

CENTRE FOR
ECONOMIC
POLICY
RESEARCH

CEPR PRESS

Edited by Bernard Hoekman, TU Xinquan,
and WANG Dong

Rebooting Multilateral Trade Cooperation: Perspectives from China and Europe

Respect

Rebooting Multilateral Trade Cooperation: Perspectives from China and Europe

CEPR PRESS

Centre for Economic Policy Research

33 Great Sutton Street

London, EC1V 0DX

UK

Tel: +44 (0)20 7183 8801

Email: cepr@cepr.org

Web: www.cepr.org

ISBN: 978-1-912179-48-0

Copyright © CEPR Press, 2021.

Rebooting Multilateral Trade Cooperation: Perspectives from China and Europe

Edited by Bernard Hoekman, TU
Xinquan, and WANG Dong



This project has received funding from the European Union's Horizon 2020 research and innovation Programme under the grant agreement number 770680.



CENTRE FOR ECONOMIC POLICY RESEARCH (CEPR)

The Centre for Economic Policy Research (CEPR) is a network of over 1,500 research economists based mostly in European universities. The Centre's goal is twofold: to promote world-class research, and to get the policy-relevant results into the hands of key decision-makers.

CEPR's guiding principle is 'Research excellence with policy relevance'.

A registered charity since it was founded in 1983, CEPR is independent of all public and private interest groups. It takes no institutional stand on economic policy matters and its core funding comes from its Institutional Members and sales of publications. Because it draws on such a large network of researchers, its output reflects a broad spectrum of individual viewpoints as well as perspectives drawn from civil society.

CEPR research may include views on policy, but the Trustees of the Centre do not give prior review to its publications. The opinions expressed in this report are those of the authors and not those of CEPR.

Chair of the Board

Sir Charlie Bean

Founder and Honorary President

Richard Portes

President

Beatrice Weder di Mauro

Vice Presidents

Maristella Botticini

Ugo Panizza

Philippe Martin

Hélène Rey

Chief Executive Officer

Tessa Ogden

Contents

Foreword

Introduction 7
Bernard Hoekman, TU Xinquan, and WANG Dong

Cross-cutting institutional challenges

- 1. Reviving the negotiation function of the WTO:
Why the onus falls on the three major powers** 29
TU Xinquan and Robert Wolfe
- 2. Transparency and Local Subsidies in China and the United States** 45
Simon J. Evenett and KONG Qingjiang
- 3. China, the European Union, and the WTO Dispute Settlement Crisis** 61
LIAO Shiping and Petros C. Mavroidis
- 4. Special and differential treatment and developing country status:
Can the two be separated?** 75
Patrick Low
- 5. National security and other non-trade objectives under WTO law** 103
CUI Fan, Catherine Hoessler, and Stephanie C. Hofmann

Managing international competitiveness spillovers

- 6. Is it Possible to Promote an Agricultural Agenda in the WTO?** 115
LU Xiankun and Alan Matthews
- 7. About Knowledge and Rulemaking: Reforming WTO Rules on Subsidies** 127
LI Siqi and Luca Rubini
- 8. A Core Proposal for Reforming the WTO's Subsidy Rules** 149
LIU Jingdong
- 9. What kinds of rules are needed to support digital trade?** 153
Martina F. Ferracane and LI Mosi
- 10. Updating the General Agreement on Trade in Services** 177
Bernard Hoekman and SHI Jingxia
- 11. The EU-China Comprehensive Agreement on Investment:
A Model for Investment Coverage in the World Trade Organization?** 191
Jürgen Kurtz and GONG Baihua
- 12. State-Owned Enterprises and International Competition:
Towards Plurilateral Agreement** 211
Bernard Hoekman and André Sapir
- 13. Climate Change, Trade Policy, and the WTO** 225
ZHANG Jianping and XIE Zhiyu

FOREWORD

As multilateral trade negotiations have stagnated and tensions between major players have surged, the relevance of the World Trade Organization (WTO) has waned in recent years. The WTO is no longer fulfilling one of its primary functions – to provide an effective dispute mechanism for trade-related disputes. WTO members are increasingly pursuing bilateral and regional agreements, and on occasion resort to pursuing unilateral action outside of the WTO. These developments are undermining the rules-based multilateral trade order.

To remain a key element of the global trade framework, the WTO must evolve to sufficiently meet the demands of its members in a rapidly changing world economy. In order to do so, substantial changes are needed to revitalise the institution and rebuild confidence in its capabilities - meaningful cooperation between the major trade powers is essential for progress.

This CEPR eBook, a product of a Horizon 2020 research project on Realising European Soft Power in Economic Cooperation and Trade (RESPECT), brings together leading experts in international trade policy from China and Europe to provide new analysis on the key issues facing the WTO, and explores in detail potential avenues to revitalise the institution.

The eBook starts with an introduction by the editors, and then continues with various contributions that highlight the importance of reforming the dispute settlement functions, improving transparency, and negotiating agreements on a core set of areas where national policies create negative spillover effects. The focus is on fundamental issues relating to the operation of the WTO, and includes proposals for moving forward on a plurilateral or multilateral basis. This publication builds on previous research on WTO reform, and makes important contributions towards formulating an effective roadmap for change.

CEPR is grateful to Bernard Hoekman, TU Xinquan, and WANG Dong for their editorship of this eBook. Our thanks also go to Alexander Southworth for his expert handling of its production. The Editors are very grateful to all the authors for participating and have benefitted from complementary research contributions to RESPECT by Ingo Borchert, Christian Bluth, Simon Evenett, Matteo Fiorini, Weinian Hu, Petros Mavroidis, Douglas Nelson, Jacques Pelkmans, Charles Sabel, and Robert Wolfe.

CEPR, which takes no institutional positions on economic policy matters, is delighted to provide a platform for an exchange of views on this important topic.

Tessa Ogden

Chief Executive Officer, CEPR

July 2021

INTRODUCTION

Bernard Hoekman, TU Xinquan, and WANG Dong

EUI and CEPR; UIBE; Peking University

Rising geopolitical and geoeconomic tensions among major trade powers are undermining the rules-based multilateral trade order. In principle, the World Trade Organization (WTO) is the institution where trade-related conflicts should be resolved, but the organisation no longer provides an effective dispute settlement mechanism. Both China and the European Union (EU) are highly trade-dependent, and both have expressed a strong commitment to sustaining an open global trade order. Pursuit of issue-specific negotiations on an open plurilateral basis offers prospects for revitalising the WTO but does not remove the need for balance in the choice of issues put forward for negotiation and for systemic WTO reform to bolster the scope for deliberation and enhance support for implementation of agreements. Joint leadership by China and the EU to establish a balanced work programme that spans both old and new issues of interest to all WTO members is a necessary condition to reboot the rules-based trade order.

Views in many OECD member countries on China's reintegration into the world trade order, often seen through the lens of its accession to the WTO in 2001, have become less positive over time (Winters 2021). Perceptions that very rapid growth in China and associated competitive pressures are due in part to the role of the state in China's economy and to 'unfair trade practices' have led to trade tensions. As what one country regards as an 'unfair' trade practice may constitute good economic policy to another, an important function of the WTO is to provide a platform for members to negotiate rules of the game that attenuate negative cross-border competitive spillovers generated by trade-related economic policies – and mechanisms to resolve disputes about implementation of negotiated agreements.

The WTO has not been fulfilling this function. Many members have prioritised bilateral or regional cooperation. Some – notably the United States (US) – have resorted to unilateral action instead of going through the WTO, targeting perceived unfair trade practices by China as well as other trading partners. Those affected can no longer challenge these measures through the WTO dispute settlement process because of parallel US action to shut down the WTO Appellate Body, reflecting unhappiness with rulings on disputes centering on US measures against imports from China and specific features of China's trade regime. Without a functioning Appellate Body, a WTO member that loses a dispute case at the first instance panel stage can 'appeal into the void', with the result that the panel report does not enter into force. This greatly reduces the effectiveness of the WTO dispute settlement system and the ability (incentive) of WTO members targeted by unilateral measures to contest these at the WTO, fostering recourse to unilateral retaliatory measures in turn.

China, the EU, and the US, the three WTO members with the largest global trade shares, play a critical role in keeping the WTO fit for purpose in a rapidly changing world economy. As argued by TU and Wolfe in the first chapter of this volume, WTO reform is a triangular challenge in the sense that if the three largest trade powers cannot agree, progress is not possible. Of course, such agreement is necessary, not sufficient, as systemic reforms require consensus among the membership. Satisfying the necessary conditions calls for tripartite deliberations focused on dealing with the underlying sources of tension and disagreement. This has been missing. Engagement has instead been bilateral (US-China, EU-China, EU-US) or deliberately excluded China – e.g. the EU-Japan-US trilateral meetings of trade ministers, the negotiations leading to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), and talks initiated in 2013 on a Trade in Services Agreement. Recently, this pattern has begun to change, most notably reflected in the conclusion of negotiations on a Regional Comprehensive Economic Partnership (RCEP) agreement among Asia-Pacific countries, including China. RCEP, together with the China-EU Comprehensive Agreement on Investment (CAI), which addresses many contentious issues, suggest tripartite agreement on trade and investment-related policies may be possible.

Both China and the EU have been subject to unilateral US actions restricting trade. Both have strongly objected to the associated decision by the US to circumvent the WTO and the parallel US action to block new appointments to the Appellate Body. China and the EU are both participants in the Multi-Party Interim Appeal Arbitration Arrangement (MPIA), established after it became clear that the Appellate Body would no longer be able to operate. The MPIA and the active participation of China and the EU in all of the ongoing ‘joint statement initiative’ negotiations among groups of WTO members illustrates willingness to cooperate on a plurilateral basis under WTO auspices. China and the EU also share some commonalities on specific matters that concern the US. An example is state-ownership or control of enterprises, which is a feature of the economic landscape in several EU member states.

The EU external policy strategy emphasises transatlantic cooperation (European Commission 2020, 2021a) and working with groups of countries – such as the Ottawa Group¹ – on subjects of common interest, including WTO reform. The recent EU trade policy review communication recognises China and India as ‘indispensable partners for WTO reform discussions’ and notes that ‘[d]iscussions with China and India should help to better understand our respective perspectives, including on the issues for which progress should be achieved at MC12 and beyond’ (European Commission 2021b: p. 17). The essays in this volume argue that China and the EU should go beyond discussing their respective perspectives and cooperate to revitalise the WTO as a forum for agreeing on trade policy-related rules and the venue where trade disputes are resolved.

1 Australia, Brazil, Canada, Chile, the EU, Japan, Kenya, Republic of Korea, Mexico, New Zealand, Norway, Singapore, and Switzerland.

The authors comprise teams of mostly Chinese and European experts. Each chapter reviews the state of play in an area and suggests approaches to address policy tensions. Chapters focus on challenges that are of interest (concern) to most if not all WTO members. The aim is not to be exhaustive in covering the myriad of possible subjects that may – and arguably should – be on the table of the WTO. The focus is on ‘bread and butter’ issues pertaining to the operation of the organisation and a set of old and new policy areas that are central to the trading system. The essays complement and build on the rapidly expanding research and proposals for WTO reform.² The spirit of the project is captured by a remark made by EU Director-General for Trade, Sabine Weyand, at an event celebrating the 25th anniversary of the WTO to the effect that ‘the WTO is not the place to drive systems change. It is not about regime change. This is about dealing with the consequences of certain economic systems and to make sure that these are being dealt with in a manner that everyone can live with. And that requires compromise on all sides’ (Monicken 2020).

The contributions distinguish between systemic or crosscutting issues and substantive areas of trade-related policy. Part 1 includes five chapters that address systemic challenges: reviving the WTO negotiation and dispute settlement functions, improving transparency, the treatment of economic development differences, and managing the interface between trade policy and non-trade objectives, including national security. Chapters in Part 2 address substantive policy areas: agriculture, services, investment, subsidies, state-owned enterprises (SOEs) and trade-climate change. All are arguably core topics for the WTO in the sense of affecting most if not all WTO members. Many of the associated policies revolve around the use of tax/subsidies of one form or another. A common denominator is that the underlying policies can affect the conditions of competition on either the home market of national firms and/or foreign markets.

1. WTO REFORM: EU AND CHINA PERSPECTIVES

EU trade policy has multiple objectives, including sustainable development, combating global warming, and responding to the digital transformation of the global economy. It is also an instrument to promote European values as well as European commercial interests (European Commission 2021a).³ WTO reform is a priority area of focus for EU trade policy, illustrated by the fact that the Annex to the Trade Policy Review Communication takes up almost as many pages as the whole trade strategy (European Commission 2021b). The EU trade strategy notes that the first order of business is to restore a sense of common purpose among WTO members. Doing so requires proceeding incrementally, starting with short-term confidence-building measures, including concluding the fisheries subsidies negotiations and launching an initiative on trade and public health. The EU highlights

2 Recent compilations and references to the literature on global trade policy challenges confronting the WTO include Evenett and Baldwin (2020), Fitzgerald (2020), and Hoekman and Zedillo (2021).

3 The RESPECT project, to which this volume of essays is a contribution, includes many papers analysing this dimension of EU external policies. See <http://respect.eu.eu/>.

the need to revisit how the WTO deals with disparities in levels of economic development and the design of – recourse to – special and differential treatment (SDT) provisions, arguing that restoring the credibility of the WTO as a negotiating forum requires a new approach to SDT. The EU also stresses the need for agreeing on new rules on digital trade and investment policies, addressing competitive distortions resulting from state intervention in the economy, and reinforcing the dispute settlement, monitoring, and deliberative functions of the WTO.

In its statements and submissions to the WTO, China has emphasised the need to break the impasse on appointing Appellate Body members, to tighten disciplines to curb abuse of the national security exception, and to bolster disciplines on unilateral measures that are inconsistent with WTO rules (MOFCOM 2018, WTO 2019, Gao 2021). China has noted the need to clarify rules on the use of trade remedies (e.g. price comparison in anti-dumping proceedings, what constitutes a subsidy, calculation of benefits conferred). China has also argued for a holistic approach to considering new rules to attenuate the spillover effects of national subsidy programmes, stressing that deliberations should include agricultural support policies. In response to arguments by OECD countries that disciplines are needed on the behaviour of SOEs, China has pointed out that state ownership as such should not be a matter for the WTO. On the latter point the EU concurs. The EU position calls for a level playing field, no matter the ownership and control structure of companies operating in a market.

Many scholars have pointed out the interdependence between the negotiation and dispute settlement functions of the WTO (e.g. Liu 2019, Hoekman and Mavroidis 2021). Making progress in substantive rulemaking on matters covered by WTO agreements is not possible without addressing systemic issues, including how to incorporate open plurilateral agreements into the WTO and re-establishing a functional dispute settlement mechanism. At the same time, clear signals by the major players of willingness to engage in substantive, policy-specific negotiations, including matters of particular interest to many developing countries, will help achieve needed systemic reforms that require consensus to be implemented.

WTO submissions by China and the EU, as well as policy documents issued by both WTO members, suggest a common view on the need for systemic reforms, but differences in the priority accorded to the need for revisiting or negotiating rules in specific policy areas. Taken together, it is clear that there is a large potential agenda for deliberation and eventual negotiation. This includes issues only partially covered by the WTO or not at all, such as policies towards foreign investment or the use of trade measures in national programmes to combat climate change. The large number of potential issues creates opportunities for bundling of subjects, but such packaging requires great care.

WTO reform and updating will need to proceed in stages. Efforts to reboot the WTO should differentiate between crosscutting, systemic reforms, and efforts to negotiate on specific policies. Core functional dimensions of the WTO include decision making,

dispute settlement and transparency. To some extent the decision-making issue has been taken up, reflected in the willingness of groups of WTO members to pursue talks on a plurilateral as opposed to a universal basis. Many WTO members have called – repeatedly – for addressing Appellate Body crisis, and independent surveys make clear that this is the foremost reform priority for many WTO members (Fiorini et al. 2021). Substantive, issue-specific negotiations on rules that affect core interests of many WTO members will take time, whether this involves matters covered by WTO agreements, such as agriculture or subjects that are not, such as disciplines for SOEs, investment policies, and trade and sustainable development.

2. CROSSCUTTING (INSTITUTIONAL) CHALLENGES

Revitalising the negotiation function

Establishing an agenda for negotiation is a complex endeavor, as is determining the appropriate approach to the conduct of negotiations and whether (and which) issues could/should be linked. The Doha Round Agenda and negotiating process – the Single Undertaking approach, entailing that nothing was agreed until everything was agreed – ended in deadlock. The consensus-based decision-making working practice permitted WTO members to oppose adding discussion of new policy priorities such as industrial subsidies, SOEs, or investment policies to expand the negotiating set beyond the Doha talks as originally conceived in 2001. The exercise of the veto option effectively sidelined the WTO for much of the post-2008 period.

After almost ten years of deadlock, in 2017, many countries decided to shift gears and launch talks on a plurilateral basis. The associated joint statement initiatives (JSIs) span e-commerce, domestic regulation of services, investment facilitation, and measures to enhance the ability of micro and small and medium enterprises (MSMEs) to utilise the opportunities offered by the rules-based trading system. The JSIs bring together a cross-section of the WTO membership. China and the EU participate in all four JSIs. Although the Trump administration chose to join only one of these initiatives, on e-commerce, the US engages in the other JSI activities as well. The e-commerce talks involve 80+ WTO members and focus on a mix of trade restrictive policies such as regulation of cross-border data flows and data localisation requirements and digital trade facilitation – issues like electronic signatures, e-invoicing, electronic payment for cross-border transactions, and consumer protection. Talks on services domestic regulation span 60+ WTO members and center on matters associated with authorisation and certification of foreign services providers with the aim to reduce the trade-impeding effects of domestic regulation. The MSME and investment facilitation groups differ from the other two JSIs in addressing matters that are not covered in existing WTO agreements. The talks on MSMEs involve some 90 WTO members; those on investment facilitation over 100 members.

Plurilateral approaches are not a panacea, but they offer a mechanism to cooperate without all WTO members agreeing to participate. In their chapter, TU Xinquan and Robert Wolfe argue that leadership is needed by the three major powers to improve the institutional framework for negotiations that maintains the integrity of the WTO while confirming the end of the de facto veto held by WTO members reluctant to engage in deliberations or negotiations on issues put forward by other WTO members. The challenge they highlight is squaring the circle of the formal equality of members with the practical inequality of their willingness and capacity to participate. Tu and Wolfe argue that the move to plurilaterals is a partial solution to the difficulty of attaining consensus, but successful conclusion of a plurilateral negotiation requires a critical mass of WTO members to participate. They echo the suggestion by Hoekman and Sabel (2021) for proponents of plurilateral engagement to put in place new governance principles to assure non-participating WTO members that any plurilateral agreement will be supportive of the rules-based multilateral trading system. In addition, agreement must be sought on criteria and procedures to incorporate new non-discriminatory open plurilateral agreements addressing matters not covered by extant treaties into the WTO.

Even if plurilateral negotiations replace the single undertaking as an aggregation and forcing mechanism, it is important to recognise that the need for issue linkage and package deals is likely to remain. Plurilaterals do not remove the need for action in three crosscutting areas – transparency, SDT, and dispute settlement. Addressing these three systemic challenges arguably is important for WTO members to have incentives to pursue plurilateral agreements that extend beyond soft law cooperation, for WTO members that do not wish to engage in plurilaterals to accept that others do so, and more generally to improve the functioning of the multilateral trading system.

Transparency

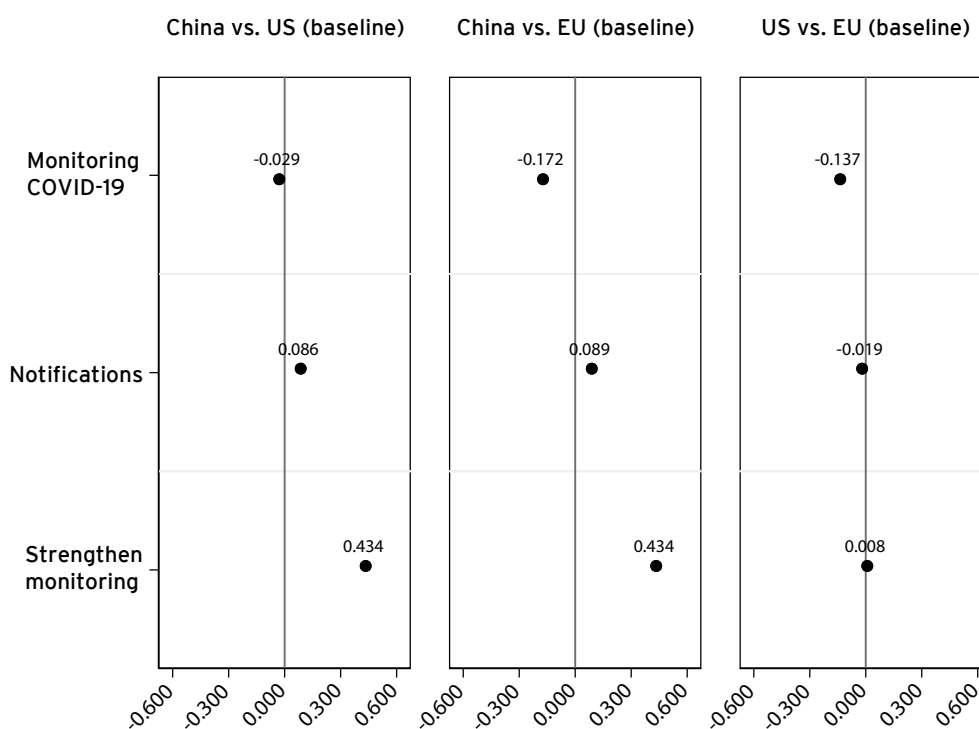
Transparency is a key input into negotiation, monitoring implementation of agreements, and dispute settlement. Transparency has been a major concern to the EU and the US, with China and other emerging economies often singled out for not living up to notification commitments. Less well understood is that this is also a matter of interest to China, and indeed, to most countries.⁴ The US, for example, is less than exemplary when it comes to notifications of services trade policies. The US is also less cooperative than China or the EU in providing information for the periodic WTO Secretariat trade monitoring exercise (WTO 2020a: Appendix 1) and many WTO members do not provide timely and comprehensive information on subsidy programmes.⁵

4 One reason for this is the general upward trend in the use of policies affecting trade. See e.g. Evenett (2021).

5 In their chapter, Evenett and Kong note that the WTO secretariat stopped including information on so-called General Economic Support measures in their G20 trade monitoring reports on account of the lack of cooperation.

WTO agreements have numerous formal notification obligations. Inadequate notification of trade policies is longstanding, 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 GATT-related agreements. 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. If the problem is outdated and overly complex notification requirements, a thorough review is warranted (Wolfe 2018). In a recent expert survey (Fiorini et al. 2021), Chinese respondents attach higher priority to improving compliance with notification obligations and strengthening monitoring of trade policies than EU and US respondents (Figure 1). While the small sample size for Chinese respondents precludes inference, this result suggests transparency is a shared concern.

FIGURE 1 EXPERT VIEWS ON TRANSPARENCY: CHINESE, EU, AND US RESPONDENTS



Note: Point estimates indicate whether belonging to a given group is associated with less utility (if negative) or higher utility (if positive) from priority being assigned to the issue in the question, relative to the baseline group.

Source: Based on data reported in Fiorini et al. (2021).

In their contribution to this volume, Simon Evenett and KONG Qingjiang note that subsidies have a pride of place in discussions on transparency at the WTO. In part, this is because many members do not notify subsidy programmes on a timely basis (as of April 2021 one third of the membership had yet to submit notifications for 2015) and in part, it

reflects the fact that subsidies have become the most frequently used policy instrument globally. A presumption that subsidies underpin the competitiveness of Chinese products in international trade and impedes the ability of foreign firms to contest the Chinese market is a major driver of the trilateral call by the EU, Japan, and the US for stronger international disciplines on industrial subsidies and SOEs as beneficiaries and channels of state support.⁶ Improving the knowledge base regarding the magnitude and incidence of subsidies is a precondition for any effort to revisit extant WTO rules in this area (Hoekman and Nelson 2020). The absence of comprehensive and comparable data on the use of subsidies in leading trading nations has made it difficult to assess the extent of subsidies and thus their effects.

Evenett and Kong argue that a priority in enhancing subsidy transparency is to bolster the evidence on sub-central subsidies. They review available information on this for both China and the US, showing that such support is prevalent in both countries and has systemic implications. Enhancing transparency of central and sub-central subsidy programmes is important for both the national and local governments concerned and not just to potentially affected competitors. Better information and greater transparency will help make local government more accountable and reduce the scope for wasteful internal competition between sub-national jurisdictions. It would also permit central governments to submit more timely and comprehensive notifications to the WTO and allow for evidence-based deliberation of the cross-border ramifications of national subsidy policy.

Economic development differentials and reciprocity

An important dimension of the challenge of squaring the circle of the formal equality of WTO members with the practical inequality of their willingness to participate is the heterogeneity in levels of economic development and capacity across the membership. Patrick Low notes that WTO members determine their own developmental designation, but most aspects of SDT require cooperative action of one kind or another from other members. A key argument in his chapter is that to address the SDT quandary a distinction must be made between regulatory SDT and market access SDT. The former focus on the rules of the trading system while the latter are instrumental in determining the terms of participation in a given market.

When it comes to *market access* SDT, non-reciprocal tariff and quota preferences are offered and withdrawn on a non-contractual basis under the full control of the party granting the concessional access. Beyond trade preferences, market access conditions offered to fellow members of the WTO arise from contractual commitments and are MFN-based. Market access outcomes are driven by reciprocal considerations in negotiations, not by SDT dispensations. Low shows that the incidence of above-average tariffs and quotas

6 https://trade.ec.europa.eu/doclib/docs/2020/january/tradoc_158567.pdf.

protecting sensitive products often does not correlate with declared developmental status. Low divides *regulatory* SDT provisions into five categories: i) best-endeavour provisions; ii) flexibilities; iii) transitional timeframes; iv) technical assistance; and v) provisions pertaining to least-developed countries. An analysis of the application of these elements of SDT to the WTO agreements shows that the only element of regulatory SDT exclusively in the hands of beneficiaries pertains to the ‘flexibilities’ category. Access to every other aspect of regulatory SDT requires cooperative action of one kind or another from other WTO members. The ‘flexibility’ category of SDT constitutes less than one-quarter of all SDT provisions, thus limiting the scope for opportunistic access to SDT by those considered undeserving. Low calls for concerted action to determine which members make use of this subset of SDT as a useful way of informing governments whether flexibilities are indeed used and to provide a basis for decisions by individual WTO members to indicate they do not intend to do so in the future.

The Appellate Body and dispute settlement crisis

In their chapter, LIAO Shiping, and Petros Mavroidis argue that effective dispute settlement procedures are critical to sustain multilateral cooperation on trade. 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-politicised conflict resolution. An effective dispute settlement mechanism is critical for existing WTO agreements to remain meaningful, and for the negotiation of new agreements, including new plurilateral agreements that embody binding commitments.

The US has long been critical of the Appellate Body, arguing it has too frequently overstepped its mandate. 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 Agreement on Subsidies and Countervailing Measures helped fuel US frustration with WTO dispute settlement (Ahn 2021). The Appellate Body ceased operations in December 2019 because of US refusal to agree to appoint new adjudicators or re-appoint incumbents. By the end of 2020, sixteen appeals ‘into the void’ were pending before the now dormant Appellate Body. More telling, only five new disputes had been filed, the lowest since the establishment of the WTO in 1995. 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. The Multi-Party Interim Appeal Arbitration Arrangement (MPIA), which includes the EU and China, may provide a short-term alternative for the 24 WTO members that signed it, but does not offer a solution. Liao and Mavroidis note that a resolution to the Appellate Body crisis requires commitment of all stakeholders, but especially the major trade powers, to reform WTO dispute settlement. Whether a redesigned dispute settlement system will continue to include two-instance adjudication or take another form is something they are agnostic on – what matters is to ensure conflict resolution continues to be depoliticised

and encompasses all WTO members. Open and substantive negotiations among the WTO membership to re-establish an operational dispute settlement mechanism is a clear priority for the continued salience of the trade regime.

National security and non-trade objectives

Another systemic challenge confronting the WTO is to manage the increasingly prevalent use of trade policy instruments motivated by non-trade objectives. CUI Fau, Catherine Hoeffler, and Stephanie Hofmann address this subject in their chapter, noting states have many concerns when trade does not align with political goals in areas such as food security, environment and climate change, labour rights, culture, or national security. The integrity of WTO rules and the success of efforts to reform the WTO requires to maintain some policy space for states to address such concerns while keeping the WTO as a system of trade rules. The WTO has over time developed processes and agreements that clarify and define rules for matters such as product standards and domestic regulation, based on application of the national treatment rule and agreed good administrative principles (e.g. necessity to restrict trade to attain a regulatory goal, proportionality, using measures that are least-trade restrictive, etc.). The immediate challenge confronting the WTO membership pertains to the use of trade measures motivated by national security concerns. Cui, Hoeffler, and Hofmann argue legitimate security grounds may not be able to be defined but can be embedded in other rules. They call for a more open process of the evaluation of states' invocation of the national security exceptions in WTO agreements, thereby increasing the efficiency and legitimacy of WTO rules.

3. SUBSTANTIVE SUBJECTS FOR NEGOTIATION

The essays addressing substantive policy areas span a mix of 'old' and 'new' issues. A common denominator is that many of these policy areas have a subsidy dimension, reflecting the increasing prevalence of subsidy instruments and perceptions that the associated cross-border spillovers are significant. Subsidy programmes of some type are central in the long-running negotiations on fish, are prominent in agriculture, are essential in trilateral discussions between the EU, Japan, and the US pertaining to support to industrial activities, and figure importantly in efforts to combat climate change – e.g. reduction of fossil fuel subsidies, support for renewable energy. Implicitly, if regarded as measures that influence the choice of mode of supplying a market, subsidies are also an element of the digital and services trade policy agenda, e.g. taxation of digital services and electronic transmissions as a means for (re-)establishing a level playing field for companies in different sectors.

Agriculture

Agriculture is important for many developing countries and many WTO members – including China – argue that any efforts at new rulemaking must encompass agriculture. LU Xiankun and Alan Matthews review the state of play in agriculture. They note the prominent role played by subsidies (domestic support measures) in agriculture, and that agricultural trade policy reform increasingly is an agenda spanning developing nations, which accounted for almost 60% of global food trade in 2018. Improving multilateral rules for domestic support will reduce market and production distortions, enhance stability of the global market for agricultural products, and help mitigate their environmental impact. Lu and Matthews argue radical steps are needed to break the logjam that has prevailed for over a decade on agricultural trade policies. They suggest WTO members start with revising the WTO methodology to calculate product-specific support to ensure it only captures instances where programmes transfer resources at above world market prices and does not penalise countries where transfers are negative – as is the case in India. They also suggest revising domestic support rules through the lens of climate change, as agricultural activity accounts for a quarter of all human-caused greenhouse gas emissions.

Subsidies

As mentioned, one of the most contentious areas in trade policy are the (perceived) 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 minimise negative spillovers of such measures on trading partners. As has been demonstrated by data collected by the Global Trade Alert initiative,⁷ this is not solely a ‘China issue’. Subsidies of one type or another constitute the majority of trade interventions imposed since 2009, accounting for more than 50% of all new measures imposed in the last decade. A revamped subsidy regime requires participation of all three major trade powers. A necessary condition for China to do so is that deliberations are not presented as an attempt to isolate or transform China.

Not all scholars agree new rules are needed. For example, Zhou et al. (2019) argue the unique challenges created by China’s economic model largely can be addressed by the WTO’s existing rules on subsidies coupled with the specific obligations China made in its accession protocol. They suggest greater and more effective use of WTO dispute settlement based on existing rules would have helped to clarify the need for new rules. In the event, with the removal of the Appellate Body a dispute settlement-centered strategy is no longer available to WTO members.

7 <https://www.globaltradealert.org/>.

In their chapter, LI Siqi and Luca Rubini call for updating existing WTO rules but argue that determining where and how to do so requires better knowledge on the prevalence of subsidy measures, the underlying policy goals and their effects. The implication is that any WTO law reform exercise must be informed by a serious and transparent, open and expert-based knowledge-gathering effort so that WTO members can develop a common understanding of where new rules are needed and the form they should take. A key element of any such exercise is greater transparency and a programme of data collection as called for by Evenett and Kong. A consequence of the lack of a common understanding and comprehensive database is that this is a subject that cannot be addressed in the short run: the required data compilation, analysis and deliberation will require time. As argued by Hoekman and Nelson (2020), this should not be regarded as a problem, as a common understanding among WTO members – or a group of WTO members working towards a plurilateral agreement to expand extant WTO rules – is a necessary condition for agreement.

In his contribution, LIU Jingdong identifies specific areas where the WTO Agreement on Subsidies and Countervailing Measures needs to be revised. This includes focusing on more precisely defining ‘public body’ – a matter on which there appears to be substantial agreement in the scholarly literature (e.g. Ahn 2021). Liu calls for strengthening rules regarding transparency and burden of proof, making notification requirements more specific, restoring the category of non-actionable subsidies, and incorporating both industrial and agricultural subsidies into one set of rules.

Services and digital trade

Martina Ferracane and LI Mosi discuss the prevailing multilateral rules regulating digital trade, which predate the global internet. They argue that updating WTO rules is important, given the rapid growth in digital trade, unilateral implementation of new policies to regulate the digital economy that have both direct and indirect effects on trade in both goods and services, and the trend for countries to embed rules for cross-border trade in digital products in preferential trade agreements. Ongoing plurilateral negotiations on e-commerce in the WTO offer an opportunity to build on recent regional agreements to support cross-border digital trade. Ferracane and Li note there are commonalities in the preferences of China and the EU on some elements of digital trade policy. The EU has been much more hesitant than other OECD countries to include provisions on data flows in trade agreements and has only been able to agree to a small number of bilateral agreements determining that data protection regimes in partner countries are ‘adequate’. They conclude that prospects for cooperation may be greater than they appear to be.

Bernard Hoekman and SHI Jingxia focus on services trade policy more broadly: Since the establishment of the WTO in 1995, little has been done to adapt and expand multilateral disciplines to promote trade in services. Structural transformation trends are increasing the role of services in economic activity but have not been accompanied by expansion of WTO coverage of services trade policies, reducing the salience of the organisation to

the innumerable firms and households that provide and source services across borders. Hoekman and Shi note that ongoing talks among groups of WTO members on e-commerce and domestic regulation of services will help fill the gap but that much more is needed to expand and update the coverage of the General Agreement on Trade in Services (GATS). China and the EU, for different reasons, have a strong interest in supporting services trade, as do other large WTO members including India and the US. The authors argue that seeking to establish an open plurilateral agreement on services with signatories adding new commitments to their GATS schedules is more likely to be successful than a multilateral negotiation among all WTO members, and that to be meaningful such an agreement must include China and India. They echo the suggestion by Jürgen Kurtz and GONG Baihua in their chapter on investment that the recent China-EU Comprehensive Agreement on Investment provides a good basis for a China-EU led plurilateral initiative to resuscitate talks on trade in services in the WTO. This could include the 23 WTO members that launched negotiations on a Trade in Services Agreement (TiSA) in 2013 outside the WTO. The TiSA talks ceased at the end of 2016 because of the opposition of the Trump administration to the initiative, but arguably they would have done little to improve market access because China and India were not participants. Inclusion of China would help to attain critical mass and make participation more interesting for India.

Investment

Kurtz and Gong discuss a policy area that is only partially covered by the WTO through commitments under the GATS on mode 3 supply of services, involving inward FDI in services sectors. Historically, foreign investment policies have been a fiercely contested issue for the international trade regime. The launch of JSI discussions on investment facilitation under WTO auspices suggests greater willingness among some WTO members to discuss investment policies. They argue that the China-EU CAI provides a basis for negotiating investment policy disciplines in the WTO on a plurilateral basis. While the prospects for ratification of the CAI by the EU are uncertain, the CAI provides a baseline for possible investment rules in the WTO, in the process potentially advancing rulemaking in related areas such as regulation pertaining to technology transfer and national security. Kurtz and Gong make a strong case that investment rules anchored both against the CAI outcomes and structured on an open plurilateral basis are a logical part of any effort to revitalise the WTO.

