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## Evaluating the Current World Trading System; Considering its Future Prospects

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# “EVALUATING THE CURRENT WORLD TRADING SYSTEM; CONSIDERING ITS FUTURE PROSPECTS”

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First, a disclaimer: I am not speaking here today on behalf of the World Trade Organization (WTO), with which I have served as Deputy Director General for almost six weeks, nor for the WTO’s members. My point of view has been formed over nearly a half century of involvement as a student and at times a participant in the

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formulation of international trade policy.

## SOME RELEVANT HISTORY OF INTERNATIONAL TRADE POLICY

Since the mid-1940s most of world commerce has been conducted within a Pax Americana. The United States was the prime mover in the creation of the current world economic order. The World Order reflected an American consensus.<sup>1</sup> It is a system of global governance enunciated by Cordell Hull in the 1930s, envisaged by Franklin Roosevelt and Winston Churchill at Placentia Bay Newfoundland in 1942, and enabled by the post war institutional arrangements for the economic world order, notably the International Monetary Fund (IMF), the World Bank, and the General Agreement on Tariffs and Trade (GATT)(and since 1995, its successor, the World Trade Organization).

The United States did not act out of pure altruism—no country does. There was nevertheless a measure of altruism—more than the U.S. is often given credit for. Churchill called America's Lend-Lease Program that underwrote the survival of its allies in Europe during the Second World War “the most unsordid act in history.” This is a judgment that could be made of the creation of the postwar trading system as well: in this case there was reciprocity, but it was not full reciprocity in terms of a *quid pro quo* received by the United States. The United States did not choose to create a system of imperial preferences, like that which colonial powers had in the pre-war period, although it could have done so. What the United States did was foster most-favored-nation treatment. This expression of enlightened self-interest was created in reaction to and flight from the severe, self-absorbed and self-destructive protectionist policies of the 1930s. There was to be benefit for all. The rules-based liberal trading system was and is extraordinary, and has been a central factor in lifting hundreds of millions of the earth's inhabitants above subsistence levels. It has been fundamentally beneficial for the American people as well.

My use of the term “Pax” in the phrase Pax Americana is not

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1. The term is used by Henry Kissinger in his 2014 book *World Order*.

meant to imply that trade has been untroubled in all respects, or that America was always consistent. However, the system was grounded in the principle that world markets should generally be open to the extent possible for all. A code of rules was drafted under American leadership that strove to provide greater opportunities for the trade of every participant, combined with rules and measures attempting to provide fairness. While trade disputes could become heated, high tariff walls, import quotas and competitive currency depreciations no longer characterized world trade. The system survived a number of tests. For example, when the European common market was formed, new discrimination denied access for American poultry. The permitted reaction was increased U.S. tariffs on imports of European brandy, dextrine, potato starch, and automobile trucks. The conflict, although called the “Chicken War,” was contained and is only a footnote in trade history books now. In short, the system worked.

### MOVING TOWARD THE PRESENT: THE IMPACT OF THE 2016 U.S. ELECTION

It is easy to be critical of aspects of America’s stewardship of the world trading system, but to focus now on any past American shortfalls from its ideals is to miss the central challenge to the world economy here and now—the absence of American leadership in the world trading system. Atlas, tired of his burden, shrugged. The country that was indispensable to the creation of the international trading system has opted out of its leadership role, and the date and nature of its return to anything like its former position is completely uncertain.

The change in American policy was not the result of long-term planning. It was the almost incidental product of direct, as opposed to representative, democracy. Henry Kissinger in his magnificent book, *World Order*, notes that “internal changes within societies are able to shake the international equilibrium more profoundly than aggression from abroad.” The idea is worth emphasizing. Dr. Kissinger was referring to the French Revolution and events in the 20<sup>th</sup> century—no doubt in Russia in 1917 and in Germany in 1933. However, he was prescient in his diagnosis, as within two years of his book appearing in 2014, the Brexit vote occurred and Donald

Trump was elected the 45<sup>th</sup> president of the United States.

As a result of this last seismic event, where we find ourselves at present is that the United States, which was the prime guarantor of an open multilateral trading system, has stepped back, leaving a structure in place that was created with U.S. leadership, which now is without a clear leader.

