The Future of the WTO and the International Trading System: Investigating the Institutional Crisis

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Abstract: this paper explores a number of the forces that have contributed to the current institutional stalemate in multilateral trade diplomacy and advances a range of proposals, both procedural and substantive, aimed at enhancing the governance of the WTO and imparting forward movement to its rule-making and market opening functions.


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Background considerations

Charting a future course for the WTO at a time when its membership is as mired as ever in the intractable challenges put up by the Doha Development Agenda is a decidedly daunting task. As the contributions to today’s workshop unanimously attest, it has, sadly, become increasingly difficult to talk of the Doha Round in the present tense. In my two and half decades of involvement in trade diplomacy, I cannot recall a moment as uncertain – some would say bleak - as the one the multilateral trade community currently confronts. A mere decade ago – remember Seattle and its immediate aftermath, the WTO was viewed by many as the very embodiment of all that was wrong with corporate-led globalization. For a short while, it even dislodged the IMF as the world’s most vilified international organization. Today, the Geneva-based trade body almost inspires pity.

There is, of course, undue hyperbole in the above comments. Trade policy has a marked propensity towards emotional overshooting. It is a policy domain whose practitioners typically promise more than can realistically be delivered, notably by assigning to trade policy objectives it is ill suited to pursue (e.g. short-term employment gains). It is also one whose detractors hold responsible for outcomes over which trade policy typically does not exert first order influence.

Furthermore, undue WTO-pessimism typically derives from the predominant tendency to regard the trade body as a one-trick (i.e. market opening) pony. There is little denying that the WTO’s trade liberalizing and decision-making machinery show a number of worrisome signs warranting serious attention. Still, one would be hard pressed to sustain the argument that the WTO’s equally core adjudicatory and
surveillance functions suffer from debilitating institutional shortcomings. Maintaining a sense of policy proportions is thus a precondition for thinking clearly about what might lie ahead for the multilateral trading system.

This paper identifies a number of issues – some in the form of factual observations, others of a more prescriptive nature – likely to weigh on the future of the WTO and the multilateral trading system.

I. Recalling the costs of non-Doha

The Doha Round was all but buried at the WTO’s December 2011 Ministerial Meeting. Still, a few words on the costs of non-Doha, both direct and indirect, and over both the short and longer terms, are worth recalling as these are non-trivial. The direct short-term hit from non-Doha may well be more symbolic than real. The World Bank and many leading think tanks and academic researchers have in recent years greatly reduced the scale of the direct economic benefits of what is on the table, arguing in some cases that a completed DDA would contribute a mere few weeks of extra growth to the world economy.

Yet such calculations can be greatly misleading. For one, they often tend to be static in character, when in fact trade agreements typically deploy their beneficial effects dynamically over the medium- and long-term as negotiated commitments and agreed rules are phased-in. One should thus bemoan the fact that world leaders have not exhibited greater concern over the likely indirect, and longer-term, costs of non-Doha. These include:
(i) the loss of economic confidence that failure of essence entails, doubtless of greater salience at a time of still tepid economic recovery in many parts of the world, and notably on this continent;

(ii) evidence of the further breakdown of multilateralism and the capacity for collective action;

(iii) proof of the failure to deliver on the promise of a development round (compounding the failure to honour successive G-8 aid pledges); and

(iv) an inevitable ebbing of the WTO’s authority, feeding in turn the greater temptation (and observed greater marginal propensity) towards non-compliance by key members.

By almost any standards, and certainly by the trading system’s historical standards, what was on the DDA table before its fate was de facto sealed last December was far from commercially trivial (with the possible – and yet altogether not surprising - exception of services, the weakest leg in the DDA’s market access trinity).

A completed DDA would have marked the first significant cut in industrial tariffs by the majority of its developing – and especially emerging – country members (other than those who have recently acceded to the world trade body by generally paying a high price of admission). The DDA also promised significant forward movement in dismantling hitherto Himalayan obstacles to trade in agriculture after the decidedly tepid market opening advances of the Uruguay Round in the sector.