State-ownership or control of enterprises

Together with the increasing focus on the competitive spillovers of domestic subsidy programmes, the behaviour of foreign state-owned enterprises has become a concern to many OECD country governments. As is true for subsidies, this is an area where there is limited transparency (information) and even less empirical evidence on the operation and effects of such entities, whether through direct production activities or indirectly by providing subsidised inputs or services to firms that gives them a competitive advantage.

China has many SOEs that play an important role in the economy. State ownership or control of firms across a range of sectors is also a feature of several European member states. In the EU state-ownership of firms is not considered problematical in the sense of distorting competition because all firms – whether private or (partially) publicly owned or controlled – are subject to the same competition policy disciplines. Moreover, EU disciplines on subsidies (state aids) apply to SOEs as well as to private firms.

Analogous to the case of investment policies, the prospects for agreement on rules pertaining to SOEs may be greater than is often assumed. Liu (2019), for example, argues that in principle, China should support concepts such as the role of market orientation and competition neutrality in regulating the behaviour of SOEs, as well as discussion of measures to better use trade for sustainable development, as doing so is consistent with China's national interest and strategic priorities.

In their chapter, Bernard Hoekman and André Sapir suggest that taking no action on SOEs is not an option given concerns about the competitive spillovers of Chinese SOEs. They argue that recent bilateral and regional agreements signed by China, the EU, and the US include provisions on SOEs and offer a basis on which to build, suggesting the possibility of negotiating a plurilateral agreement among major WTO members. Many of the extant proposals to address SOE-related spillovers suggest building on disciplines negotiated in recent trade agreements such as the CPTPP, USMCA, EU-Japan, etc. While an apparently pragmatic approach they note that the China-EU CAI illustrates that there is an alternative option, one that goes beyond a focus limited to state-ownership but is based on a broader approach that focuses on undertakings ('covered entities'). As the CAI approach was agreed by two of the big three WTO trade powers, it provides an alternative template for plurilateral deliberation in the WTO setting.⁸

Whatever approach is pursued, Hoekman and Sapir echo Evenett and Kong, and Li and Rubini in arguing that WTO members currently do not have sufficient information to develop a common understanding of where new rules may be needed, as opposed to tweaking existing WTO provisions. A first step could be for the EU and China – probably the two main jurisdictions where SOEs are headquartered – to take the lead to create a WTO Working Party on SOEs to prepare the ground for a plurilateral negotiation on new rules for SOEs. One element of work should be to develop a solid evidence base on the prevalence of SOEs, their economic performance, and estimates of associated cross-border competition spillover effects.

The appropriate role of trade policy in national programmes to reduce the carbon intensity of economic activity has been the subject of discussions in the WTO for many years, going back to the 1990s (Low 2021). This is a subject that has become increasingly prominent as countries implement their Paris Agreement commitments, with several

8 In the event the CAI remains on ice for political reasons, launching plurilateral discussions in the WTO to include more countries while narrowing their scope may help to promote domain-specific cooperation on SOEs (and investment, as argued by Gong and Kurtz) that is not tied to a broader agreement spanning many issues.

countries launching negotiations on a plurilateral agreement on climate change, trade and sustainability (ACCTS) that spans both import liberalisation as foreseen by the discussions on a WTO Environmental Goods Agreement (EGA), and concerted action to reform specific tax-subsidy programmes to reduce greenhouse gas emissions. In their chapter on trade policy dimensions of programmes to combat climate change, ZHANG Jianping and XIE Zhiyu discuss several challenges posed to the multilateral trading system by national policies to respond to climate change and achieve carbon emission reduction and carbon neutrality goals, arguing that any trade measures imposed by countries must comply with WTO rules, including non-discrimination. They highlight the example of the EU's planned introduction of a carbon border adjustment mechanism (CBAM), noting that while much depends how this is designed and implemented, many developing countries are concerned that a CBAM may lead to discrimination. More broadly, they argue that WTO members disagree on the equitable allocation of carbon emission reduction obligations and the use of carbon border adjustment taxes and point to the need for the WTO to support the use of market-based instruments to lower greenhouse gas emissions. They conclude that a priority for WTO members is to finalise EGA negotiations on liberalisation of trade in low-carbon and environmental products and to launch discussions on alternative approaches to address climate issues in the WTO.

CONCLUDING REMARKS

China and the EU have different in views on the relative importance of the cross-border spillovers associated with various types of international trade policy and the potential for joint gains from cooperation. This is neither surprising nor a problem. What matters is that both attach great value to a multilateral trade regime that can serve as an effective platform for negotiating rules for trade-related policies and resolving trade conflicts. Both oppose recourse to unilateralism. The successful conclusion of the bilateral Comprehensive Agreement on Investment between China and the EU at the end of 2020 illustrates cooperation on sensitive policy matters is possible, as do the extensive sector- and issue-specific bilateral dialogues between China and the EU over many years (Hu and Pelkmans 2020). China and the EU cannot provide the public good of an open rules-based multilateral trading system on their own. But jointly they carry significant weight in the WTO. Joint action to support the effort needed to address the governance challenges confronting the WTO can help to keep the organisation fit for purpose and relevant to its core constituencies.

A willingness to proceed on a plurilateral critical mass basis on issues where waiting for the full membership is not necessary arguably is a key part of revitalising the WTO. Greater reliance on variable geometry to facilitate trade in goods and services and support a shift to a greener, more digital economy is important for the WTO to become more relevant again to the international business community and to permit like-minded countries to cooperate on regulatory matters of common interest. Bolstering the deliberative capacity

of the WTO, compiling the data and generating the analysis needed for WTO members to explore the potential contours of new agreements are necessary ingredients. Permitting the WTO Secretariat greater latitude to support the membership through provision of information and encouraging greater participation by stakeholders in WTO deliberations to learn from practice and identify priorities for action to address negative cross-border spillovers would enhance the prospects for cooperation (Hoekman 2019). This does not entail a need for ‘structural’ reform – it simply requires a willingness by the membership to recognise that a ‘member driven’ organisation does not require unanimity for day-to-day operations and will benefit from full utilisation of the resources of the Secretariat and pro-active engagement with stakeholders (Wolfe 2021, Alben and Brown 2021).

The agenda confronting WTO members extends beyond the subjects addressed in the contributions to this volume. The topics selected reflect a collective view that these constitute core issues that are relevant to most WTO members and that require collective attention. There certainly is scope – and need – to make progress on other important subjects as well. An example is to draw lessons from the responses to the Covid-19 pandemic and putting in place a framework to bolster the role of trade in addressing global public health crises. Cooperation in this policy area is already being pursued on a plurilateral basis: the Ottawa Group (WTO 2020b) has put forward proposals for an agreement on trade and public health. The prospects for making progress on this subject and those discussed by contributors to this book is conditional on addressing the core cross-cutting challenges related to the operation of the WTO highlighted in part 1 of this eBook. A first order of business in the run-up to MC12 should be for China and the EU to work with other WTO members to establish a work programme to address the crosscutting institutional challenges confronting the organisation.

REFERENCES

Ahn, D (2021), Why Reform Is Needed: WTO ‘Public Body’ Jurisprudence, *Global Policy*, 12(S3): 61-70.

Alben, E and L Brown (2021), Is the WTO in Sync with the Business Community? *Global Policy*, 12(S3): 23-29.

European Commission (2020), A New EU-U.S. Agenda for Global Change, JOIN(2020) 22 final, December 2. At https://ec.europa.eu/info/sites/info/files/joint-communication-eu-us-agenda_en.pdf.

European Commission (2021a), Trade Policy Review - An Open, Sustainable and Assertive Trade Policy. COM(2021) 66 final.

European Commission (2021b), Trade Policy Review - An Open, Sustainable and Assertive Trade Policy. Annex: Reforming the WTO: Towards a Sustainable and Effective Multilateral Trading System. COM(2021) 66 final.

Evenett, S (2021), The Pre-Trump Buildup of Trade Discrimination: Scale, Drivers, and Effects. In B. Hoekman and E. Zedillo (eds), *Trade in the 21st Century: Back to the Past?*. Washington DC: Brookings Institution.

Evenett, S and R Baldwin (eds) (2020), *Revitalising Multilateralism: Pragmatic Ideas for the New WTO Director-General*, CEPR Press.

Fiorini, M, B Hoekman, P C Mavroidis, D Nelson, and R Wolfe (2021), Stakeholder preferences and priorities for the next WTO Director General, *Global Policy*, 12(S3): 13-22.

Fitzgerald, O (2020), *Modernizing the World Trade Organization*. Waterloo: Center for International Governance Innovation.

Gao, H (2021), WTO reform: A China round? Proceedings of the ASIL Annual Meeting, Vol. 114, pp. 23-32. At doi:10.1017/amp.2021.4

Hoekman, B (2019), Urgent and Important: Improving WTO Performance by Revisiting Working Practices, *Journal of World Trade*, 53(3): 373-94

Hoekman, B and P C Mavroidis (2021), WTO Reform: Back to the Past to Build for the Future, *Global Policy*, 12(S3): 5-12.

Hoekman, B and D Nelson (2020). Rethinking International Subsidy Rules, *The World Economy* 43(12): 3104-32.

Hoekman, B and C Sabel (2021), Plurilateral Cooperation as an Alternative to Trade Agreements: Innovating One Domain at a Time. *Global Policy*, 12(S3): 49-60.

Hoekman, B and E Zedillo (eds.) (2021) *Trade in the 21st Century: Back to the Past?* Washington DC: Brookings Institution.

Hu, W and J Pelkmans (2020) "EU-China trade-related dialogues, a first assessment," *EUI Working Paper RSCAS 2020/46*. <https://cadmus.eui.eu//handle/1814/67850>.

Liu, J (2019), "Necessity of WTO reform and the design of reform issues," *International Economic Review*, No. 1, pp. 34-57. At <http://jtp.cnki.net/bilingual/detail/html/GJPP201901002>.

Low, P (2021), What Can Be Done to Blunt Potential Conflict Between Climate Change and Trade Policies? In B Hoekman and E Zedillo (eds), *Trade in the 21st Century: Back to the Past?* Brookings Institution.

MOFCOM, China (2018), China's Position Paper on WTO Reform, Press Release, Dec. 20, at <http://english.mofcom.gov.cn/article/newsrelease/counseloroffice/westernasiaandaficareport/201812/20181202818679.shtml>.

Monicken, H (2020), For US, WTO reform hinges on economic model ‘convergence’, World Trade Online, <https://insidetrade.com/daily-news/us-wto-reform-hinges-economic-model-%E2%80%98convergence%E2%80%99>.

Winters, L (2021), China and the world trading system: Will ‘in and up’ be replaced by ‘down and out’? in B Hoekman and E Zedillo, eds, Trade in the 21st Century: Back to the Past? Brookings Institution.

Wolfe, R (2018) *Is World Trade Organization Information Good Enough? How a Systematic Reflection by Members on Transparency Could Promote Institutional Learning*, Bertelsmann Stiftung.

Wolfe, R (2021) Informal Learning and WTO Renewal: Using Thematic Sessions to Create More Opportunities for Dialogue, *Global Policy*, 12(S3): 30-40.

WTO (2018), China’s Trade-Disruptive Economic Model: Communication from the United States, General Council, WT/GC/W/745.

WTO (2019), China’s Proposal on WTO Reform, General Council, Communication from China WT/GC/W/773.

WTO (2020a) Overview of Developments in the International Trading Environment: Annual Report by the Director-General (Mid-October 2019 to Mid-October 2020), World Trade Organization, WT/TPR/OV/23.

WTO (2020b) COVID-19 and Beyond: Trade and Health. World Trade Organization WT/GC/223.

Zhou, W, H Gao, and X Bai (2019), Building a market economy through WTO-inspired reform of state-owned enterprises in China, *International & Comparative Law Quarterly* 68(4): 977 - 1022.

ABOUT THE AUTHORS

Bernard Hoekman is Professor and Director, Global Economics, at the Robert Schuman Centre for Advanced Studies, European University Institute, where he also serves as the Dean for External Relations. He is a CEPR Research Fellow. His research focuses on commercial policy, trade in services, public procurement, and global trade governance.

TU Xinquan is Dean and Professor of the China Institute for WTO Studies at the University of International Business and Economics located in Beijing, China. He received his PhD in international trade from this university in 2004. His research and teaching focus on Chinese trade policy, WTO, and US-China trade relations.

WANG Dong is Full Professor with tenure at the School of International Studies, Peking University. He has a BA in law from Peking University and a PhD in political science from UCLA. Dr. Wang serves as Executive Director of the Institute for Global Cooperation and Understanding (iGCU), Peking University.

CROSS-CUTTING INSTITUTIONAL CHALLENGES

CHAPTER 1

Reviving the negotiation function of the WTO: Why the onus falls on the three major powers¹

TU Xinquan and Robert Wolfe

University of International Business and Economics; Queen's University

Leadership is needed by the three major powers to improve the institutional design for negotiations that would maintain the integrity of the World Trade Organization (WTO) while ending the de facto veto on change held by members reluctant to engage in efforts to expand its coverage. The institutional challenge is to square the circle of the formal equality of members with the practical inequality of their willingness and capacity to participate. While the single undertaking as an aggregation and forcing mechanism is dead, and plurilateral negotiations are now mainstream, governance principles have not kept pace, and the need for issue linkage and package deals remains.

INTRODUCTION

One of the primary tasks of the WTO is to provide a forum for multilateral negotiations among its members. The organisation had early successes on telecommunications and financial services, and later achievements on trade facilitation, export subsidies in agriculture, government procurement, and information technology. But the attempt to conduct an ambitious comprehensive 'round' of negotiations, the Doha Development Agenda, ended in failure. The negotiation mandated by the Uruguay Round agreements on services was largely abandoned, and the agriculture negotiations, begun in 2000, are far from completion. Despite the impetus provided by inclusion in the UN sustainable development goals, the fisheries subsidies negotiations are not yet complete. Discussions about 21st century digital trade issues have been ongoing for more than 20 years, without conclusion. World trade is changing faster than the rules of the trading system. The negotiation function of the WTO is not dead, but revival is overdue.

Each round of multilateral trade negotiation under the General Agreement on Tariffs and Trade (GATT), including the Uruguay Round, only crystallised when the United States and Europe had reached a basic accommodation, which then provided the parameters for the rest of the bargains. The European Union (EU) and the US still disagree about many

¹ We are grateful for the helpful comments of Bernard Hoekman, Nicolas Lamp, Patrick Low, Hamid Mamdouh, and Don Stephenson.

things, notably how to pursue regulatory cooperation and the role of the Appellate Body, but solving their outstanding conflicts will not remove the central blockage in the WTO. The accession of China at the 2001 Doha ministerial was eclipsed by the launch of the ill-fated Doha Round at the same ministerial, a round undermined in part by a failure to consider whether the unfinished aspects of the Uruguay Round negotiations still made sense in light of Chinese accession (Wolfe 2015). The EU and the US should recognise that China now has a leadership role in global governance; also needed is a full acceptance by China of the obligations that role entails. Solving this triangular problem is an essential precondition for reviving the negotiation function of the WTO. Washington and Beijing need not like each other, but progress will not be made in multilateral cooperation if they are not prepared to see each other as partners, as Brussels and Beijing did while negotiating the proposed Comprehensive Agreement on Investment (CAI).

Other chapters in this book consider the substantive issues that must be on the future agenda. Our task is to focus on the negotiation process. Analysts of the WTO work with an implicit mental model of how members could reach agreements. When the process seems too slow, or fails, analysts attribute the problem to one part of their model: if the secretariat or members could do that thing differently, then the obstacles could be overcome. This reasoning is counterfactual, meaning something that has not happened but might happen under different conditions. The usual suspects include:

- Unsuitability of the WTO to address 21st century issues.
- A lack of business support in the domestic politics of key members.
- Too many small players.
- Obstruction by some members.
- Special and differential treatment.
- Absence of trust among delegates in Geneva, who we know are often not on the same page as capitals (Fiorini, Hoekman, and Wolfe, in progress).

In this paper we focus on two factors. Firstly, the need for leadership by the three major powers (EU, China, and the US), and secondly, the need to improve the institutional design for negotiations that would maintain the integrity of the WTO *acquis* and its benefits for all members, while ending the de facto veto on change held by members reluctant to engage in negotiations, let alone liberalise.² For the first factor, we need say little, although it is worth stressing that the Doha Round broke down at the informal ministerial in July 2008 when Brazil, China, the EU, India, and the US failed to agree on certain core issues, just as the Nairobi package only came together at the last minute

2 The *acquis* is the accumulated rules and practices of the WTO, which must be accepted by new members; and all members apply all agreements simultaneously with respect to all other members.

in November 2015, when these same five members reached an agreement on new rules for export subsidies in agriculture. China, the EU, and the US now account for a huge share of global trade, and many of the tensions in the trading system arise in the strained relations among them. If they signalled a zone of possible compromise, other members would know how to align themselves. So long as they remain at loggerheads, often for reasons exogenous to the WTO, the negotiation process will be slow.

For the second factor, if countries want to negotiate, they will. If the WTO is a more favourable forum than the outside options, they will negotiate there. Nobody should forget, however, that the outside options exist. The Trump administration in the United States negotiated with China on a bilateral basis. Groups of countries have concluded regional trade agreements such as RCEP and CPTPP. For some years, countries tried to negotiate a Trade in Services Agreement (TiSA) outside of the WTO. If you want new areas of commercial policy covered in a multilateral framework with transparency, committees, and dispute settlement; and if you want all members to be able to participate in those negotiations if they choose, and to know what is going on in the negotiations if they choose not to participate, for now at least, then you need the WTO. Members who think that new issues should be discussed on a multilateral basis within the WTO have to be sure that this inside option is possible, and attractive.

Would institutional reform help? The question implies two familiar themes. The first is the hypothesis that the way in which *interests* are aggregated changes outcomes. A change in WTO procedures will not alter the interests of farmers, but a change in how decisions are made will transform how those interests can be mobilised. For example, are less-than-universal agreements appropriate, should there be differentiation among developing countries, and is some sort of package of agreements feasible? The second theme is that deliberation aids *learning* and new understanding of interests, which changes outcomes. The institutional challenge is then to square the circle of the formal equality of members with the practical inequality of their willingness and capacity to participate.

The rest of this paper is structured as follows. In the next section we discuss the negotiation process and internal transparency, which constrains deliberative opportunities, followed by a brief discussion in section two of the problem of the single undertaking as an aggregation and forcing mechanism. In section three, we turn to a discussion of why plurilateral negotiations are now the mainstream approach, and in section four, we address whether plurilateral negotiations are ‘legal’ and the associated need for new governance principles. Section five concludes with suggestions on steps that members can take to improve prospects for the next WTO ministerial.

1. INTERNAL TRANSPARENCY AND THE NEGOTIATION PROCESS

The general perception of WTO negotiations is of episodic ministerials at which all the work is accomplished. Close observers know, however, that ministerials are the tip of an iceberg of diplomatic activity in and out of Geneva, and that is what needs reviving

– without good preparation, a ministerial cannot succeed. Do small group meetings advance negotiations, or should all informal meetings be open ended? Should the chair select some members to attend consultations, and if so, should they be the major players, the like-minded, or the principal antagonists on a particular issue? In short, who should negotiate and where?³

The WTO is a forum, not an ‘actor’, and it is member driven. Unlike the International Monetary Fund or the World Bank, it has a tiny professional staff whose role is to serve as a Secretariat to the dozens of WTO bodies. The Secretariat can prepare background papers, but negotiating proposals come from members. The WTO is a place to talk, and the talking is done by representatives of members. They talk in dozens of formal on-the-record meetings every year, and in many hundreds of more informal meetings. Sometimes they talk in ‘confessionals’, where a chair explores options with one delegate at a time. Such complexity creates practical problems for efficient negotiations. A Member that lacks the capacity to be an informed presence at every meeting is at a disadvantage, but the alternatives are not obvious. Disaggregation into multiple negotiating groups makes things simple while engaging distinct policy networks in capitals, but it increases the number of meetings that small delegations must cover. No organisation with 164 members can find consensus on sensitive matters such as agricultural reform if all discussions must be held in public, in large groups, with written records (Lamp 2017). Plenary sessions of negotiating groups are held for transparency; they provide an opportunity for all members to hear about the informal smaller group meetings where much of the work is done. In the current agriculture and fisheries subsidies negotiations, for example, ‘facilitators’ conduct such informal meetings on topics assigned by the chair of the negotiating group, and then report back to plenaries. Such meetings are not always open to all members, which leads to questions about transparency, even if the outcome of any process can only be adopted by consensus, which is inherently inclusive.

Only the largest traders can monitor and participate in all meetings. And members with small Geneva delegations may also lack the analytic capacity in their capitals to monitor and prepare instructions for all meetings. The principal ideas in most negotiating groups come from a small set of members, often submitting proposals developed with a handful of co-sponsors. The institutional design issue becomes one of structuring a process whereby the more active members can get on with negotiations without losing touch with the interests of the rest, and in a way that builds confidence in the process and the results. One solution is for members to aggregate their strength with others by forming coalitions.

The coalitions that played a large role in the Doha Round had their roots in earlier GATT rounds – indeed, in long-established multilateral practices going back to the League of Nations. Two sorts of coalitions are relevant for WTO negotiations. Coalitions based on a broad *common characteristic* (such as a region or level of development, e.g. the African

3 For more on the interaction of internal transparency and negotiations, see (Ungphakorn and Wolfe, 2021).

Group) can influence many issues, including the round as a whole, but only weakly. Coalitions based on a *common objective or interest* (such as agricultural trade e.g. the G-33)⁴ can have a great deal of influence, but on a limited range of issues. Many of the coalitions that proliferated during the Doha Round may be less active now, which could limit future deliberative opportunities for smaller members.

A third type is more like a club than a coalition. *Bridge clubs* can be essential for breaking deadlocks, or for managing negotiations, often by building bridges between opposed positions. The first bridge club created in the Kennedy Round eventually became the Quad (US, EU, Japan, and Canada) in the Uruguay Round. That Quad no longer meets at ministerial level, but the Deputy Permanent Representatives of those members plus Australia still get together in Geneva – that grouping, however, does not include all the opposing interests. Efforts since the start of the Doha Round to create a new bridge club in various configurations spanning the new significant players in world trade all ultimately failed. The Ottawa Group is a new sort of coalition since it groups members with diverse interests and characteristics. It is not a bridge club, however. Its focus is promoting ideas on institutional reform, rather than trying to broker compromises.

Bridge clubs are run by members, but a trusted Director-General has scope to try to convene meetings of the principal antagonists, often known as a ‘green room’. The original Green Room practice, carried into the WTO, reflects three negotiating realities: first, that informality is vital; second, that the largest members must always be in the room; and third, that other interested parties should be engaged in the search for consensus. It has been problematic for more than 20 years (Blackhurst and Hartridge 2004). The key is ‘inclusiveness’ of all members and all interests; and ‘transparency’: representatives in the room must fairly articulate the views of their coalition and expeditiously and comprehensively report back on the deliberations. The chair must fairly present any results when reporting on negotiations in plenary meetings or drafting documents designed to attract consensus. Smaller countries and their NGO supporters complained profusely early in the Doha Round about the green room process and the necessity of ‘internal transparency’. Today, we still see obligatory nods to the importance of an inclusive process, but internal transparency does not seem to be mentioned, notably in India and South Africa’s complaint about the ‘joint statement initiatives’ (WTO 2021a) discussed below. This may not be a good sign.

The green room as a formal practice among ministers essentially died in July 2008 (Wolfe 2010). The dynamic of meetings with 30 or more ministers, each with one additional official, was not conducive to real engagement. Ministers, one wrote, were sitting together like sardines in chairs that are not the world’s most comfortable, while listening to speeches repeating familiar positions. Another minister told stakeholders that he had not sat down for so many hours in one day to listen and not speak since grade school. Another

4 The so-called ‘Friends of Special Products’ in agriculture is a coalition of developing countries pressing for flexibility for developing countries to undertake limited market opening in agriculture.

newcomer to the process complained that ministers admonished others for mentioning sticking points, then proceeded to mention their own. At subsequent ministerial conferences ministers still found ways to search for consensus in smaller groups, but not in anything like a green room.

More seriously, the practice has also vanished from Geneva. In a remarkably defensive speech to the General Council in July 2017 (WTO, 2017: 111), the then Director-General Roberto Azevedo said that instead of the former practice of having a green room before every General Council, since 2014 he had convened a full meeting of all Heads of Delegation where everybody could be invited and could address any topic. In effect, he decided that the Director-General has no role in seeking to broker a consensus, in helping to move negotiations forward. So instead of trying to find various configurations in which the principal antagonists on an issue could find common ground, he gave up. Perhaps we no longer hear complaints about internal transparency because Azevedo went to the inclusive extreme. There were no more worries about transparency, because there was no restricted group to be transparent about. The unfortunate result is that ambassadors are said to talk past each other in the General Council and the environment is increasingly toxic (Ungphakorn 2021). We are not aware of any bridge club meeting that currently includes China, the EU, and the US, but one will be needed.

2. THE SINGLE UNDERTAKING IS DEAD. OR IS IT?

Anyone who knows anything about the WTO knows that the single undertaking is dead. Not so fast. We can see three meanings of ‘single undertaking’ in the Doha declaration (WTO 2001): ‘the (1) conduct, (2) conclusion and (3) entry into force of the outcome of the negotiations shall be treated as parts of a single undertaking’. The three parts do not stand or fall together. The Doha mandate as a single undertaking in itself is clearly dead, but the notion that the result must be some sort of package applies to most negotiations. And the WTO *acquis* remains a reality.

The single undertaking as a negotiating technique had been evolving since the Dillon Round of the 1950s. In the Tokyo Round of the 1970s it was intended in part to impose the same constraint on the membership as a whole that American negotiators faced in the US Congress, where under the ‘fast track’ process, the results of a trade deal must receive a single up or down vote with no possibility of amendment. The American problem is acute. Given the heterogeneity of Congress, any significant deal must generally have something in it for multiple diverse constituencies, but if there are any doubts about all members in Geneva being committed to all aspects of a package, the whole thing could unravel in Washington.

Studying the possibility of linkage among issues and parties in treaties and negotiations has a long tradition (Wolfe 2009). The way an issue is framed can have the effect of adding or dropping members from some aspect of the negotiations. For example, least developed countries (LDCs) were not expected to cut any tariffs in the Doha Round negotiations

on non-agricultural market access, and some other developing countries were asked to do little more than reduce the gap between their tariff commitments and the tariffs actually applied, but all were expected to join the overall consensus by not objecting to the obligations undertaken by other members. On some issues, agreement is needed only among a subset of countries, like government procurement, while on other issues, like subsidies, binding rules require everyone to participate.

Adding or dropping an issue from a negotiation is complex. Adding divisive issues can undermine negotiations, especially if it brings in more domestic opponents than supporters of an issue. Adding unrelated issues that the parties value differently can be helpful. Packages work when negotiators can find trade-offs between issues and countries – indeed, when negotiators can see the trade-offs between import-competing and export interests within a given economy. Any package also creates multiple entry points for critics, and veto players. Recent trade negotiations sometimes stir up a hornet’s nest of opposition, without anybody having enough at stake in the outcome to ensure strong support for the negotiations, let alone ultimate ratification. Every package must have something that key constituencies in developed countries and developing countries alike want, because, inevitably, packages will contain elements they will not want.

The 2013 WTO ministerial in Bali showed that a mini package is possible, if the large players want one, but it also showed that single-issue deals are hard to negotiate, even on something as useful, and as internally balanced, as the Trade Facilitation Agreement. The Bali package only succeeded with the inclusion of development issues and agriculture. And even agriculture had to have balancing issues within that micro part of the Bali mini package, a package that was adopted by consensus (in that sense Bali was a single undertaking, as was Nairobi two years later). Every part of a WTO negotiation takes place among a subset of the members, and participation in the eventual outcome of each part must represent a critical mass for the issue concerned, making most-favoured-nation (MFN) application of the results possible without major free riders.

The single undertaking may be dead, but package deals? Not so much. We will come back to the package problem in the conclusion, but first we discuss the emergence of plurilateral negotiations.

3. PLURILATERALS ARE NOW MAINSTREAM

With the Doha Round dead, in 2017 many countries decided to shift gears and move away from negotiations based on the working practice of consensus decision-making by all WTO members by launching plurilaterals, meaning simply talks inside the WTO among a subset of members whose eventual outcome would make use of WTO transparency and dispute settlement procedures. The so-called ‘joint statement initiatives’ (JSIs) that are now being pursued in the WTO span e-commerce, domestic regulation of services, investment facilitation, and measures to enhance the ability of micro and small and medium enterprises (MSMEs) to utilise the opportunities offered by the rules-based trading system. Most address coordination failures or entail joint efforts to identify good regulatory practices. These initiatives include a broad cross-section of the members; with a heterogenous WTO membership, unlike the early days of the GATT, there may be no other way to discuss regulatory issues (Mavroidis and Sapir 2021: 35). The EU participates in all four groups, as does China, but the US only participates in one JSI.⁵

Other issues are also moving forward in a similar way. Recently, a proposed declaration on Agriculture Export Prohibitions or Restrictions Relating to the World Food Programme had to be issued as a joint statement (WT/L/1109) after being blocked by India; China was not a signatory. The Ottawa Group proposed an initiative on trade and health as a joint statement (WT/GC/223). Another group is organising ‘structured discussions’ on environmental sustainability based on a document similar to a joint statement (WTO 2020).

Whether and how the JSI negotiations can be brought to a successful conclusion is an open question, but plurilaterals are now clearly the mainstream approach. Such negotiations raise political questions about the process used, and legal questions about the variety of options for incorporating any outcomes in the WTO (Mamdouh 2021). There are two process concerns: that they can undermine internal transparency; and that ambiguity about the potential outcome creates anxiety about the process even when, in the case of the JSIs, no decisions have been made about the legal form of any outcome. Political consideration of how to launch, conduct, and conclude plurilaterals would be useful.

The first step in *launching* a plurilateral now seems to be reaching agreement on a joint statement. We think that ought to evolve from an open process of analysis and deliberation before launching negotiations on an issue, as has been the case with the current trade and health initiative and the structured conversations on sustainability as well as the JSIs. Such deliberation would be enhanced by ‘thematic sessions’ open to all members, which should include stakeholders (Wolfe 2021). The Secretariat could be asked to provide background papers, often in collaboration with other international organisations.

5 China joined the Information Technology Agreement and is in the process of acceding to the Government Procurement Agreement. China also participated in the Environmental Goods Agreement, though with a narrower list of goods than some other participants had wished and had wanted to participate in the now moribund Trade in Services Agreement (TiSA) negotiations.

The *process* of the negotiations should be sufficiently transparent that non-participants understand what is going on. The current JSIs are less transparent, at least to outsiders, than most recent WTO negotiations – outsiders, at least, cannot see what proposals have been made, for example. In e-commerce, the ‘co-convenors’ established several small groups led by facilitators. What are called ‘clean texts’ have been emerging from these groups. The Secretariat reports the fact that reports from the facilitators are discussed at meetings of the e-commerce negotiations, and the topics addressed, but the texts themselves are not made public. In his analysis of the historical background to the India and South Africa paper (see below) Lamp (2021) argues that one reason developing countries were upset with the Tokyo Round Codes, which admittedly took place in a different institutional context, was a lack of transparency in the negotiations. They were not part of the early stages and ‘in some cases (specifically, the codes on anti-dumping and civil aircraft) they did not even find out that codes were being negotiated until the final stages of the Round.’

As for the *outcome* of such negotiations, plurilaterals inside the WTO come in a number of forms (Mamdouh 2021), but two broad options are available. The first is a critical mass agreement in which participants in the negotiations incorporate the results in their schedules of commitments; such agreements come into effect when a pre-determined number of participants have circulated revised schedules.⁶ The question is always on which issues critical mass would be appropriate, and how to define it – in terms of percentage of WTO Membership, international trade shares in the sector, or both? Critical mass could also vary by level of commitment, which can address special and differential treatment concerns. Critical mass works for tariff reductions, as for example in the Information Technology Agreement (ITA). It also worked for the Reference Paper that was a key part of the package on trade in basic telecommunications services. The approach could work for scheduling other non-tariff concessions for any regulatory domain if, once a critical mass of participants is achieved, free riding by other members of the WTO is not a concern (Hoekman and Mavroidis 2017). Critical mass agreements affect the obligations of signatories but leave the rights of non-signatory WTO members unaffected.

If the intent is to restrict the benefits of the deal to participants, the second option is conclusion under Annex 4 of the WTO Agreement, an approach that limits the risk of free riding on liberalisation by non-participants but is *de jure* discriminatory. That route requires permission from the full membership by consensus, which may now be unlikely for anything new (Hoekman and Mavroidis 2015, Adlung and Mamdouh 2018). Plurilateral negotiations are clearly a political challenge for the WTO, which has been misconceived by some members as a legal issue.

6 Technically revised schedules must be certified by participants; non-participants could block new commitments that they think violate existing rights.

4. ARE PLURILATERALS 'LEGAL'?

In its first discussion paper on WTO reform (WTO 2018), Canada argued that:

While no WTO Member should be expected to take on obligations to which it did not consent, likewise no Member should expect to be able to prevent others from moving forward in various configurations in areas where they are willing to make greater commitments which could vary from political statements to more ambitious binding agreements, e.g. plurilateral initiatives. Binding initiatives should be inclusive, open and provide clear rules for accession by other Members or eventual multilateralization.

In a new submission on the legal status of the JSIs, India and South Africa explicitly say that the Canadian argument was wrong (WTO 2021a: 19-22). Their *political* argument is that members ought not to conduct plurilateral negotiations, which is worthy of discussion, but the legal justifications offered for this political position are flimsy at best. We have no space to go through the legal arguments in detail, so we will make only brief observations. The document says that 'Plurilateral Agreements' refers only to agreements included by consensus under Annex 4 of the treaty. But Article III:2 of the WTO treaty does not specify the legal forms that negotiated outcomes might take or the exact procedures that should be followed, which might vary depending on the subjects covered and their relation to current rules (Adlung and Mamdouh 2018: 90-2). India and South Africa also say that JSIs are inconsistent with amendment procedures, but many negotiations have been conducted among a subset of the WTO membership, who then implement the results on an MFN basis. Request and offer negotiations on market access are typical examples.

India and South Africa's detailed legal analysis confuses process and outcomes. On *process*, members would of course have to agree by consensus to launch negotiations that would affect the rights and obligations of other members, just as they would have to agree by consensus to incorporate the *outcome* of such negotiations into the WTO, either by amending an existing agreement or entering a new agreement under Annex 4 of the treaty. On the other hand, a process that only creates new obligations for the participants needs no such consensus to start talking. The explicit target of India and South Africa is the JSIs, but those *processes* have not yet reached the point of considering the legal form their eventual *outcomes* might take. The WTO treaty provides considerable flexibility on how any agreement may be concluded and offers no legal restrictions on the process members might take to get to an outcome (Mamdouh 2021).

As Canada suggested in 2018, ways can be found to ensure that the whole membership can be comfortable with plurilateral negotiations. In its new paper on WTO reform, the EU, recognising the failure of 'the single undertaking approach' calls on WTO members to reflect on ways of better integrating plurilateral agreements, notably by identifying certain principles that plurilaterals should meet if they are to be incorporated in the WTO

framework (EU 2021). These principles covering both process and outcomes could relate to openness to participation and future accession by any WTO member, facilitation of the participation of developing countries, transparency of the negotiating process, as well as means of protecting the existing rights of non-participants while avoiding free riding.