Positive outcomes from trade negotiations have not been easily obtained since the WTO was founded in 1995. There are three recent substantial positive examples, however. These are: the decision at the 2015 WTO Ministerial in Nairobi to forswear use of agricultural export subsidies, the negotiation and adoption of the Trade Facilitation Agreement, and the expansion of the Information Technology Agreement. These were far from minor achievements. The Trade Facilitation Agreement alone is considered to be the equivalent of elimination of over a 14% average tariff on world trade. That is nearly double the current average actual tariffs in place. And the Information Technology Agreement provides for a tariff-free environment for over \$1.3 trillion in per year of global trade.

These are solid successes, but the road ahead looks more difficult. There are areas of agreement that potentially could be harvested next month in Buenos Aires—with respect to agriculture, an agreement on public stockholding, on maximum levels of domestic support, on transparency of export restrictions and improved disciplines on certain sanitary and phyto-sanitary regulations; on services, agreeing that domestic regulations will not impair benefits already committed; for the environment, an agreement to curb fisheries subsidies; as well as an agreement on a work program going forward including electronic commerce and ways to create benefits for small and medium enterprises. But even with U.S. leadership, nothing on this list would have simply fallen into place. Each requires extraordinary effort. Without U.S. active engagement, the chances of success are lower.

## WHAT NOW?

The key challenge facing the world trading system now is: “If the era of American trusteeship of international trade is potentially

over—what can take its place?” Perform a thought experiment in another sphere, the geopolitical. What if the United States announced that its troops on the Korean Peninsula, in Japan and in Germany, would be neutral, or in a more extreme case, withdrawn? What would the potential be for changes in those regions, what changes in the world order? Of course, no analogy is perfect, but this one is nevertheless instructive at least in considering that the political world would be unlikely to remain the same were these events to take place. In the world of international commerce, a United States that has become inactive must of necessity cause some differences in results with respect to outcomes in the realm of international commerce. The indispensable country has, at least at present, absented itself from its customary role.

Given the fact that we should not expect the Trump Administration to suddenly and fully embrace multilateralism, something else has to change, and that of necessity is the behavior of others. There is little outward evidence that there has yet been the necessary adjustment to the new reality on the part of the others—not the other world’s most important trading nations—not their governments, not their executive branches, not their legislatures, not businesses here or abroad, not civil society.

There is a second part to the present predicament. The United States, professing itself tired of over a decade of complaining about what it sees with some justification as overreach of the WTO dispute settlement system, has stated that without some fundamental corrections, without institutional reform, it will not approve the seating of new Appellate Body Members. At the end of this year, three of the seven seats on the Appellate Body will be empty, and absent some resolution of the current impasse, a fourth seat becomes empty ten months later. Why is this serious? At some point, a WTO member who has prevailed in litigation before a WTO panel on the illegitimacy of another member’s trade practices, and frustrated by an appeal that cannot be heard, may well take matters into its own hands, imposing retaliatory trade measures, followed by a response in kind from the other member. Trade cases can be very large in coverage and go very deep in terms of vested interests and vital national policies. It is not far-fetched to envisage the beginning of a trade war. It is harder to estimate whether it can be contained and

how it will end.

### WHERE ARE OTHER PLAYERS?

If that is where we find the United States and the WTO at present, can and will other WTO members step forward to maintain order in the system and work toward progress? There may in fact be some evidence that there is change in Geneva. What cannot be ascertained is whether in the vacuum created by the absence of the U.S. from its accustomed role, the activities of others are greater or is it only that they appear greater due to the lack of major activities by the former lead actor. Examples of initiatives by others are the European Union (EU) and Brazil joining together on a proposal on public stockholding of commodities for food security, a proposal by the Russian Federation on the same subject, and a proposal from China on E-Commerce, to name a few. But my informal survey of member governments makes it clear that it is the view of many members that no WTO member or group has stepped forward to drive negotiations forward the way that the United States did for the last 70 years.

The first candidate for exercising renewed multilateral leadership, the European Union, might say that it is doing what it can despite the fact that it has Brexit to contend with. This is not considered enough by a number of other members that I have talked with. Perhaps it is unrealistic for Brussels to consider a change in priorities, but the impact on the world economy of a rudderless WTO is potentially far greater than any of the possible BREXIT outcomes.