To progress and chart a sustainable future path, the WTO system arguably needs a revamped operating system – WTO 2.0 so to speak - one that ensures greater adequacy between the world economy of today and the trade rules that should govern such a new environment. Such an operating system would need to be firmly anchored in the trade
policy realities WTO Members face in 2012. Absent such adaptive efforts, the multilateral community is left with a rule book designed in the early 1990’s - WTO1994 in trade speak. Tectonic changes have occurred in the world economy since the end of the Uruguay Round, and the inability of the WTO membership to revisit its collective rule-book seems certain to shackle the institution’s quest to stay relevant and negatively affect the legitimacy of those functions that the WTO has continued to perform well even with a dated rule-book. The costs of non-Doha are thus not merely commercial in character. They also carry genuine institutional consequences. Any meaningful effort to “reset” the WTO button must thus focus on the need for change on both the liberalization and rule-making fronts alongside the organization’s decision-making machinery.

II. Negotiating against the backdrop of a world in transition

Many reasons can be adduced in explaining the WTO’s current travails. Perhaps the single most important of these is the global transition towards a multi-polar world with which the DDA coincided. This transition has seen an “old” economic and trade aristocracy (which the “Quad” grouping2 used to embody) somewhat in denial over its relative decline – what Jagdish Bhagwati famously coined the “diminished giant syndrome”, and a considerably younger emerging and developing country bourgeoisie not yet used to or unwilling to fully assume the obligations that come with its newfound might. Yet, with voice comes responsibility! The tragedy of the Doha Round was to be sandwiched between these competing forces.

In systemic terms, the DDA has witnessed the difficulty, pervasive in policy domains other than trade - think climate change or nuclear non-proliferation - that

2 The Quadrilateral Group of Members comprised Canada, the European Union, Japan and the United States.
multilateralism encounters in the absence of a benign hegemon. The relative decline of yesterday’s hegemonic powers, and first and foremost the Transatlantic partners, and their increasing political intolerance towards free riding by major emerging powers, have singularly reduced the range of acceptable bargains in Geneva.

Launched in the ancien régime, with a substantive agenda heavily influenced by the policy preferences of the system’s former rule-making powers (the “Singapore Issues” being a case in point) even as it came with a development coating in the emotive immediacy of the tragedy of 9/11, the DDA quickly revealed a new and considerably more contestable and democratic landscape of multilateral diplomacy, one in which alliances between developing countries and with assertive non-governmental actors shaped a market for “voice” in trade matters that has clearly complicated the quest for consensus.

The fact that the DDA also coincided with the ongoing prosecution of the Washington consensus and its trade policy tenets - a process which the financial crisis of 2008-09 visibly reinforced, heightened demands for clawing back policy space foregone during the Uruguay Round. Confronted with such doubts and their vocal, articulate, expression at the WTO, it is not altogether surprising that the leading members of yesterday’s trade policy Directoire have sought refuge in alternative negotiating fora, asserting their still considerable negotiating leverage in the narrower confines of (often highly asymmetrical) bilateral investment treaties and preferential trade agreements whose numbers have mushroomed since the curtain fell on the Uruguay Round.
III. More - and less - than meets the eye

Not all, however, is bleak in this story. The world economy is considerably more open – and domestic markets considerably more contestable - than one might be led to believe in trade negotiating circles. This is a result both of unilateral benevolence – for the most part (and notwithstanding the recent rethink described above) countries have voluntarily pursued policies that engage world markets in recent decades, as well as a reflection of the significant doses of WTO+ and WTO-X\(^3\) advances secured via preferential trade and investment agreements. The gap between what host countries do in practice and where their negotiated commitments stand at the WTO has become significant. This is most noticeably the case for services trade and investment.

Should the above developments be a cause for concern? Is there a risk that preferential advances lead to a form of preference addiction capable of durably undermining and marginalizing the WTO? The traditional narrative on the WTO’s alleged institutional crisis assigns to ascendant regionalism a fair share of the blame. This, in my view, confuses symptom with cause. As the WTO’s latest World Trade Report devoted to preferential agreements aptly recalled, if one excludes intra-EU trade, only 16% of world trade is actually conducted along preferential lines. Moreover, some 87% of trade conducted preferentially carries preference margins averaging 2 per cent.\(^4\)

What’s more, with the bulk of today’s trade policy agenda devoted to “behind the border” issues of a non-tariff/domestic regulatory nature, much of what is negotiated and committed to in preferential trade agreements (PTAs) tends to be applied on a \(de\)
facto MFN basis. Finally, and perhaps most importantly, the rise of preferentialism is part and parcel a response to a world in which the production of both goods and services increasingly takes place along value chains where geography, time zone differences, trade and transport costs can be best optimized through “neighbourly” forms of economic cooperation.