The challenge from India and South Africa may be more political than legal, but it should be addressed. Hoekman and Sabel (2021) suggest that one way to do so is through the establishment of a code of conduct that signatories of plurilateral agreements commit to apply. Providing a governance framework for new plurilateral agreements that ensures they are consistent with multilateralism would help to recognise valid concerns of non-members. Ironically, negotiating such governance principles would face the same obstacles to consensus as any other negotiation at the moment, so they suggest that it be done as a 'reference paper', to be incorporated in the schedules of the members who drafted it, with any WTO Member interested in participating in an open plurilateral negotiation or acceding to the results accepting to incorporate the reference paper into their schedules. We worry that even a reference paper might be difficult to negotiate, but all that is needed is a joint statement on governance principles and a political commitment to conduct every plurilateral in accordance with them.

The stakes are high. On the one hand, Lamp (2016, 2021) argues that the Uruguay Round single undertaking provided leverage for a 'club' of dominant traders to force recalcitrant developing countries to accept all the agreements and join the new WTO. The main concern of India and South Africa (WTO 2021a), and hence their desire to retain a veto, could be that control of the agenda of the multilateral trade regime appears to be slipping away from developing countries yet again. On the other hand, if the outside options are attractive, there is a risk that the major powers will abandon MFN. The EU paper (EU 2021) contains an implicit warning: if no effective formula is found to integrate plurilateral agreements in the WTO, there would be no other option than developing such rules outside the WTO framework, which could fragment the system. What they mean is that the outcome of some possible agreements might not be suitable for inclusion in schedules and so members must debate the Annex 4 option.

The warning applies to India, and South Africa, and to anybody tempted by their analysis, but it also applies to the three major powers. We can infer China's position from the fact that it is participating in all the current JSIs; the US position is more ambiguous since they are only a formal proponent of the e-commerce JSI, but they are said to be very active in the domestic regulation in services talks. The risk of free riding by any of the three major powers means that each of China, the EU and the US will be needed to reach a critical mass deal.

CONCLUSION: WHAT CONCRETE STEPS CAN BE TAKEN NOW?

Nothing will happen in the WTO unless China, the EU and the US want it to, but they need support from the other members. When it is safe to do so, as the threat of Covid-19 recedes, delegates should go to lunch more often: it would help if members spent more time talking to, rather than at, each other. That might mean more bridge clubs are needed, at all levels and all areas. The trilateral meetings between the EU, Japan, and the US are far from being a substitute for a bridge club involving China, although it responds to the desperate need to find informal ways of making progress on thorny issues. The Director-General might set the tone here. Her apparent engagement with various groups of members in the fisheries subsidies negotiations is a promising start. She will need to find ways to include all the principal antagonists, who vary by issue. The three major powers are the core, but they will need to engage with others, including India as needed while avoiding the risk of any negotiation getting too big, with obstructionists in the room, hence no ability to do anything. But the three major powers should avoid the temptation, born of frustration, to follow unilateral or bilateral tracks. Even the most apparently intractable issues involving the role of the state in the economy are best discussed multilaterally (Mavroidis and Sapir 2021: 213).

More concretely, the three major powers should enter negotiations for a joint statement on governance principles for open plurilaterals starting, as suggested by Mamdouh (2021), with an analysis based on WTO experience of whether reform efforts should seek to change the rules, or the way they are understood and applied. With their leadership, other members could be induced to participate in elaborating principles that should be the basis to launch, conduct, and conclude any open plurilateral agreement, including the circumstances under which Annex 4 agreements could be expected to be acceptable. Those principles might allow everyone to agree to progress on the JSIs, even the ones where they choose not to participate. While Annex 4 agreements cannot be allowed to degrade the rights of members, non-participants should not have a veto on their inclusion in the WTO. Such a discussion of a more flexible architecture should begin at the 12th Ministerial Conference (MC12) beginning in November 2021.

Finally, while the single undertaking is dead, package deals are a negotiation reality. MC12 will need an agenda proposing a set of agreements that can attract a broad consensus. In March 2021 Brazil suggested just such a package, with nine components, including flexible geometry for WTO negotiations (WTO, 2021b); other proposals will no doubt follow. Without a forcing device, and if the results of each negotiation now underway cannot stand on their own, how can they be knit together? The major powers have asymmetric interests with respect to any single trading partner; and they tend to have asymmetric interests on any one issue. *If* the three have to be part of a deal to get critical mass, and *if* they have asymmetric interests, *then* do they have to have a package of critical mass deals to reach agreement on any one of them?

If package deals are needed, is it more feasible to bind two or more issues into one package? If so, what are the likely elements? Other chapters in this book elaborate on the possibilities. Here are three ambitious ones. China subsidises its high-tech industries partly because of export controls in OECD countries – perhaps the two issues of industrial subsidies and high-tech export controls could be linked (Zhou and Fang 2021). While some think industrial subsidies could be a standalone negotiation, it could possibly be linked to agriculture subsidies in an eventual package (Li and Tu 2020). Or an agreement on domestic support in agriculture at MC12 could be linked to conclusion of the negotiations on fisheries subsidies.

We are not naïve. These are all intractable issues; indeed, agricultural trade has long been the issue that cannot succeed on its own because reform is the most important objective for many countries while being strongly resisted in others. We mention them rather than the higher profile JSIs because the developing countries for whom agriculture is the overriding priority may not have outside options, but their continued engagement in the trading system ought to matter for everyone.

If everybody knows that a plurilateral will succeed, and if a joint statement on governance principles has been accepted by the participants, is there an incentive for recalcitrant members to try to shape the outcome, or simply stand aside, instead of obstructing it? That is a political not a legal question. The fate of the JSI approach and the prospects for reviving the negotiation function of the WTO may hinge on the answer.

REFERENCES

Adlung, R and H Mamdouh (2018), 'Plurilateral Trade Agreements: An Escape Route for the WTO?', *Journal of World Trade* 52:1 85-111.

Blackhurst, R and D Hartridge (2004), 'Improving the Capacity of WTO Institutions to Fulfil Their Mandate', *Journal of International Economic Law* 7:3 , 705-16.

EU (2021), 'Reforming the WTO: Towards a Sustainable and Effective Multilateral Trading System,' European Commission, COM(2021) 66 final ANNEX,.

Fiorini, M, B M Hoekman, and R Wolfe (in progress), 'Where Trade Negotiators Sit Influences Where They Stand: Officials in Geneva and Capitals Have Different Views on WTO Priorities'.

Hoekman, B M and P C Mavroidis (2015), 'Embracing Diversity: Plurilateral Agreements and the Trading System,' *World Trade Review*, 14:01 101-16.

Hoekman, B M and P C Mavroidis (2017), 'MFN Clubs and Scheduling Additional Commitments in the GATT: Learning from the GATS,' *European Journal of International Law*, 28:2 387-407.

Hoekman, B M and C Sabel (2021), 'Plurilateral Cooperation as an Alternative to Trade Agreements: Innovating One Domain at a Time', *Global Policy*, 12:S3 49-60.

Lamp, N (2016), 'The Club Approach to Multilateral Trade Lawmaking', *Vanderbilt Journal of Transnational Law*, 49: (2016), 107.

Lamp, N (2017), 'The Receding Horizon of Informality in WTO Meetings', *Journal of the Royal Anthropological Institute*, 23:S1 63-79.

Lamp, N (2021), 'A Historical Perspective on India's and South Africa's Threat to Block the Implementation of the Joint Statement Initiatives in the WTO, and a Potential Way Forward', *International Economic Law and Policy Blog*, February 26, 2021, <https://ielp.worldtradelaw.net/2021/02/a-historical-perspective-on-indias-and-south-africas-threat-to-block-the-implementation-of-the-joint.html>.

Li, S and X Tu, (2020), 'Reforming WTO Subsidy Rules: Past Experiences and Prospects', *Journal of World Trade*, 54:6 853-88.

Mamdouh, H (2021), 'Plurilateral Negotiations and Outcomes in the WTO', King & Spalding, Geneva, unpublished memo, 16 April 2021.

Mavroidis, P C and A Sapir (2021), *China and the WTO: Why Multilateralism Still Matters*, Princeton University Press: 35.

Ungphakorn, P (2021), 'Dire WTO General Council Meeting Shows Size of Okonjo-Iweala's Task', *Trade Blog*, <https://tradebetablog.wordpress.com/2021/03/05/dire-wto-general-council/>.

Ungphakorn, and R Wolfe (2021), 'How Wide Should the WTO Window Be Set? A Long Read on Transparency and Trade Negotiations', *Trade Blog*, <https://tradebetablog.wordpress.com/2021/04/26/wto-transparency-short/>.

Wolfe, R (2009), 'The WTO Single Undertaking as Negotiating Technique and Constitutive Metaphor', *Journal of International Economic Law*, 835-58.

Wolfe, R (2010), 'Sprinting During a Marathon: Why the WTO Ministerial Failed in July 2008', *Journal of World Trade* 44:1, 81-126.

Wolfe, R (2015), 'First Diagnose, Then Treat: What Ails the Doha Round?', *World Trade Review* 14:01, 7-28.

Wolfe, R (2021), 'Informal Learning and WTO Renewal Using Thematic Sessions to Create More Opportunities for Dialogue', *Global Policy* 12:S3 30-40.

WTO (2001), 'Ministerial Declaration,' World Trade Organization, Ministerial Conference, Fourth Session, Doha, 9 - 14 November 2001, WT/MIN(01)/DEC/W/1.

WTO (2017), 'Minutes of the Meeting Held on 26 July 2017', World Trade Organization, General Council, WT/GC/M/168.

WTO (2018), 'Strengthening and Modernizing the WTO: Discussion Paper,' Communication from Canada, JOB/GC/201.

WTO (2020), 'Communication on Trade and Environmental Sustainability: Communication from Australia; Canada; Chad; Chile; Costa Rica; European Union; the Gambia; Fiji; Iceland; Japan; Korea, Republic of; Liechtenstein; Maldives; Mexico; Moldova, Republic of; Montenegro; New Zealand; North Macedonia; Norway; Senegal; Switzerland; the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu; and the United Kingdom,' Committee on Trade and Environment, WT/CTE/W/249, 17 November 2020.

WTO (2021a), 'The Legal Status of 'Joint Statement Initiatives' and Their Negotiated Outcomes,' General Council, communication from India and South Africa, WT/GC/W/819.

WTO (2021b), 'The MC-12 Package: Moving the WTO Forward,' General Council, Communication from Brazil, JOB/GC/253.

Zhou, W and M M Fang (2021), 'Subsidizing Technology Competition: China's Evolving Practices and International Trade Regulation in the Post- Pandemic Era' *Washington International Law Journal*, (forthcoming).

ABOUT THE AUTHOR

TU Xinquan is Dean and Professor of the China Institute for WTO Studies at the University of International Business and Economics located in Beijing, China. He received his PhD in international trade from this university in 2004. His research and teaching focus on Chinese trade policy, WTO, and US-China trade relations.

Robert Wolfe is Professor Emeritus at the School of Policy Studies, Queen's University, and a member of the Global Affairs Canada Trade Advisory Council. He was a part of the Bertelsmann Stiftung project on WTO reform and has published extensively on WTO transparency mechanisms and deliberative functions.

CHAPTER 2

Transparency and Local Subsidies in China and the United States¹

45

Simon J. Evenett and KONG Qingjiang

University of St. Gallen and CEPR; China University of Political Science and Law

Market-distorting subsidies have risen to the top of the international trade policy agenda. While the focus of policy deliberation is largely on central government largesse, less attention is given to the award of subsidies to local firms by provinces, states, and cities. Evidence on the latter awarded by sub-national bodies in China and the United States is presented here. We draw out the systemic implications of these findings for multilateral trade deliberations on transparency and subsidy notifications in particular.

INTRODUCTION

There has been growing interest in transparency in recent years. For example, the recently concluded Comprehensive Agreement on Investment (CAI) between China and the European Union (EU) mentions the word ‘transparency’ more than 30 times. The obligation of transparency now reaches far beyond the general discipline on transparency enshrined in the Marrakesh Agreement and sector-specific obligation in certain trade agreements. In principle, it has been expanded to almost every aspect of trade policy.

In fact, promoting greater clarity of trading partners’ policies and intentions has been seen as critical to a strong rule-based trading system since the creation of the multilateral trading system just after the Second World War. The diplomats who negotiated the General Agreement on Tariffs and Trade and later the World Trade Organization (WTO) saw transparency, together with non-discrimination and national treatment, as one of the foundational principles of the system.

The exchange of information on trade policies, inquiries into specific measures that have been applied, and monitoring of government trade policy actions – especially since the onset of the Global Financial Crisis – are vital components in the work of the WTO. Today, nearly every WTO agreement contains provisions on transparency and WTO members have called for enhanced transparency provisions in virtually every negotiation held in the run-up to the eleventh Ministerial Conference (MC11).

¹ The authors thank participants at two meetings of the China-EU Dialogue on WTO Reform for their suggestions.

The Trade Policy Review mechanism mandates that trade policies of all WTO members be regularly reviewed by the WTO Secretariat and subject to scrutiny in meetings of members in the Trade Policy Review Body. In negotiations to open markets further or to improve trade rules, governments believe possession of relevant information is essential to determine the scope of any deal that may be struck and its implementation.

Yet subsidies have a pride of place in discussions on transparency at the WTO for three reasons. First, as the Chairman of the WTO Committee on Subsidies and Countervailing Duties noted on 27 April 2021 ‘...despite reminders to members to submit their notifications in time, 80 members have still not submitted their 2019 notifications. In addition, 67 members still have not submitted their 2017 subsidy notifications, and 57 have still failed to submit their 2015 notifications.’² Furthermore, as a review of the minutes of this Committee’s meetings reveals, some notifications are seen as incomplete or deficient in some other respect.

Second, as numerous reports by the Global Trade Alert have shown, governments have made extensive resort to selective subsidies during the Global Financial Crisis, in the years of recovery that followed, and again once the Coronavirus pandemic hit. With the notable exception of the China-US trade war, taxing imports has declined in use and subsidies, often under the radar screen, have been deployed instead. Subsidies, it seems, have become the discriminatory tool of choice. The reluctance of many G20 governments to cooperate with the WTO Secretariat’s monitoring of subsidies is telling.³

Third, it is often asserted – not necessarily with much evidence – that subsidisation is a key feature of state-driven forms of capitalism. The absence of centralised inventories of subsidies in leading trading nations has made it difficult to refute allegations made by trading partners of the extent and transparency of subsidies. Combined with the second point mentioned above, subsidies have become a growing source of trade tensions between major trading nations, and this has been central to discussions on market distorting policies and on the appropriate relationship between WTO membership and economic development priorities.

A comprehensive discussion of the sources of market-distorting subsidies ought to recognise that many levels of government can award state aid. In Federal constitutional structures, such as the United States, cities and states cannot resort to internal border taxes and so different forms of state largesse are often seen as the principal form of selective policy. Even in jurisdictions such as China, which claim to have unitary government, it does not follow that each level of government knows exactly how much subsidisation is taking place in other levels. The quantum and transparency of subsidisation may be affected by constitutional privileges and obligations.

² WTO news item: https://www.wto.org/english/news_e/news21_e/scm_27apr21_e.htm.

³ Indeed, the WTO secretariat stopped including information on so-called General Economic Support measures in their G20 trade monitoring reports on account of the lack of cooperation.

In this chapter we discuss the reaction by certain governments to the subsidy-related notification deficit at the WTO. While that notification deficit is normally expressed in terms of late or missing notifications, in principle the degree of notification could be contrasted to known inventories of subsidies awarded. Such inventories are, however, largely missing in many jurisdictions and so the rest of the paper focuses on what is known about the trade-related aspects of sub-national subsidies, an important data gap. To fix ideas, these data gaps are discussed in the context of China and the United States. Implications for the reform of the WTO approach to transparency are drawn in the concluding section.

2. THE NOTIFICATION DEFICIT IN SUBSIDIES AND WTO MEMBERS' REACTION

Underpinning the notion of transparency in the multilateral trading system is the faith that members place in each other to provide the information on a timely basis necessary to monitor trade policy choices accurately and effectively. Overall, members provide this information through a process called notification. Yet, as noted earlier, there is a significant notification 'deficit' in the area of subsidies, taken to mean that many governments have failed to make notifications at all or have made them with a significant delay.

Certain WTO members have advanced proposals in various negotiating forums that would address this shortcoming. The United States made an initial proposal at the Council for Trade in Goods in November 2017. That proposal was amended and subsequently Argentina, Australia, Canada, Chinese Taipei, Costa Rica, the European Union, Japan, and New Zealand joined as co-sponsors. On 11 April 2019, at a meeting of the Council of Trade in Goods, the head of the US delegation motivated the proposal as follows:

'This lack of transparency is problematic for traders, and it undermines the proper functioning and operation of the WTO Agreements... From a systemic perspective, it is also very difficult to develop, evaluate and assess negotiating proposals to improve operation of various WTO agreements without the information that should have been provided under existing WTO notification obligations... Lack of compliance with basic notification obligations also undermines confidence in the system. If Members cannot comply with the most basic obligations, what certainty can there be that they are complying with the more substantive ones?'⁴

The United States and co-sponsors took a carrot and stick approach to encouraging the submission of required notifications. Developing countries could seek technical assistance from the WTO Secretariat in preparing notifications. The proposal also included 'modest administrative measures that acknowledge that sustained problems in compliance should have at least some consequences'.⁵

4 <https://geneva.usmission.gov/2019/04/12/procedures-to-enhance-transparency-and-strengthen-notification-requirements-under-wto-agreements/>.

5 <https://geneva.usmission.gov/2019/04/12/procedures-to-enhance-transparency-and-strengthen-notification-requirements-under-wto-agreements/>.

American representatives specifically distinguished between the submission of notifications in the first place and the quality of such submissions, noting that their proposal referred only to the former. Separately, in respect to subsidies, the United States put forward a proposal on transparency and the need for greater diligence in notifications.⁶

China submitted a WTO reform proposal, which recognised that members' overall fulfilment of notification obligations still falls short of the requirements under various WTO agreements. It seems that this observation applied to notification of subsidies by members. Still, China's tone was mild, stating that 'due to their limited capacity and other constraints, some members could not submit the notifications on time.' Moreover, it argued in the meantime that 'the quality of counter-notifications submitted by some members still needs further improvement.'⁷

Recognising that the notification deficit, among others, detracts from the 'operational efficiency' of the WTO, China made several proposals: 'Firstly, developed members should lead by example in submitting comprehensive, timely and accurate notifications. Second, members should improve the quality of their counter-notifications. Third, members should increase exchange of their experiences on notifications. Fourth, the WTO Secretariat needs to update Technical Cooperation Handbook on Notifications as soon as possible and intensify training in this regard. Fifth, developing members should also endeavor to improve their compliance of notification obligations. Technical assistance and capacity building should be provided to developing members, in particular LDCs, if they are unable to fulfil notification obligations on time.'⁸

Interestingly, when it comes to the transparency concerning subsidies, in a separate section on trade remedies in the same WTO reform proposal, China switched to focus on greater transparency towards the processes that governments use to determine whether and to what extent imports have been dumped or subsidised, particularly in investigations involving small and medium size enterprises.

In sum, there is a general recognition of the notification deficit regarding subsidies among WTO members. Yet China has taken a broader approach to this issue. While it has sought to address under-notification, it brought counter-notifications and their apparent deficiencies into the discussion. With respect to subsidies, China sought to bring the transparency of countervailing duty investigations into the discussion. For China, the issue of transparency regarding subsidies is not only concerned with notification, but also associated with the approach to the determination of the subsidies. China concurred with others about the importance of technical assistance to build notification-related capacity in developing countries.

6 Proposed guidelines for submission of questions and answers under Articles 25.8 and 25.9, G/SCM/W/557/Rev.4, 26 October 2020.

7 China's proposal on WTO reform, WT/GC/W/773, 13 May 2019.

8 Ibid.

In the view of some analysts, China is the target of enhanced subsidy notification requirements.⁹ To round out assessments of Chinese central government subsidisation, and to facilitate a fact-based assessment of what is at stake, our attention turns to the subsidies offered by China's local governments. We then balance that discussion with some evidence of the resort to subsidies by American cities and states.

3. LOCAL SUBSIDIES IN CHINA AT A GLANCE

In recent years, in order to respond to the country's call for mass entrepreneurship and innovation, and to cultivate strategic emerging industries, government agencies at all levels have introduced a large number of favourable support policies. Among these subsidies are one of the most commonly used measures for governments to support the development of enterprises.

Unfortunately, the exact amounts of subsidies paid are often unknown, possibly ranging from hundreds of billions to a few trillions of yuan. A study by Haitong Securities, a leading investment firm in the country, shows that the subsidies granted to companies in 2017 was estimated at more than 430 billion yuan.¹⁰

TABLE 1 RBA BALANCE SHEET (\$ BILLION)

Department granting subsidy at local level	Types of subsidies			
Bureau of Science and Technology	Technology development	Platform construction	Innovation and entrepreneurship	Achievement award
Bureau of Industry and Information	Industrialisation	Informatisation	Technology innovation	Market development
Bureau of Development and Reform	Project of strategic importance	Novel industries	Important project construction	Platform
Bureau of Commerce	E-commerce	Trade fair and exhibition	Foreign trade	Urban consumption promotion
Bureau of personnel administration	Retaining of talented personnel	Social insurance premium allowance	Re-employment	Employee training and education

9 For example, see Gao, H (2018), 'The WTO transparency obligations and China', *Journal of Comparative Law*, 12(2): 329-355.

10 Haitong Securities, How much are the subsidies?. Available at: <https://www.htsec.com/jfimg/colimg/upload/20180813/4301534146895711.pdf>.

Bureau of Market Regulation	Branding and Trademarking	Quality management	Patent application	Standardisation
-----------------------------------	------------------------------	-----------------------	-----------------------	-----------------

3.1 Forms of local subsidies available

The main forms of government subsidies include financial grants, interest rate reductions (subsidised credit), tax rebates, and free allocation of non-monetary assets.

(1) Financial grants are unpaid funds allocated by the government to support enterprises. This type of state support usually has strict policy conditions. Only enterprises that meet the reporting requirements can apply for grants, and the specific uses of funds are stipulated at the time of appropriation. Examples include the fixed grain subsidies allocated by the financial department to enterprises and incentives to encourage enterprises to place fired employees in re-employment.

(2) Subsidised credit refers to the subsidy provided by the government to the interest payments on loans by an enterprise in order to support the development of a specific field or region in accordance with the country's macroeconomic situation and policy objectives. There are two main ways to discount interest: one is that the financial department directly pays the funds to the beneficiary enterprises; the other is that the financial department directly allocates the interest discount funds to the lending bank, and the lending bank provides loans to the enterprise at a preferential interest rate lower than the market interest rate.

(3) Tax rebates involve the repayment of tax to the enterprise by the government in accordance with the relevant regulations of the state. Thus, it is a government subsidy given in the form of preferential taxation. Direct tax reductions, tax exemptions, increase in tax credits, and partial tax credits are examples.

In each of the three examples above, the government does not directly provide assets to an enterprise.

(4) The free allocation of non-monetary assets mainly including land use rights, forests, etc.

3.2 Subsidies available to enterprises at different stages of growth

Start-up companies, which refer to all types of companies that have just been established and do not have sufficient funds and resources, may apply, in light of their industry field, asset scale, cost input, intellectual property rights, and sales, for subsidies designed for technology research and development, technical services, industrialisation results, informatisation construction, fixed asset investment and construction, and other fund subsidies or interest subsidy policies.

In addition, such companies may also be eligible for tax reduction and exemption policies, high-tech enterprise designation, technology contract registration, and deduction of R&D expenses. Entrepreneurial support projects, including entrepreneurial competitions, entrepreneurship-driven employment, entrepreneurial talent awards, etc. may also be provided to start-ups.

Growing enterprises, which have begun to emerge in an industry and enjoy rising market shares, the gradual enhancement of market competitiveness, the gradual increase of enterprise scale, and the gradual improvement of enterprise qualifications, are often eligible for incentives for research transformation, R&D environment improvement or R&D investment subsidy policies, new OTC listing support policies, and tax reduction and exemption policies.

Mature companies, whose size, scale of production, profit and market share are close to their optimal state, and whose marketing capabilities, production capabilities, and R&D capabilities are also well established, may undertake some national-level science and technology plan projects. They may also choose to apply for national-level special funds for science and technology, the qualifications of municipal enterprise technology centres, municipal engineering technology research centres or key laboratories, enterprise research and development institutions, and enterprise listing subsidies, and actively participate in the customisation of industry standards and national standards, and trademarks development.

Subsidies are even made available to companies in transition, such as those undertaking technology upgrading, staff re-employment and exit support for enterprises with high-energy-consumption.

In addition, local governments even provide subsidies to listed companies headquartered in their respective regions. Recently, 21st Century Economic News, a leading financial news agency, reported that some of the most profitable state-owned enterprises, such as banks, received various government subsidies. The report found that A-share listed companies in the first three quarters received a total of 105.548 billion yuan in government subsidies, exceeding the profits made by their net profits.¹¹

3.3 Subsidies tailored to the special needs of various industries

Subsidies are available to a large number of targeted industries. For example, enterprises in software industry can apply for subsidies from the Bureau of Industry and Information and Bureau of Commerce. Meanwhile, companies in the IT industry and bio-chemical and pharmaceutical industry may reap subsidies more from the Bureau of Science and Technology.

¹¹ A-Share Listed Firms compete for Government Subsidies: the amount of subsidies obtained by 505 listed firms has exceeded their total profits, 21st Century Economic News. Available at <http://epaper.21jingji.com/>, or, alternatively, <https://stock.hexun.com/2019-12-25/199786169.html>.

Other forms of subventions include R&D subsidies from the Bureau of Science and Technology and a talented personnel allowance from the Bureau of Personnel Management and Social Security.

Awards for branding and trademarking are generally available to all sorts of enterprises.

In sum, there is a multi-faceted framework of subsidies from different departments of local governments.

4. INCENTIVES FOR CHINESE LOCAL GOVERNMENTS TO RESORT TO SUBSIDIES

Empirical studies have shown decentralisation is instrumental to economic development as local governments are given more autonomy.¹² Even authoritarian states, which by definition are averse to direct political accountability, stand to benefit from decentralising.

Even though it is a unitary country, China introduced a policy of decentralisation in order to galvanise sub-national governments to develop local economies. In this regard, two factors are noteworthy. One is that, on this logic, economic growth is entwined with an active government role as part of the Chinese model for economic growth. The other is that the leaders of local governments are evaluated for promotion primarily in terms of the economic performance, or GDP, of the regions they administer. Consequently, local governments, or more precisely their leaders, have an incentive to provide subsidies to targeted enterprises.

Given these two factors, once local governments are given autonomy to use their own budget or to borrow money to encourage the growth of local economies, they are better positioned to take advantage of the financial resources at their disposal for the purpose of providing subsidies to targeted or championed enterprises. Moreover, they are increasingly inclined to resort to subsidy use for the desired economic growth.

In addition, there are inadequate constraints on local government budgets and borrowing. More alarmingly, certain local governments have applied to the central government for repayment or writing-off of any bad debt incurred by the former. This has given rise to a growing confidence, on the part of local government, in the central government playing the role of the lender of last resort. This has reinforced the tendency of local governments to borrow.

In sum, local governments have the incentive to offer subsidies and there are relatively loose constraints on local governments doing so. Thus a dependency on the subsidy policy for the desired economic growth of their municipalities, cities, prefectures, and counties has arisen.

¹² See Lin, J Y and Z Liu (2000), 'Fiscal Decentralization and Economic Growth in China,' *Economic Development and Cultural Change*, 49 (1): 1-21. And Zhang, T and H Zou (1998), 'Fiscal Decentralization, Government Spending and Economic Growth in China', *Journal of Public Economics*, 67: 221-240.

Furthermore, enterprises, particularly state-owned enterprises, and prospective investors, have developed a reliance on subsidies for their growth. Investment location has also been affected. While subsidies, as non-recurring profit and loss income of listed companies, boost the business performance of the subsidised enterprise, even more companies, which suffer from 'blood transfusion dependence', rely on financial subsidies to sustain themselves while making losses. For example, in order to preserve the 'shell' of listed companies, local governments have continuously injected special subsidy funds to help companies maintain their 'shell'. In this manner, resource allocation has been skewed by local government subsidies.

5. EVALUATION OF THE TRANSPARENCY OF CHINESE LOCAL SUBSIDY POLICIES

5.1 General evaluation of the local subsidy policies

(1) Industrial policy has huge impact on subsidies. It is often found that all enterprises in favoured industries enjoy 'subsidy banquet'. Moreover, the new energy auto subsidy policy once gave rise to rampant subsidy fraud.¹³

(2) State-owned enterprises are favoured by the subsidy policy. In theory, all eligible enterprises may apply for subsidies. For example, eligible private enterprises and small and medium-sized enterprises may apply for and obtain local fiscal funds at all stages of development (in the seed stage, start-up stage, initial growth stage or rapid growth stage of their development), as long as they comply with national and local industrial policies. In reality, a Xinhua News Agency report disclosed in the first half of 2014 that of a total of 32.3 billion yuan of government subsidies, 61.64% went to 854 local state-owned enterprises and central state-owned enterprises.¹⁴

(3) Local borrowing is the primary source of local subsidy. Since local governments have no right to formulate measures related to tax incentives, local subsidy policies are often bond financed and tax related.

(4) Allocation of subsidies is not efficient. Since many local departments or bureaus are involved in subsidy granting and, consequently, there are many types of policies, many companies eligible for subsidies may not be aware of those policies or don't know how to apply for subsidies. Also, owing to bureaucracy, subsidy processing and payment is often delayed.

13 Wang, M (2018), 'A Study of the Subsidy Policy for New Energy-driven Automobile', PhD dissertation submitted to Beijing Jiaotong University.

14 Xinhua Viewpoints: A Perspective of the attainment of government subsidies by enterprises , 19 November 2014: http://www.gov.cn/xinwen/2014-11/19/content_2780740.htm.

On the whole, subsidies are not efficiently allocated. In recent years, the steel, cement, building materials, and other industries have received large amounts of subsidies, and this is theorised to have caused overcapacity. The survival of such firms has become a worrying problem. Some listed companies to which local subsidies are channelled have continued to lose money.

Given the uneven distribution of subsidies and the low efficiency of the subsidy policy, there have been calls for strict restriction of local government in granting industry subsidies.¹⁵

5.2 Transparency evaluation of the local subsidy policies

According to the *Report on Fiscal Transparency of Chinese Municipal Governments 2020*¹⁶ released by Tsinghua School of Public Administration, among the 294 governments at the prefecture-level and above across the country, the overall situation of fiscal transparency and openness was significantly better than that of the previous year. However, the openness and transparency of their fiscal expenditures, and of the final accounts of 388 governments at the county level and below in the country, still needs to be improved.

Given the complex framework of local subsidies, the incentive of local governments to offer subsidies, and the relatively loose constraints on local government financing of subsidies, it is difficult for the central government to have a clear nationwide account of the extent of local government subsidisation.

Although China is a unitary country, the central government, which is obligated to notify the WTO about its subsidy policies, does not have the full capability to collect all necessary information about local subsidies. Under these circumstances it would not be surprising if the central government was unable to provide complete and accurate information on the country's local subsidies.

6. STATE AID AWARDED BY US SUB-NATIONAL GOVERNMENTS

Like their Chinese counterparts, US state and city officials can deploy state largesse to support the development of their local economies.¹⁷ While the incentives faced by policymakers differ across these two jurisdictions, US politicians have a keen electoral interest in improving the well-being of their local populations.

¹⁵ Strictly restrict local government in granting industry subsidies, *China Energy News*, 25 May 2020. In addition to strict restriction of local government in granting industry subsidies, the recommendations include Industrial subsidy policy has shifted from differentiation and selectivity to inclusive and functional, introduce the cap control and performance review of industrial subsidies, and actively and effectively promote international negotiations on industrial subsidy rules.

¹⁶ An abstract of the Report is available at <http://news.xinhua08.com/a/20201119/1964222.shtml>.

¹⁷ For a more detailed analysis of this matter see Evenett, S J (2021), 'Economic Statecraft: Is There a Sub-National Dimension? Evidence from United States-China Rivalry', *World Trade Review* 20(2): 220-237.

Given the prohibition in the U.S. Constitution on states erecting barriers to internal trade in goods, arguably US officials are more dependent on tax and subsidy tools than their Chinese counterparts. The purpose of this section is to provide a brief overview of the resort by US sub-national bodies to state aid for business.

As in China, there is no centralised inventory of subsidies and tax breaks awarded by US cities and states to the private sector. In another parallel to the Chinese experience, US sub-national officials do not necessarily welcome oversight of their issuance of state aid. This is evidenced by the fact that not every US city and state complies with Statement number 77 of the U.S. Government Accounting Standards Board, which has, since August 2015, mandated publication of tax abatements provided to firms.¹⁸

According to the *Goods Jobs First* initiative, which has assembled what GASB 77 filings have been made public, approximately \$54 billion in tax abatements have been declared for the years 2017-2020. The actual total is likely to be larger, on account of reporting lags for 2020 (where the current recorded total of \$7.3 billion is less than half of the annual average reported totals for the three preceding years). Any suggestion that the scale of US sub-national subsidies is trivial can be set to one side.

For the purposes of this chapter, however, information on the resort to sub-national government subsidies was extracted from the Global Trade Alert database. Information has been collected since November 2008 on different types of subsidies (and other potential trade distortions) undertaken by state bodies at all levels of government (supra-national, national, and sub-national). At the time of writing, this database included information on over 31,000 policy interventions undertaken worldwide that affect any form of cross-border commerce (therefore, going beyond trade in goods).¹⁹

As far as subsidy announcements are concerned, the Global Trade Alert database includes information on the introduction, expansion, contraction, and removal of subsidies so long as the amount of the change involved exceeds \$10 million. This helps weed out subsidies and subsidy changes likely to have limited commercial impact, in particular cross-border commercial impact.

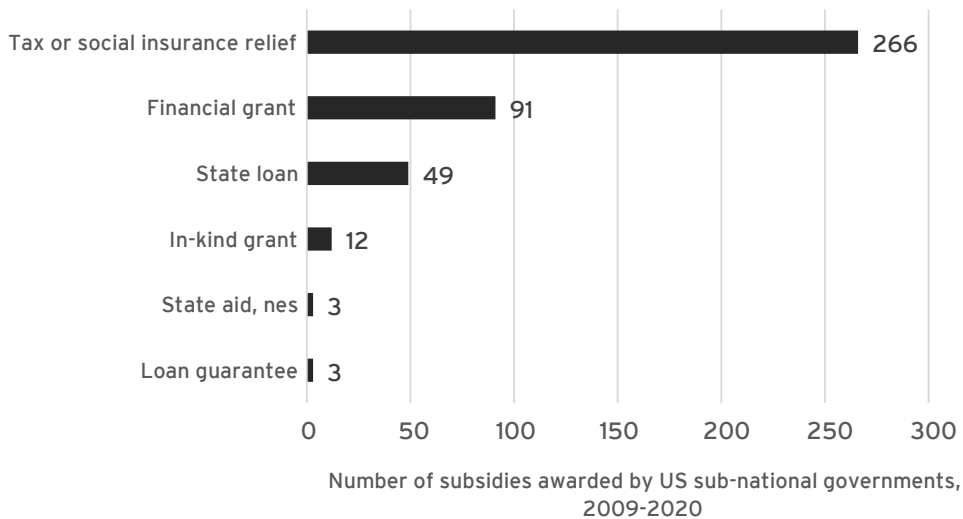
Like the rest of the entries in the Global Trade Alert database, there is a strong preference to use official documents to record any subsidy award. However, if a firm declares receipt of state aid then this can substitute for an official source. In exceptional cases, a media report or press announcement can be used to document a sub-national subsidy award, although this is not the preference, and confirmation from several press reports is typically sought in such cases.

¹⁸ https://www.gasb.org/jsp/GASB/Document_C/DocumentPage?cid=1176166283745&acceptedDisclaimer=true.

¹⁹ For further details about the manner in which information is collected and coded in the Global Trade Alert database see Evenett, S and J Fritz (2020), *The GTA Handbook*. 14 July. Available in the third panel of this URL: https://www.globaltradealert.org/data_extraction.