The EU would also perhaps say that it is intensifying as a possible substitute for multilateral progress, its efforts with respect to a series of bilateral arrangements, most notably so far, CETA (its Free Trade Agreement with Canada), and its negotiations of an EU-Japan arrangement that is said to be a potential template for an updating of the WTO some point in the future. It is far from clear however, that these endeavors are steppingstones on the way back to Geneva designed to enhance the world's multilateral trading system. There is always a question with any regional arrangement whether it is dividing the world rather than unifying it.

What about Japan? Japan played a leading role in crafting and completing the Trans-Pacific Partnership (TPP), very much a

departure from its defensive stance in prior WTO and GATT rounds. That said, there is no evidence that Japan aspires to assuming a similar major role in leading the world economy. For the near term, Mr. Abe has a domestic economy that he is seeking to stimulate and a constitution that he may seek to change, not to mention worrying about North Korean missile overflights. There is no current evidence that Japan expects to take on a leadership role. Japan is occupied with finding alternative means to expand its trade relationships—by design as with the EU, in the TPP minus one, and for the region, RCEP—the Regional Comprehensive Partnership.

Of the largest trading entities, that leaves China. China's top leader, Xi Jinping, has been using all the right words about the kind of world trading system China supports, starting with his positive statement at Davos earlier this year. While China has tabled some forward-leaning proposals, for example for E-Commerce, China appears hesitant to take up the mantle cast aside by the United States. Perhaps the world's largest beneficiary of the global trading system will at some point pick up more of the burden of leading it.

Well, that leaves all the rest. They fall into three camps: friends of the system, those who appear nonaligned, and those who have a more limited agenda. Amongst those countries already declared as supporters of the system, one has yet to find a sense that these smaller countries can fill much of the void left by the United States. To be sure, if Rome was not built in a day, neither was it replaced in a day as the central force governing world trade. While patience may be called for, my judgment is that these friends can accomplish more individually and collectively than perhaps they believe. Among these friends is experience and creativity. They are dependent on a world order that is now at risk. They may well come to have a vision of a need to play a larger role in order to maintain the integrity of the international trading system. Were they more active, their activities might even stimulate additional leadership from the EU, Japan and China.

What happens absent a coalescing of a broader group of activist positive countries? It is not by any means a guaranteed return to the dark ages, in trade this would be a sliding back toward the protectionism of the 1930s. I do not believe that will happen. The

world is not in the midst of an economic depression. What will more likely occur is a narrowing of the prospects for possible progress, when progress is needed. That has negative consequences for world growth, but it is not a sudden catastrophe. The world trading system is more likely to experience erosion perhaps not avulsion (when a large cliff face falls into the sea).

My message is one of concern, not alarm. There is an enormous amount of potential for forward progress in the multilateral trading system right now. There should be some degree of momentum derived from the successful conclusion of the Trade Facilitation Agreement, the decision to abolish agricultural export subsidies taken at the last Ministerial Conference, and the elimination of tariffs on most of the world's IT trade. There is potential for reducing the impact on trade of domestic regulation in the form of licensing procedures; qualification requirements and technical standards; there is the possibility of a broad Trade Facilitation Agreement for Services; for an agreement on investment facilitation; for focusing on the issues presented by digital commerce; and for advancing the participation of small and medium enterprises in world trade. There is also a real opportunity to place limits on the subsidies that are supporting overfishing in the world's oceans. Throughout all these issues, the interests of developing and industrialized countries are more interwoven than ever before. They have a joint stake in making the trading system work better even if their mutual interest is not recognized by all.

What is required is a collective sense that more is possible, combined with dedication to achieving it. The United States does not appear to intend to stand in the way of progress broadly supported by others. While the U.S. at present will apparently not create the momentum for going forward, but it could join it. For this to occur, there would need to be greater effort on the part of other countries to move forward.

For this to succeed, there must be vigorous sustained support from the private sector and from leaders in the world's legislators. The intellectual basis needs to be supplied by academia, think tanks and nongovernmental organizations, among others. This must become an accustomed role for each actor in the trade policy formulation

process. This condition does not exist today. Acting as if nothing has changed is a luxury that can no longer be afforded. The stakes are too high, and the risks too great.

The system may be more fragile than is generally known, if as noted above, the WTO dispute settlement system ceases to function effectively. The WTO system of contractual obligations that currently underwrites almost all of world trade could begin to at some point to unravel. This contingency is not so remote that it is impossible. The failsafe mechanism of the WTO rules might not hold. Again, this is not a time for alarm, but for positive action.

There is a need to think of the future of the world trading system and take a few sensible steps forward.