Still, for those who worry about the systemic downsides of rampant regionalism – and there are many, a strengthening of WTO disciplines (Article XXIV GATT and V GATS) governing the multilateral trading system’s interface with PTAs could be envisaged whose aim would be to extend all PTA preferences on an MFN within a date certain that could be differentiated according to PTA members’ level of development (for example 5 years for OECD countries, 7 to 10 years for developing countries, and up to 15 years for least developed ones).

IV. Governing a world of fragmented production

The fragmentation of production and the rising salience of trade in intermediate inputs, both goods and services, and the greater ease with which production can today be splintered, outsourced or remotely supplied – a phenomenon trade theorists have coined “trade in tasks”, has been changing the geography of trade and investment in ways that the WTO system has proven slow or incapable to respond to. For one, the WTO does not offer a coherent arsenal of investment rules able to govern the rising tide of efficiency-seeking (and typically export-promoting) foreign direct investment that has come in the wake of the trade in tasks’ (alternatively dubbed “Made in World”) phenomenon.
As noted above, such an objective has tended to be assigned either to bilateral investment treaties or to PTAs featuring comprehensive norms on investment protection and liberalization (which, the relevant literature informs us, tend to induce greater FDI effects given the increasing complementarity between trade and investment activity).

Similarly, the WTO has not proven particularly adept at liberalizing cross-border trade and investment in services - the most vibrant component of the world economy in recent decades – and where a host of activities play a central trade-facilitating role in a world of ever-fragmented production. The fact that the DDA was effectively taken hostage by the developmental symbolism of agricultural liberalization (with both offensive and defensive interests conspiring in the policy kidnap) has afforded comparatively little space for a services bargain to emerge. Here again, attention has shifted away from the WTO towards PTAs and, most recently, towards a called-for International Services Agreement (ISA)\(^5\) whose possible anchoring at the WTO in the form of a conditional MFN plurilateral agreement remains an important unresolved issue.

V. **A growing disconnect between product and negotiating cycles**

Much ink has been spilled bemoaning the relative apathy, relative to the Uruguay Round, of the global business community towards the DDA and the WTO more

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generally. Today even anti-global NGOs have a hard time mobilizing their troops over the putative ills that the process of WTO negotiations is meant to spread on an MFN basis! The WTO Public Forums held in Geneva each autumn have gone some way towards reducing policy temperatures in trade circles, embodying the WTO’s (and its Members’) laudable efforts to make the organization’s modus operandi more transparent. The more regular and transparent trade policy dialogue process that has characterized the post Seattle environment greatly complicates the life of conspiracy theorists!

The lower degree of business engagement in multilateral trade diplomacy reflects a growing disconnect in the parallel universes negotiators and business people tend to operate in. Globally active (and especially publicly listed) firms contend with ever-shortening product cycles as competition intensifies in world markets. A familiar case in point is the dizzying pace at which Apple and its main competitors introduce new versions of mobile phones or tablet computers. At the very same time, the pace at which trade negotiations proceed has slowed down noticeably in each successive multilateral round. This is so for many reasons, including the growing complexity of the new issues tackled (e.g. services, trade-related intellectual property), the (concomitant) declining harvest of low-hanging fruits likely to sustain negotiating momentum, and the sheer difficulty of reaching consensus in a negotiating setting made more challenging by the (paradoxically) legitimacy-enhancing but institutional efficiency-curtailing expansion of the WTO membership (to say nothing, for now, of the manner in which negotiations proceed, i.e. the Single Undertaking).

Incapable of projecting themselves several product cycles ahead of time, private sector interests have, once more quite logically, fed the political demand for preferential trade agreements in view of their demonstrated ability both to secure WTO+ and WTO-X
outcomes more speedily and to tackle a host of trade-facilitating regulatory convergence agendas with greater relative efficacy.