In late April 2021, the Global Trade Alert database contained information on 424 instances when US cities or states introduced or increased the value of subsidies worth more than \$10 million. Forty states were responsible for the overwhelming majority of these subsidies (cities offered large tax breaks far less often.) New York was responsible for 65 such subsidies, Connecticut for 64, and California for 37.

FIGURE 1 OF THE 424 INSTANCES OF SUB-NATIONAL GOVERNMENT SUBSIDIES AWARDED IN THE USA, 62% WERE IN THE FORM OF TAX BREAKS



Source: Global Trade Alert database, data extracted on 29 April 2021.

Three types of subsidy account for nearly all of the 424 US sub-national government subsidies recorded in the Global Trade Alert database. The prevalence of tax breaks and relief on employment-based taxes is highlighted in Figure 1. Almost three times as many tax breaks were awarded than financial grants, the second most used policy instrument. State loans come in third, at 49 entries. Loan guarantees and in-kind grants are rare in this data source, perhaps marking a difference with observed Chinese sub-national practice.

Complaints are often made by US analysts and officials about the scale of Chinese sub-national subsidies. It turns out that US states are not shy of handing out billion-dollar-plus incentive packages to local firms, as the examples in Table 1 show. This table does not include the highly publicised bidding competition between US cities and states triggered by Amazon's announcement to create a second headquarters in September 2017. A total of 238 US cities and states competed for this multi-billion-dollar prize. New York's bid included incentives valued at \$3.5 billion.²⁰ Concerns have been rightly expressed about the public finance implications of large subsidies by US sub-national governments.

20 See <https://www.brookings.edu/research/five-economic-development-takeaways-from-the-amazon-hq2-bids/>.

TABLE 2 EXAMPLES OF US BILLION DOLLAR PLUS FINANCIAL SUPPORT OFFERED BY US CITIES AND STATES

Year	Sub-national jurisdiction	Recipient	Amount
2010	Michigan	Chrysler	\$1.3 billion
2012	Louisiana	Semper Energy	\$2.1 billion
2012	Oregon	Nike	\$2 billion
2016	Louisiana	Sasol USA Corporation	\$1.5 billion
2016	Louisiana	Sabine Pass Liquefaction	\$1.2 billion

Source: Global Trade Alert database, data extracted on 29 April 2021.

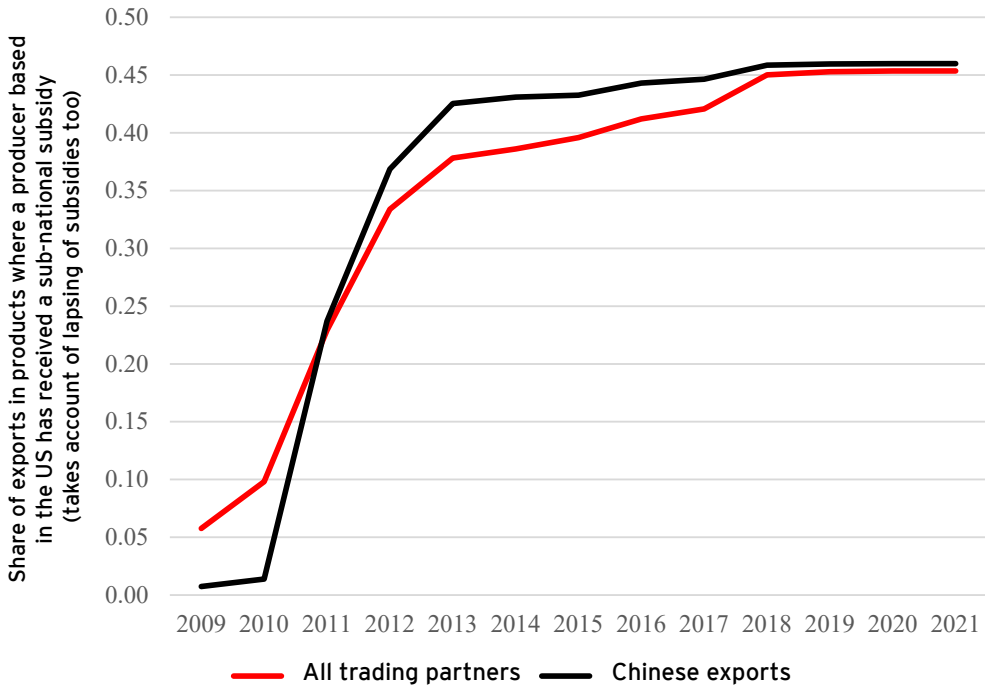
One advantage of using the Global Trade Alert database is that, for sub-national subsidies to goods producers, steps were taken to conservatively identify the products produced by the subsidy recipient. Knowing the relevant HS codes²¹ of such products allows analysts to calculate, for each year, the share of total US goods imports that compete against local firms that have benefited from either a subsidy or a subsidy increase. These trade coverage calculations take account of the date when a subsidy is introduced or increased and any subsequent date of removal or subsidy reduction. Any failure to document relevant US sub-national subsidies implies that the import coverage estimates based on the Global Trade Alert database and reported below are likely to understate the true exposure of foreign trade partner exports to subsidisation by US sub-national governments.

Figure 2 reports sharp growth since 2009 in the share of US goods imports that compete against local firms which have received subsidies from US cities and states. The shares are reported for all US goods imports and for US goods imports from China. In both cases, by 2021, approximately 45% of such imports faced subsidised US competitors. Given the scale of US goods imports, these estimates imply trade exposure running into trillions of US dollars.

Interestingly, foreign trade partner export exposure to US sub-national subsidies took off well before the US-China trade war, indeed before the years typically associated with populism and the growth in electoral popularity of Donald Trump. However, the finding that Chinese export exposure rose faster than that for all US trading partners may be consistent with US cities and states offering more financial support to local firms facing enhanced competitive pressure from China. Thus, defensive considerations may well have influenced the decisions taken by US city and state officials.

21 Harmonized Commodity Description and Coding System.

FIGURE 2 FORTY-FIVE PERCENT OF GOODS IMPORTS INTO THE UNITED STATES CURRENTLY COMPETE AGAINST AT LEAST ONE LOCAL RIVAL THAT HAS RECEIVED A SUBSIDY FROM A US CITY OR STATE



Sources: Global Trade Alert database, data extracted on 29 April 2021.

FIVE DOMESTIC POLICY RECOMMENDATIONS AND THEIR IMPLICATIONS FOR ENHANCING TRANSPARENCY AT HOME AND AT THE WTO

Five policy recommendations follow from our accounts of American and Chinese logical government subsidies. As shown in our assessment of the export exposure of foreign companies to American sub-national subsidies, it should be evident that trading partners as well as domestic constituencies have a stake in reforms to subsidies awarded by sub-national governments. Those benefits arise from enhanced transparency of subsidy awards and a better allocation of whatever subsidies are awarded. Profound reforms would probably have beneficial public finance implications, as fewer tax breaks would be offered (in the case of American cities and states) and lower levels of public sector debts (relevant to both the American and Chinese cases).

The first recommendation is to discipline local government resort to subsidies for business development. Hard questions need to be asked about the rationale for each subsidy. What market failure is being tackled? What type of subsidy, if any, is the right response? Does the subsidy actually increase the overall quantity of the desired commercial activity – or

does it merely reshuffle resources across sub-national jurisdictions? A related matter is to reduce the incentive of local government officials to grant subsidies. Enterprises should be weaned off subsidies and tax breaks as well.

The second is to better align whatever government support is offered with enterprise needs. Consideration should be given to providing enterprises with a ‘menu’ that can be selected independently within a pre-established quota of funding support. It is recommended to combine the resources available to government departments, such as industry funds, financial subsidies, scientific research project support, etc. to form a service ‘menu’ on the government supply side. Within the allocated quota, the enterprise will choose the support method in accordance with its own development needs, so that the policy will be closer to the needs of the enterprise.

The third is for China to introduce a centralised and coordinated approach to subsidy in one region. Establishing a centralised managerial mechanism is recommended to administer the subsidy policy in the region.

The fourth is to enhance the transparency of the decision-making process concerning the award of subsidies. An inventory of all sub-national subsidy policies should be assembled by pooling information about the policies of all levels of local departments and bureaus. This could be combined with firm-level and industry information (on tax payments, employment, environmental performance etc.) and an algorithm deployed to score each application for a subsidy programme. Such ‘policy calculators’ can be designed for every level of sub-national government, to be made available to all the enterprises of prospective investors in the particular region. Greater openness and transparency of local subsidy policies could be accomplished by rolling out such calculators nationwide.

The fifth recommendation is to make full use of the Big Data techniques to collect information on the award of local subsidies. Modern technology will allow government departments to evaluate in a timely fashion the pertinence, effectiveness and sustainability of policies, and continuously improve the technocratic underpinning of policy formulation.

These five policy recommendations are intended, among others, to make local government more accountable concerning the use of the policy instrument of subsidy and to discourage local governments from over-reliance on this policy instrument to boost economic growth.

As local subsidy policy becomes more transparent, then it will be possible for central governments in Beijing and Washington, DC, to submit more and more extensive notifications of sub-national subsidies to the WTO. This, in turn, will allow for more evidence-based deliberation of the cross-border ramifications of local subsidy policy, potentially reducing trade tensions in cases where resort to subsidisation is shown to be less significant than initially feared.

A key lesson here is that international transparency practices have their roots in the institutions that deliver transparency of domestic policy. International deliberations on trade policy transparency should not only consider whether national governments

have the personnel and expertise to make WTO notifications but also whether domestic institutional arrangements to collect needed information exist in the first place. Further consideration should be given to whether multilateral disciplines are needed on the latter.

ABOUT THE AUTHORS

Simon J. Evenett is a Professor of International Trade & Economic Development at the University of St. Gallen, Switzerland; Research Fellow, International Trade & Regional Economics, CEPR; and Founder, the St. Gallen Endowment for Prosperity Through Trade.

KONG Qingjiang has been a full professor of law since November 2002. He is currently Dean of the School of International Law, China University of Political Science and Law. Specializing in international economic law, the WTO law and China issues, he has published more than 50 articles with international journals.

CHAPTER 3

China, the European Union, and the WTO Dispute Settlement Crisis

LIAO Shiping and Petros C. Mavroidis

Beijing Normal University; Columbia Law School

Effective dispute settlement procedures are critical to sustain cooperation on trade. China has joined the European Union (EU) initiative to establish an interim appeals mechanism that World Trade Organization (WTO) members can use while the Appellate Body (AB) remains unable to function. A resolution to the AB crisis requires commitment of all stakeholders, and especially the major trade powers to agree on reform of WTO dispute settlement to ensure conflict resolution continues to be depoliticised, irrespective whether the future design will continue to include two-instance adjudication or take another form.

1. INTRODUCTION

The WTO dispute settlement system, the crown jewel of the multilateral regime, has been tarnished as a result of actions taken during recent years. Disagreements across the membership regarding the adjudication practice were evident, and had been voiced during the DSU (Dispute Settlement Understanding) review. Undoubtedly though, it is the actions of the Trump administration that led to the downfall of the AB, and provoked the ripple effects that paralysed the adjudicatory function of the WTO. Even if we reserve the status of proximate cause for the downfall to the US attitude, the impact was dramatic.

In this paper, we aim to advance proposals on how to get out of the current crisis. To do that, we first explain the current state of play in Section 2, and then the solution to address the crisis advanced jointly by China and the EU in Section 3. Because the self-professed nature of their joint proposal is an interim solution, in Section 4, we lay out the essential elements of a (more) permanent solution, before we briefly conclude in Section 5.

2. THE STATE OF PLAY

As things stand, dispute adjudication is moribund. The numbers tell a story. 593 disputes (DS1-593) had been submitted by the end of 2019, an average of almost 24 disputes per year. Five were submitted in 2020 (DS594-598), and 2 in 2021 (DS599-600). How did we end up here?

2.1 The Attitude of the Trump Administration Towards the Appellate Body

The United States was very much behind the strengthening of the General Agreement on Tariffs and Trade (GATT) dispute adjudication during the Uruguay round, unhappy, as Davey (2014) has persuasively argued, with the increasing politicising of adjudication during the last years of the GATT. Hudec's monumental study (1993) has provided empirical support for the derailing of the previously impeccable GATT record. The United States took justice into its own hands, practicing, as per Bhagwati's (1990) inimitable expression, 'aggressive unilateralism'. Abandoning this attitude (exemplified through the use of Section 301) was the *quid pro quo* for de-politicising adjudication in the WTO-era with the adoption of the Dispute Settlement Understanding (DSU).¹ But from early on, some congressmen were having second thoughts regarding the sovereignty that the United States was relinquishing, and Senator Dole advanced proposals to find a middle ground between sceptics and enthusiasts.²

And then, the occasional expression of displeasure whenever a hostile report was issued notwithstanding, the United States behaved in line with its DSU obligations. The Obama administration engaged in a minor altercation when it opposed the reappointment of the Korean AB member, Seung Wa Chang. This was the culmination point, the high watermark of its displeasure with a few WTO decisions. Almost immediately thereafter, it did not oppose the appointment of Kim Hyung Chong, another Korean citizen, in his place.

Everything changes with the advent of the Trump administration at the Capitol Hill. Following some early skirmishes, that some might have interpreted as unnecessary bravado, the United States took decisive action like never before, it blocked each and every (re)appointment of AB members since 2017, leading to a reduction from a body meant to comprise seven individuals, down to one individual, and consequently to dysfunction.

Fiorini et al. (2020) have shown that some other members shared, and continue to share, some of the US grievances. No other WTO member though, was willing to adopt the same belligerent attitude towards the WTO, not for now at least. The Trump administration, when it came to its policy towards the WTO, was isolated in Geneva.

2.2 The Appellate Body in Abeyance and the Ripple Effects: Appeals into the Void

The AB crisis could hardly remain self-contained. By virtue of Article 16.4, the DSU panel reports will not be adopted, if an appeal has been lodged. The question of whether an appeal can be lodged to a dysfunctional AB is now of historical interest. Appeals lodged after December 2019, when the AB had been reduced to one member and did not have the

1 Mavroidis (2016) discusses the negotiating record of the DSU. Jackson (1990) had offered a blueprint.

2 Committee on Finance, US Congress, 104th Congress, First Session on S. 16, May 10, 1995, S. HRG. 104-124, at pp. 2 et seq.

necessary quorum of three members to adjudicate disputes anymore, entailed that the panel reports would not be adopted for some time (at least), and thus would have little if any legal significance.

Fifteen panel reports have been appealed so far, and they cannot be discussed anymore, since there is no functional AB division in place to discuss them. There are currently fifteen appeals into the void, namely: DS 316, DS371 twice, as both the original as well as the second compliance panel reports were appealed; DS436; DS461; DS476; DS494; DS510; DS518; DS523; DS533; DS534; DS541; DS543; DS567).

The parties that prevailed in these cases scored Pyrrhic victories, which were never translated into implementation (by the losing party) of adverse findings. There was some consolation for two categories of WTO members: those who entered into ad hoc agreements obliging signatories to accept the panel's findings as definitive, and the MPIA (Multi-Party Interim Agreement).

Indonesia and Vietnam, for example, had been embroiled in a dispute regarding the consistency of safeguard measures that the former had imposed. As their dispute was dragging on, and the end of the AB was approaching, they agreed to waive their right of appeal on one of the remaining issues:

The parties agree that if, on the date of the circulation of the panel report under Article 21.5 of the DSU, the Appellate Body is composed of fewer than three members available to serve on a division in an appeal in these proceedings, they will not appeal that report under Articles 16.4 and 17 of the DSU.³

We discuss the MPIA in Section 3. The MPIA was not the only attempt to resolve the crisis. Before that, two multilateral processes were initiated and both failed. The DSU Review, and the so-called 'Walker process'.

2.3 Failed Attempts to Resolve the Crisis

The DSU Review was scheduled to start during the first years of the WTO, and aimed to address shortcomings that the implementation of DSU in the real world had revealed. Why not wait for a few years, when membership would have gained more experience of, at the very least, statistical significance? To make things even more problematic, the statutory deadline to complete the review was four years.

This birth defect of the DSU Review was healed in practice. As the four years lapsed, with the membership having nothing concrete to show, the review was extended until August 1999, and then prolonged until the end of 1999, with the intention that the results would be dealt with at the ill-fated Seattle Ministerial Conference (Nov 30 - Dec 3, 1999).⁴ No satisfactory conclusion proved possible during that period, and negotiations continued. In

³ WTO Doc. WT/DS496/14 of March 27, 2019.

⁴ WTO Doc. WT/DSB/M/52 of February 3, 1999.

fact, they were folded into the Doha negotiations, with Ministers establishing a mandate to use the work completed up to that point, as the basis for negotiations to improve and clarify the DSU.⁵ Once folded into the Doha round negotiations, the DSU Review suffered the fate of the Doha round – in went on forever.

The June 2019 report, issued by Ambassador Coly Seck of Senegal, who was the latest Chair of the DSU Review, serves as the definitive account on the state of play following more than 20 years of uninterrupted negotiations.⁶ The subject matter of negotiations was bottom-up, as every WTO member had the opportunity to include items on the agenda. Ambassador Seck's report mentions that the following issues were raised:

- Time-frames;
- Mutually agreed solutions;
- Third-party rights;
- Panel composition;
- Strictly confidential information;
- Transparency and amicus curiae briefs;
- Remand authority of the AB;
- Effective compliance;
- Sequencing between compliance panels and requests for authorisation to retaliate;
- Post-retaliation;
- Developing country interests;
- Flexibility and member control.

Some of these issues, like sequencing, had *de facto* been resolved in practice, and the DSU Review was supposed to recommend that practice be translated into operational language. It did not manage to do that, even though this was the obvious low-hanging fruit. Others, like the selection of panellists, the available remedies, and/or the participation of developing countries in dispute adjudication, have been hotly debated both in DSU practice, as well as in academia, but took the form of parallel monologues with no agreement in sight, in the realm of the DSU Review.⁷

5 Formally, the DSU Review was not part of the Doha Development Agenda single undertaking but a stand-alone exercise. The decision was taken to merge the two negotiations early on during the Doha round negotiations, WTO Doc. TN/C/M/1 of February 5, 2002, at §30.

6 'Special Session of the Dispute Settlement Body: Report by the Chairman, Ambassador Coly Seck,' WTO Doc. TN/DS/31, cited above.

7 McDougall (2018) provided an eloquent description of the failure to conclude on the DSU Review.

Anticipating the failure of the DSU Review, Director-General (DG) Azevedo appointed a very well respected individual, and genuine expert on all things WTO, the Ambassador of New Zealand to the WTO, David Walker, to head a process aiming to avert the AB crisis.⁸ It is quite clear that Ambassador David Walker, who is a PhD economist, was appointed against the disappointing background of an inconclusive DSU Review. He was the designated rescuer, entrusted with the task of saving multilateral adjudication. He might have hoped to go about his task heading a more high-level, political process, where people who mattered in the national capitals would be implicated. Had this been the case, it would no longer be an average WTO delegate who would have been asked to participate in the DSU Review. But this did not prove to be the case.

Ambassador Walker's mandate included issues that had appeared in the DSU Review, and, arguably, should have been addressed well before the crisis had erupted. Following extensive consultations with numerous delegations to the WTO, and having carefully listened to grievances expressed, he formulated his pathway forward. His 'Walker Principles' were meant to address the US concerns with the operation of the AB, and ensure that:

- Appeals are completed within 90 days;
- AB members do not serve beyond their terms;
- Precedent in case law is not binding;
- Facts cannot be the subject of appeals;
- The AB be prohibited from issuing advisory opinions;
- Dispute settlement findings cannot change obligations or rights provided by the WTO Agreements.

The 'Walker Principles' are thus, fully consistent with, and indeed often echo, what is already in the DSU. David Walker, without fanfare, aimed to underline the basic features of the agreed, depoliticised DSU, which the trading nations had signed up to. By emphasising the spirit of the Uruguay round negotiations, and adding a couple of points of interest primarily to the United States, the hope was that the United States would abandon its destructive attitude, and return to the negotiating table. Alas, this very honourable endeavour did not manage to tilt the balance within the Trump administration, and bring the US back to the WTO drawing table. In December 2019, it became clear to all that the AB was no more.

8 WTO Doc. JOB/GC/222 of October 15, 2019.

Thus, the membership was left with insurance mechanisms to avert a total breakdown of dispute adjudication. We have already discussed how bilateral, ad hoc, agreements avoid the trap of an appeal into the void. We now turn to the joint China-EU initiative to establish the MPIA.

3. CHINA, AND THE EU REACT: THE ADVENT OF THE MPIA

3.1 What is the MPIA?

Several lawyers from the Geneva office of Sidley Austin LLP were the first to publicly put forward the basic idea of appeal arbitration for an alternative of the AB. In view of the WTO's delay in initiating the selection of AB members, they suggested referring to the arbitration process under article 25 of the DSU as a provisional alternative for the AB.⁹ The EU and Canada, and the EU and Norway, respectively informed the WTO of their willingness to invoke article 25 as an appeal procedure for the settlement of disputes between them.¹⁰ On April 30 2020, the EU, China, and 17 other members informed the WTO of the MPIA, which shifted the attention towards the proposal from bilateral level to the 'plurilateral' forum. Til now, there are 24 WTO members who participate in the MPIA, and the total number of participants is 51, covering nearly one-third of the WTO members, if counting EU members individually.

The MPIA consists of a position statement and a detailed arrangement. The position statement is relatively brief, emphasising the necessity of retaining the appeal procedure to be an integral part of the WTO dispute settlement. In addition, the statement specifically states that consistency and predictability of the interpretation of the covered agreements are of great value to WTO members. Thus, it is within expectations that a large number of WTO precedents will become an important part of the legal arguments in the future awards under the MPIA.

The arrangement consists of 15 items, of which the key elements are:

- General Provisions
- Arbitration Procedure
- Arbitrator Pool

The participating Members commit that they will not pursue appeals under Articles 16.4 and 17 of the DSU, but will instead use the appeal arbitration procedure based on the substantive and procedural aspects of Appellate Review pursuant to Article 17 of the

⁹ Andersen et al, Using Arbitration under Article 25 of the DSU to Ensure the Availability of Appeals, Centre for Trade and Economic Integration Working Papers, CTEI-2017-17, 2017.

¹⁰ Statement on a Mechanism for Developing, Documenting and Sharing Practices and Procedures in the Conduct of WTO Disputes. JOB/DSB/1/Add.11, 25 July 2019. Statement on a Mechanism for Developing, Documenting and Sharing Practices and Procedures in the Conduct of WTO Disputes. JOB/ DSB/1/Add.11/ Suppl.1, 21 October 2019.

DSU. This choice will make the appeal process return and leave no place for both ‘appeal into the void’ and shelving the panel decision. The main provisions of the arbitration procedure established through MPIA, which, as per the MPIA statute, include 19 articles in total, are generally the same as the regular appeal procedure in article 17 of DSU. Additionally, some improvements have been made, including that any appeal examined by the arbitrator should be limited to dispute resolution, the award should be rendered within 90 days, a time limit is specified, and the arbitrator may consult with the parties on specific measures (such as limiting the number of pages of written submissions and the hearings). The improvements above are reminiscent of the Trump administration’s criticism of the AB, echoing some of them, such as the advisory opinions within the AB reports, frequent ‘overdue adjudication’ and tackling of ‘issues of fact’.

Almost following the same way of the selection of the AB Members set in article 17 of the DSU, a pool of arbitrators, consisting of ten standing appeal arbitrators, who are unaffiliated with any government and are of recognised authority, with demonstrated expertise in law, international trade, and the subject matter of the covered agreements generally, has to be established. Each appeal will be heard by three appeal arbitrators selected from the pool, and the minutes of the proceeding will be forwarded from the panel to the arbitrators selected. All members of the pool of arbitrators were determined in July 2020.¹¹

3.2 Can the MPIA work?

Far more than just an appeal approach for resolving disputes between dozens of WTO members, the MPIA is a model for responding to the crisis in the event of the dysfunction of the AB. As discussed in Baroncini (2020), the flexible, dynamic, and open nature of the MPIA is crucially attracting the attention of more WTO Members: any interested country may join the interim solution at any time, through a simple notification to the Dispute Settlement Body (DSB), declaring the endorsement of the contingency measures. Likewise, a participating member may decide to cease its participation in the MPIA just by notifying its intention to the same institution. Participants to the appellate contingency measures may also agree to depart from the MPIA discipline with respect to a specific dispute. Theoretically speaking, the WTO dispute settlement crisis will be alleviated if more WTO members choose to join the MPIA. The operation of the MPIA, if everything goes smoothly, is bound to shed some light on the future mechanism, whether the AB returns or not.

11 The final 10 arbitrators were Mr. Mateo Diego-Fernández Andrade (Mexico), Mr. Thomas Cottier (Switzerland), Ms. Locknie HSU (Singapore), Ms. Valerie Hughes (Canada), Mr. Alejandro Jara (Chile), Mr. José Alfredo Graça Lima (Brazil), Ms. Claudia OROZCO (Colombia), Mr. Joost Pauwelyn (EU), Ms. Penelope Ridings (New Zealand), Mr Guohua YANG (China). See WTO document: Statement on a Mechanism for Developing, Documenting and Sharing Practices and Procedures in the Conduct of WTO Disputes. Job/DSB/1/Add.12/Suppl.5, 03 August 2020.

Even the many features listed above, do not mean that the MPIA is a perfect design for saving the fading of the crown jewel of the multilateral trade regime. The legitimacy of the MPIA under the WTO Agreements is still unclear. Baroncini (2020) correctly argues that the MPIA's choice is to base the interim solution on the existing alternative mechanism contemplated in Article 25 of the DSU, combined with the already-in-force WTO Working Appellate Procedures and Rules of Conduct, overcomes the thorny issue of indicating which procedural rules would be advisable to choose for the temporary arbitration to guarantee WTO-coherent proceedings and awards. However, it is the Article 25 of the DSU, not the MPIA, which sets a possible approach for the potential awards to be incorporated into the jurisprudence of the WTO. The MPIA itself is not a covered agreement or a plurilateral agreement under the Annex 4 to the WTO Agreement within the WTO legal framework. Judging from the text of Article 25 of the DSU, whether it is applicable for the appeal is still pending, since no explicit treaty language says so. Even presuming the answer is positive, whether it is WTO-consistent for the MPIA Members to make an *inter se* agreement is also pendent. As clearly written in Article 17 of the DSU, it is the AB, not any other body, that hears appeals from panel cases. Although the paralysis of AB *de facto* made the article 17 into a nominal clause, this article is still legally valid. Judging from the perspective of general international law, establishing the MPIA as an alternative for appeal is an *inter se* agreement between several WTO Members. When it comes to the legality of an *inter se* agreement, Article 41 of Vienna Convention on the Law of the Treaties is the most relevant rule.¹² The Marrakesh Agreement establishing the WTO says nothing on the modification, but something on amendment (Article 10), and it is critical to evaluate whether the MPIA has affected the rights and obligations of the other WTO members.

The MPIA is an interim arrangement and it is uncertain how long it can last and how many cases can be heard.¹³ Simon Lester (2020) has made elaborations on the uncertainties about the MPIA on its legal culture and attitude towards technically tough issues. Besides, it is even more uncertain how many members will join the MPIA. The initiative of the potential participants, to some extent, will be restrained, as they will be incapable of nominating an arbitrator, since the pool is not subject to reselection until 2022.

12 Article 41 reads as follows: 'Two or more of the parties to a multilateral treaty may conclude an agreement to modify the treaty as between themselves alone if: (a) the possibility of such a modification is provided for by the treaty; or (b) the modification in question is not prohibited by the treaty and: (i) does not affect the enjoyment by the other parties of their rights under the treaty or the performance of their obligations; (ii) does not relate to a provision, derogation from which is incompatible with the effective execution of the object and purpose of the treaty as a whole'.

13 There are currently only four cases that may fall into the scope of the MPIA, if any disputing party claims to appeal: DS522, DS524, DS537, DS591. See Canada-Measures Concerning Trade In Commercial Aircraft, Agreed Procedures For Arbitration Under Article 25 of The DSU. WT/DS522/20, 03 June 2020; Costa Rica - Medidas Relativas A La Importación De Aguacates Frescos Procedentes De México Procedimiento Convenido Para El Arbitraje Previsto En El Artículo 25 Del Esd . WT/DS524/5, 03 June 2020; Canada-Measures Governing the Sale of Wine, Agreed Procedures for Arbitration Under Article 25 of the DSU. WT/DS537/15, 03 June 2020; Colombia-Anti-dumping Duties on Frozen Fries from Belgium, Germany and The Netherlands , Agreed Procedures For Arbitration Under Article 25 of The DSU. WT/DS591/3, 15 July 2020.

The operation of the MPIA also needs some institutional support. At this stage, there is uncertainty regarding the identity of parties that will bear the financial cost of the endeavor. The point is, seeking funding from the WTO is not a realistic option, because traditionally, there is no budget for the proceeding initiated under article 25 of the DSU. Administrative staff and legal assistants are also required for the daily communications among arbitrators and the hearings. It should be noted that the Ambassador of the United States wrote to the DG of the WTO on June 5, 2020 expressing an objection to the MPIA, claiming that the MPIA was no more than a duplication of AB, stressing the particular concern of using WTO resources and funding to support the MPIA.¹⁴ The frank opposition to the MPIA from the US casts a shadow on the future work of the endeavour.

4. ADDRESSING THE CRISIS

On June 28 2018, China published the White Paper on China and the World Trade Organization,¹⁵ generally defining its position on the firm support of the reform of the WTO dispute settlement reformation.¹⁶ Following two joint proposals submitted to the WTO with other WTO members requesting the discussion on concerns raised by the US,¹⁷ China, on May 13 2019, submitted to the WTO an individual proposal on WTO reform, which strongly recommended the start of a negotiation without delay to appoint the AB members in order to return to an effective functioning of the dispute settlement mechanism.¹⁸

China seems to take the return of the AB as the priority of the reformation on dispute settlement. However, the return of the AB is not the return of the WTO. As we will discuss later, the idea of depoliticisation of the dispute settlement and its implementation is the nucleus. Another responsible response for an influential trade member like China, is to act as an active promoter of multilateral trade negotiations in future rounds. To some extent, the activism of the dispute settlement mechanism lies in the standstill of the multilateral rules-making process. If China, based on commitments already made in the Comprehensive Agreement on Investment (CAI) with the EU, offers broader and substantial concessions with regards to trade and trade-related topics at the multilateral level, and succeeds in pushing the other major WTO members to conclude some new agreements within the WTO framework, then the need for a comprehensive and compulsory dispute settlement will re-emerge for the uniform application of the new agreement and the interpretation of the ambiguous clauses therein.

14 https://insidetrade.com/sites/insidetrade.com/files/documents/2020/jun/wto2020_0268a.pdf.

15 http://english.www.gov.cn/archive/white_paper/2018/06/28/content_281476201898696.htm.

16 <http://www.scio.gov.cn/zfbps/32832/Document/1632334/1632334.htm>

17 WT/GC/W/752, WT/GC/W/753.

18 WT/GC/W/773.

The EU, in a recent official communication,¹⁹ reiterated its view that the future of WTO dispute settlement is inexorably linked to the re-emergence of the AB. Acknowledging that some of the points of critique that the US delegation had raised criticising the working of the AB, it has argued in favour of a new (reinvigorated) AB, which:

- Will not be bound by precedent.
- Will observe and practice judicial economy.
- Will not deviate from mandatory time-lines.
- And will be independent.

Even if the EU means that there should be no *stare decisis*, that is, an obligation to follow precedent, this point makes little sense. Even in common law countries, the highest court in the hierarchy can change course, and the AB is at the top of the WTO pyramid. This seems like more of an attempt to placate the United States than anything else. Judicial economy has its pros and cons, as Busch and Pelc (2010) have shown. It all depends on the manner in which it is used. After all, what is strictly necessary to resolve a dispute is a matter of judgment. But one can hardly disagree with the EU that excesses, adopting that is an *obiter dictum* that is remotely, if at all, connected to the dispute resolution, should be avoided. In fact, in Hoekman and Mavroidis (2021), we argue that, because WTO judges are agents by legislative fiat (Article 3.2 of the DSU), and thus, are limited to a role of agents tasked to observe a specific mandate, they should pronounce a *non liquet* as well, whenever they face a case where there is no law, or where the law is manifestly unclear. Mandatory timelines make absolutely no sense. For starters, their observance depends not only on the judicial body, but also on the parties to the dispute. Furthermore, there are disputes concerning one provision that has already been interpreted *ad nauseam* in the past, as there are disputes with various novel issues. In function of which class of disputes will the deadline be set? If this was such a good idea, why not adopt it at home as well? Thirdly, there are hardly any domestic courts that must wrap up within a predetermined period, as human prescience is bounded. Finally, mandatory deadlines might provide judges with the wrong incentives, as they might privilege brevity over accuracy and correctness and clarity. No harm done, if an indicative list were adopted.

No one would argue that judiciary must be depoliticised. Having gone through the seventies' and eighties experience, adequately discussed in Hudec (1993), the WTO membership decided, for good reasons, to turn the page. This is the quintessential element of the DSU, and it must be retained in the DSU 2.0 that will hopefully (eventually?) emerge from the negotiations to kick-start WTO dispute adjudication once again.

¹⁹ COM (2021) 66 final, Brussels, February 18, 2021.

This is the one area where few, if any, would disagree with the statement that no change is warranted: the spirit of depoliticised dispute resolution, exemplified through the endorsement of compulsory third-party adjudication and negative consensus, must be preserved at all costs. This was, after all, the driving force behind the negotiation of the DSU. The AB was not the key concern of the DSU negotiation. The key concern was how to avoid politicking in dispute adjudication. The self-professed reason of the United States for going unilateral was its disappointment with scoring inconsequential wins before GATT panels: the EU had blocked adoption of various reports dealing with farm subsidies. The United States was also disappointed with the turn of events in the Domestic International Sales Corporations (DISC) dispute.²⁰ Following these misadventures, it took justice into its own hands. It was willing to give up on unilateralism, if the other trading nations were willing to give up on politicking in the realm of dispute adjudication.

The DSU was built on this foundation. It was a very laudable effort to weave de-politicisation into the legal/judicial fabric of the emerging multilateral institution. Neither the United States, nor its partners, have explicitly renounced the idea of keeping the DSU politicised. The question is what should be done to keep the depoliticised context, while addressing the concerns of the United States and others. In what follows, we try to respond to this question.

In this vein, in Hoekman and Mavroidis (2020), we argue that preserving the depoliticised character of the DSU should be the focus of negotiators. AB, or no AB, this is not the key issue. What matters is that judges are left alone to decide on disputes. Conversely, the membership should probably rethink the wisdom of the current system of selecting panellists. Even if one does not endorse the views expressed in Pauwelyn and Pelc (2019) regarding the influence of the WTO Secretariat in the drafting of reports, there are undeniable agency costs when the common agent (WTO Secretariat) is tasked to propose (and often select) judges. Recent practice shows that the overwhelming majority of panellists chosen have no prior approval of the membership, as they are not chosen from the agreed roster.

5. CONCLUDING REMARKS

The crisis of WTO dispute adjudication is the consequence of the attitude of the Trump administration, and the inability of the DSU Review to address some real concerns that the membership has voiced. It would be counterproductive to tackle the crisis of the WTO judiciary in self-contained manner, as, unless the wider legislative crisis has been also addressed, the WTO judiciary risks seeing the volume of disputes submitted to it waxing. The EU and China have recently renewed their commitments to international adjudication by participating in the MPIA, and also in the CAI. The commitment of all

²⁰ Both Hudec (1988) and Jackson (1978) have discussed the importance of this dispute, and its influence on the turn of events. It was a genuine inflection point in the history of GATT adjudication, that precipitated reform.

stakeholders, and especially the most important ones, is necessary for the WTO dispute settlement of the future to continue to be depoliticised, irrespective whether the future design will include a one- or two-instance adjudication.

REFERENCES

Bhagwati, J N (1990), 'Aggressive Unilateralism: An Overview', in Bhagwati, J and H Patrick (eds), *Aggressive Unilateralism, America's 301 Trade Policy and the World Trading System*, Harvester Wheatsheaf.

