
Future of the Global Trading System

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The first two decades of the WTO's life were quite dull, but the last five years have been anything but dull.

International supply chains are consciously being disrupted. Trade barriers have risen. And the rules-based trading order is under greater strain than at any time since the 1930s.

Today, I want to share some views on how we reached this point, how it will affect the Australian and the broader international economy, and what policy options do we have, as a mid-sized open economy to shape the rules-based trading order.

What is the world trading system?

Like most good ideas, the rules-based trading order is simple in concept and yet profound in its reach.

It is built from a shared commitment to free and open markets and is underpinned by just three principles: non-discrimination, transparency and reciprocity.

These principles are translated into agreed norms of practice that are codified and pervade trade agreements and country level policies.

They provide predictability and give a voice to all nations, big or small, rich or poor.

The rules-based order was a bold plan – and it worked.

It has secured progressively lower trade barriers and kept them low. This has been a driver of economic growth, lifting living standards and contributing to poverty reduction.

The World Bank estimates that over the past quarter-century, more than a billion people elevated themselves out of extreme poverty, in many cases by seizing the opportunities trade has created.

The world trading system's authority and credibility are wavering

Despite the world trading system's strengths and accomplishments, support for this liberal global order is wavering.

In President Trump's inaugural address, he declared:

We must protect our borders from the ravages of other countries making our products, stealing our companies, and destroying our jobs.

His words were followed through with decisions that left few doubting his bravado.

- Three days after his inauguration he withdrew the United States from the Trans-Pacific Partnership agreement.
- A similar fate met the Transatlantic Trade and Investment Partnership negotiations.
- Over the next 24 months, tariff walls on a wide range of goods between the US and China were progressively raised.
- By the end of 2019, the average US-China tariff rate had reached 21 per cent, nearly a seven-fold increase from early 2017. And the average China-US tariff rate jumped from 8 to 21.8 per cent.

Tariff rates between the US and China have remained broadly steady since then.

In sum, over the past four years we have witnessed the fastest escalation in protectionist measures ever seen in the era of the rules-based trading order.

It's a major concern when countries not only begin to question the value of the rules-based trading order but take deliberate steps to weaken it.

Some feared this period would ultimately mark the moment the United States abandoned the rules-based trading system.

Troubles at the core of the trading system

Nevertheless, it would be a mistake to read too much into the US-China trade conflict. Tensions had been brewing below the surface for many years.

In a way these tensions were a symptom of a broader malaise, extending to the core of the rules-based trading order – the WTO.

There are also geo-strategic forces at play.

Clearly, there are significant challenges to address in each of the three areas of WTO responsibility: monitoring; negotiations; and dispute settlement.

Let's briefly look at each in turn.

The WTO monitors member states' trade policies.

When it works well, it restrains countries from applying trade restricting measures and defuses potential disputes through dialogue.

However, for it to work well it requires timely notification and open discussion of the issues in good faith. This is where the problem lies.

In late 2020, for example, a third of the 164 WTO members had not yet lodged their 2015 subsidy notifications.

Moreover, the information provided is often incomplete. A prominent example is where state-owned enterprises grant subsidies.

On trade negotiations, they have stumbled.

No broad multilateral agreement has been concluded since 1994 – over a quarter century ago.

It means the trade rules have not kept pace with new forms of trade, like the rise of global supply chains and digital trade.

Or kept pace with new issues, like forced technology transfer or the internationalisation of State-Owned Enterprises.

The TPP partly filled this void in the rules, but the global rules still need to catch up.

One of the contemporary difficulties with advancing multilateral negotiations is developing countries benefit from “special and differential treatment” under the WTO.

This allows weaker requirements for market access and longer timetables for implementing agreements, without reciprocating.

The issue is that countries self-identify as ‘developing’ and there are no established mechanisms for ‘graduation’ to ‘developed’ status. Only one country has ever declared their graduation to developed status.

This has been a slow burner issue for the WTO and is arguably one of the hardest ones to crack.

It has come to the fore as the developing country share of world trade, led by China, has risen sharply since the finalisation of the Uruguay round.

The third challenge relates to dispute resolution.

This is a surprising one, as most members would say it has been the biggest success story for the WTO.

The arrangements generally play an effective role in defusing tensions and avoiding retaliation that might degenerate into broader political conflicts.