## FIVE SUGGESTIONS FOR MOVING FORWARD

What ought to be done? I have five suggestions, and I am sure that others who support a vibrant international trading system will see other possibilities

### POLICY PLANNING

My happy assumption is that there is a trade policy planning staff within each government, although I confess that this is not something we had for trade in the U.S. government during the period when I served. If no office or inter-ministerial committee exists, it should be created and tasked with considering what the country's trade policy should be in the new circumstances. The prior assumptions are no longer operable—that there would always be progress within a multilateral negotiating forum and that the existing dispute settlement system can be maintained without change. Each government should consider what steps it can take to ensure that the multilateral trading system functions effectively.

Each should determine where its interests lie and how to go about fostering them, or it can let nature take its course. Nature, unfortunately, is not always kind nor is it predictable.

### OUTREACH

Once objectives are set, it is axiomatic that no single country is

going to dictate the external environment in which its trade will take place, even if it resorts to barter, which is neither likely nor desirable. This requires working in cooperation with others. In fact, some of the policy planning will no doubt be an iterative process resulting from contacts with the governments of other trading nations, and can be the product of a joint policy planning process.

#### COALITIONS OF THE WILLING WITHIN THE WTO ON MULTILATERAL APPROACHES

Once an agenda is agreed, the next step is to put it into effect. Differing constellations of WTO members will coalesce around issues for reform and progress at the WTO. Ministers must be engaged in capitals while in direct contact with their representatives in Geneva, and meeting in special sessions to drive progress.

#### PLURILATERALS

Fully multilateral agreement in their purest form no longer are created. Agreements exist, a number within the WTO, in varying hues reflecting differing levels of obligations. This is the case in the Trade Facilitation Agreement, the Information Technology Agreement, and for that matter, most of the agreements in the WTO. The Government Procurement Agreement is the starkest example of this phenomenon. Differing levels of obligation, as they remain proportion to levels of benefit and capacity provide flexibility in reaching broader accords.

#### REGIONAL TRADE AGREEMENTS (RTAs)

Regional trade agreements (RTAs) have their place, and are irresistible as forward progress in the WTO is not always possible, but also because regional integration can be a net positive for the world trading system. RTAs should always be negotiated with a view to having as positive an impact on the multilateral trading system as is practicable. At their best, they should be templates for eventual WTO agreements. This was a reasonable purpose to ascribe to both TPP and the Transatlantic Trade and Investment Partnership (TTIP).

## CONCLUSION

### KEY RECENT ACCOMPLISHMENTS AND NEEDS GOING FORWARD

*Bringing Agriculture and Services under the multilateral framework, regulating domestic subsidies.* The Uruguay Round outcomes were just a start and contained a built-in agenda to further develop the rules and open markets. Aside from the deal in Nairobi on export subsidy elimination (which is a major step forward but by the way has yet—two years down the track—to be implemented in schedules of some major players), there has been no progress on these issues. Further disciplines on agriculture and industrial domestic subsidies and further opening of agriculture and services markets are way overdue.

*Binding dispute settlement.* It is a major step forward for all members to have the possibility (even if it is more theoretical for some) to be able to enforce the contract. Of course, nothing is perfect and there are still ways in which some can look to game the system—e.g. through compliance process—but in aggregate it is much better to have a system that keeps most honest than the alternative.

*What more do we need.* The key overall point is that the world (and the way in which business is done) has changed over the past 20 years. In addition to getting the unfinished business from the 20<sup>th</sup> (and 19<sup>th</sup>) century sorted, we need to be able to address issues of relevance to today's world—particularly in the digital space.

And importantly, there is also, as yet, so real substitute for positive U.S. engagement in looking to further open markets and strengthen the system. I do not believe that this is the end of the story. I think that the U.S. will at some point be back. Theory as to what is the best trade policy can only take national action so far. At some point reality intrudes.

One prominent trade minister, a strong critic of the WTO in a number of respects, reportedly said recently, “If the WTO did not exist, it would have to be invented.” That is a good thing to remember and take to heart. Care must be taken that the world trading system supported by the WTO is not eroded through ill-advised trade-limiting national measures or simple inattention on the

part of governments and major private sector stakeholders and civil society. What we have is in some respects imperfect but re-creating even this system might prove to be an impossible task.

We need to cherish the legacy we have received in the form of the WTO, and we need to maintain it and improve it.