Busch, M L and K J Pelc (2010), 'The Politics of Judicial Economy at the World Trade Organization', *International Organization* 64: 257-279.

Davey, W J (2014), 'The WTO and Rules-Based Dispute Settlement: Historical Evolution, Operational Success and Future Challenges', *Journal of International Economic Law* 17: 679-700.

Baroncini di E (2020), 'Saving the Right to Appeal at the WTO: The EU and the Multi-Party Interim Appeal Arbitration Arrangement', available at <https://www.federalismi.it/nv14/articolo-documento.cfm?Artid=43858>.

Fiorini, M, B M Hoekman, P C Mavroidis, M Saluste, and R Wolf (2020), 'WTO Dispute Settlement and the Appellate Body Crisis: Insider Perceptions and Members' Revealed Preferences', *Journal of World Trade* 54: 667-698.

Hoekman, B M and P C Mavroidis (2021), 'Preventing the Bad from Getting Worse: The End of the World (Trade Organization) As We Know it?', *European Journal of International Law*.

Hoekman, B M and P C Mavroidis (2020), 'To AB or Not to AB? Elements of a Response to a Question Never Asked', *Journal of International Economic Law* 23: 703-722.

Hudec, R E (1993), *Enforcing International trade Law: the Evolution of the Modern GATT Legal System*, Butterworth.

Hudec, R E (1988), 'Reforming GATT Adjudication Procedures: The Lessons of the DISC Case', *Minnesota Law Review* 72: 1443-1481.

Jackson, J H (1990), 'Restructuring the GATT System', Council of Foreign Relations.

Jackson, J H (1978), 'The Jurisprudence of International Trade: the DISC Case in GATT', *American Journal of International Law* 72: 747-781.

Mavroidis, P C (2016), 'Mind over Matter', in Bagwell, K and R W Staiger (eds), *Handbook on Commercial Policy, Handbooks in Economics*, Elsevier.

McDougall, R (2018), 'The Crisis in WTO Dispute Settlement: Fixing Birth Defects to Restore Balance', *Journal of World Trade* 52: 867-896.

Pauwelyn, J and K Pelc (2019), 'Who Writes the Rulings of the World Trade Organization? A Critical Assessment of the Role of the Secretariat in WTO Dispute Settlement', available at SSRN: <https://ssrn.com/abstract=3458872> or <http://dx.doi.org/10.2139/ssrn.3458872>.

Lester S (2020), 'Can Interim Appeal Arbitration Preserve the WTO Dispute System?', available at: <https://www.cato.org/publications/free-trade-bulletin/can-interim-appeal-arbitration-preserve-wto-dispute-system>.

ABOUT THE AUTHOR

LIAO Shiping is a Professor at Beijing Normal University. His areas of speciality are public international law, international trade law, international investment law, and the extraterritoriality of Chinese law and US law. He serves as a member on the International Law Advisory Broads of Chinese Ministry of Foreign Affairs and Ministry of Justice.

Petros C. Mavroidis is Professor at Columbia Law School. He has acted as Chief Reporter for the American Law institute study on WTO (2013). His most recent publication is *China and the WTO*, coauthored with Andre Sapir, Princeton Univeristy Press (2021).

CHAPTER 4

Special and differential treatment and developing country status: Can the two be separated?

75

SPECIAL AND DIFFERENTIAL TREATMENT AND DEVELOPING COUNTRY STATUS CAN THE TWO BE SEPARATED? | LOW

Patrick Low¹

Debate on the appropriate relationship between levels of development and the depth of policy commitments undertaken by different members of the GATT/WTO is long-standing and unresolved. In the WTO, members determine their own developmental designation, while special and differential treatment is a matter for negotiation. Most aspects of special and differential treatment (SDT) require cooperative action of one kind or another from others besides the SDT recipients – the scope to invoke unilateral ‘flexibilities’ in implementing WTO rules is limited. A distinction between regulatory and market access aspects of WTO obligations is important to an understanding of the dimensions of SDT. To move the SDT debate ahead, a useful exercise would be to determine which members are making use of the subset of SDT flexibilities where they have the independent choice of doing so. This would inform governments whether particular flexibilities are used and provide a basis for decisions to indicate they do not intend to do so in the future.

1. INTRODUCTION

The multilateral trading system (MTS) under the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO) has always faced the challenge of how to design trade rules and calibrate commitments to market openness among members with differing priorities, needs, and development levels. The task has not become easier over the years. The membership of the GATT and subsequently the WTO has expanded significantly, accentuating diversity. At the same time, interdependency among nations has grown in a rapidly changing world, adding to the complexity of managing trade relations.

The GATT started out in 1948 with 23 signatories. The WTO came into being at the beginning of 1995 with 76 members, increasing to 112 by the end of that year. Currently, the WTO has 164 members, with another 23 in the process of accession. In terms of increased complexity, the GATT initially focused on tariffs and a range of flanking

¹ Patrick Low is a Geneva-based consultant and former Chief Economist of the World Trade Organization. He wishes to thank Robert Wolfe and Xiaodong Hong for useful comments on an earlier draft.

policies aimed at protecting the value of tariff commitments. The flanking rules have evolved in terms of precision and complexity, and at the same time new agreements have been added, particularly in the Uruguay Round. These developments have taken WTO rules further behind the border and deepened the level of accountability associated with growing international economic integration.

It is against this background that deliberations on links between levels of development and the depth of policy commitments are set. The debate has been a continuing source of contention, often slowing progress in realising opportunities among GATT/WTO members for mutually beneficial cooperation through trade. The need to find accommodation in this area has intensified, as many parties that define themselves as developing countries have become increasingly prominent and influential in international trade.

A defining feature of the debate around the balance of rights and obligations among economies within the MTS has been the absence of agreement about where – whether in economic, socio-economic, or political terms – individual countries should find their place in terms of an appropriate balance of those rights and obligations. The debate on this issue has intensified in recent decades as the centre of economic gravity has both shifted and become less nationally concentrated. The rise of China, along with the country's accession to the WTO in 2001, has been an important factor in intensifying the geopolitical aspect of the discussion.

In short, at the heart of the issue is what SDT should be available to different WTO members? Much of the focus has been on two sets of members – developed and developing countries – and the composition of the two groups. The latter group – variously referred to over the years as third world countries, under-developed countries, less-developed countries and more recently developing countries – were considered eligible for SDT.

An important exception to the lack of clarity about the composition of groups is the least-developed country (LDC) grouping, created through a United Nations resolution in 1971,² and adopted by the GATT in 1979 at the close of the Tokyo Round of multilateral trade negotiations. The LDCs, of whom there are currently 46, are identified as those economies with the highest poverty and economic vulnerability levels and greatest weaknesses in terms of human resource indicators (nutrition, health, education, and adult literacy). The composition and size of the group is adjusted over time on the basis of reviews of these development indicators. Because the LDCs are a well defined group designated by the United Nations, the debate about access to special treatment in the WTO has not been relevant for this category of members.

2 UN Resolution 2768 (XXVI) of 18 November 1971.

No agreement exists on the definition of developing countries in the WTO, and the designation of the status is treated as a matter for individual members. Since SDT provisions are formulated as entitlements for developing countries, they have been considered by definition eligible for SDT, barring selective criteria attached to a few SDT provisions. The combination of self-selection and largely unfettered access to SDT in a world where countries have significantly different development needs is at the centre of disagreement on how to move this issue forward.

The cut-off point between developed and developing countries has been discussed from time to time, and was raised explicitly in early 2019 by the United States with a proposal for a set of technical criteria to determine whether a country may access WTO provisions designed to facilitate the fuller participation of developing countries in the MTS.³ In other words, the proposal would determine whether members had access to SDT or not. The appropriateness of this binary approach was questioned by many members.

Concerns about the automatic conflation of developing country status and entitlement to SDT need to be assessed, acted upon where necessary, and put to rest. As we shall argue, the way to do this is to break the link between what a country calls itself and what access to SDT should be available. We shall also argue that in practice, developing countries use SDT in varying degrees. Attempts to negotiate data-related thresholds that will define development status are unlikely to succeed. The one notable exception to this is the LDC group, as discussed above.

In what follows, Section 2 of the paper briefly traces the origins and evolution of SDT in the GATT and the WTO that has brought us to where we are today. Section 3 dissects the constituent parts of SDT in the WTO in order to identify where contentious issues could be addressed. A key question to be considered in this analysis is how much ‘space’ exists or should exist for a country that designates itself as developing to have access to SDT provisions. Section 4 discusses possible approaches to addressing the SDT issue in ways that lessen its impact as a hold-up issue in the work of the WTO. Section 5 concludes.

2. THE EVOLUTION OF THE SDT DEBATE

As discussed in more detail later, we argue that it is useful analytically to distinguish between SDT relating to levels of commitments to market access in goods and services, and SDT relevant to the rules that underpin the GATT/WTO multilateral trading system. When the GATT entered into force in the late 1940s, the core focus of the fledgling institution was to restore trade relationships among major trading nations that had been ravaged by the Great Depression and the Second World War. The main emphasis back then was on removing tariff and non-tariff barriers to trade. It was clear from the beginning that the major trading countries were going to do this selectively.

3 See WTO documents WT/GC/W/757/Rev1 of 14 February 2019, and WT/GC/W/764 of 15 February 2019.

Tariff-cutting negotiations in successive GATT rounds of from 1947 onwards⁴ yielded some appreciable results. But there were exceptions. Developed countries were reluctant to lower tariffs on agricultural products and labour-intensive manufactures. Both of these sectors accounted for small shares of GDP but were backed by strong interest groups. Little domestic opposition to high protection levels in these sectors was apparent, in part for socioeconomic reasons as well as the existence of strong and well organised lobby groups supporting the sectors concerned. Moreover, the products concerned were small items in many consumption baskets.

For their part, the developing countries relied significantly on these products for their exports but lacked the bargaining power to make their case effectively for better market access. At the same time, most developing countries were unwilling to undertake significant tariff cuts of their own, a position they defended on the grounds of developmental and diversification imperatives. A further difficulty related to the request-offer negotiating technique, where bilateral reciprocal exchanges of tariff cuts were made among large countries. The smaller market size of developing countries rendered their offerings less capable of securing the kind of reciprocity to clinch bargains that were to then be multilateralised on a most-favoured-nation (MFN) basis.

By the late 1950s and early 1960s, the issue of non-participation of developing countries in tariff negotiations was attracting increasing attention. The establishment of UNCTAD was a galvanising influence. The solution settled upon was for developed countries to introduce non-contractual preferences for developing countries in order to give them access to their major potential markets. The arrangement evolved into the Generalised System of Preferences (GSP). This lesser, unilateral and non-contractual deal was not subject to serious negotiation. As soon as such preferential access became useful to the recipients, they tended to be excluded on the basis of competitive criteria that did not necessarily imply an ability to compete in those same markets on an MFN basis. Political criteria, not linked directly to trade, are also brought to bear under some GSP schemes. At the same time, in those early years developing countries were not pressed by their major trading partners to open their markets. This may be seen as something of a *quid pro quo* for the absence of contractual commitments on the other side of the arrangement.

This setup can be characterised as a minimalist alliance (Low et al. 2018) with mitigated, time-bound benefits for preference-receiving developing countries and of limited economic consequence for developed countries. The arrangements also established a vested interest among preference receivers to oppose MFN market-opening in order to protect their favourable margins. Nevertheless, this state of affairs represented something of an equilibrium in market access matters, more or less until the 1970s. Things began to change in the Tokyo Round (1973-79) and its aftermath. Developing countries were

4 GATT multilateral trade negotiating sessions were launched in Geneva (1947), Ancey (1949), Torquay (1950-51), Geneva (1956), Geneva (1960-61) - also known as the Dillon Round, the Kennedy Round (1964-67), the Tokyo Round (1973-79).

becoming more significant players in international trade and they used the Tokyo Round to press for greater stability and a more wide-reaching set of arrangements to address their development challenges.

It was in the Tokyo Round that the phrase ‘special and differential treatment’ gained currency. The Enabling Clause⁵ gave permanent legal standing to GSP, which had hitherto been granted through waivers. It also provided for SDT under agreements on non-tariff measures, lessened already weak GATT disciplines on preferential trade agreements among developing countries, and introduced additional MFN exemptions for LDCs. While reiterating the non-reciprocity provisions in GATT Article XXXVI:8, the Enabling Clause also introduced ‘graduation’ language, stating that developing countries were expected to participate more fully in the GATT, along with the progressive development of their economies and improved trade situation.

In the area of non-tariff measures (NTMs), a number of ‘codes’ were negotiated. With the exception of the Agreement on Government Procurement and one or two smaller and less consequential agreements, the remaining five codes all built on existing GATT provisions.⁶ Developing countries were permitted to opt out of these agreements while still enjoying their benefits on an MFN basis.

In the years following the end of the Tokyo Round, it became increasingly apparent that the old suboptimal quasi-equilibrium defining trade relations between developed and developing countries was becoming less stable. Pressure was mounting on both sides for change. Developing countries wanted to see the discontinuation of the virtual exclusion of agriculture from GATT trade disciplines, and the actual exclusion of textiles and clothing through the Multi-Fibre Arrangement. Developed countries wanted greater levels of participation from some developing countries.

The Uruguay Round was launched in 1986, and this was in many ways a turning point in relations between developed and developing countries on the issue of how to define and manage SDT. The GATT was incorporated into the WTO as a result of the Uruguay Round. The agenda of the newly-minted WTO was broadened out in significant ways, with the addition of the GATS and TRIPS Agreements, as well as some revamping of existing NTM Agreements and the introduction of several new agreements.⁷

The Uruguay Round was launched with a Single Undertaking Agreement, which stipulated that nothing was agreed until everything was agreed. The purpose of the undertaking was to ensure that countries could not harvest results that interested them and then disengage from issues on which they had no interest, or did not wish to see included in the final package. As the Uruguay Round progressed, however, and as it became clearer

5 Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries, Decision of 28 November 1979 (L/4903).

6 The agreements covered technical barriers to trade, subsidies and countervailing duties, customs valuation, import licensing, and anti-dumping.

7 These included agreements on agriculture, sanitary and phytosanitary measures, textiles and clothing, trade-related investment measures, pre-shipment inspection, rules of origin, and safeguards.

that the GATT would become the WTO, the notion of a single undertaking assumed a quite different meaning. It was that no GATT member could join the WTO in a piecemeal fashion. A single undertaking intended as an instrument to protect all members' interests – especially the less influential among them – had become a precondition for signing up to the WTO. The proposition was that for the agreement to apply, everything must be adopted by all members by way of rights and obligations.

An immediate consequence of this was that the opt-out possibility allowed under the Tokyo Round Codes was swept away. Practically all the Uruguay Round texts did, however, contain STD provisions. As opposed to offering an opt-out, they sought to facilitate convergence to core provisions and standards under each agreement. This approach reinforced the notion that all WTO members would eventually converge around a uniform set of rules. Developing countries that had not signed up to the Tokyo Round codes were thus obliged to 'catch up' and accept many more new agreements and conditions than their more developed counterparts. Many of them expressed concern with the situation, eventually resulting in a process organised in the Committee on Trade and Development to consider proposals from developing countries for STD-related modifications to agreements or associated procedures.

This exercise became known as the Implementation Agenda. At one end of the spectrum it was about a re-examination of certain provisions in some WTO agreements in terms of their suitability from a development perspective. At the other end, it was about technical assistance necessary for developing countries to be able to manage their obligations, many of which had been acquired as a result of the Uruguay Round single undertaking. Unsurprisingly, developing countries tended to emphasise the need for amended rules and procedures in the name of SDT, while the developed countries were more inclined to think of technical assistance as the solution to the difficulties.

This exercise continued with limited results. The Doha Round was launched at the end of 2001. The Implementation Agenda was carried into these negotiations, and the Doha Declaration was replete with language aimed at addressing SDT issues. Paragraph 44 of the Doha Agenda stated that '... all special and differential treatment provisions shall be reviewed with a view to strengthening them and making them more precise, effective, and operational'. This was part of the implementation mandate that was incorporated into the Doha negotiating mandate.

A Doha Ministerial Decision entitled 'Implementation-Related Issues and Concerns'⁸ covered some 50 points for action in different agreements.⁹ Paragraph 12 of the Doha Ministerial Declaration cross-referenced this Decision and stated 'that negotiations on outstanding implementation issues shall be an integral part of the Work Programme'

8 WT/MIN(01)/17, 20 November 2001, Decision of 14 November 2001.

9 These included the GATT and agreements covering agriculture, sanitary and phytosanitary measures, textiles and clothing, technical barriers to trade, TRIMS, anti-dumping, customs valuation, rules of origin, subsidies and countervailing measures, and TRIPS.

established under the Declaration.¹⁰ Since the Doha Round has ceased to record progress, in practice the Implementation Agenda has been in abeyance. It is open to question whether this exercise is framed in a manner that can lend itself to further progress.

With a moribund Doha Round and minimal advances in addressing SDT issues, the membership once again finds itself at an impasse. Agreement remains elusive on what constitutes an equitable balance of rights and obligations among members of the WTO. In the meanwhile, the dynamics of the discussion have changed, not least following the accession of China to the WTO in 2001. The Chinese authorities made it clear during accession negotiations, and in the Protocol of Accession, that they considered China a developing country. China had already enjoyed rapid growth beginning in the 1980s, and it picked up in the 2000s after WTO accession. Against the background of its economic success, some WTO members have questioned the appropriateness of China's developing country status.

China's size and growing influence on outcomes in the world economy has placed it in the spotlight in relation to the SDT debate. China's fundamental argument is that the development process is far from complete. While certain sectors and areas of the country have modernised and become internationally competitive, many development challenges remain to be addressed. While all countries are entitled to determine whether they consider themselves developing countries, this choice does not signal a specific positioning in respect of the multiple elements that constitute SDT in the WTO.¹¹

3. DISSECTING SDT

At the beginning of Section 2 we alluded to a distinction between 'regulatory SDT' and 'market access SDT'. While the distinction may not always be entirely clear-cut, we believe that there are enough differences between these two aspects of SDT to warrant an analysis along these lines. We shall also briefly consider the GATS approach to development issues, as well as procedures adopted in the TBT and SPS Committees that can be effective in addressing development needs.

Regulatory SDT

I start with regulatory SDT. Regulatory SDT involves provisions relating to trade rules. As indicated in the previous Section, links between trade rules and SDT became a more important issue when the GATT members started to negotiate a strengthening of non-tariff measure disciplines, beginning in the Kennedy Round (1964-67), and especially from the Tokyo Round (1973-79) onwards. The WTO Secretariat has helpfully produced

¹⁰ Doha WTO Ministerial Declaration 2001. WT/MIN(01)/DEC/1, 20 November 2001. Paragraph 12.

¹¹ See WTO document WT/GC/W/773, date 13 May 2019, a submission by China. Part of Paragraph 2.34 reads: '...encourage developing Members to actively assume obligations commensurate with their levels of development and economic capability'.

and periodically updated a document that systematically identifies all SDT provisions in GATT/WTO texts.¹² The document uses a taxonomy to describe measures in terms of their purpose. The categories include:

1. Provisions aimed at increasing the trade opportunities of developing country members
2. Provisions under which WTO members should safeguard the interests of developing country members
3. Flexibility of commitments, of action, and use of policy instruments
4. Transitional time-periods
5. Technical assistance
6. Provisions relating to LDC members

I have slightly adjusted the taxonomy for the purposes of this chapter. Since one of the objectives is to determine the ‘wobble room’ that exists for developing countries to autonomously make use of SDT provisions, I have bundled categories 1) and 2) together to capture their shared character as best-efforts undertakings.

Table 1 summarises SDT provisions contained in WTO Agreements, of which there are a total of 183. The vertical axis identifies the WTO Agreements containing SDT provisions and the last column indicates the total and percentage shares of these provisions in each agreement. The last column of the horizontal axis shows the number and the percentage share of each kind of SDT provision (items 1-5 in the Key to Table 1) contained in the agreements.¹³

The only regulatory SDT provisions included in Table 1 where a beneficiary member can unilaterally decide to make use of SDT is under the *Flexibilities* column. What Table 1 tells us, then, is that developing countries can act unilaterally to garner SDT benefits in respect of only 24% of the total number of regulatory SDT provisions in WTO agreements. One might argue that transitional timeframes can also be accessed independently, but these are negotiated time-bound options and in any case many of them have expired. The SDT provisions listed as flexibilities allowing unilateral action are fairly concentrated, with some 60% of them contained in three agreements – the Agreement on Subsidies and Countervailing Measures, the Agreement on Agriculture and the Government Procurement Agreement.

¹² WT/COMTD/W/239, 12 October 2018.

¹³ Annex 1 to this paper includes a number of illustrative examples of provisions relevant to the first four of these categories.

TABLE 1 SPECIAL AND DIFFERENTIAL TREATMENT PROVISIONS IN WTO AGREEMENTS

AGREEMENT	1	2	3	4	5	TOTAL	
General Agreement on Tariffs and Trade 1994	21	4				25	14
Understanding on Balance of Payments of GATT1994		1		1		2	1
Agreement on Agriculture	1	9	1		3	14	8
Agreement on the Application of Sanitary and Phytosanitary (SPS) Measures	2		2	2		6	3
Agreement on Technical Barriers to Trade	13	2	1	9	3	28	16
Agreement on Trade-Related Investment Measures (TRIMs)		1	2		1	4	2
Agreement on Implementation of Article VI of GATT 1994	1					1	1
Agreement on Implementation of Article VII of GATT 1994	1	2	4	1		8	4
Agreement on Import Licensing Procedures	3		1			4	2
Agreement on Subsidies and Countervailing Measures (SCM)	2	10	7			19	10
Agreement on Safeguards	1	1				2	1
General Agreement on Trade in Services (GATS)	7	4		2	2	15	8
Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)			2	1	3	6	3
Understanding on Rules and Procedures Governing the Settlement of Disputes	7	1		1	2	11	6
Agreement of Government Procurement (GPA)	3	6		1	2	11	6
Agreement on Trade Facilitation (TFA)		3	7	7	9	26	14
TOTAL	62	44	27	25	25	183	100

Note: 1. Best-endeavours provisions, 2. Flexibilities, 3. Transitional Timeframes, 4. Technical Assistance, 5. Least-Developed Countries.

Source: Committee on Trade and Development, WT/COMTD/W/239, 12 October 2018.

In all other cases, the nature of the measures does not permit a developing country to independently access SDT provisions. Best-Endeavours Measures are in the gift of the party providing the treatment, not the party receiving it. The same applies to Technical Assistance and in the case of measures for LDCs, the group of developing countries with access is pre-selected through a third-party process.

We do not present a detailed analysis of each SDT measure presented here, but many of them are either not used in practice by various developing countries or provide relatively little by way of differential treatment. The Agreements that one might wish to analyse here are the Agreement on Agriculture and the Agreement on Subsidies and Countervailing Measures in terms of the number of SDT provisions contained in these two agreements.

In addition to the special and differential treatment (S&D) provisions in the 16 WTO Agreements identified in Table 1, a further 32 decisions taken by ministers and the General Council over the years also contain STD provisions.¹⁴ Some 60% (19) of these decisions relate exclusively to LDCs. Of the remaining 13, half of them (seven) deal with aspects of the Agreement on Agriculture, two concern the Transparency Mechanism for Preferential Trade Agreements, and the remaining four relate to the 1979 Enabling Clause, customs valuation, the 2005 TRIPS Amendment, and fisheries subsidies.

There is a sense in which the Agreement on Agriculture and accompanying texts provide varying degrees of 'special' treatment for all WTO members. This subject is a source of considerable contention, but we would argue that the underlying market access issues go beyond a straightforward matter of developing countries uniquely enjoying special and differential treatment. The agricultural sector offers special provisions for all WTO members and the analysis of how to assess the mix of tariff and domestic subsidy support measures for each member is a complex exercise.

As for the other Decisions that are not limited to LDC considerations, fisheries subsidies are currently the most contentious issue badly in need of a negotiated resolution. This particular negotiation does not fall neatly into the distinction we have made between regulatory and market access SDT. This is because the negotiation turns on subsidisation levels, and subsidies are neither tariffs nor simply regulations, but they are about which countries can use subsidies, to what extent, and for what purpose. This issue clearly divides countries in terms of perceptions of the development imperatives claimed by the parties concerned. This makes it a challenging negotiation.

A final point to make here relates to the extent to which developing countries actually use regulatory SDT provisions even if they are putatively entitled to do so. This is an empirical question to which we do not have an answer, but it is an important one that we believe should be brought into the reckoning.

14 WT/COMTD/W/239, 12 October 2018.

In the case of China, two examples where SDT has not been relied upon to the fullest extent permitted are in the Agreement on Agriculture (AoA) and the Trade Facilitation Agreement (TFA). Under the AoA, domestic subsidies were capped at 10% for developing countries, as opposed to 5% for developed countries. China agreed to a cap of 8.5%. Under the TFA, member-specific commitments in relation to the entry into force of the Agreement were divided into three categories – immediate implementation (Category A), implementation with a phase-in period (Category B), and implementation conditional upon technical assistance and without a specified implementation date (Category C). China and a number of other developing countries have foresworn any commitments under Category C.¹⁵ It should also be noted that China only included four Category B entries upon signature of the Agreement. All the rest of the commitments are in Category A.¹⁶

In addition, it may be noted that notwithstanding the country's self-declared status as developing, China joined the other signatories of the second iteration of the Information Technology Agreement (ITA II) in eliminating import duties and other charges from a range of key inputs and finished products in the IT sector. This is an illustration of how being a developing country does not need to define the extent to which a party resorts to SDT.

Unfortunately, no data exist that systematically identify where members are resorting to available SDT flexibilities, reducing their use of them, or refraining altogether. It may make sense to launch an exercise to establish which members are relying on SDT measures and consider undertakings in respect of future use. This could be the basis of a meaningful negotiation that would promote certainty without undermining economic interests, and would target specific needs rather than rely on blanket categorisations.

Market access SDT

As noted in Section 2, market access SDT was a primary focus of attention in the early years of GATT. The story here is mixed, in that non-contractual preferences were enjoyed by some developing countries on the one side, while on the other until the 1990s agricultural policies and the Multi Fibre Arrangement (MFA) practically took these sectors out of GATT contention altogether. Even when the Agreement on Agriculture came into being and the MFA was phased out after the Uruguay Round, tariffs against these products remained high. The basic point here is that all countries have high tariffs, at least in some sectors, and in the case of the developed countries these tend to be sectors of particular interest to many developing countries.

¹⁵ See Trade Facilitation Agreement Facility at <https://www.tfafacility.org/notifications>. Other developing countries that have no Category C reservations include, for example, Argentina, Brazil, Chile, India, Indonesia, Korea, Malaysia, Mexico, Singapore, Thailand, and Uruguay.

¹⁶ The Category B entries related to the Establishment of Publication and Average Release Time (Article 7.6); Single Window (Article 10.4); Temporary Admission of Goods and Inward and Outward Processing (Article 10.9); and Customs Cooperation (Article 12).

The central question is whether it makes sense to see market access through the narrow lens of SDT when virtually all countries maintain measures that amount to considerably less than free trade. Socio-economic and political imperatives drive this reality and it is common to the entire WTO membership. The question then, is what more can be exchanged in terms of market opening among members, be they designated developed or developing, to the mutual advantage of the parties involved. There will always be limitations that stop short of free trade. Unlike with regulatory SDT, there is no presumption of eventual convergence when it comes to market access.

A point worth making here is that the GATT/WTO has sought over the years to promote market-opening, but with mitigated success. Perhaps the most significant success story was the reduction by developed countries over several decades from 1948 onwards of tariffs on most but not all manufactures. This exercise was aimed at undoing much of the protectionism of the previous two to three decades in a concerted manner that would avoid terms-of-trade losses that might otherwise have resulted from unilateral market-opening. The GATT played a coordinating role in an exercise that the parties involved wished to carry forward.

Other than this, there have been some successes such as the two Information Technology Agreements. Much less has been accomplished in agriculture and labour-intensive manufactures. As far as developing countries are concerned, very few examples can be found of binding reductions being made to applied MFN tariffs on the altar of a GATT/WTO round of negotiations. Contributions in the form of reduced bindings have generally kept the MFN rates above the applied rates, and considerable water remains in the tariff schedules of many developing country members across a wide range of products. As with regulatory SDT, this is an area where greater certainty could be imparted without changing conditions of market access.

If the WTO has generally proven not to be an especially effective vehicle for market-opening, which would seem to be the case in comparison with unilateral market-opening initiatives and preferential trade agreements, perhaps the institution could focus more on what it has done much better, which is to establish rules for the conduct of trade. When a tariff or some other scheduled market access commitment is bound, it still reflects a certain level of market access but in the form of a rule than maintains the access constant. The role of the WTO could be more that of a consolidator and keeper of policy consistency and certainty rather than that of a pioneer in liberalising markets.

Returning to the question of how far SDT is reflected in market access, the attached table and accompanying graphs provide some indication. Table 2 summarises the total binding coverage of 26 selected countries, their simple average agricultural and non-agricultural bound and unbound rates, their *non-ad-valorem* duties expressed as a percentage share of the relevant HS6 subheading, and the maximum duty recorded on the national schedules of the listed countries.

TABLE 2 TARIFF PROFILES OF SELECTED COUNTRIES

	Total binding coverage (%)	Simple average duties (%)		Non-ad-valorem duties (HS 6-digit subheadings in %)		Maximum duty	
		Bound	MFN applied	Bound	MFN applied	Bound	MFN applied
Argentina	100						
Agricultural Products		32.4	10.3	0	0	35	35
Non-Agricultural Products		31.7	14	0	0	35	35
Australia	97.1						
Agricultural Products		3.5	1.2	1.7	0.9	29	21
Non-Agricultural Products		10.7	2.6	0.2	0	55	5
Brazil	100						
Agricultural Products		35.4	10.1	0	0	55	35
Non-Agricultural Products		30.8	13.9	0	0	35	35
Canada	99.7						
Agricultural Products		14.3	15.1	18.6	11.1	540	511
Non-Agricultural Products		5.1	2.1	0.3	0	20	25
Chile	100						
Agricultural Products		26.1	6	0	1.1	98	6
Non-Agricultural Products		25	6	0	0	25	6
China	100						
Agricultural Products		15.7	13.9	0	0.3	65	65
Non-Agricultural Products		9.1	6.5	0	0.3	50	50
Colombia	100						
Agricultural Products		91.5	14.3	0	15.6	227	98

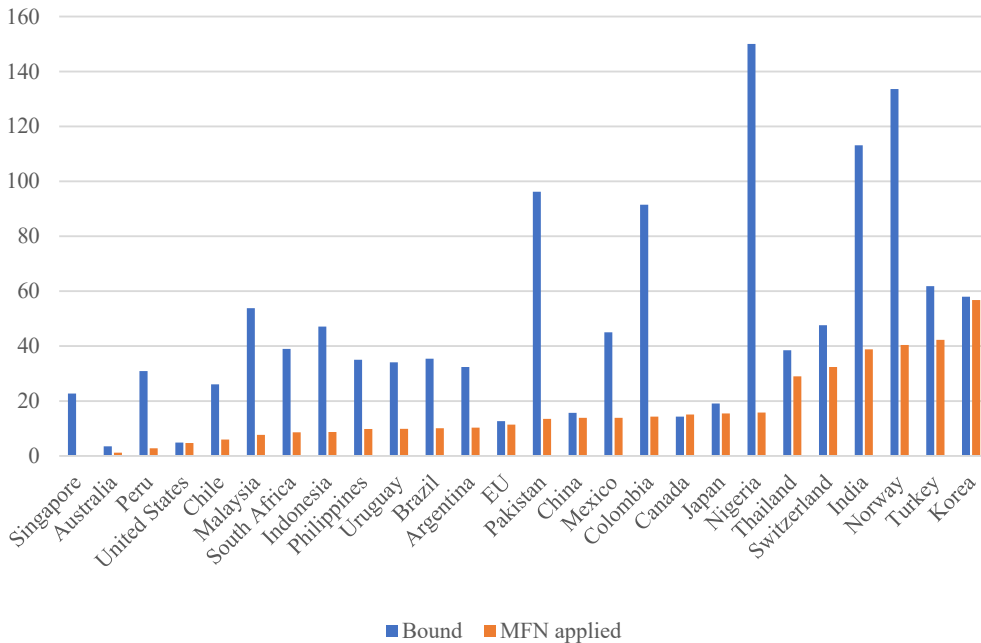
Non-Agricultural Products	33.5	4.1	0	5.2	104	35
EU	100					
Agricultural Products	12.7	11.4	31.7	32.3	405	261
Non-Agricultural Products	3.9	4.2	0.6	0.5	26	26
India	74.3					
Agricultural Products	113.1	38.8	0.3	0.3	300	150
Non-Agricultural Products	36	14.1	5.7	5.5	150	125
Indonesia	96.3					
Agricultural Products	47.1	8.7	0	1.4	210	150
Non-Agricultural Products	35.5	8	0	0	60	150
Japan	99.7					
Agricultural Products	19.1	15.5	15.1	13.2	716	716
Non-Agricultural Products	2.5	2.5	1.7	1.9	465	315
Korea	94.9					
Agricultural Products	58	56.8	5.2	3.1	887	887
Non-Agricultural Products	9.8	6.6	0.1	0	87	104
Malaysia	84.3					
Agricultural Products	53.8	7.7	21.1	4.8	1000	1000
Non-Agricultural Products	14.9	5.3	0.1	0	62	60
Mexico	100					
Agricultural Products	45	13.9	7.3	4.7	254	75
Non-Agricultural Products	34.8	6	0	0.1	156	50
Nigeria	20.1					
Agricultural Products	150	15.8	0	0	150	35
Non-Agricultural Products	49.7	11.5	0	0	150	35

Norway	100						
Agricultural Products	133.6	40.4	66.7	43.3	1000	1000	
Non-Agricultural Products	3	0.4	2.3	0.1	100	100	
Pakistan	98.7						
Agricultural Products	96.2	13.5	0.1	4.4	200	200	
Non-Agricultural Products	55.1	11.9	0	0.1	100	100	
Peru	100						
Agricultural Products	30.9	2.8	0	0	68	11	
Non-Agricultural Products	29.3	2.3	0	0	30	11	
Philippines	66.9						
Agricultural Products	35	9.8	0	0	60	65	
Non-Agricultural Products	23.4	5.5	0	0	50	50	
Singapore	72						
Agricultural Products	22.7	0.1	3.5	0.2	1000	96	
Non-Agricultural Products	6.2	0	0	0	10	0	
South Africa	94.3						
Agricultural Products	39	8.6	0	13.7	597	110	
Non-Agricultural Products	15.7	7.6	0	0.9	50	754	
Switzerland	99.7						
Agricultural Products	47.6	32.4	78	69.7	1000	1000	
Non-Agricultural Products	1.9	1.7	78.9	75.7	59	58	
Thailand	75.2						
Agricultural Products	38.5	29	44	27.8	712	226	
Non-Agricultural Products	25.6	7.2	14.9	6.4	220	143	
Turkey	50.5						

Agricultural Products	61.8	42.3	0	3.4	225	225
Non-Agricultural Products	17.3	4.5	0.1	4.5	100	82
United States	100					
Agricultural Products	4.9	4.7	41.3	42	350	350
Non-Agricultural Products	3.2	3.1	3.3	3.1	56	56
Uruguay	100					
Agricultural Products	34.1	9.9	0	0	55	3.5
Non-Agricultural Products	31.2	10.4	0	0	35	35

Source: WTO, ITC, UNCTAD (2020), World Tariff Profiles.