The WTO’s Appellate Body has been the focus of criticism. The United States has raised procedural concerns, objections to the way the system operates and with the body’s interpretation of WTO agreements.

Against this background, appointments to the WTO’s dispute settlement Appellate Body have been blocked and since December 2019 it has no longer been functioning.

Pulling it all together, the combination of poor conformity with WTO monitoring processes, a lack of consensus on the rules needed to handle new issues and the erosion of trust between countries is undermining the integrity of the rules-based trading order.

The rules-based trading order, however, is not broken and remains the foundation of multilateral trade policy.

In fact, the WTO has secured several less widely known successes in recent years.

- Agricultural export subsidies have been abolished;
- Customs processes are being redesigned to facilitate trade; and
- A government procurement and expanded IT plurilateral agreements have entered into force.

A fork in the road: which way forward?

Notwithstanding these successes, Australia cannot afford to take for granted that continued progress will be made.

Even though the US and China has reached some kind of truce, the absence of trade conflict will not by itself reform the rules-based trading order.

The rules-based trading order, and the spirit of multilateralism more generally, has reached a fork in the road.

Leading off to the right, the trade fracas of the last four years could be the first act in what could become a prolonged era of nationalism and protectionism.

Leading to the left is a road yet to be sealed that restores trust and confidence in the multilateral system and can update agreed rules that deal with the challenges of the 21st century.

The Productivity Commission sketched out in a 2018 report a picture of what the destination reached would look like when turning right. It does not look pretty.

It is anyone's bet on what the destination when turning left ultimately would look like. But I am optimistic it will be the path followed.

Australia has a strong incentive to do so, as we and other middle-sized economies have the most to lose from a weakening of the rules-based trading order.

But the order is not an end in itself. It matters because it is a means to deliver higher living standards. And that's the basis on how reforms to the system's renewal should be judged.

What can Australia do alone?

Now let me share some thoughts on how to seal the path leading to the left.

This involves measures that Australia can take alone, and measures Australia could pursue in cooperation with others.

Let me start with the measures we can take alone.

The single most important policy setting for Australia is to keep our own borders open and to continue working towards freer markets, including through unilateral removal of barriers.

There is ample scope for the Australian Government to remove 'nuisance' tariffs, to lower non-tariff barriers and to simplify rules of origin.

Commission analysis has shown that a country gains most of all from reducing its own trade barriers, especially non-tariff barriers, regardless of what other countries do.

The prevalence of global supply chains only strengthens the case for lowering barriers while upholding and respecting agreed rules governing trade.

Australia has successfully pursued this strategy in the past. And up to now, it has largely not deviated from it.

An exception is our impulsive recourse to anti-dumping duties.

Despite their poor justification, use has intensified this decade.

More generally, governments need to make the case for open markets cannot be taken for granted.

This means better consultation and engagement with the community on prospective trade agreements and on the rationale for free trade.

Broader policies that strengthen the economy's resilience to technological changes and create an environment that spreads the benefits of globalisation more inclusively would also help build public confidence and acceptance in open markets.

At the end of the day, however, there is only so much that Australia can do on its own.

What can Australia do in co-operation with others?

Australia must also continue to work with other like-minded countries in efforts to help bridge the impasses facing the world trading system.

We have a lot to offer.

For instance, our experience operating a competitive neutrality complaints mechanism could be examined as a model for dealing with State Owned Enterprises, industrial subsidies and competition issues.

Another example lies with our mutual recognition arrangements that allow different regulatory regimes without impeding trade unnecessarily.

Resolving the deadlock on 'special and differential treatment' would be a major breakthrough.

Here, we could sponsor work in developing countries to promote awareness of the domestic gains from unilateral liberalisation and share our own experience.

We could also start a process to develop and build consensus on a framework for classifying economies and when they transition to a developed economy status.

There is also scope to initiate a dialogue on how to incorporate into WTO agreements the advances made in agreements negotiated outside the WTO fold, such as with digital trade and standards.

And we could pursue at the WTO the long overdue cause of reviewing existing WTO agreements.

Review provisions in the TRIPs Agreement, for example, have never been used.

These are just some of the options to strengthen and to move the rules-based order forward.

The stakes are high, and small steps, taken in the right direction, can make a big difference.

If we don't renew the rules-based trading order, it may be replaced – and we might not like what replaces it.