if it vitiates the point of the exercise.

In May and November 2019, the US submitted a proposal for a decision on “Procedures to Strengthen the Negotiating Function of the WTO” with criteria for assessing which countries will not avail themselves of special and differential treatment in WTO negotiations (WT/GC/W/764/Rev.1). The US asked for this item to be placed on the agenda of one General Council meeting after another in 2019 and 2020, with some support from other members but met with unrelenting opposition from China and most developing countries. For example, at the July 2020 meeting of the General Council (WT/GC/M/186), the representative of China said that it is better to respect the current practice of self-designation of developing country status and at the same time to encourage those in a position to do so to make a greater contribution to the best of their capabilities. China was willing to do so, he said.

Whether China will contribute by being part of the critical mass on any JSI remains to be seen. The signs are not good if we consider an “old” issue still on the table, the negotiation on fisheries subsidies. Launched in 2001, these talks have repeatedly missed deadlines, in part because of special and differential treatment. China supports disciplines that prohibit fisheries subsidies that contribute to overcapacity and overfishing as long as “appropriate and effective special and differential treatment for developing country Members and least developed country Members [is] an integral part of the negotiations (TN/RL/GEN/199).” The EU and US might accept such differentiation for some developing countries, but not for China. Low et al. (2019) argue flexibilities be made available to those Members who actually need them to fully benefit from their membership in the organization. Whether such a principle will be included in new plurilateral agreements and accepted by China will do much to determine whether this approach can revitalize negotiation in the WTO.

### **IMPROVING TRANSPARENCY**

Transparency of actor behavior and expectations within regimes requires high-quality information (Wolfe 2018). The WTO agreements have dozens and dozens of formal notification obligations. Inadequate

notification of trade policies is an old issue, but its inclusion on the “WTO reform” agenda only began when the US tabled a detailed proposal that reviewed the unsatisfactory compliance with notification obligations under the Trade in Goods agreements. The US proposal included punishment for Members who are behind in their notifications (WTO 2017). A much-revised version of that proposal (WTO 2020b) remains before the General Council, now with co-sponsors, including the EU. An important question that has not been adequately confronted is why compliance with notification requirements varies by WTO Agreement and by Member. If the problem is a lack of capacity, then technical assistance may be needed, although a failure to notify by the countries most likely to need technical assistance is a problem for them not the system. If the real difficulty is outdated and overly complex notification requirements, a thorough review is warranted. Only if the reason for a poor notification record is bad faith would penalties as suggested in the US proposal be appropriate.

The US could do more itself to contribute to WTO information. One of the most contentious areas in trade policy are the negative international spillovers of industrial subsidies. Subsidies can help to address market failures and therefore might have a good economic rationale, but cooperation is needed to minimize negative spillovers of such measures on trading partners. As discussed at greater length in Hoekman and Nelson (2020), this is not simply a “China issue.” Subsidies of one type or another constitute the great majority of trade interventions imposed since 2009. Here too the problem is inadequate information. The periodic monitoring reports prepared by the Secretariat to aid in understanding Members’ trade policy do not cover the full extent of the “general economic support” provided by governments. Information on subsidies, including general economic support, is requested periodically in questionnaires issued by the WTO Director-General (DG). The overall response is dismal. For the most recent report, 67 WTO Members and one Observer volunteered information on 638 Covid-19-related general economic support measures. The EU did so; the US and China did not. The US is less cooperative than China or the EU with the trade-monitoring exercise (WTO 2020c, Appendix 1).

The EU, Japan and the US have pursued discussions on a trilateral basis with a view to identifying gaps in WTO subsidy rules and suggest new disciplines. A revamped subsidy regime requires participation of China. A necessary condition for China to do so is that the effort not be perceived as an attempt to isolate or “reform” China. At the same time, China should accept that it has a leading role to play in the regime. In the short term, agreement on binding rules is unlikely to be possible. Work on developing more informal discipline on subsidies based on information, dialogue and peer review may be more feasible. As

noted by Hoekman and Nelson (2020), calling for a work program on subsidies may be criticized as kicking the can down the road. It is not. WTO members simply do not have enough information to develop a common understanding of where new rules are needed and the form they should take. One of the ways to get there is to make better use of WTO bodies.

### **WTO DELIBERATIVE BODIES CAN BE BETTER USED**

WTO committees and councils are first and foremost deliberative bodies for discussing emerging issues and addressing trade concerns without recourse to the dispute settlement system. Or at least they should be (Wolfe 2020). Most WTO bodies address so-called “specific trade concerns (STCs)” to some extent. Doing more to encourage committees and other WTO bodies to discuss STCs pertaining to policies under their purview is one way to improve conflict management and to increase the relevance of the organization for its stakeholders.

One suggestion to this effect is to establish guidelines for all WTO bodies. Tabled by the EU and supported by 19 other Members, including China, this proposal, WTO document WT/GC/W/777/Rev.5, or 777 in what follows, aims to make better use of the possibility offered by WTO Council and committee meetings to discuss and resolve concerns with trade-related measures by equipping them with horizontal procedural guidelines. The 777 proposal begins with clarifying timelines for convening documents and other meeting arrangements, which are important for making efficient use of committee time. China shared that objective in its own reform paper (WTO 2019). The 777 proposal encourages submission of written questions and answers, which would enhance transparency for other Members, or firms, having the same concern. The US has made a similar proposal in the SCM Committee for ensuring timely written responses to questions posed by Members on the subsidy programs of other Members (G/SCM/W/557/Rev.4). China has resisted every time the item comes up, arguing that the ASCM does not require members to submit responses to such questions in writing, nor to provide them within a specific time period, and that setting deadlines as proposed by the US would impose substantial new notification obligations on WTO members and cause difficulties for developing countries in particular.