FIGURE 1 AGRICULTURE - SIMPLE AVERAGE BOUND AND APPLIED TARIFFS (%) - 2019

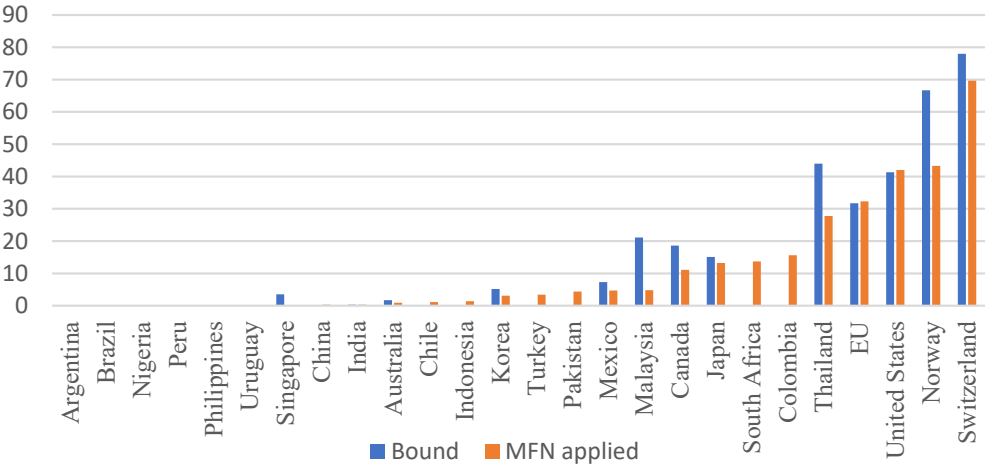


Source: WTO, ITC, UNCTAD (2020), World Tariff Profiles.

Figure 1 highlights two notable features of agricultural tariffs for the countries shown in the figure. First, many developing countries have significantly higher bound than applied tariffs, leaving room for reductions in the bindings without affecting MFN applied rates. Second, when looking at the countries represented there is considerably less variance in

applied rates among countries than bound rates. The outliers with high MFN applied rates include Thailand, Switzerland, India, Norway, Turkey, and Korea. After that, a number of countries have quite similar MFN applied rates, with little difference, between China and the EU in this regard.

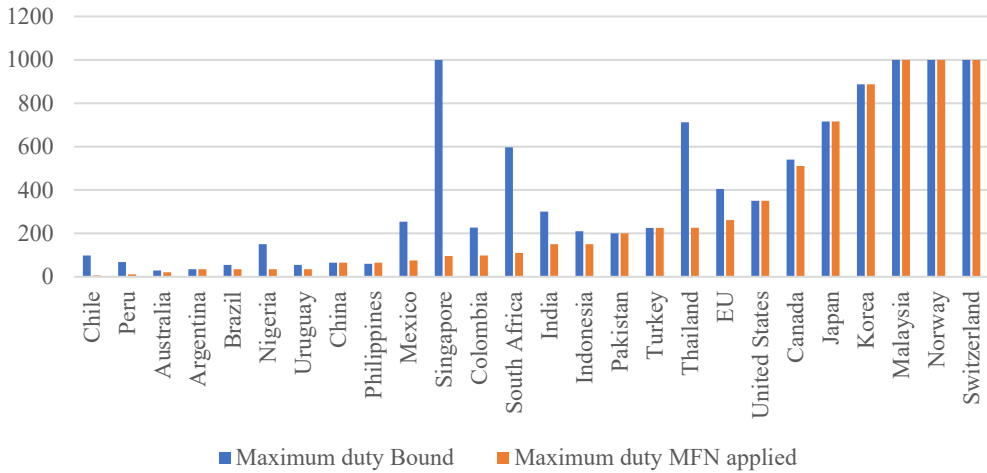
FIGURE 2 AGRICULTURE - NON AD-VALOREM DUTIES BOUND AND APPLIED TARIFFS (HS 6-DIGIT SUBHEADINGS IN %)



Source: WTO, ITC, UNCTAD (2020), World Tariff Profiles.

Figure 2 looks at the use of specific duty rates for the same group of countries, showing the *ad-valorem* duty equivalents of the specific rates as a percentage of the relevant 6-digit sub-heading. Many of the countries in the sample are using very few specific rates, while others rely on them, in many cases as a way of hiding high *ad valorem* equivalents. The most intensive users of specific duties include Switzerland, Norway, the US, the EU, Thailand, Cambodia, South Africa, Japan, and Canada. On the basis of the data presented, it is notable that in both Figures 1 and 2, there is no clear dividing line between developed and developing countries in terms of actual market access when it comes to agriculture.

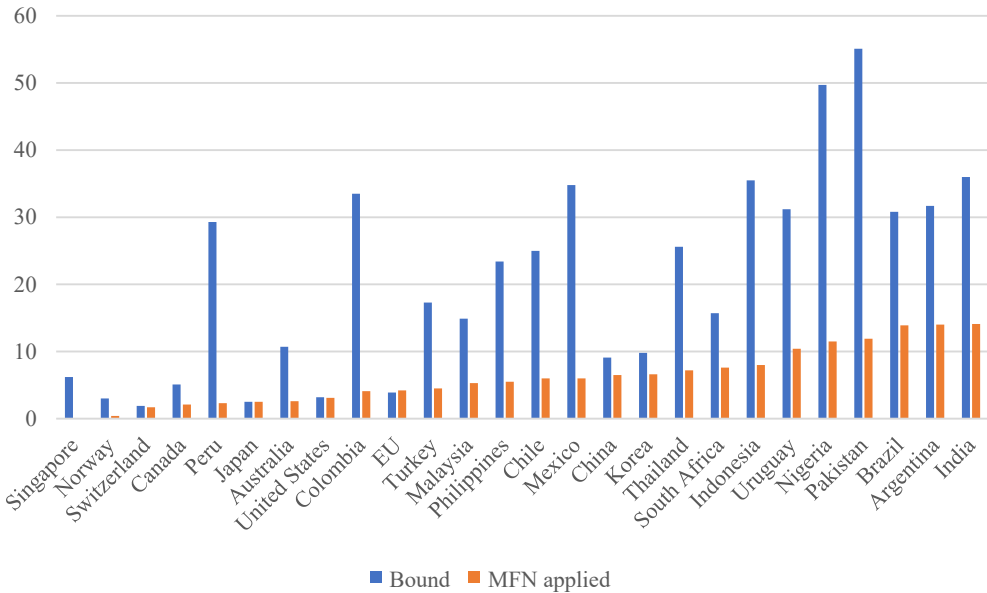
FIGURE 3 AGRICULTURE - MAXIMUM DUTY BOUND AND APPLIED TARIFFS (%)



Source: WTO, ITC, UNCTAD (2020), World Tariff Profiles.

Figure 3 simply identifies the highest single bound and applied tariff in each country’s schedules. This is a crude indicator of the likelihood that the highest single tariff will not be standing alone in the wilderness. It is probable that other high tariffs are to be found in the relevant schedules.

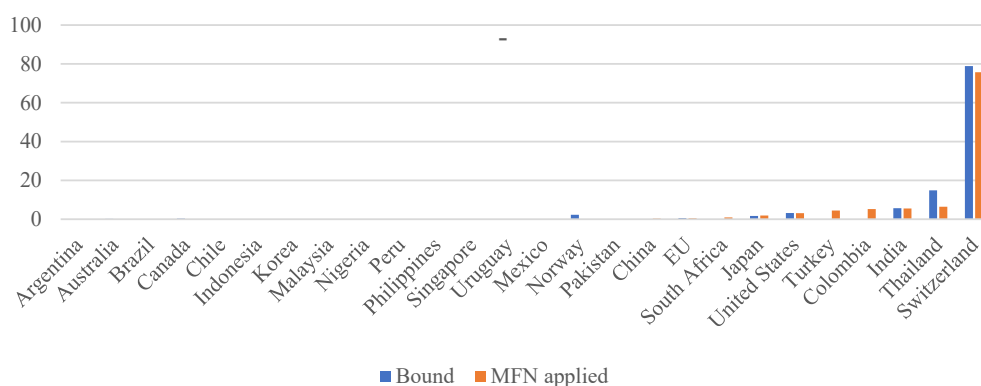
FIGURE 4 NON AGRICULTURE - SIMPLE AVERAGE BOUND AND APPLIED TARIFFS (%)



Source: WTO, ITC, UNCTAD (2020), World Tariff Profiles (2).

Figure 4 turns to non-agricultural products, showing the simple average bound and applied tariffs on these products in the 26 countries included in the table. Once again, there is a considerable gap between the bound and applied tariff rates for developing and developed countries. But as far as applied tariffs are concerned, there are some similarities in applied MFN rates, with Indonesia and all countries to its left having simple average applied tariff rates at below 10% *ad valorem*. The overall pattern in Figure 4 is of countries with reasonably similar MFN rates, but a clear tendency for the developed country simple average applied tariffs to be lower than those of the developing countries.

FIGURE 5 NON AGRICULTURAL - NON AD VALOREM BOUND AND APPLIED TARIFFS (HS 6-DIGIT SUBHEADINGS IN %)

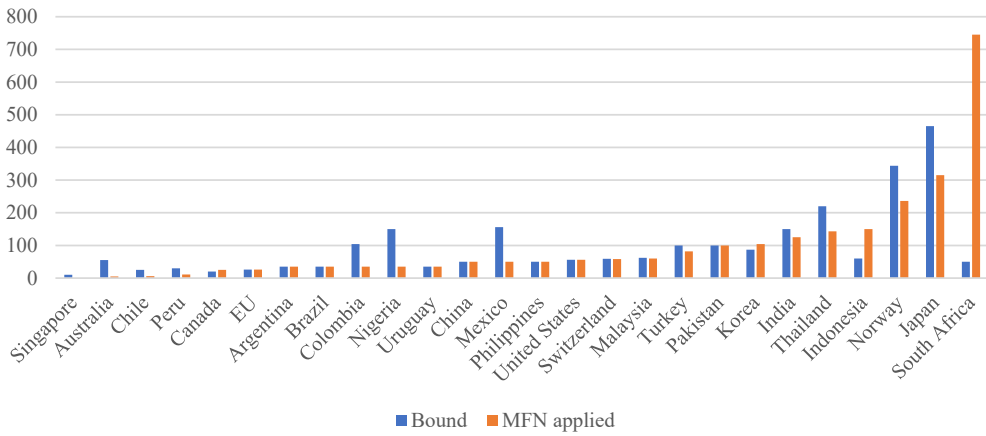


Source: WTO, ITC, UNCTAD (2020), World Tariff Profiles.

Figure 5 looks bare, indicating that countries represented in the graph do not tend to rely extensively (in relation to their total trade) on specific duties to conceal high rates *ad valorem*. However, to the extent that there are some hidden high *ad-valorem* equivalents behind specific rates, these are likely to be on products of interest to developing countries. Switzerland is an outlier in all these tables because the country maintains its entire tariff schedule with duties expressed in specific rather than *ad valorem* terms. Other countries that have a smattering of specific duties include Thailand, India, Cambodia, Turkey, United States, and Japan.

Figure 6 does for non-agricultural products what Figure 3 did in identifying the single highest tariff in each schedule. The highest tariff for many countries are quite low, with a maximum applied MFN rates of below 10% in *ad valorem* equivalents. Those with applied rates above 10% include Pakistan, Korea, India, Thailand, Indonesia, India, Japan, and South Africa. Again, there is no clear dividing line between developed and developing countries using this metric.

FIGURE 6 NON-AGRICULTURAL - MAXIMUM DUTY BOUND AND APPLIED TARIFFS (%)



Source: WTO, ITC, UNCTAD (2020), World Tariff Profiles.

Finally, while the discussion above has focused on trade in goods, trade in services would merit a similar analysis. Such an analysis is beyond the scope of this paper. Suffice it to say, however, that the EU’s position on audio-visual services illustrates the point. The EU has consistently declined to open up this sector to international competition. A similar situation applies in relations to maritime transport cabotage in the US. The Jones Act restricts waterborne cargo transport within the US to shipping that is built, owned, and operated by US suppliers. This is not to argue that these sectors should be opened up – that is a matter for the governments concerned. Rather, it is merely to point out that most if not all countries maintain some high or prohibitive barriers to imports. There is no binary distinction – but rather a continuum – in relation to market access conditions between developed countries and those that call themselves developing.

Beyond SDT: other ways of addressing development needs

This subsection briefly considers alternative approaches to addressing development needs that do not necessarily require explicit distinctions between those members who are entitled to SDT and those that are not.

The GATS approach

Negotiations under the GATS have not taken off since the end of the Uruguay Round, when the Agreement came into existence. The only exceptions are the post-Uruguay Round negotiations on financial services and the telecommunications in the late 1990s. In this sense, we have a limited basis on which to assess whether the architecture of GATS makes it easier to navigate the developed-developing country divide than it has been on the goods side.

A polarising bifurcation between developed and developing members is largely avoided by relying on a generally applicable notion of progressive market opening through market access (Article XVI), national treatment (Article XVII), and additional commitments (Article XVIII) as circumstances and national interests allow. There is no reference to SDT in the GATS text. More levers are available for changing the conditions of competition within a market than in the case for goods, where a single data point, the tariff, is the sole focus of attention.

Another feature of the GATS that may smooth the path to cooperation is the link between specific commitments in schedules and the level of regulatory obligations assumed under Article VI of the GATS. Linking access to regulatory disciplines reflects the GATS approach to incremental opening through a combination of policy levers.

There is, however, acceptance of the notion that increased participation by developing countries is dependent on increased levels of specific commitments. But the language in paragraph 1 of Article IV clearly carries the implication that the capacity to engage more fully depends also on the actions of other members in opening up their markets, making fuller participation a shared endeavour. This is an important nuance relevant to the earlier discussion of market access SDT in goods sectors.

Specific trade concerns in the TBT and SPS Agreements

The Committees responsible for these Agreements have a standing agenda item dealing with Specific Trade Concerns (STCs). This permits members – developed and developing alike – to raise particular problems with their counterparts that they have encountered in standards-related actions. This is a practical way of defusing issues without recourse to formal dispute procedures and without invoking any form of SDT. These procedures are simpler, less costly, faster and more transparent than dispute settlement. The procedures have been used extensively, often with positive results, and are generally regarded as a good way of proceeding. A question arises as to whether such approaches could be adapted for use in other areas of the WTO's work.

Special and Differential Treatment in GATT/WTO Texts

The discussion so far in Section 3 has focused on questions regarding the nature and incidence of SDT once it has been partly unpacked into its constituent parts. More detailed analysis, beyond the scope of this paper, could throw further light on some of the issues we have raised. However, it is important not to lose sight of the fact that SDT is recognised as an integral part of the WTO Agreements.

GATT Article XXXVI:8, along with an interpretative note, states:

The developed contracting parties do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties

Ad note: It is understood that the phrase ‘do not expect reciprocity’ means, in accordance with the objectives set forth in this Article, that the less-developed contracting parties should not be expected, in the course of trade negotiations, to make contributions which are inconsistent with their individual development, financial and trade needs, taking into consideration past trade developments.

The Tokyo Round Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries (otherwise referred to as the Enabling Clause), paragraphs 6 and 7:

6. Having regard to the special economic difficulties and the particular development, financial and trade needs of the least-developed countries, the developed countries shall exercise the utmost restraint in seeking any concessions or contributions for commitments made by them to reduce or remove tariffs and other barriers to the trade of such countries, and the least-developed countries shall not be expected to make concessions or contributions that are inconsistent with the recognition of their particular situation and problems.

7. The concessions and contributions made and the obligations assumed by developed and less-developed contracting parties under the provisions of the General Agreement should promote the basic objectives of the Agreement, including those embodied in the Preamble and in Article XXXVI. Less-developed contracting parties expect that their capacity to make contributions or negotiated concessions or take other mutually agreed action under the provisions and procedures of the General Agreement would improve with the progressive development of their economies and improvement in their trade situation and they would accordingly expect to participate more fully in the framework of rights and obligations under the General Agreement.

Finally, GATS Article XIX.2 states that:

The process of liberalisation shall take place with due respect for national policy objectives and the level of development of individual members, both overall and in individual sectors. There shall be appropriate flexibility for individual developing country members for opening fewer sectors, liberalising fewer types of transactions, progressively extending market access in line with their development situation and, when making access to their markets available to foreign service suppliers, attaching to such access conditions aimed at achieving the objectives referred to in Article IV.

These quotations from the WTO texts make it clear that SDT is an integral part of the Agreements, and this proposition has not been put at issue by members. In different ways, the above texts also indicate that SDT is not an unchanging state of affairs as far as those members that benefit from it are concerned. In other words, SDT must be attuned to

circumstances. Those circumstances do not necessarily embrace entire economies, which is why SDT needs to be customised both among and within developing countries on the basis of development needs. This is particularly the case when it comes to regulatory SDT.

At the same time, accommodation on this issue entails recognition among members that especially in the domain of market access, where all members espouse particular interests and priorities, there is no simple correlation between openness and the distinction between developed and developing countries. Market access commitments will always fall short of unfettered trade, and addressing this is not simply a matter of adjusting developing country access to SDT. While the assumption of convergence over time underpins regulatory STD, there is no assumption of convergence to free trade among members when it comes to conditions of access to one another's markets.

4. CONCLUSIONS

No WTO member questions the legitimacy of SDT as an integral part of the WTO Agreements. The challenge is to design SDT provisions that serve the members who need the breathing space and/or support in order to participate in, and benefit more from the WTO. SDT should be focused on enabling beneficial participation in international trade, not exempting countries in ways that inhibit participation.

No unassailable nexus exists between being classified as a developing country and access to SDT. The two must be separated. It is up to members to characterise their development status, and it is up to the membership collectively, with the full participation of all members, to determine the design and content of SDT. This cannot be something that is determined by the major players and handed down to the rest of the membership.

Much of what is regarded as SDT, both in relation to regulations and market access, is of a best-endeavours nature. Only a subset of SDT is available to potential beneficiaries on a unilateral basis. This suggests that the possible abuse of SDT options by developing countries is more circumscribed than some discussions of the subject might suggest.

Progress will not be made in this debate unless members are willing to unpack SDT instead of treating it as a monolithic phenomenon that members either have access to, or do not. Such an unpacking exercise would explore the constituent parts of SDT, how they operate, who has access to SDT, and why.

The distinction between regulatory SDT and market access SDT is essential to an understanding of the true nature and purpose of SDT. Regulatory SDT is largely about time-bound or circumstance-bound flexibilities, with the aim of enabling members to advance development and converge towards a common set of rules. Technical assistance is a key element in this process. In other words, there is a clear and measurable end-game. Regulatory SDT therefore needs to be customised to specific country and sectoral needs if it is to be relevant and purposeful. But key here is the process by which needs and use are determined – the beneficiaries must have a voice in this process.

A useful exercise would be to determine which members are making use of SDT flexibilities where they have the independent choice of whether to do so. This would only concern a subset of SDT, bearing in mind how much of such treatment must be triggered by third party actions in order to become operational. Perhaps an exercise of this nature could lead to a situation where governments announce that they are no longer using particular flexibilities and do not intend to do so in the future.

As for market access, fully free trade is not the end-game, and this should be factored into any discussion of market access SDT. Virtually all members have sectors and economic activities they will not give up to the free trade standard, and as we saw from our preliminary analysis in Section 3, there is no clear developing/developed divide in terms of degrees of committed market access in a range of product areas. All countries have their reservations about free trade, and these respond to political, socio-economic and developmental needs. The way forward here is for members to negotiate market opening possibilities aimed at teasing out mutual benefits. As already noted, it would seem that market opening, at least in recent years, has resulted more from unilateral actions or through preferential trade agreements.

Much of this paper is concerned with how SDT has operated up to now. What matters is how members decide to address this matter in future negotiations. In addition to our analysis of how to manage measures and provisions that fall under the rubric of STD, we included a short subsection in Section 3 about other possible mechanisms. These would mostly be of a procedural nature, such as the Specific Trade Concerns process in the TBT and SPS Committees, that would adequately address development needs without directly implicating SDT. The TFA approach, with its self-declaration mechanism, is also worth a closer look when negotiating future agreements.

REFERENCES

Bacchus, J and I Manak (2020), 'The Development Dimension: What to Do about Differential Treatment in Trade', Policy Analysis, Cato Institute, Number 887, available at: <https://www.cato.org/policy-analysis/development-dimension-what-do-about-differential-treatment-trade>.

Gao, H and W Zhou (2019), 'Myth busted: China's status as a developing country gives it few benefits in the World Trade Organisation', *The Conversation*, available at: <https://theconversation.com/myth-busted-chinas-status-as-a-developing-country-gives-it-few-benefits-in-the-world-trade-organisation-124602>.

Hedge, V and J Wouters (2020), 'Special and Differential Treatment under the World Trade Organization: A Legal Typology', Humanities and Social Sciences Group – Ku Leuven, Working Paper No. 227, available at: <https://ghum.kuleuven.be/ggs/wp227-special-and-differential-treatment-wto-legal.pdf>.

Hoekman, B (2005), 'Operationalizing the Concept of Policy Space in the WTO: Beyond Special and Differential Treatment', *Journal of International Economic Law*, 8(2): 405-424, <https://doi.org/10.1093/jielaw/jgio27>.

Hoekman, B (2013), 'Re-Thinking Economic Development in the WTO RSCAS PP 2013/09', Robert Schuman Centre for Advanced Studies Global Governance Programme, <https://cadmus.eui.eu/handle/1814/27294>.

Hoekman, B (2018), 'Revitalizing Multilateral Trade Governance at the World Trade Organization. Report of the High-Level Board of Experts on the Future of Global Trade Governance', Bertelsmann Stiftung, <https://www.bertelsmann-stiftung.de/en/publications>.

Hudec, R and J Finger (2010), *Developing Countries in the GATT Legal System*, Cambridge University Press.

Keck, A and P Low (2004), 'Special and Differential Treatment in the WTO: When, Why and How?', World Trade Organization, Working Paper ERSD-2004-03, https://www.wto.org/english/res_e/reser_e/ersd200403_e.htm.

Low, P, H Mamdouh, and E Rogerson (2018), 'Balancing Rights and Obligations in the WTO: A Shared Responsibility', Government Offices of Sweden, <https://www.swedenabroad.se/globalassets/ambassador/fn-geneve/documents/balancing-rights-and-obligations-in-the-wto.pdf>.

Mitchell, A D and T Voon (2009), 'Operationalizing Special and Differential Treatment in the World Trade Organization: Game Over?', *Global Governance* 15(3): 343-357.

Page, S (2004), 'The Evolution of Special and Differential Treatment in the Multilateral Trading System', Mimeo. <https://odi.org/en/about/our-work/the-evolution-of-special-and-differential-treatment-in-the-multilateral-trading-system>.

UNCTAD (2019), 'From Development to Differentiation: Just how much has the world changed?', UNCTAD Research Paper No 33. UNCTAD/SER.RP/2019/5/Rev.1. https://unctad.org/system/files/official-document/ser-rp-2019d5_en.pdf.

ANNEX 1¹⁷

Illustrative List of SDT Provision in WTO Agreements

Category 1. Best-Endeavours Provisions (requires third-party action to trigger benefits).

17 These are all citations from WTO legal texts.

1. Articles 10.6 of TBT agreement: ‘The Secretariat shall, when it receives notifications in accordance with the provisions of this Agreement, circulate copies of the notifications to all Members and interested international standardizing and conformity assessment bodies, and draw the attention of developing country Members to any notifications relating to products of particular interest to them’.

2. Article 4.2 of GATS: ‘Developed country Members, and to the extent possible other Members, shall establish contact points within two years from the date of entry into force of the WTO Agreement to facilitate the access of developing country Members’ service suppliers to information, related to their respective markets, concerning:

- Commercial and technical aspects of the supply of services;
- Registration, recognition and obtaining of professional qualifications; and
- The availability of services technology’.

3. Article 12.10 of TBT: ‘The Committee shall examine periodically the special and differential treatment, as laid down in this Agreement, granted to developing country Members’.

4. Article 8.10 of DSU: ‘When a dispute is between a developing country Member and a developed country Member the panel shall, if the developing country Member so requests, include at least one panelist from a developing country Member’.

Category 3: More flexibilities in making commitment and using policy tools (Exist as stand-alone provisions in agreements and/or can be triggered by beneficiaries).

1. Article 6.4 of the Agriculture Agreement: ‘For developing country Members, the de minimis percentage under this paragraph shall be 10%’.

2. Article 12.2 of the Agriculture Agreement: ‘Disciplines on Export Prohibitions and Restrictions The provisions of this Article shall not apply to any developing country Member, unless the measure is taken by a developing country Member which is a net-food exporter of the specific foodstuff concerned’.

3. Para 3 of Annex 2 (footnote) of the Agriculture Agreement: ‘For the purposes of paragraph 3 of this Annex, governmental stockholding programmes for food security purposes in developing countries whose operation is transparent and conducted in accordance with officially published objective criteria or guidelines shall be considered to be in conformity with the provisions of this paragraph, including programmes under which stocks of foodstuffs for food security purposes are acquired and released at administered prices, provided that the difference between the acquisition price and the external reference price is accounted for in the AMS’.

4. Article 5.3 of GATS: ‘Where developing countries are parties to an agreement of the type referred to in paragraph 1, flexibility shall be provided for regarding the conditions set out in paragraph 1, particularly with reference to subparagraph (b) thereof, in accordance with the level of development of the countries concerned, both overall and in individual sectors and subsectors’.

5. Article 19.2 of GATS: ‘The process of liberalization shall take place with due respect for national policy objectives and the level of development of individual Members, both overall and in individual sectors. There shall be appropriate flexibility for individual developing country Members for opening fewer sectors, liberalizing fewer types of transactions, progressively extending market access in line with their development situation and, when making access to their markets available to foreign service suppliers, attaching to such access conditions aimed at achieving the objectives referred to in Article IV’.

6. Article 5 (g) of the Telecommunication Annex of the GATS: ‘Notwithstanding the preceding paragraphs of this section, a developing country Member may, consistent with its level of development, place reasonable conditions on access to and use of public telecommunications transport networks and services necessary to strengthen its domestic telecommunications infrastructure and service capacity and to increase its participation in international trade in telecommunications services’.

Category 4: Phase-in period for developing members (Written into agreements and can be used independently by beneficiaries).

1. Article 15.2 of the Agriculture Agreement: ‘Developing country Members shall have the flexibility to implement reduction commitments over a period of up to 10 years. Least-developed country Members shall not be required to undertake reduction commitments.’

Category 5: Technical Assistance (in the hands of the provider).

1. Article 9.1 of SPS agreement: ‘Members agree to facilitate the provision of technical assistance to other Members, especially developing country Members, either bilaterally or through the appropriate international organizations’.

2. Article 12.7 of TBT agreement: ‘Members shall, in accordance with the provisions of Article 11, provide technical assistance to developing country Members to ensure that the preparation and application of technical regulations, standards and conformity assessment procedures do not create unnecessary obstacles to the expansion and diversification of exports from developing country Members.’

3. Article 25.2 of GATS: ‘Technical assistance to developing countries shall be provided at the multilateral level by the Secretariat and shall be decided upon by the Council for Trade in Services’.

4. Article 67 of TRIPS Agreement: ‘In order to facilitate the implementation of this Agreement, developed country Members shall provide, on request and on mutually agreed terms and conditions, technical and financial cooperation in favour of developing and least-developed country Members’.

ABOUT THE AUTHOR

Patrick Low is a consultant on trade matters. He was an Adjunct Professor at the University of Hong Kong (2016-19), and Vice-President for Research at the Fung Global Institute (2013-2015). He worked at the secretariat of the World Trade Organization (WTO) from 2005 and was Chief Economist from 1997 to 2013.

CHAPTER 5

National security and other non-trade objectives under WTO law

103

CUI Fan, Catherine Hoeffler, and Stephanie C. Hofmann

SITE and UIBE; Sciences Po; IHEID

In an ideal(ised) classical economic model, trade between states is always good and mutually beneficial. However, states have many concerns when trade with each other does not align with other political goals in areas such as food security, environment and climate change, labour rights, culture, or national security. The integrity of the World Trade Organization (WTO) rules and the success of reform of the WTO requires keeping some policy space for states to address such concerns, while keeping the WTO as a system of trade rules rather than a boxing ring of political fighting. Legitimate security grounds may not be able to be defined, but can be embedded in other rules. A more open process of the evaluation of states' invocation of Article XXI may trigger more willingness to engage in it, thereby increasing the efficiency and legitimacy of WTO rules.

1. SECURITY MATTERS UNDER WTO LAW

Under what lawyers call exceptional circumstances, national security constitutes a legitimate ground for states not to abide by their commitments in many international treaties. If we turn our gaze to international trade and General Agreement on Tariffs and Trade (GATT)/WTO law, the 'security exception' laid down in Article XXI grants such room for manoeuvre to states.

While the security exception is the most obvious institutional entry point, discussions about the linkages of, and interdependencies between, security and trade issues in international trade are not solely constrained to Article XXI. Instead, states have already claimed national security prerogatives in everything but name. For instance, the Airbus/Boeing disputes have been framed as trade issues and treated with traditional WTO rules such as the regulation of state subsidies. Yet, no one can doubt the underlying security implications of such a trade 'war' between the two aerospace giants across the Atlantic and its geopolitical implications. This example underlines that while the security exception article is the most visible – and currently relevant – institutional tool, it constitutes but the tip of the iceberg of instruments for states to voice their national security concerns. Another example is the food security issue, which is often treated as part of widely defined 'national security'. The Doha Round negotiations collapsed in July 2008, because of the inability of India and the US to agree on a special safeguard mechanism for the agricultural products of developing countries designed to address food security concerns. Rather than

fitting in a neatly delineated category, states' national security concerns pervade in many different ways how international trade works and is regulated. We therefore need to look beyond the use and abuses of Article XXI if we want to locate national security thinking in WTO. This requires us to consider more fundamentally how trade and security are co-constituted and how this impacts rules and practices in international trade regulation.

2. WHY AND HOW THE TRADE-SECURITY NEXUS MATTERS FOR THE WTO

2.1 Article XXI: A Damocles' sword over international trade rules

Until recently, the WTO had dealt little with national security matters, at least formally. States had only rarely invoked Article XXI, and if this was the case, other states had not challenged the state(s) that did so.¹ This scant use of the security exception can be explained by the member states' unwillingness to more formally define the security proceedings and to question states' sovereignty over security matters. This behaviour had been based on, but has also reproduced, the taken-for-granted 'self-judging' character of Article XXI until recently. An additional reason why states might not want to explore these uncharted waters is that they can use other legal mechanisms to protect their national security interests without invoking the said security exception provision. The restraint of using national security considerations could also be found in economic relations outside of the WTO, until recently. In 2012, the US and the European Union (EU) released a joint statement on shared principles for international investment, which advocates 'narrowly-tailored reviews of national security considerations: governments should ensure that their reviews, if any, of the national security implications of foreign investments focus exclusively on genuine national security risks'.²

Despite this limited use, the WTO security exception has been considered potentially disruptive, for there was always the possibility of states making use of this article to circumvent international trade rules. This use of Article XXI could harm the integrity of WTO trade laws, but it could also hurt states that do not possess strong military or international influence, i.e. less developed member states, which could suffer from powerful states' arbitrary use of Article XXI (Cann 2001:416).

However, we might be at a turning point, as in recent years, some states have made more frequent use of this security exception clause. This is the case for instance in the Russia-Measures concerning Traffic in Transit (WT/DS512/7) or in the Saudi Arabia-Measures concerning the Protection of Intellectual Property Rights (WT/DS567/8) cases. The Section 232 tariffs of 25% on steel and 10% on aluminium imposed by the US caused

1 In the era of GATT, Article XXI was invoked by Ghana on the occasion of the accession of Portugal in 1961, by EEC and its member states, Canada, Australia against import from Argentina in 1982, by US in its trade embargo against Nicaragua in 1985, among other occasions.

2 <https://2009-2017.state.gov/p/eur/rls/or/2012/187618.html>

nine cases of dispute settlement in the WTO. While it falls outside the scope of WTO jurisdiction, the strengthening of national security screening in many countries is another sign that testifies to the increased importance given to security over trade.

2.2 Increased politicisation and securitisation of world trade

This renewed interest in the security exception clause enclosed in WTO law reflects broader dynamics of politicisation and securitisation of international trade and investment. For the sake of this chapter, we refer to politicisation as the process where ‘something – an issue, an institution, a policy – that previously was not a subject to political action into something that now is subject to political action’ (Palonen et al. 2019:249). The concept has been used to analyse the trend by which certain organisations, most notably the EU, have become more ‘political’, through either increased salience of the issues they are dealing with, larger and broader participation of actors, and/or last but not least, stronger polarisation (De Wilde 2011). Historically, economists and lawyers involved in the development of autonomous international law through the GATT and the WTO have regarded politicisation as a threat to the efficiency and very existence of these institutions. The rising politicisation of international trade, which has been happening for a few years now, however, seems difficult to ignore.

This is even more difficult to ignore as this multifaceted dynamic called politicisation has used one specific policy frame as of late, namely national security. International trade has been increasingly portrayed as linked to national security concerns. This process has been analysed in international relations through the concept of securitisation (Balzacq and Guzzini 2015, Buzan et al. 1998). The process of securitisation entails that in the name of an existential threat to the political community, political authorities suspend normal (democratic) rules, and grant themselves exceptional powers. The concept of securitisation has been developed to explain the inclusion of certain issues/topics (such as internal security, terrorism, frontiers) into the realm of ‘traditional’ security and defence policies. It has also been applied to other policies (health, migration, environment, energy) (Hofmann and Staeger 2019, Huysmans 2000, McInnes and Rushton 2013) to designate more broadly the framing of these policies from a security perspective and to point to the (mostly detrimental) effects of such a process.

While they are not synonyms, politicisation and securitisation both point to interesting political dynamics in international trade. Obvious indicators of these trends are the increased use of war metaphors to describe trade disputes and the return of geopolitics/geoeconomics in policy and academic circles. However, these dynamics do not always unfold clearly: governments can try to play their cards through different strategies, using or discarding the ‘security’ card. Different examples illustrate these two-sided dynamics. On the one hand, the aluminium-trade ‘war’ spearheaded by President Trump under the premise of national security shows how security can be deployed to uphold ordinary trade rules through the use of Article XXI. On the other hand, the rare earths cases, in which the EU and the US filed complaints against China, demonstrates that actors such as the

EU and the US see their security interests at stake when China claims protective measure of its rare earths. China's rare earth reserve accounts for about 37.8% of the world reserve, while China accounted for 98% of the world production in 2010. When China invoked the exception of 'the conservation of exhaustible natural resources', some sort of concern on national security might be in mind. This could be understood as a covert (as China does not claim that its policy is motivated by security concerns) securitisation move by China, as it limits full access to security-related minerals to arms-producing and technologically-inclined countries by using export tax and quota, which is not allowed according to some specific commitments in China's protocol of WTO accession.³

As such, politicisation and securitisation have the potential to impact the WTO in different ways. Firstly, it is likely that WTO member states will invoke the security exception more frequently in the future, thus jeopardising the tacit restraint that prevailed until recently. Secondly, it is possible that states will disrupt long-standing WTO procedures, by not complying to WTO rulings on Article XXI if they should see their national security concerns, however defined, not being taken into account. Finally, a broader implication could reside in the overall contestation of the artificial (read: political) boundary between security and trade/investment. States could decide to adopt broader definitions of security, which would have implications of what they define as their essential national security interests. Negating the very relevance of the boundary drawn between trade and politics/security would amount to a fundamental challenge to WTO's intellectual foundations.

3. THE PATH AHEAD: WTO REFORM AND INTERNATIONAL/NATIONAL SECURITY

More than ever, any reform of the WTO system should be designed to take into account international and national politics. The politicisation and securitisation of trade, observable from the 'top', i.e. world politics, to the 'bottom', i.e. its local implications, is here to stay. The WTO cannot afford to contest national sovereignty. Similarly, the embeddedness of trade in national politics and the existing and potential interlinkages between trade and other political goals such as security, but also the environment (just think of a green global economy), health (e.g. access to medicine) or human rights (PTAs with HR clauses), need to be reckoned with – not as a limitation to trade but as a precondition for it. In the meantime, in certain areas such as environment and climate change, states should shoulder common but differentiated responsibilities, and the least developed countries should be given more help to meet the minimum standards.