VI. Death by Single Undertaking

A strong case can be made that the (partial) institutional crisis confronting the WTO system is home-made. There is today a pressing need to consider constitutional changes in the WTO’s governance structure and modus operandi so as to allow greater flexibility in decision-making, agenda-setting and the very conduct of negotiations. Simply put, the time has come to reconsider the pros and (mostly) cons of the Single Undertaking and explore ways of embedding needed doses of flexibility into the multilateral trading system. The EU’s rich experience with multi-speed economic integration make it ideally suited to supply the policy impulse needed on this front.

Conceived at the end of the Uruguay Round by the Quad countries as an anti free-riding political straightjacket so as to ensure full compliance by all Members with the Round’s ambitious outcomes⁶, the Single Undertaking has today become one of the most powerful sources of collective inertia in the multilateral trading system, providing an effective veto to all members and a ready-made excuse to foot drag for those wishing to do so, whether for substantive or tactical reasons. A sad but symptomatic case in point was provided at the 2009 WTO Ministerial meeting, when determined opposition from a small subset of Members (collectively accounting for less than one half of one percent of world trade) managed to jettison any meaningful discussion of a number of reasonable proposals on structural reform issues. The sad fate of the Singapore Issues at the WTO’s Cancun Ministerial in 2003 offers another example of the tyranny of the

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⁶ From a developing country perspective, preservation of the Single Undertaking may also have been motivated to secure the protracted – and overall unsatisfactory - bargain on agricultural trade wrested from developed countries in the Uruguay Round.
Single Undertaking, even if some responsibility for the debacle also lies with some of the protagonists, among which the EU.

Far from suffering from an alleged democratic deficit, the WTO is arguably afflicted by an excess of democratic virtue! Ways must today be found to embed greater doses of variable geometry in - and/or critical mass approaches to – the way in which decisions are taken, agendas set, negotiations conducted and agreements reached. The Warwick Commission, whose December 2007 report on the future of the multilateral trading system the author contributed to, offered several sensible ideas and criteria in this regard which have in my view retained their full relevance.7

On many rule-making issues – take trade and competition or trade facilitation for instance, the risk of free-riding on MFN-brokered outcomes is arguably non-existent. Critical mass or full (i.e. unconditional) MFN approaches can and should thus be envisaged in such instances. Where market access issues are more prominent – think services, government procurement or investment for example, there is clear legitimacy to the belief that non-participating members should abstain from claiming or be rewarded with MFN benefits. In such instances, MFN-constrained plurilateralism in the manner of the numerous codes brokered in the Tokyo Round could define the new norm, so long as all WTO Members are free to take part in the negotiations in a fully transparent manner, that these are serviced impartially by the WTO Secretariat, and that all Members are given the opportunity to opt-in at a later date if desired through an accession clause designed for this purpose.8 The experience from the Tokyo Round


8 The recently launched discussions on a possible plurilateral International Services Agreement do not appear to date to have been pursued in an open, transparent, manner, with both the WTO Secretariat and would be observers currently unable to attend ISA meetings.
codes suggests that their “partial equilibrium existence” helped pave the way for their subsequent multilateralization in the Uruguay Round (admittedly with the help of the Single Undertaking).

The WTO could thus aim to become what Robert Lawrence once dubbed “a club of clubs” in regard to new rule-making or market opening compacts. The Organization’s increasing diversity – and the overwhelming influence that developing countries already wield given their share of its membership – a trend that is set to grow as pending accessions proceed – makes the quest for greater flexibility all the more justified and necessary.

VII. Walking on all four legs

The WTO is a four-dimensional construct, with executive (decision-making), legislative (negotiating), surveillance (monitoring) and judiciary (dispute settlement) functions. The problem today is that the WTO largely hangs by the thread of its judiciary, arguably its component with the weakest political legitimacy. While the recent economic crisis and the policy measures taken in its wake have shed useful light on the important surveillance functions assumed by the WTO, an area where the Secretariat benefits from – and has made active use of - greater autonomy on the part of an otherwise micro-managing membership, both its executive (decision-making) and, especially, legislative (negotiating) functions have ceased to work properly. This fuels the apathy of its main cheerleaders in the private sector and reinforces the shift towards (more speedily concluded) preferential agreements.