### **THE APPELLATE BODY CRISIS**

A central dimension of the “value proposition” offered by the WTO is independent, third-party adjudication of trade disputes reflected in the principle of de-politicized conflict resolution (Hoekman and Mavroidis 2020). An effective dispute settlement mechanism is critical for existing WTO agreements to remain meaningful, and for the negotiation of new agreements.

The US has been critical of the system, alleging that the Appellate Body has too frequently overstepped its mandate. US concerns are long-standing, and the US is not alone in at least some of its concerns. Although China lost many of the cases brought against it, Appellate Body rulings on key matters such as what constitutes a public body under the ASCM fueled US frustration (Ahn 2021). The Appellate Body ceased operations in December 2019 because of US refusal to agree to appoint new adjudicators or re-appoint incumbents. Resolution of the crisis requires reform of how the system works.

By the end of 2020, sixteen appeals were pending before the now dormant Appellate Body and only 5 new cases had been filed, the lowest for any of the WTO's 25 years. If appeal “into the void” remains possible, issued panel reports will have no legal value, unless the disputing parties forego their right to appeal, and accept the panel report as the final word in their dispute. For the 24 participants in the Multi-Party Interim Appeal Arbitration Arrangement (MPIA), including the EU and China, but very much not the US, that route may provide a short-term alternative. However, the US would see no point in any kind of WTO reform that did not address this problem. And equally, the US would see no point in any new agreements aimed at Chinese practices if dispute settlement remains slow and ineffective. All three trade powers have an incentive to make dispute settlement operational again.

### INCREASING THE PROSPECTS FOR COOPERATION

The WTO agenda is large. Prominent items include ensuring a consistent response to global public health crises, resolution of conflicts regarding the use of industrial-cum-tax-subsidy policies, taxation of digital services, regulation of data privacy and cross-border data flows, and the appropriate role of trade policy in reducing the carbon intensity of economic activity. Revisiting the terms of engagement with China is a necessary condition for revitalizing the WTO as a forum to address these matters and to sustain an open world economy, but equally important will be reinvigorating cooperation between the US and the EU.

The basic premise of the mostly misguided approach of the Trump Administration—relying on unilateral trade actions that were not sanctioned by the WTO—did little to address core differences between the two countries (Economist 2020). The EU has been more balanced, seeing China as a negotiating partner for cooperation, an economic competitor, and a systemic rival (European Commission 2020a). This is beginning to be reflected in EU policy initiatives, including the White Paper on industrial subsidies (European Commission 2020b). The Biden Administration may well use Trump's China tariffs for negotiation leverage. Similar thinking animates the EU ratcheting up its ability to act against subsidies, restricting the

ability of Chinese firms to bid on public procurement, and screening inward investment. Whether such pressure will increase China's willingness to engage in the WTO is an open question.

The revealed preference of many WTO members has been to pursue regional trade agreements. Most such agreements lack strong disciplines on policy areas that are central to trade tensions with China—notably subsidies. Many also do little to assure transparency, especially for non-signatories. WTO mechanisms therefore remain critical, which is why reforms to bolster transparency are so important. Everybody would benefit from knowing more about each other's trade policies and from more analysis of issues coming onto the agenda. A collaborative rather than punitive solution is possible, especially if the three major powers work with like-minded Members, such as the Ottawa Group.

The Doha Round deadlock means plurilateral initiatives and agreements are the (short term?) future for negotiations on adding to the WTO rule book for domestic economic and regulatory policies that have repercussions for international competition. A feature of plurilateral initiatives is that countries that want to insist on special and differential treatment do not have to participate, which allows Members like the African Group to stand aside. At the same time, when it comes to policy areas such as subsidies and state-owned enterprises, to address the sources of underlying trade tensions China must participate. Thus, a revamped subsidy regime requires participation of the US, the EU and China.

Chinese officials in Geneva profess support for WTO reform, but demand respect and non-discrimination, which leads to an insistence on maintaining China's status as a “developing country.” China does not want to be treated differently from other developing countries. But China is both a very large economy and is more prosperous than many other developing countries. It cannot and should not expect to be treated differently to other signatories of any new agreements, and it should accept that it can no longer hide behind the obstruction of supposed developing country leaders such as India and South Africa. China will need some political cover to allow it to maintain support for the principle while accepting a pragmatic approach in new plurilateral negotiations.

China, the EU and the US have substantially different views on the relative importance of many areas of international trade policy and potential cooperation. The three do not agree with each other and no two of them can provide the public good of an open liberal multilateral trading system on their own, which is why it is a triangular problem. How the three could conclude a package of reforms given the potential for obstruction by some other WTO Members should be a major focus of the policy officials and advisors tasked with the design of trade strategy in the three major trade powers. And they should be willing to proceed



on a critical mass basis on issues where waiting for the full membership is not necessary.

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