Here are a few things that, we argue, are worthwhile to be considered:

3 According to Article XI:2(a) of the GATT 1994, 'export prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting Member'. The Panel in *China - Raw Materials* contrasted the language used in Article XI:2(a) with that used in Article XXI, and held that the determination of whether a product is 'essential' to that Member should not be decided by the Member on its own.

We need to keep WTO system as a system of trade rules rather than a boxing ring of political fighting

To prevent over-politicisation, we need to stick with WTO's basic principles such as non-discrimination. Within the WTO, the tradition of ownership-neutrality goes hand in hand with the principle of non-discrimination. The idea of ownership-neutrality can be best illustrated by Article 345 of the Treaty on the Functioning of the EU (TFEU), formerly Article 295 of the Treaty Establishing the European Community (TEC) and, before that, Article 222 of the Treaty Establishing the European Economic Community (EEC), which states that 'the Treaties shall in no way prejudice the rules in Member States governing the system of property ownership'. Mavroidis and Cottier (1998: 3) believe that this article proclaims its ideological neutrality with respect to property ownership. When national security exception is used to target states with different systems of property ownership or other different ideology, it will be difficult for the WTO, with 164 members, to sustain. However, WTO members have legitimate reasons to counter competitive advantage earned by enterprises, because of governmental ownership or control. Competition neutrality, the recognition that significant state-owned business activities, which are in competition with the private sector, should not have a competitive advantage simply by virtue of governmental ownership and control, should be followed just as ownership neutrality.

Legitimate security grounds may not be able to be defined, but they can be embedded in some other rules

National security can be defined in a broad way and a narrow way as well. National security with a broad definition can be linked with all kinds of concerns. Serious deterioration of the environment may damage national security of certain states. Climate change may influence national security of countries with low elevations more seriously than other countries. Food security is one facet of national security as well. The worry that foreign telecommunication equipment might pose a threat to national security can be addressed by setting technical standards and requirements. Such technical standards should be objective and based on scientific evidence and follow Technical Barriers to Trade (TBT) rules. If foreign producers are willing to disclose technical details and source codes to regulators of importing countries, the regulators should allow market access and help the producers to keep commercial secrets.

For all those concerns, the WTO should provide suitable tools or policy flexibility for members to address such concerns rather than solely rely on Article XXI of GATT 1994. If an exception is invoked to address concerns mentioned above, preconditions should be clearly defined.

National security should be defined in a narrow way if Article XXI is invoked. A WTO member may take 'any action which it considers necessary' to protect its 'essential security interests', however the circumstances that 'essential security interests' are related to are not totally 'self-judging'. The Panel in the case *Russia-Measures concerning Traffic in Transit (DS512)* holds that 'that the adjectival clause, which it considers in the chapeau

of Article XXI(b), does not extend to the determination of the circumstances in each subparagraph. Rather, for action to fall within the scope of Article XXI(b), it must objectively be found to meet the requirements in one of the enumerated subparagraphs of that provision.’

However, some uncertainty still persists as to whether the emergency condition of the national security exception covers the entire Article XXI or only part of it. Article XXI does not define critical concepts such as ‘essential security interests’ and ‘other emergency in international relations’, which causes ambiguity (Lindsay 2003). In the case *Russia-Measures concerning Traffic in Transit*, the respondent identified the situation that it had considered to be an emergency in international relations by reference to the following factors: ‘(a) the time-period in which it arose and continues to exist, (b) that the situation involves Ukraine, (c) that it affects the security of Russia’s border with Ukraine in various ways, (d) that it has resulted in other countries imposing sanctions against Russia, and (e) that the situation in question is publicly known. The Panel regards this as sufficient, in the particular circumstances of this dispute, to clearly identify the situation to which Russia is referring, and which it argues is an emergency in international relations’.⁴ As to ‘essential security interests’, the Panel in the case *Russia-Measures concerning Traffic in Transit* noted that a Member is not ‘free to elevate any concern to that of an “essential security interest”’. Rather, the discretion of a member to designate particular concerns as ‘essential security interests’ is limited by its obligation to interpret and apply Article XXI(b)(iii) of the GATT 1994 in good faith.⁵

Which measures are necessary to address security concerns?

The ‘good faith’ argument is not only applied to the interpretation of ‘essential security interest’ but also applied to the measures taken to protect the essential security interest. The Panel in the case *Russia-Measures concerning Traffic in Transit* considered that this obligation ‘is crystallised in demanding that the measures at issue meet a minimum requirement of plausibility in relation to the proffered essential security interests, i.e. that they are not implausible as measures protective of those interests’.⁶ It would need to review whether the measures ‘are so remote from, or unrelated to, the ... emergency that is implausible that Russia implemented the measures for the protection of its essential security interests arising out of the emergency’.⁷ China and the EU have at different times promoted the idea that the invocation of the security exception should be followed by compensation measures proportionate to the initial move. This could help avoid litigation and the political risks attached to constraining the states’ use of Article XXI.

There are many measures a state can take to protect essential security interests. To determine the necessity of trade intervention, possibility of other policy tools should be considered. In many cases, it is not necessary to resort to measures inconsistent with

4 WTO Panel Report, *Russia - Traffic in Transit*, para. 7.119.

5 WTO Panel Report, *Russia - Traffic in Transit*, para. 7.132.

6 WTO Panel Report, *Russia - Traffic in Transit*, para. 7.138.

7 WTO Panel Report, *Russia - Traffic in Transit*, para. 7.139.

other WTO rules. Bhagwati (1969) considered an economic model with many possible measures to address a non-economic objective, and he believes that the policy intervention that creates the distortion directly affecting the constrained variable is optimal, i.e. policy intervention should target the policy objective, which is known as the ‘targeting principle’. The ‘targeting principle’ is helpful but may not be strict enough to determine necessity. Even if the cost of other tools is higher than that of the trade intervention, as long as it is not unreasonably higher, it is still not necessary to use trade restrictions. Very rigorous calculation of welfare cost of policy tools may be difficult, as WTO Members may use national security concerns as an excuse to refuse to provide certain information. However, WTO panellists can still use available information to determine if a WTO Member has considered the necessity of trade intervention in good faith.

Who assesses the legitimate use of Article XXI?

Even more important than the definition of the conditions covered by Article XXI is the question about the evaluation of whether a state has met the requirements for invoking Article XXI or not. Recent cases such as DS512 have challenged the idea of self-defining security grounds, taking away this freedom from governments. While this move makes sense from a functional perspective, it could lead to states trying to avoid using this article altogether and pursuing the same interests through other means. Rather than putting national (security) interests under the rug, a more open process of the evaluation of states’ invocation of Article XXI may trigger more willingness to engage in it, and henceforth, an increased efficiency and legitimacy of WTO rules.

A second option lies in formulating better inter-institutional cooperation, i.e. on security matters, between the WTO and the UN, and/or regional security organisations such as the African Union or the EU. The United Nations (UN) is referred in Article XXI(c) and security exception is given when ‘taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security’. Perez (1998) finds that while there is a UN Supremacy Clause, there is no similar clause in the WTO, which ensures that in the case of a direct conflict, any state member of both the UN and WTO would be compelled to observe its UN obligations.

In conclusion, beyond simply fixing the use of the security exception, these options could have a larger effect on how trade is considered and assessed in conjunction with other political commitments and interests such as security that states pursue.

Opening up this process can take different forms. A first option would be to enrich WTO dispute settlement mechanism on security matters. For example, to enlarge and diversify the composition of WTO panels which are ruling on the cases where a state invokes Article XXI. If the parties in the dispute agree, a specific arbitration may be used, or a group of security experts may be organised to make a conclusion.

A second option lies in formulating better inter-institutional cooperation, i.e. on security matters, between the WTO and the UN, and/or regional security organisations such as the African Union or the EU. The UN is referred in Article XXI(c) and security exception

is given when ‘taking any action in pursuance of its obligations under the UN Charter for the maintenance of international peace and security’. Perez (1998) finds that while there is a UN Supremacy Clause, there is no similar clause in the WTO, which ensures that in the case of a direct conflict, any state member of both the UN and WTO would be compelled to observe its UN obligations.

In conclusion, beyond simply fixing the use of the security exception, these options could have a larger effect on how trade is considered and assessed in conjunction with other political commitments and interests such as security that states pursue.

REFERENCES

- Balzacq, T, and S Guzzini (2015), ‘Introduction: “What Kind of Theory – If Any – Is Securitization?’ *International Relations*, 29(1):97–102. doi: 10.1177/0047117814526606a.
- Bhagwati, J N (1969), ‘The generalized theory of distortions and welfare’, *Trade Balance of Payments & Growth Papers in International Economics in Honor of Charles P Kindleberger*, 12(3), 161–174.
- Buzan, B, O Wæver, and J de Wilde (1998), ‘Security: A New Framework for Analysis’, Lynne Rienner Pub.
- Cann, W A (2001), ‘Creating Standards and Accountability for the Use of the WTO Security Exception: Reducing the Role of Power-Based Relations and Establishing a New Balance Between Sovereignty and Multilateralism’, *Yale Journal of International Law* 26:7.
- Pieter De W (2011), ‘No Polity for Old Politics? A Framework for Analyzing the Politicization of European Integration’, *Journal of European Integration* 33(5): 559–75. doi: 10.1080/07036337.2010.546849.
- Hofmann, S C and U Staeger (2019), ‘Frame Contestation and Collective Securitisation: The Case of EU Energy Policy’, *West European Politics* 42(2):323–45. doi: 10.1080/01402382.2018.1510197.
- Huysmans, J (2000), ‘The European Union and the Securitization of Migration’, *Journal of Common Market Studies*, 38(5):751–77, doi: 10.1111/1468-5965.00263.
- Lindsay, P (2003) ‘The Ambiguity of Gatt Article XXI: Subtle Success or Rampant Failure?’, *Duke Law Journal* 52(6): 1277–1313.
- Mavroidis, P C and T Cottier (1998), *State Trading in the Twenty-First Century*, The University of Michigan Press.
- McInnes, C, and S Rushton (2013), ‘HIV/AIDS and Securitization Theory’. *European Journal of International Relations* 19(1):115–38. doi: 10.1177/1354066111425258.

Palonen, K, C Wiesner, V Selk, N Kauppi, H-J-Trenz, C Dupuy, V Van Ingelgom, and P Liste (2019), 'Rethinking Politicisation', *Contemporary Political Theory* 18(2):248–81. doi: 10.1057/s41296-019-00326-y.

Perez, A (1998), 'WTO and U.N. law: institutional comity in national security', *Yale Journal of International Law*, Vol(23):301-381.

Slobodian, Q (2020) *Globalists: The End of Empire and the Birth of Neoliberalism*, Harvard University Press.

ABOUT THE AUTHORS

CUI Fan is a Professor of International Trade, at the School of International Trade and Economics (SITE) of the University of International Business and Economics (UIBE) in Beijing. He is also the Director of Research at the China Society for WTO Studies. He has received a PhD in Economics and a LLM in International Commercial Law from the LSE.

Catherine Hoeffler is an Associate Professor in Political Science at Sciences Po Bordeaux/Centre Emile Durkheim, France, and is currently a Visiting Professor at the Graduate Institute, Geneva. Her research interests lie in the political economy of security, comparative public policy, and theories of European integration.

Stephanie C. Hofmann is Professor of International Relations and Political Science at the Graduate Institute of International Relations and Development Studies. Her research revolves around issues in international security, international organizations, the interlinkages between global and regional understandings of order, the nexus of regional economic and security cooperation as well as national foreign policy preference formation.

MANAGING INTERNATIONAL COMPETITIVENESS SPILLOVERS

CHAPTER 6

Is it Possible to Promote an Agricultural Agenda in the WTO?

115

LU Xiankun and Alan Matthews

LEDECO GENEVA and Friends of Multilateralism Group (FMG); Reserve Bank of Australia

Agricultural trade policy reform is increasingly an agenda spanning developing as well as high-income countries: developing nations accounted for almost 60% of global food trade in 2018 excluding intra-European Union (EU) trade. Improving multilateral rules for domestic support will reduce market and production distortion, enhance stability of the global market of agricultural products, and help mitigate their environmental impact. Radical steps are needed to break the logjam. A first step would be to revise the World Trade Organisation (WTO) methodology to calculate product-specific support, to ensure it only captures instances where programs transfer resources at above world market prices and does not penalise countries where transfers are negative – as is the case in India. Revising domestic support rules through the lens of climate change is also important given that agricultural activity accounts for a quarter of all human-caused greenhouse gas emissions.

1. REVIEW OF AGRICULTURAL LIBERALISATION UNDER THE MULTILATERAL TRADING SYSTEM

In the long history of the multilateral trading system, it was not until the Uruguay Round (1986-1994) that the issue of agriculture was brought under multilateral discipline for the first time. The Agreement on Agriculture (AoA) concluded at the end of that Round included disciplines on agricultural policies across three pillars, i.e. domestic support, market access, and export competition. The AoA helped to increase market access by lowering tariffs, defining, and limiting trade-distorting agricultural subsidies, and disciplining export programmes such as export subsidies and credits.

Given the political sensitivity of agriculture in many economies, efforts to push for agricultural reform within the multilateral trading system have always been balanced by governments' desire to pursue their legitimate agricultural policy goals, including non-trade concerns such as food security and the livelihood of rural populations. Therefore, the agricultural reforms remained a work in progress.

To continue the reform, the AoA specifically included a 'built-in agenda' in its Article 20, with members recognising that 'the long-term objective of substantial progressive reductions in support and protection resulting in fundamental reform is an ongoing

process' and committing to restart negotiations 'one year before the end of the implementation period'. In February 2000, WTO members decided to launch new negotiations on agriculture under the Committee of Agriculture in Special Sessions. When the Doha Round was launched in December 2001, the agriculture negotiations were integrated into the Round and members reaffirmed their commitment to 'a programme of fundamental reform' aiming at 'substantial improvements in market access; reductions of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support'.

The importance of making progress on further agricultural trade policy reform was underlined by world leaders when they adopted the UN Sustainable Development Goals (SDGs) in 2015. One element of SDG 2 to end hunger, achieve food security and improved nutrition, and promote sustainable agriculture is a commitment to 'correct and prevent trade restrictions and distortions in world agricultural markets, including through the parallel elimination of all forms of agricultural export subsidies and all export measures with equivalent effect, in accordance with the mandate of the Doha Development Round'.

However, as for the broader Doha agenda, agriculture negotiations have made little progress in achieving the above-mentioned objective. Agreements were reached on tariff rate quotas (TRQs) and Public Stock Holding (PSH) in 2013 at the Bali Ministerial conference and on export subsidies in 2015 at the Nairobi Ministerial Conference. However, the global market for agricultural products remains highly distorted.

Based on OECD statistics (2017-2019), transfers to producers in OECD countries averaged 17.6% of gross farm receipts, with 48% directly linked to prices, output or input use, hence considered to be highly market-distorting. For the emerging economies covered in the OECD database, aggregate support to producers averaged 8.5% of gross farm receipts, of which 83% fell into the market-distorting category. The agricultural sector also has a higher world average bound (applied) tariff of 62% (17%) as compared to 29% (9%) for industrial products, as well as a higher incidence of tariff peaks and non-tariff measures such as tariff quotas, import licensing, and abusive sanitary and phytosanitary measures.

2. A NEW CONTEXT FOR AGRICULTURAL TRADE AND POLICIES

Many reasons can be listed behind the difficulties to move the agriculture reform agenda forward in the WTO. A major reason has been the broader geopolitical context that has put the WTO into crisis and undermined its main functions of legislation and litigation as well as implementation. The emergence of China as the top-ranked trader of goods has called into question the traditional distinction between developed and developing countries and entitlement to special and differential treatment (S&D) which has also spilled over into the agricultural negotiations. More recently, Covid-19 has made negotiations more difficult as meetings have moved to a virtual format, while also prompting countries to apply trade measures, especially export prohibition or restriction measures, that would not be used in more normal times.

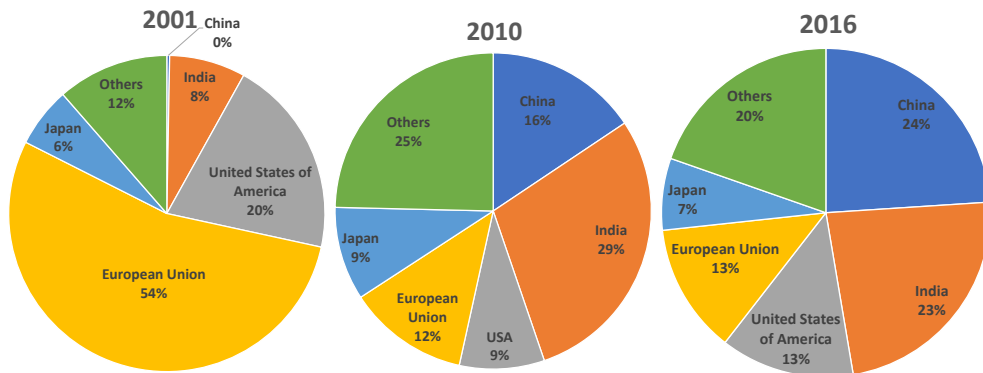
Global agricultural trade has also witnessed some new developments. Trade in agricultural products has grown significantly in size and in importance. Global agricultural exports have more than tripled in value and more than doubled in volume since the AoA came into force in 1995, exceeding \$1.8 trillion in 2018. Agricultural trade plays an important role in meeting the domestic food needs of many countries, with import shares, e.g. for wheat (25%), soyabean (43%), and even rice (increased from 4% to 9%). The UN Food and Agriculture Organization (FAO) projects that global food demand will increase by 50%, from 2012-2013 levels, by 2050, with expected continuation of upward trends in population, urbanisation and income, particularly in developing countries. International trade of agricultural products is highly relevant for the achievement of the UN SDGs, not only Goal 2 (zero hunger), but also Goal 12 (sustainable consumption and production), Goal 15 (life on land), as well as other goals such as Goal 6 (water), Goal 7 (energy), and Goal 13 (combat climate change).

As global trade of agricultural products has grown since 1995, developing countries are playing an increasingly important role. From 1995 to 2018, the share of total food imports and exports by developing countries grew from 26% to 40% and from 31% to 40%, respectively. If intra-EU trade is excluded, their imports and exports accounted for almost 60% of global food trade in 2018. South-South trade also increased, accounting for over 24% of total food trade in 2018 compared to 12% in 1995.

The landscape of agricultural support is also changing. Focusing first on trade-distorting support (TDS), as defined in the AoA Article 6 whether exempted from reduction commitments or not, the global total has increased only slightly between 2001 (when China joined the WTO) and 2016 (the latest year when all the major players have submitted notifications). It was \$106 billion in 2001, \$116 billion in 2010, and \$122 billion in 2016. This partly reflects the success of the disciplines on trade-distorting support introduced in the AoA. Whereas developed countries accounted for most domestic support in 2001, the share provided by developing countries has been increasing (Figure 1).

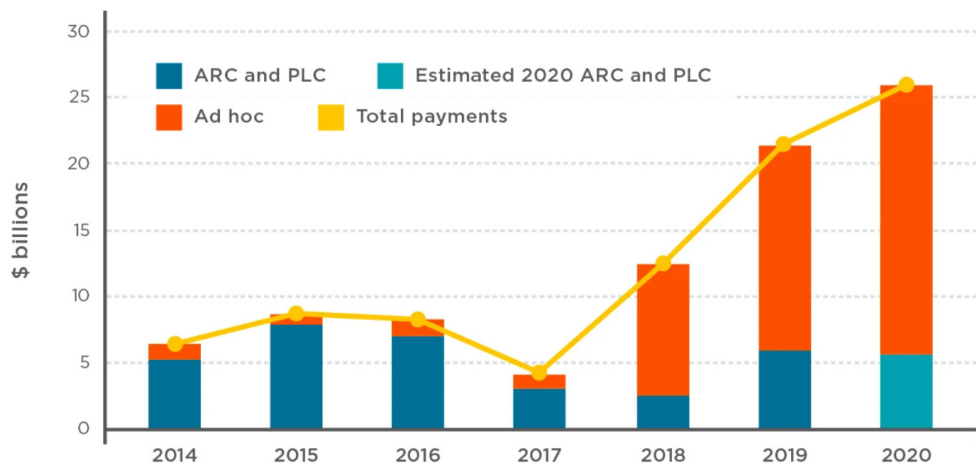
Around 80% of TDS is due to the five major members separately identified in the figure. Strikingly, in 2001, the EU accounted for half of all global TDS, one indicator of the malign impact that its Common Agriculture Policy (CAP) had on world markets at that time. CAP reform since then, through the decoupling of previously coupled payments, has significantly shrunk the EU contribution. There has been a rapid increase in the share of global TDS now provided by China and India, while the US share, having shrunk considerably in the first period, has grown again in the second period. The US share will have continued to grow in later years when agricultural subsidies ballooned under the Trump administration in compensation packages for their losses because of US trade conflicts with other countries and Covid-19.

FIGURE 1 COMPOSITION OF GLOBAL ARTICLE 6 TRADE-DISTORTING SUPPORT BY COUNTRY



Source: Own calculations based on the updated analytical tool made available by Canada, JOB/AG/190.

FIGURE 2 US FARM SUBSIDY PAYMENTS BETWEEN PROGRAM YEARS 2014 AND 2020



Source: Environmental Working Group (EWG) and the Congressional Budget Office's January 2020 Baseline for Farm programmes. ARC refers to the Agricultural Risk Coverage and PLC to the Price Loss Coverage programmes.

On the other hand, expenditure on Green Box measures (exempted from disciplines by virtue of Annex 2 of AoA) has grown considerably from \$142 billion in 2001, \$368 billion in 2010 to \$456 billion in 2016. Green Box measures include government services such as research, advice and training, pest and disease control, agri-environment payments to farmers as well as domestic food aid. Higher expenditure on these measures can support sustainable agricultural development and domestic food security and should be welcomed. Green Box measures also include various kinds of direct payments to farmers that meet specific criteria to ensure their trade-distorting effect is reduced to a minimum, but the sheer size of these payments in some countries has raised concerns that this may not be the case.

3. DIFFICULTIES FOR FURTHER AGRICULTURAL REFORM

In recent years, WTO agricultural negotiations have centred around seven priority issues: domestic support, public stockholding (PSH) for food security purposes, cotton, market access, the special safeguard mechanism (SSM), export competition, and export restrictions. While all these issues are important, making progress on domestic support is seen as the key issue by all countries, as it will reduce market and production distortions, enhance stability of global market of agricultural products, and help mitigate their environmental impact.

Domestic support

WTO disciplines on domestic support have been successful in limiting the growth in more market-distorting forms of support and most of the growth in domestic support has taken the form of expenditure on Green Box measures. Nonetheless, the rules on domestic support are perceived as unfair. Trade-distorting support is measured by an Aggregate Measurement of Support (AMS). While most countries are required to limit their use of trade-distorting support to exempted categories and have an AMS entitlement of zero, a few countries have a positive AMS entitlement because they provided high levels of trade-distorting support in the past. Over half of the 32 countries with positive AMS ceilings are developing countries, but the EU, Japan, US, Canada, Switzerland, and Norway among them make up 87% of the total positive AMS entitlement. Countries that have a positive AMS entitlement have the additional advantage that this positive AMS can be focused on one or a few products, thus permitting effective product-specific support well above the 10%, 8.5%, or 5% limits for countries with a zero AMS entitlement.

Trade-distorting support is primarily support linked to either production, inputs, or prices. Market price support is provided when a government purchases products at a guaranteed minimum support price. Another bone of contention is that the formula used to calculate market price support can have anomalous outcomes that do not make economic sense. The formula used multiplies the quantity of product eligible for support by a price gap. The price gap, in turn, is the difference between the value of the administered support price and a fixed external reference price based on the world price in the base period 1986-1988, as set out in Annex 3 of the Agreement.

Because of the sharp rise in nominal prices since the AoA entered into force, this formula can show the existence of apparent market price support, if the administered support price is greater than the external reference price (which must be counted towards the product's AMS), even where the administered support price is below the current world price (where, in an economic sense, no support is provided to producers). Several countries classed as developing, including China, India, and Turkey, have exceeded their domestic support commitments in recent years.

Public stockholding for food security purposes (PSH)

The AoA specifies that expenditure on building food security stocks at market prices and, for developing countries, disposing of food at subsidised prices to low-income households, is a Green Box measure and is not limited in any way. However, it also specifies that, where stocks of foodstuffs for food security purposes are acquired and released at administered prices, the difference between the acquisition price and the external reference price should be accounted for in the AMS.

India, which operates a significant food reserve programme of this kind, has long argued that the purchase of food stocks at minimum prices for food security purposes should be exempt from AMS disciplines. It has been supported in this position by the G33 group of developing countries. For India and other proponents, the fear is that, if they must account for the gap between these administered prices and their fixed external reference prices, they would likely exceed the product-specific *de minimis* limit of 10% of the value of production in some key products. This is made virtually certain by the general uplift in food prices since the 1986-88 base period used to set the fixed external reference price. For non-proponents, the risk is that stocks built up based on minimum prices might subsequently be exported at less than the acquisition price, leading to the disruption of commercial markets and to the detriment of their interests.

At the Ministerial Conference in Bali in 2013, WTO members agreed to an interim ‘peace clause’ that exempted any support provided through existing PSH programmes for traditional food staples from challenge, provided that the country met certain transparency provisions and committed to ensuring that stocks procured under the PSH programme do not adversely affect trade or the food security of other members. The conference also agreed to work towards a permanent solution that would be open to all developing countries by the Ministerial Conference in Buenos Aires in 2017, and that the interim solution would remain in place until a permanent solution was found. As noted, no solution was agreed at the Ministerial Conference in Buenos Aires so the interim arrangement remains in place. India invoked the Bali Decision for the first time in its domestic support notification for the marketing year 2018-2019 submitted in March 2020.

Cotton

Cotton has had a special status in the negotiations, since the July Package adopted by the WTO General Council in 2004 recognised that cotton ‘will be addressed ambitiously, expeditiously, and specifically, within the agriculture negotiations’. This was in response to a cotton initiative reflecting the importance of cotton in the export earnings of a handful of least-developed countries in West Africa, that are the main proponents of this initiative. Under the 2015 Nairobi Ministerial Decision on Cotton, exports of cotton and cotton-related products from least developed countries should have duty-free and quota-free access in developed country markets and in developing countries in a position

to provide this. Cotton-specific trade-distorting support, notably provided first by the US and then by China, is thus the central element of the negotiations on cotton. Although disciplines on cotton-specific support could be addressed separately to domestic support in general, it seems there has been very limited engagement on this issue in the agricultural negotiations to date.

Market access

Reductions in high tariffs, particularly on 'sensitive' products such as beef, dairy, and rice, remain an objective of agricultural exporting countries, including the developing ones. However, there is no expectation of any immediate progress on further tariff liberalisation. The majority of WTO members have defensive positions in this pillar. Instead, the focus has been on enhancing transparency and facilitating agricultural trade without altering the core tariff commitments in members' schedules. The elements under discussion include applied tariffs transparency and treatment of shipments en route, tariff simplification, and transparency of tariff rate quota (TRQ) administration. Other issues that have been raised include tariff escalation, tariff peaks, access for tropical products, and the status of the Special Safeguard. The existence of considerable binding overhang (i.e. a large difference between countries' bound tariffs and the tariffs they actually apply) suggests some scope to lock-in tariff reforms that countries have already undertaken, but such overhang is not distributed evenly across all WTO members. There has, as of yet, not been much discussion on a possible way forward for tariff reduction in recent years.

Special Safeguard Mechanism.

WTO members have agreed that developing countries should have access to a Special Safeguard Mechanism (SSM) to counter the negative impacts of import surges and price falls. Disagreement over the technical parameters (trigger, remedies, duration, etc.) was one of the principal reasons why negotiations on the Revised Modalities proposed by then Chair of the agricultural negotiations Crawford Falconer broke down in 2008. A Ministerial Council Decision at the Ministerial Conference in Nairobi in 2015 authorised the continuation of negotiations on this topic but there has been no real progress since then.

Disagreement over the purpose of the SSM is one major block to progress. Developing country proponents see it as linked to their broader food security objectives, designed to protect their poor and vulnerable farmers from import surges and sudden price declines. For non-proponents, the SSM is linked to progress on market access reforms. This group rejects any notion that the SSM could result in tariffs being raised above the levels bound in previous negotiations. In recent discussions, proponents have argued that the challenges the SSM seeks to address arise largely because of trade distortions and heavy agricultural subsidisation. Non-proponents have indicated their willingness to enter technical discussions on the design of an SSM that would not penalise exports of countries that do not engage in agricultural subsidisation.

Export competition

The Nairobi Ministerial Conference Decision on Export Competition, which mandated the elimination of export subsidies, has been one of the few WTO successes in the agricultural negotiations since the end of the Uruguay Round. Some countries still see unfinished business under this pillar, including disciplines on export finance, on international food aid, and the need to minimise the trade distorting effects of the export monopoly power of state trading enterprises. However, these issues are not subject to active negotiations at the moment.

Export restrictions

Several countries have imposed restrictions on food exports because of the Covid-19 pandemic (although, liberalising measures on trade in food outnumber restrictive measures). This has raised the relevance of this issue in the negotiations. Singapore introduced a proposal that would exempt from export restrictions food purchases for humanitarian purposes by the World Food Programme (WFP). It was hoped that this might be adopted by the WTO General Council at its meeting in December 2020. This did not happen, due to objections by India and several other countries, that were concerned that such purchases could adversely affect the food security of the supplying country, even though the proposal was explicitly amended to take this objection into account. Subsequently, 53 WTO members signed a unilateral declaration committing not to impose export prohibitions or restrictions on foodstuffs purchased for non-commercial humanitarian purposes by the WFP. The failure to agree on this ‘trust-building’ measure is just one indication of the difficulties in making progress on the agricultural agenda.

4. POTENTIAL WAY FORWARD

Recent new developments in the WTO and broader global context give some hope, albeit slim, that the organisation may be able to move ahead incrementally. These include a renewed commitment to multilateralism by the US Biden administration, new concessions from China in preferential agreements on some thorny issues such as market access for both manufacturing and services, industrial subsidies and state-owned enterprises, leadership from the new Director-General Dr. Ngozi Okonjo-Iweala, and enhanced engagement of members in the run up to the Ministerial Conference, now scheduled for November 2021. Given the divergences on key issues around agriculture reform, as well as the political and economic sensitivity of agriculture, a sense of pragmatism and openness is required of WTO members to incrementally push forward the reform agenda of agriculture.

Initiatives are required in both the short and longer term. In the short term, progress should be made on export-restrictive Covid-19 measures in the agriculture sector that can negatively impact on the food security of other members. Actions could include enhanced transparency and a review and roll-back mechanism on such measures under a Working

Group of the Committee of Agriculture. Members should also work to issue a ministerial declaration to commit to an immediate abolition of export restrictions on humanitarian food aid by WFP to help combat Covid-19 based on the Singapore-led initiative.

Transparency must be enhanced for WTO members by improving the notifications on domestic support programmes and market access. Agreement is unlikely on certain elements of the proposal by the EU, the US and some other members (JOB/GC/204) in 2018, such as on punitive measures. However, members could endeavour to reach agreement on elements such as capacity building for developing countries, requiring an appropriate explanation for failure to notify, and reviewing notification compliance under trade policy reviews.

More ambitiously, members could explore the possibility to cut the ‘water’ between bound and applied levels for both market access and domestic support. A less dramatic move would be a stand-still commitment on domestic support among major players such as the US, the EU, Japan, China, and India.

As noted, making progress on domestic support disciplines is a priority for all members. Indeed, members have put forward a wide range of proposals detailing how this might be done. Some proposals focus on reducing existing limits (on AMS support, on Blue Box support, on *de minimis*), while others focus on introducing a new limit on Overall Trade Distorting Support (OTDS). But a breakthrough on this issue will probably require some revision of the methodology set out in the AoA to measure AMS support in the first place. This would also aid progress on the running sore, i.e. the failure to reach agreement on the treatment of purchases at administered prices for the purposes of public stockholding for food security purposes. Such a fundamental discussion, that would require reopening the rules agreed in the AoA, would be a radical step, and is not yet on the Geneva agenda. But the absence of momentum in the negotiations until now suggests that radical steps are needed to break the logjam.

The issue is that the measurement of market price support for the purposes of the AoA no longer reflects whether a member is providing economic support to its farmers or not. This gives rise to a deep sense of unfairness particularly for countries with a zero AMS entitlement, where support must be limited to their *de minimis* entitlement. We highlighted earlier that India has submitted a domestic support notification for the marketing year 2018-2019, in which it noted that its product-specific support for rice exceeded its *de minimis* level. This was the result of its minimum support price when purchasing for its public food reserve stocks being well above the fixed external reference price used to calculate the rice product-specific AMS.

Yet, the OECD Producer Support Estimate (PSE) database, which measures economic support to different products, reports that the transfer to rice producers in India was -9.83% in 2018 and -17.38% in 2019. In other words, India’s minimum support price was far below world market prices in those years and subsequently, there was no economic support to rice producers. Indeed, there has been a negative transfer to rice producers in

India in nearly all years since 2000 when the OECD started its measurements. In fact, India's total PSE for all crops has been negative in every year that the OECD has measured since 2001. It is no wonder that India feels aggrieved when other countries challenge it for providing unreasonable amounts of trade-distorting support to its producers.

Better aligning the measurement of market price support for AoA purposes with conventional measures of economic support while accounting for the need for legal certainty could help to facilitate an agreement on public stockholding that would meet the concerns of both proponents and non-proponents. An agreement on PSH, in turn, might open the door to a wider-ranging agreement on domestic support. The EU has already indicated that it is open to a significant reduction in its entitlement to trade-distorting support. Concessions would be required by both the US and China.

A roadmap on how to deal with domestic support related to climate change could also be valuable. This issue has become particularly important, given that agricultural production and land use change account for about a quarter of all human-caused greenhouse gas emissions. Some meaningful approaches could be developed to improve coherence between agriculture trade policy and the Paris Agreement on climate change, such as a rethinking of the Green Box to enhance the connection between Green Box payments and environmental sustainability through, e.g. a clearly defined government environmental programme.

Ultimately, WTO members should try to agree on a work programme to reconfirm their commitment for comprehensive reform on agriculture, to list general guidelines on the structure and objective of such reform, and to put down concrete timelines and a roadmap to achieve such reform objectives. The old Doha approach of a single undertaking has fallen out of favour, with many countries arguing that they can make faster progress through plurilateral agreements with other like-minded members. But this approach cannot work for some of the more complicated issues in the agricultural negotiations, particularly the reform of domestic support disciplines. Furthermore, it is hard to envisage a reform agenda of agriculture in isolation, given its political sensitivity and economic importance for many WTO members. Getting agreement on agricultural issues may require trade-off with other issues, such as on sectoral initiatives on market access of non-agricultural products or liberalisation initiatives on services, in multilateral or plurilateral formats.

5. CONCLUSION

Both China and the EU are leading players for WTO reform and their active participation is indispensable for its success. Other than interacting multilaterally within the organisation, they established a bilateral working group on WTO reform at vice-minister level in July 2018, through which they have collaborated successfully on certain issues on which they have common ground. For example, they developed joint proposals on the Appellate Body and dispute settlement, which were co-sponsored by some other

members. They also led the establishment of the Multiparty Interim Appeal-Arbitration Arrangement (MPIA) which is meant to replace the paralysed Appellate Body of the WTO Dispute Settlement System on an interim basis. However, they have yet to tackle the difficult issues such as industrial subsidies and agriculture.

On agriculture, both the EU and China face serious challenges for domestic reform, in particular on domestic support and market access. However, a successful reform effort on agriculture would help open doors for other issues under WTO reform, hence strengthening the multilateral trading system to which both the EU and China attach great importance.

ABOUT THE AUTHORS

LU Xiankun is a former senior trade diplomat for the Chinese government. He is now Managing Director of LEDECO Geneva, and CEO of the Friends of Multilateralism Group (FMG), a Geneva-based thinktank on WTO reform. LU is also associated to some Chinese and European universities and think tanks, and publishes regularly on trade and economics.