Bernard Hoekman’s contribution to this workshop lists the promotion of greater institutional coherence between the WTO and other leading international institutional (and the complementary policy domains they operate in, such as the World bank, the IMF, the ILO, etc.) as a fifth core focus of the WTO.
It matters that the WTO walks on all four legs and that each one of these legs be reinforced. A useful step in this direction was taken in the Doha Round with regard to the notification and multilateral surveillance of preferential trade agreements. Similarly, the WTO Director General deserves credit in ratcheting up, together with other international organizations (UNCTAD and the OECD), the degree of post-crisis scrutiny of Members’ trade policy stances.

Still, a system that delivers on only two of its four core mandates and increasingly assigns to dispute settlement (and thus to unelected judges and, in many instances, non-expert first instance panellists) that which its Members cannot reach agreement on at the negotiating table, is a system that is likely more fragile that many are prepared to admit. Proposals to professionalize the dispute settlement system through the establishment of a permanent body (or rosters) of first instance judges seem sensible in this regard.

VIII. Moving forward on substance

Forward movement is not a luxury for the WTO system, it is an absolute necessity, not least because the world of trade and investment is ever changing, with new patterns of comparative advantage and, thus, a new geography of trade and investment integration emerging, new voices in need of being heard, both within and outside the trading system, trade and non-trade sensitivities in need of greater policy reconciliation, new responsibilities assumed by those whose systemic influence has recently become significant, and new negotiating challenges addressed.
The need to tackle new negotiating issues and to revisit some slightly older new issues forms a central part of any serious attempt at charting a future course for the WTO. I do not share the optimism of those calling for nothing less than a reinvention of the WTO. I do not believe such a task possible nor do I see it as necessary as all is not broken in the system to start with.

There is certainly no shortage of possible candidates for new issues to be tackled at the WTO, starting with the “old” new issues of investment and competition, which were taken off the DDA radar screen for all the wrong reasons and whose links to trade and pro-competitive regulation in a globally integrated world economy should be clear to all by now. The case for migrating investment law to the global level should not prove unduly arduous given the pervasiveness of its treatment in PTAs. The most challenging dimension of such a migration – the multilateralization of investor-state arbitration – could actually offer a ready-made platform to fix the many travails of the current dispute settlement system in the investment field, notably by shifting the onus towards dispute mediation.

A similar migratory journey will likely take longer on the competition front, not least because of the weaker degree of internationalization we start with (even PTAs have tended to underwhelm to date at this policy interface), and the more acute bureaucratic obstinacy of major institutional players. Some degree of prior or parallel PTA experimentation may thus prove necessary on this front.

Among the set of issues that will also likely need to command greater attention are the trade policy implications of measures taken to mitigate the effects of climate change. This challenge will of essence entail a revisiting of rules on contingent protection in
ways that may require re-balancing given the rising ascendancy of environmental considerations in the hierarchy of economic policy making.

Another arguably pressing issue is that of digital trade, on which the Uruguay Round was silent and where WTO rules remain grossly inadequate given the business interests at stake and the staggering growth (and potential for further growth) in e-trade since the entry into force of the Marrakesh Agreement establishing the WTO. This is yet again an area where PTAs have raced ahead in a manner that continues to inform – and should thus greatly facilitate - multilateral rule-making and market opening.

The complex controversies lying at the interface of trade and labour – both trade-related labour standards and trade-related labour mobility - form yet another challenge that WTO Members will need to address or revisit if globalization is to remain politically and developmentally sustainable. The Stolper-Samuelson theorem, which alerted us to the fact that a country’s scarce factor of production (labour in OECD countries, capital in most developing countries) tends to incur the steepest costs from trade opening, still has legs! Indeed, the outsourcing revolution has clearly given it new life as concerns over the redistributive impacts of freer trade and investment flows, which now extend to highly educated, politically vocal, white collar workers in the service industries of advanced industrial economies have become real as the labour market for skills becomes truly global in character. The above concerns will likely need to find some resonance in trade agreements. Better that be in the WTO than in asymmetrical North-South PTAs.

