The WTO needs a Plan B

If the WTO members do not reinvent the WTO, the world will return to less prosperous times.

The author:

Gabriel Felbermayr
President, Kiel Institute for the World Economy

The institution:

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The World Trade Organization (WTO) has brought enormous benefits to the international community. In small, open economies, such as the Netherlands, around a quarter of the wealth per capita depends on the WTO trading system; in Germany, the figure is around five percent or USD 66 billion. The economic gains for China or the US are even bigger in absolute terms. But the multilateral trading order is in a deep, existential crisis – to which there is no easy solution. The WTO must reinvent itself if it wants to prevent the world from returning to less prosperous times.

On April 15, 1994, when the GATT members agreed on the Marrakesh Declaration that led to the creation of the WTO, there was a shared vision of the future geopolitical landscape. Following the demise of Soviet-style communism, it was generally assumed that all countries would gradually transition to a democratic, market-based system. The only remaining superpower, the United States, would create a liberal world order in its own image.

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political fault lines as the economic and humanitarian systems of the various political actors converged. Unfortunately, that hope has failed to materialize — as is now abundantly clear from the current rivalry between “Western” democratic market capitalism and the autocratic state capitalism of some emerging economies, notably China.

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This is the fundamental problem facing the WTO. Currently, the organization has 164 member states, ranging from the extremely poor to the extremely rich, from some of the world’s most appalling autocracies to model democracies, and from illiberal, closed economies, such as Venezuela, to very liberal ones, like Singapore. And even if countries have very similar institutional structures, they may pursue quite different interests within the WTO.

The WTO is an entirely member-driven body, with each member having an equal right of veto, except in the proceedings of the now defunct Appellate Body. Given the enormous diversity of its members and systemic competition between major nations, such as the US and China, it is very difficult for the WTO to agree on a common set of rules. There are widely differing views on key economic matters, for example, including the legitimacy of state subsidies and the issue of monopoly power.

This political divergence within the WTO has been accompanied by a convergence of economic power. The GDP of the G7 countries as a percentage of global GDP has declined from almost 65 percent in the early 1990s to less than 40 percent today. The economic rise of the non-G7 countries has been driven in part by the integration of former low-wage countries into the global value chain. However, this economic convergence has not led to the hoped-for political convergence.

The motivation for liberalizing world trade has always been to promote economic convergence. That objective has been achieved. Some of the greatest beneficiaries of the WTO’s multilateral system have been countries that formerly have been relatively poor. The fact that China has been particularly successful without having copied the Western democratic, free-market model is a cause of widespread concern.

The United States, and probably also many European countries, would never have agreed to China’s accession had they known that, just a quarter of a century later, China would overtake them economically — using a radically different and opposing social model. China stopped aligning its economy with the Western model following the global economic and financial crisis of 2009, if not before, making the incompatibilities between Chinese state capitalism and the Western economic model increasingly obvious. The situation has been further exacerbated in recent years as China seeks to export its own model through the Belt and Road Initiative. It is thus hardly surprising that the United States has been gradually abandoning the role it assumed back in the 1990s as the driving force behind a more liberal world trade system.

Political differences and increasing economic parity are not an issue in themselves. However, they do become a barrier when trust breaks down between key actors and each suspects the other of opportunistic behavior. Trust doesn’t appear to have been an issue when China was originally admitted to the WTO in November 2001. Since then, it has declined significantly, though.

The World Trade Organization was developed for a world with no major geostrategic rivalries. The basic premise of the WTO (and of its predecessor, the GATT) was that the sole objective of economic policy should be to increase per capita income. This universal focus leads to a simple logic: whenever liberalization of international trade results in higher per capita income, it should be welcomed. Under this model, all countries benefit from an increasing division of labor, although some trading partners benefit more than others. There has to be considerable trust for this positive-sum logic to work. Every trading partner must be sure that their dependence on foreign import and export markets will not be exploited by others. The larger the trading partner relative to one’s own economy, the greater the threat.

A high level of trust between actors makes it easier for them to view per capita income as the main or only political objective in multilateral negotiations. The lower the level of trust, the more the actors will try to erode the relative economic power of their opponents — even if that means weakening their own economy somewhat in the process.

When policymakers no longer focus exclusively on per capita income, but also and possibly even primarily on the size of their own economy relative to their systemic competitors, the world switches from a positive-sum game to a zero-sum game. Actors are more concerned with the distribution of existing economic and political power than with creating and sharing new wealth. In such a world, the WTO’s textbook model is doomed. The principles of reciprocity and non-discrimination that have been so successful are no longer powerful enough to secure the benefits of cooperation. In the battle for economic power, the weapons deployed include tariffs, exchange rates, and international investment.

Many of the current tensions and developments in economic policy are due to the reemergence of systemic competition. Trading partners frequently adopt a mercantilist position, choosing policies that reflect their trade balance with a given rival. John Maynard Keynes, the intellectual godfather of the failed post-WWII International Trade Organization, was aware of this problem and advocated mechanisms to ensure balanced bilateral trade. The WTO (quite rightly) has no such rules for bilateral trade balances, as they do nothing to promote the shared prosperity generated by international trade relations in a positive-sum model.

Faced with systemic competition, it is also natural for policymakers to focus on
The challenge is to adapt the WTO’s rules to reflect the current complex political and economic realities.«

This could be achieved by means of a “club system.” A core of democratic market economies with mutually compatible value systems could then deepen their economic integration, surrender a certain amount of freedom with regard to their trade policy, and transfer sovereignty to joint dispute settlement bodies. Trade with countries whose economic systems are not compatible with this type of arrangement would be subject to a special set of rules similar to the pre-1995 GATT provisions, rather than those of an updated WTO.

In some respects, the WTO is already doing this, with members forming like-minded, plurilateral groups, which exclude systemic competitors. This two-pronged approach has its shortcomings, of course. It is only the second-best solution in a world of mutual distrust between trading partners. However, the primary threat is one of complete system failure – which would have much graver cost implications. The European Union should take the lead here.

Finally, the WTO should promote bilateral trade agreements between members. Although a poor substitute for a multilateral system, bilateral agreements at least offer some certainty at a time when the global trading order is being renegotiated. These bilateral arrangements need to be compatible with the multilateral solution that becomes possible when a new global order has been established.

The WTO marked its 25th anniversary on January 1, 2020. If the international community wants to celebrate the 30th anniversary of the WTO, it must face these realities and act now. What is at stake is the prosperity of the world – and perhaps even more than that.