Addressing the challenge of (high-skilled) labour movement will likely prove no easier. Many would argue, perhaps convincingly so, that migration-related trade matters are best left to bilateral confines, including non-trade agreements (such as bilateral guest
worker programs or migration partnership agreements). While true in some regards, this would still be short-changing the enormous potential this issue carries. There is much indeed that WTO negotiations can deliver by devising win-win scenarios on trade-related labour mobility involving more active cooperation between sending and receiving governments, their trade and migration-labour market officials, as well as the private sector (employers). This challenge needs to be tackled imaginatively as the world economy and globally active firms contend with acute shortages of labour across the skills spectrum and pronounced demographic transitions proceed in many parts of the world.

A further issue that is certain to warrant closer trade scrutiny in the coming years, in ways that will once again make clear the close links between trade, FDI and competition law, is the issue of cross-border trade and investment in natural resources (agriculture and extractive industries, including the oil and gas sector). The recent spate of concerns over export restrictions in agriculture and mining, the race for resources, the clear potential of extra-territorial anti-competitive effects of commodity arrangements, the rise of economic patriotism in the management and ownership strategic natural resource sectors, have revealed clear gaps in international rule-making in need of concerted collective action aimed at keeping markets open while also safeguarding consumer interests. The WTO offers a natural forum for tackling this complex and politically sensitive set of issues.

The current debate over the ripple effects (including on other emerging nations’ trade) of the trade and investment distortions stemming from alleged currency manipulation is certain to translate into continued calls for greater WTO activism. Gary C. Hufbauer’s contribution to this workshop usefully summarizes the resonance this issue commands in US policy circles. These are doubtless widely shared in many European capitals. But
dangers lurk in this area given the one-sidedness of the proposals advanced (with China as the script’s sole bad guy). Considerable caution should be exercised in this latter regard. Such precaution recalls the work of yet another Nobel Laureate in economics – the Dutch economist Jan Tinbergen and his “assignment problem” theorem. We should be leery of undue mission creep in assigning to the WTO issues trade diplomacy may be ill-equipped to mediate credibly in institutional and political terms. The issue of currencies and global imbalances is one where finance ministries should maintain the lead, even as greater dialogue with their trade brethren needs to be institutionalized.

Many would argue that the above observation clearly also applies to the trade-environment or trade-labour debate. That may well be true. But that is why a serious debate over the proper remit of the WTO’s rule-making boundaries should be had now that the organization’s negotiating machinery has been put in (hopefully) temporary abeyance.

A final point in looking forward concerns the need for WTO Members to build bridges between the GATT and GATS and pursue such agendas as legitimate expressions of the need to move beyond the artificial boundaries between goods and services trade inherited from the Uruguay Round.

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11 The case for targeting WTO Members shown to manipulate their exchange rates so as to afford a trade benefit to their exporters forms one side of the trade-currency coin. What then should be made of the currency misalignment effects flowing from the unorthodox set of monetary policies (quantitative easing) pursued by the United States and other countries in the wake of the recent financial crisis. The capital outflows such policies have induced have led to significant currency appreciation in a number of emerging countries, negatively impacting export prospects in such markets. In the case of proposed disciplines on the trade-distorting effects of home country support measures towards state-owned enterprises, would such disciplines not also apply to those enterprises which benefited from significant capital infusions from the bail-out programmes in banking, insurance or automotive sectors enacted in the wake of the most recent financial crisis?

12 For a fuller discussion on the pros and cons of tackling the trade distorting effects of currency misalignment in the WTO, see Staiger, R. and A. Sykes (2010), “Currency Manipulation and World Trade”, in World Trade Review, Vol. 9, No. 4, pp. 583-627
A few simple examples come to mind on which useful, North-South bridging, coalitions of the willing could be assembled. These include:

(i) Adding a WTO-brokered services component to the 1996 Information Technology Agreement, focusing on Modes 1 and 4 of the GATS;

(ii) Creating synergies – indeed a development-enhancing, supply-side enabling, bottleneck-removing package – between the GATT-centred discussions on trade facilitation (on which significant (and significantly consensual) progress was made in the DDA) and the broad universe of services that give operational, day-to-day, meaning to the very act of trading across borders. The DDA’s GATS cluster on logistics services is a useful starting point, but the circle ultimately needs to comprise elements of all transport modes on which far too little progress has been registered to date despite its centrality to trade facilitation and, indeed, to trade more generally.