Alan Matthews is Professor Emeritus of European Agricultural Policy at the University of Dublin, Trinity College, Ireland. He is a former President of the European Association of Agricultural Economists.

CHAPTER 7

About Knowledge and Rulemaking: Reforming WTO Rules on Subsidies

127

LI Siqi and Luca Rubini¹

UIBE; University of Birmingham

Thirty years after they were negotiated, the legal standards determining what types of subsidies are prohibited or actionable leave much to be desired. There has been virtually no advance in knowledge of subsidy measures, their policy goals, and their effects, detracting from the proper application of extant disciplines and inhibiting informed discussion on law reform. Any law reform exercise should be preceded by a serious and transparent, open, and expert-based knowledge-gathering effort. Stakeholders should devote the effort needed in improving our knowledge on subsidy policies and their effects to create the necessary learning base to prepare negotiations before diplomacy and politics kick in.

1. BACKGROUND

Subsidies are critical instruments that national governments widely apply to achieve a variety of policy goals. At the same time, subsidies may cause across-the-border spillovers, thus justifying some form of international control. Since, however, the attitude towards subsidisation has been very different (and at times contradictory) across nations and time, the regulation of subsidies has always represented a particularly difficult topic.

World Trade Organization (WTO) subsidy disciplines still represent the most comprehensive package of rules at the multilateral level. The Agreement on Subsidies and Countervailing Measures (SCM Agreement) includes the general disciplines regulating the obligations of members when granting subsidies and when imposing countervailing measures. Subsidies in the agricultural sector are specifically (but not exclusively) regulated in the Agreement on Agriculture (AoA), which operates differently by permitting domestic support that stays within a certain overall ceiling, or that does not distort international trade (developing economies are also permitted to grant certain export subsidies). Subsidisation in the services sector is hardly, and indirectly, disciplined in the General Agreement on Trade in Services (GATS) which mostly calls for negotiations.

¹ This paper is a joint effort and all sections have been written jointly by Siqi Li and Luca Rubini.

After 30 years since they were negotiated, WTO subsidy disciplines largely appear to be ineffective and incomplete.² The application of the rules has exposed several deficiencies, almost at every level. While the jurisprudence has ironed out some definitional questions, many – and new ones – remain open. Some interpretations of the Appellate Body have been controversial and, lacking action on the legislative side, remain for now the official reading of the rules. The legal standards of those subsidies that are prohibited or actionable are still unclear or too demanding, or both. The remedies, only applying prospectively, are weak. The governance side has left much to be desired. Transparency is rarely achieved, with the result that the work of the Committee on Subsidies has been suboptimal to say the least. Most importantly, the lack of transparency has been accompanied by virtually no advance in the knowledge of subsidy measures, their policy goals, and their effects, which is all crucial for the proper application of the disciplines and any discussion on law reform.

At the same time, the world has been changing. New challenges have emerged, such as the heightening of the climate change crisis, the occurrence of global financial and economic crises and health emergencies (the Covid-19 pandemic). Ironically, subsidies play a large role in the response to these challenges, but WTO disciplines do not refer to them at all. The political economy of subsidies has also been changing significantly in both developed and developing countries, especially in the context of a global value-chain world (Hoekman 2016a). Finally, with the emergence and coexistence of different varieties of capitalism, WTO subsidy disciplines are being tested to their limits, in the effort to accommodate economic and governance systems which are arguably very different from the one that officials, diplomats, negotiators, and members had in mind when they created the rules in the late 1980s/early 1990s.

In the light of the above, it is no surprise that the current discussions on WTO reform have focused significantly on industrial subsidies. Discussions in academic and policy circles on this topic have always been particularly lively.³ Within their dialogue on competition policy, set up in 2001, the EU and China earmarked state aid control as a key common interest of discussion in 2017.⁴ This initiative is intended to create a mechanism of consultation, cooperation, and transparency between the two parties in the field of state aid control. Leaving this initiative aside for now, the most recent proposals to change the WTO rulebook have been tabled *outside the WTO*. With the multilateral trade institution in crisis, a good deal of the action has taken place outside the WTO.⁵ Thus, the US, the EU, and Japan started discussions in late 2017 to address the increase in what they called ‘market-distortions’, and in particular those caused by industrial subsidies. After various

2 For a brief overview see, e.g. Rubini (2019). More comprehensive analysis of the deficiencies of the current system are: Crivelli and Rubini (2020), Hoekman and Nelson (2020a).

3 As latest example, see Hufbauer (2021).

4 See ‘State aid: Commission and China start dialogue on state aid control’, Press-release, Brussels, 2nd June 2017. More generally on the EU – China cooperation on competition policy see <https://ec.europa.eu/competition/international/bilateral/china.html>.

5 Think of the dramatic increase in Preferential Trade Agreements (PTAs).

rounds, in January 2020 they came out with a proposed text which mostly represents a tightening of the current WTO rules (largely in line with proposals tabled during the Doha Round and provisions included in a variety of more recent Preferential Trade Agreements (PTAs)). The EU and Canada also raised concerns on industrial subsidies in their respective position papers on WTO reform. As did the countries participating in the ‘Ottawa initiative’, spearheaded by Canada. While some of these economies could negotiate WTO + subsidy commitments in their PTAs, the ‘free rider’ problem means that it is multilateral efforts that count the most.

Against the above backdrop, this chapter attempts to frame the discussion on the reform of WTO subsidy rules. Section 2 starts by outlining the key general questions in the field. After providing a brief summary of the proposals presented in the Doha Round in Section 3, the chapter critically takes stock of the current WTO reform discussions in Section 4. Section 5 points out the way forward, highlighting the importance of preparing any future negotiation with a specific work programme aimed at generating knowledge on subsidy policies, their goals and effects, and then outlining possible approaches to facilitate negotiations in the WTO. Section 6 closes with a few final comments.

2. QUESTIONS: NEW AND PERENNIAL

There are a few general issues that surround WTO subsidy rules, some perennial, some new. We believe that no law reform effort will be successful if it does not manage to tackle most, if not all, of these issues satisfactorily.

Putting aside for the moment the political differences between WTO members, what is startling in subsidies is that, in the end, there are more things that we do not know, than those that we do; more questions than answers. One of the themes of this chapter is therefore that any rulemaking exercise in the area should be preceded, and accompanied, by a serious knowledge-gathering exercise. Generating knowledge on subsidies, their objectives, and effects is the key precondition of any discussion on subsidy rules.

Information-related gaps and challenges include the following.

1) Transparency

Whereas the SCM Agreement sufficiently specifies the notification obligations of WTO members, the notification record is poor (Wolfe and Collins-Williams 2010). The reasons might be multiple, ranging from the lack of administrative capacity to collect subsidy information, the lack of common understanding of what constitutes a subsidy, to the worries of being targeted because of the reported subsidies. Hence, multiple actions are needed to improve transparency.

In practice, governments may provide subsidies in various forms, e.g. fiscal transfers, loans and guarantees, tax breaks, purchase of goods and services, etc. Some forms of subsidies and their magnitude are easily identifiable while others are not. Importantly however, the

consequence of the lack of transparency is a lack of comprehensive information to assess the incidence and magnitude of subsidies applied by WTO members. Improvement of transparency is therefore a ‘must have objective’ of any attempt to reform WTO subsidy rules.

2) Lack of systemic analysis

Second, there is a lack of systemic analysis of the impacts of subsidies, in general and more specifically in global value-chain networks. Assessing the economic effects of subsidies is complex, given that subsidies may be applied for various policy objectives which may affect different aspects of economic activities, and the spillover effects of subsidies may be magnified through today’s frequent cross-the-border commercial activities. Since the current WTO disciplines only regulate subsidies in the goods sector, the impacts of subsidies on investment and services are neglected by WTO rulemaking, which are two important aspects of global value-chains (Hoekman 2016b).

The sustained generation of knowledge about subsidies and their effects is another important objective that should be given priority in any serious law reform agenda, both in the short-term and in the long-term. Important questions need answers in this respect (Hoekman and Nelson 2020b). What role does knowledge and epistemic communities play in the understanding and improvement of subsidy laws? How should we assess subsidy measures? What role should experts, auxiliary bodies, and the WTO Secretariat play in this new system? What role can other organisations holding subsidy information play? How can assessment be institutionalised and made to function in the context of a newly reformed governance of subsidies?

3) Defining subsidies

Third, there is the perennial issue of the definition of subsidy (Rubini 2010). In economic terms, any policy may amount to a subsidy (or a tax). In operational terms, no legal system can adopt such a broad approach. A legal definition is necessary which distinguishes what is legally relevant from what is not. This definition should be informed by economic analysis, legal systemic considerations (i.e. there may be other rules in the system that better deal with certain type of measures), and political reality (i.e. compromises and creative ambiguity may be necessary). Apart from a few important wrinkles, the WTO jurisprudence has generally advanced our understanding of the definition of subsidy. It is, however, now for negotiators to go back to the negotiating table and review the definition in the light of more than 25 years of practice, litigation, and analysis. Without wanting to be exhaustive, important issues to clarify are the definition of ‘public body’, the status of export restraints, of ‘foreign’ and ‘transnational’ subsidies, the relevance of public support along global-value-chains, the scope of the benefit analysis (and in particular the role non-market considerations/public policy objectives should play within it). We feel it

necessary to underline that, though difficult and politically sensitive, the definition is just a definition. It is about determining whether a measure is covered, not about whether it is good or bad, permitted or prohibited.

4) Distinguishing good and bad subsidies

Fourth, the viability of WTO subsidy rules depends on whether those rules do an adequate job in distinguishing good subsidies from the bad ones, i.e. what types of subsidies are most harmful and therefore, should be subject to multilateral rules in priority, and what types of subsidies can be presumed as legitimate and thus should be exempted (Rubini 2015). The challenges in drafting such balanced rules are to identify the necessary legal restrictions on subsidies while providing proper exceptions and constraining possible abuses, which requires both theoretical analysis and regulatory techniques.⁶

5) Going beyond goods

Fifth, it may be high time to reflect on the importance of subsidisation in the service sector, and on the difficulty involved in clearly distinguishing goods and services in many cases. This means that any serious subsidy law reform attempt should consider both goods and services. This would be in line with several PTAs of the latest generation that do not distinguish between the two.⁷

6) Remedies

Sixth, it may be necessary to revisit the mantra that there is no retroactivity in remedies in the WTO (Mavroidis 2010). We recall that this outcome departs from general public international law (Shaw 2008). We are fully aware that this may not be welcome among members that have already expressed their opposition to the notion that the ‘withdrawal’ of an illegal subsidy may imply something more than merely suspending its grant for the future.⁸ We, however, believe that any law reform discussion should consider that, at least in some circumstances, the remedy of ‘withdrawal’ should encompass retrospectiveness, if we want to avoid scenarios where justice would in essence be denied.⁹

7) Development

Seventh, the development issue is inherently connected to subsidies, inasmuch as subsidies may be the perfect tool to address market failures and pursue equity goals connected to the process of development. For this reason, the instrumentality of public support in the development process should be fully considered in the law reform discussion. This does not

6 The techniques available are various, ranging from strict prohibitions to presumptions, conditional permissions, use of negotiated ceilings and thresholds, individual scheduling.

7 The EU and China shared this position in their recent agreement in principle for a Comprehensive Agreement on Investment (‘CAI’), Section III (Regulatory Framework), Article B.1.

8 WTO Dispute Settlement Body, Minutes of the meeting held on 11th February 2020, WT/DSB/M/75 (7th March 2000).

9 The best example is that of non-recurring subsidies paid before litigation.

necessarily mean negotiating more policy space but rather ensuring that the entitlement to adopt potentially distorting subsidies is closely grounded on their capability to achieve the proposed development objectives.

8) Link with state enterprises

Eighth, in recent decades, state enterprises (and in particular state-owned enterprises (SOEs)) have increasingly participated in international trade and competition, becoming a point of discussion due to their structural characteristics. Because of their links with governments, the governance of state enterprises and their financial relations with the government may not be fully transparent. In other words, the issue of state enterprises is largely a subsidy issue – from the double perspective of subsidies granted *to* state enterprises *and* of subsidies granted *by* state enterprises – and, as noted, the most important concern is one of transparency.

A comparative note may be useful here. The EU internal system of state aid control is the most advanced system of subsidy control in the world. It is therefore significant that one of the very first legislative actions taken by the European Commission in the field was the so-called ‘Transparency directive’.¹⁰ This directive, which was amended at various times, introduced a variety of obligations of transparency (ensuring, for example, transparency in the origin and use of public funds, and accurate and separate accounting of costs/revenues for undertakings with different activities).¹¹ To be clear, this move was not intended to discriminate against public undertakings, at the time very prominent and pervasive in many EU Member States, but simply to address a failure of information and truly ensure that all competition rules, including state aid ones, could equally apply to all operators in the market (be they private or public). Transparency is thus a precondition of a level playing field between all operators in the market.

As we outline below, while the aim should not be about creating a ‘special regime’ for state enterprises,¹² it is better to consider as a common objective the introduction of tools ensuring that the ‘general rules’, in principle applicable to all undertakings, can apply to all without hindrance.

10 Commission Directive 80/723/EEC on the transparency of financial relations between Member States and public undertakings as well as on the financial transparency within certain undertakings, OJ L195, 29.7.1980.

11 The latter scenario refers to those cases where the undertaking is entrusted with the performance of a public service and, at the same time, operate in a different market, fully open to competition. Accurate accounting requirements are needed to avoid anti-competitive cross-subsidisation of different activities.

12 The ‘special rules’ narrative may easily turn into or perceived as a discrimination against state enterprises and state intervention in the economy, which should not be the case.

Given the close links between the issues of subsidies and state enterprises, it would be good to negotiate both areas together, and aim for a balanced regulation that combines the need to restrict market distortion with the pursuit of commonly agreed legitimate public policy objectives. In this respect, significant inspiration can be drawn from the latest generation of PTAs concluded by the EU.¹³

9) Role of dispute settlement

The final two questions relate to the enforcement and administration of subsidy rules. The first concerns the difficult relationship between rules that are ambiguous and controversial like subsidy rules *and* dispute settlement. This is not the place for an assessment of the WTO jurisprudence on subsidies (Rubini 2017). Have we had cases of judicial activism? It is not easy to say. What has certainly often been difficult for adjudicating bodies is to make sense of rules where many ambiguities were created by the negotiators and members themselves. Disputes will always arise, and dispute settlement will be needed. Our suggestion towards ameliorating the concern of judicial overreaching is that law reform efforts put a special emphasis on producing clear rules and this would go a long way towards solving this issue.

10) Role of Secretariat

Finally, we believe that subsidy negotiations, and more generally any negotiation aimed at revamping the WTO, should really consider how to better use the utter expertise, professionalism, and independence of WTO officials. With specific respect to subsidies, ways should be considered to empower the Secretariat in certain key functions, for example in transparency and assessment exercises. This may really be a low-hanging fruit to harvest, and one that can deliver more than one could think. Arguably, from a legal perspective, this could be done without any change in the SCM Agreement but by simply making full use of the possibilities offered by Articles 24 and 25. The obstacle is political. What must be overcome is another of the unwritten WTO mantras whereby the WTO would be a ‘member-driven’ organisation.

3. THE DOHA ROUND NEGOTIATIONS: FAILURE

The Doha Round of negotiations has largely left all the questions above unanswered.¹⁴ In particular, the Doha Development Agenda aimed for a modest clarification and improvement of the SCM Agreement, around which a range of subsidy-related proposals were submitted by WTO members. However, no concrete results have been achieved due to a distinct discrepancy of positions among the WTO membership. The US and India have sharply divergent views which conflict with each other. The former is quite pro-discipline,

¹³ See, e.g. EU - Singapore and EU - Vietnam. The most recent EU-UK is too quixotic to represent a useful model of inspiration.

¹⁴ A detailed exposition of the various proposals is Li and Tu (2020).

proposing to tighten up subsidy rules and make trade remedies more effective; while the latter is very anti-discipline, strongly arguing for domestic policy space in the name of developing members. Other developed members, i.e. the EU, Australia, and Canada, have taken a more balanced position, although they are more inclined to strengthen the subsidy rules. Certain developing members, e.g. Brazil, have taken a mixed stance with both pro- and anti-discipline proposals, while Egypt and Venezuela have adopted a more defensive approach to maintain or even weaken subsidy rules. What is certain is that it is very difficult for the pro-discipline supporters to convince the rest of the membership and achieve concrete multilateral outcomes.

4. CURRENT WTO REFORM DISCUSSIONS: A CRITICAL OVERVIEW

As noted, for now, the most recent proposals for reform on industrial subsidies rules come from initiatives and discussions outside the WTO. The trilateral work of the US, the EU, and Japan, in particular, is evidence of a new political economy momentum to draft more stringent rules on industrial subsidies. The trilateral group claim they aim to set the schedule for industrial subsidy discussions and finalise trilateral text-based work, in order to then engage other key WTO members as appropriate. We largely focus on the trilateral initiative, not necessarily for its legitimacy (it is clear that any discussion about law reform should be more representative, at least involving a ‘critical mass’ of participants, based on the interest in the issues discussed and on the degree of participation in world trade), but because it is the only one so far that has specifically focused on the reform of subsidy rules. When appropriate, we also make reference to the recent EU – China CAI initiative which, though focusing on investment, may both show a common understanding between the EU and China and constitute a sort of bridge between different positions.

Compared with wide-ranging issues covered in previously tabled proposals during the Doha Round, current concerns are mainly in five aspects, i.e. transparency, public bodies and SOEs, harmful subsidies, non-actionable subsidies and Special and Differential Treatment (SDT) for developing members.

4.1 Transparency

In light of continued notification failures by WTO members, the US, the EU, and Japan raised the transparency issue in their trilateral initiative, calling in particular for the introduction of specific disincentives in order to improve transparency (i.e. defining any non-notified subsidy that was counter-notified as prohibited unless the subsidising member provides the required information).¹⁵ Together with other co-sponsors, they also submitted two proposals to the WTO. In these two proposals, they put forward suggestions ranging from administrative penalties for notification failures, to the encouragement for

15 Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States, and the European Union. Washington, D.C., 14 January 2020.

‘counter notifications’ and the establishment of a Working Group to enhance notification compliance.¹⁶ The EU tabled proposals such as creating a ‘general rebuttable presumption’ according to which non-notified subsidies would be presumed as actionable, unless the subsidising member demonstrates the lack of adverse effects.¹⁷ Canada highlighted the importance of transparency, while requiring a comprehensive review of the notification obligations to ensure they are not unnecessarily complex and burdensome.¹⁸

Developing members also tabled their proposals. China expressed views in five areas. First, developed Members should lead by example in submitting comprehensive, timely, and accurate notifications. Second, Members should improve the quality of their counter-notifications. Third, members should increase exchange of their experiences on notifications. Fourth, the WTO Secretariat needs to update the Technical Cooperation Handbook on Notifications as soon as possible and intensify training in this regard. Fifth, developing members should endeavour to improve their compliance of notification obligations, with technical assistance and capacity building requirements.¹⁹ The African Group, Cuba, and India stressed the capacity constraints of developing members, thus strongly opposing to any transparency obligations that go beyond existing ones.²⁰

4.2 Public bodies and State-Owned Enterprises (SOEs)

a. The definition of ‘public bodies’ and its relationship with SOEs.

The lack of a clear definition of a ‘public body’ in Article 1 of the SCM Agreement has represented a problem from early on. Closely linked to this concern is the still open question of whether, and to what extent, the notion of a public body can encompass SOEs.

The issue has arisen in various WTO disputes and centres on the legal standard necessary to prove whether an entity is a public body and, consequently, whether its actions may amount to a financial contribution and a subsidy. While initially, the meaning that prevailed was that of ‘control’ (i.e. a public body would be any entity subject to governmental control) and this control could be proved in various ways, mostly (but not exclusively) through public ownership, in the *US – AD/CVD* (DS379) case, the Appellate Body departed from this view (which had been followed by the Panel) and essentially replaced the legal criterion of ‘control’ with one of ‘government authority’. The Appellate

16 Procedures to Enhance Transparency and Strengthen Notification Requirements under WTO Agreements: Communication from Argentina, Costa Rica, the European Union, Japan and the United States, JOB/GC/204 (JOB/CTG/14), 1 November 2018; Procedures to Enhance Transparency and Strengthen Notification Requirements under WTO Agreements: Communication from Argentina, Australia, Canada, Costa Rica, the European Union, Japan, New Zealand, the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu, and the United States, JOB/GC/204/Rev.1 (JOB/CTG/14/Rev.1), 1 April 2019.

17 Negotiating Group on Rules, Improving Disciplines on Subsidies Notification: Communication from the European Union, TN/RL/GEN/188, 30 May 2017.

18 Canada: Strengthening and Modernizing the WTO: Discussion Paper, 30 August 2018.

19 General Council. China’s Proposal on WTO Reform: Communication from China, WT/GC/W/773, 13 May 2019.

20 An Inclusive Approach to Transparency and Notification Requirements in the WTO: Communication from African Group, Cuba, and India (Revision), JOB/GC/218/Rev.1 (JOB/CTG/15/Rev.1, JOB/SERV/292/Rev.1, JOB/IP/33/Rev.1, JOB/DEV/58/Rev.1, JOB/AG/158/Rev.1), 11 July 2019.

Body has subsequently attempted to polish its finding on this strict legal standard (without retracting it) by focusing on the evidence that could be provided to satisfy it, and arguably coming out with even more confused language.

In other words, under the legal standard now prevailing in WTO law, in order to qualify as a ‘public body’, and hence as a grantor of subsidies, the relevant entity must not only be controlled by the government but must more specifically exercise governmental functions and powers. A lot has been written on this decision. Criticism has been raised from various quarters, most specifically because – so the argument goes – this interpretation would be unduly narrow and risk rendering the definition under-inclusive.²¹ In other words, the risk would be that many SOEs and their financial contributions would not be covered at all by the definition of subsidy. The possibility of resorting to the concepts of ‘entrustment’ or ‘direction’ of a ‘private body’ to make the financial contributions under item (iv) of Article 1.1. of the SCM Agreement is not considered equally effective for two reasons: first, the still ambiguous meaning of the legal standards, and, secondly and most importantly, because they would require proof of a connection between the government and the ‘private body’ in each and every case of subsidisation (rather than generally attributing financial support actions of ‘public bodies’ to the government).

Accordingly, the US-EU-Japan trilateral argued that this approach would provide leeway for SOEs and other public entities to escape scrutiny and agreed to work on a ‘public body’ definition that softens the ‘government authority’ benchmark to better capture state enterprises as subsidising entities. Similar discussions are taking place in PTA negotiations.²²

Criteria based on control, expressed in various ways, are indeed common in various jurisdictions (see, for example, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) analysed below). Once again, it is interesting to compare the similar notion of ‘public undertaking’ in EU law. The ‘Transparency Directive’ defines it as ‘any undertaking over which the public authorities may exercise directly or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein, or the rules which govern it’ (Article 2(1)(b)). Most interestingly, both the EU and China seem to share a similar understanding in their recent agreement in principle on the Comprehensive Agreement on Investment (CAI).²³ While one cannot simply equate the notion of ‘covered entity’ in the CAI with that of ‘public body’ in the WTO SCM Agreement, it is interesting to note that the various notions of ‘covered entities’ in Article 3bis of Section II (Liberalisation of investment) all refer to elements of control, direction, empowerment or designation of the entity by either Party, without seemingly mentioning any exercise of governmental authority, quite the contrary. The Parties in fact hasten to make it clear that the provision ‘does not apply to the activities conducted in the exercise

21 Critics include even prominent former negotiators and officials involved in crafting the rules. See Cartland, Depayre, and Woznozski (2012).

22 See, e.g. those between the EU and Australia and the EU and New Zealand.

23 See <https://trade.ec.europa.eu/doclib/press/index.cfm?id=2237>.

of governmental authority' or 'to non-commercial activities' (which are, thus, altogether excluded from the scope of the agreement). Where does this leave us? What is clear is that, without explicitly mentioning SOEs, this provision certainly covers several examples of SOEs or, in the EU jargon, 'public undertakings'. Whether this may have any influence on the evolution of the specific question of the definition of 'public body' in Article 1 of the SCM Agreement is an open question. We must wait and see whether the common understanding expressed by the EU and China in the CAI may also lead to a similar common position within the WTO subsidy disciplines context.

Though the solution of the 'public body' issue is central with respect to the scope of subsidy disciplines, we should perhaps reiterate the comment made above. To include SOEs within the scope of the SCM Agreement is *just* a preliminary and neutral step in the analysis. It is *simply* about determining whether a given body and its conduct are covered, and not about whether this conduct is good or bad, permitted or prohibited. Specific benchmarks, referring to market or commercial considerations, are used to assess the behaviour of the government or of public bodies. *Mutatis mutandis*, this is also the approach of the EU – China CAI where the issue of what entities are covered and their obligation to act in a non-discriminatory and commercial way are kept separate. While appreciating the political and symbolic value of a positive 'subsidy' determination, this distinction may somewhat diffuse the tensions and controversies surrounding the debate.

b. Specific rules on SOEs

WTO members hold divergent perspectives on crafting rules for SOEs, surrounding the principles of 'ownership neutrality' and 'competitive neutrality'.

On the one hand, incorporating specific SOE rules in the WTO may seem to contradict the principle of 'ownership neutrality'. The WTO recognises different types of national economic systems and has been neutral insofar as the ownership of enterprises is concerned, reflecting the logic that ownership does not matter as long as SOEs trade in competitive conditions. China supports this view.²⁴ In its proposal on WTO reform, China argues that SOEs should not be discriminated against on the basis of ownership, holding that no special or discriminatory disciplines should be instituted on SOEs when reforming subsidy disciplines.²⁵ We have commented already on this point, indicating what should be the spirit of any negotiation on any rules for state enterprises. On the other hand, the principle of 'competitive neutrality' supports the introduction of specific norms for SOEs in order to eliminate advantages that may derive from their close government connection and thus ensure that competition really operates fairly.

24 Indeed, this comes out also from the EU - China CAI where the Parties declare that '[n]othing in this Article shall be construed to prevent a Party from establishing or maintaining the covered entities', (see Section II 'Liberalization of Investment', Article 3bis, paragraph 2(a)).

25 General Council. China's Proposal on WTO Reform: Communication from China, WT/GC/W/773, 13 May 2019.

Once again, a parallel with the EU and its legal system may be useful. The two principles can already be found in the Treaty of Rome of 1957. On the one hand, Article 345 of the Treaty on the Functioning of the European Union (TFEU) clarifies that '[t]he Treaties shall in no way prejudice the rules in member states governing the system of property ownership'. If, in principle, it is for members to decide 'the system of property ownership', they are still subject to all the rules of EU law. All those entities that carry out 'economic activities' in the market are equal under the law. This is the meaning of Article 106(1) TFEU, which subjects public undertakings to all EU rules and in particular non-discrimination and competition rules. The practice and case-law has consistently developed ways to balance these two provisions with each other (Szyszczak 2007). It is also apposite to mention Article 106(2) TFEU, which includes an exception from this rule for those cases where it is necessary to enable entrusted enterprises to perform their public service mandates. Quite interestingly, this provision appears in many EU PTAs and also in the EU – China CAI (see Section III 'Regulatory Framework', Article 8.4).

The distinction between SOEs and private-owned enterprises is also included in recent PTAs that have gone further than the WTO in crafting disciplines on SOEs.²⁶ The CPTPP represents one of the best examples at the mega-regional level. The CPTPP defines the 'government control' over SOEs in terms of voting rights, equity shares, and appointment powers, and establishes separate disciplines on (1) financial advantages granted to SOEs under 'non-commercial assistance' provisions; and (2) the behaviour of SOEs under 'non-discrimination' and 'commercial consideration' provisions. While the SOE rules in the CPTPP may offer an insight into what participating countries presumably expect to be incorporated into the WTO,²⁷ the process will never be easy due to the economic and political resistance in the broader WTO context from a wide range of countries, especially those with large presence of SOEs in their economies. That being said, they highlight a significant convergence.

c. Additional transparency rules for public bodies and SOEs

An important factor complicating the possible distortive practices by public bodies and SOEs is their inherent lack of transparency. The Trilateral has argued that additional transparency rules should be introduced, especially for public bodies and SOEs.²⁸ For example, more information should be required, including the publication of a listing of all SOEs on a public website, the disclosure of government's shareholding in SOEs, titles of government officials participating on the board of SOEs, the annual revenues of SOEs, and other detailed facts on any policy programme that provides subsidies to SOEs (Katz 2018). We have already hinted at the EU Transparency Directive, which provides similar requirements.

²⁶ See, for example, the recent EU – Vietnam PTA.

²⁷ And have received some support in the literature. See Mavroidis and Sapir (2021).

²⁸ Joint Statement on Trilateral Meeting of the Trade Ministers of the United States, Japan, and the European Union, Paris, 31 May 2018.

4.3 Harmful subsidies

One strong argument in support of subsidy rules reform is the ineffectiveness of WTO disciplines for harmful subsidies (Crivelli and Rubini 2019). Three groups of proposals have been tabled in this respect.

First, prohibitions can be the most effective discipline for addressing harmful subsidisation. To this end, the Trilateral proposed four types of unconditionally prohibited subsidies to be added to the SCM Agreement, most notably: unlimited guarantees, subsidies to an insolvent or ailing enterprise in the absence of a credible restructuring plan, subsidies to enterprises unable to obtain long-term financing or investment from independent commercial sources operating in sectors or industries in overcapacity, and certain direct forgiveness of debt.²⁹

Second, since the standard of evidence for actionable subsidies is high, the Trilateral proposed four types of conditionally prohibited subsidies. These include: excessively large subsidies, subsidies that prop up uncompetitive firms and prevent their exit from the market, subsidies creating massive manufacturing capacity without private commercial participation, and subsidies that lower input prices domestically in comparison to prices of the same goods when destined for export. It is also proposed that the subsidising member should demonstrate there is no serious negative trade or capacity effect and that there is sufficient transparency about the subsidy, failing which the subsidy should be withdrawn immediately.³⁰

Third, there are proposals to target subsidies that generate overcapacity. For instance, the Trilateral proposed to consider the situation where the subsidy distorts capacity as an additional type of serious prejudice, which should be included in Article 6.3 of the SCM Agreement. Additionally, along with the work of the G20 Global Forum on Steel Excess Capacity on steel capacity, subsidies and other support measures, the US-EU-Japan trilateral, together with Mexico and Canada, called for broader discussions in the WTO SCM Committee on the role of subsidies contributing to overcapacity.³¹ China disagreed, arguing that the SCM Committee is not the proper forum to discuss the overcapacity issue, since it is a structural problem resulting from many factors, including trade protectionism.³²

29 It is interesting to note that some of these instances were already present in the original SCM Agreement, in the Article 6.1 presumption, others were proposed during the Doha Round, others are included in the most recent PTAs.

30 Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States, and the European Union. Washington, D.C. 14 January 2020.

31 Committee on Subsidies and Countervailing Measures, The Contribution of the WTO to the G20 Call for Action to Address Certain Measures Contributing to Overcapacity, G/SCM/W/569; Committee on Subsidies and Countervailing Measures, Role of Subsidies in Creating Overcapacity and Options for Addressing this Issue in the Agreement on Subsidies and Countervailing Measures, G/SCM/W/572/Rev.1.

32 WTO, Subsidies Committee Members Again Cite Concerns on Lack of Transparency (April 2019), https://www.wto.org/english/news_e/news19_e/scm_30apr19_e.htm (accessed 15 November 2019).

4.4 Non-actionable subsidies

The original version of the SCM Agreement included limited exceptions for certain legitimate subsidies. These provisions expired in late 1999. China has suggested that the provisions on non-actionable subsidies be reinstated, and their coverage expanded.³³ In its recently published Trade Policy Review Communication, the EU supports this perspective by emphasising that ‘there should also be consideration of a ‘green box’ that includes those subsidies that support legitimate public goals while having minimal distortive impact on trade. This would particularly be the case of certain types of environmental and R&D subsidies, provided they are subject to full transparency and agreed disciplines’.³⁴

The basic rationale to reinstate non-actionable subsidies is sound and relates to the fact that subsidies may be the first-best policy to achieve legitimate policy goals and contribute to global public goods. This suggests that, also for the sake of legal certainty, such subsidies should be explicitly permitted under certain conditions (Horlick and Clarke 2017). The counter-argument is that, if not well defined and monitored, such socially ‘good’ subsidies could also produce market distortionary effects (Cosbey 2013). Hence, the legitimate question is whether the social benefits of these subsidies are significant enough to compensate for their potential distortionary effects and make it worthwhile to relax the SCM Agreement. What is clear however, is that the resurrection of the non-actionable subsidies category is not simply a question of reintroducing a couple of provisions permitting certain subsidies, but would necessarily require an upgrade in the governance of subsidies themselves, in particular with respect to transparency and assessment.

The EU and China went some way towards the direction of legally recognising legitimate subsidies in the recently published CAI text. On the one hand, they specifically provide for exceptions for subsidies to tackle natural disasters or public service obligations (see Section III Regulatory Framework, Article 8). On the other hand, there is a good argument that the general exceptions in Section VI, which are broadly modelled on GATT Article XX and GATS Article XIV, may apply to subsidies too.³⁵

4.5 Special and Differential Treatment (SDT)

Debates on SDT are changing in the shifting global economic landscape. On the one hand, the development divides between developing and developed members still exist, with old divides that have not been substantially bridged, while new divides, such as those in the digital and technological spheres, become more pronounced. The developing members are still struggling for domestic policy space in order to compete in the international

33 General Council. China's Proposal on WTO Reform: Communication from China, WT/GC/W/773, 13 May 2019.

34 The European Commission. Trade Policy Review - An Open, Sustainable and Assertive Trade Policy, Brussels, February 2021.

35 This would not be new in international agreements. See, e.g. EU - Japan.

arena. On the other hand, the rapid economic growth enjoyed by some large developing members made developed members less willing to grant the same preferential treatment to the whole developing membership. Against this background, the SDT is hotly debated.

The views of developed members on the SDT are not necessarily the same. The US-EU-Japan Trilateral shares the view that overly broad classification of development, combined with self-designation of developing country status, inhibits the WTO's ability to negotiate new trade-expanding agreements. From this perspective, advanced WTO members claim developing country status should rather undertake full commitments in WTO negotiations. Specifically, the EU proposed a new graduation system of countries from developing country status to developed country status to opt-out of SDT.³⁶ The US proposed four groups of countries that can no longer enjoy SDT:

1. A WTO member that is a member of the OECD, or a WTO member that has begun the accession process to the OECD.
2. A WTO member that is a member of the G20.
3. A WTO member that is classified as a 'high income' country by the World Bank.
4. A WTO member that accounts for no less than 0.5% of global merchandise trade.³⁷

Canada proposed to take a new approach that seeks the balance between reciprocity and flexibility based on previous experience of Trade Facilitation Agreement (TFA).³⁸ Norway proposed to adopt a flexible approach to adequately respond to specific development needs of members in different economic areas, rather than negotiating criteria for members' access to SDT.³⁹

There is also a divide among developing members regarding the SDT. Brazil agreed to forgo SDT in future WTO negotiations, in exchange for US support for Brazil initiating the OECD accession procedure.⁴⁰ Korea decided not to seek SDT in future WTO negotiations.⁴¹ By contrast, China, the African Group, India, and certain developing members reaffirmed the basic principles of the SDT in the WTO that:

36 The European Commission, *WTO Modernisation: Introduction to Future EU Proposals* (2018), https://trade.ec.europa.eu/doclib/docs/2018/september/tradoc_157331.pdf (accessed on 17 October 2019).

37 *An Undifferentiated WTO: Self-Declared Development Status Risks Institutional Irrelevance: Communication from the United States (Revision)*, WT/GC/W/757/Rev.1, 14 February 2019; *Draft General Council Decision: Procedures to Strengthen the Negotiating Function of the WTO*, WT/GC/W/764, 15 February 2019.

38 *supra* no. 16.

39 *Pursuing the Development Dimension in WTO Rule-making Efforts: Communication from Norway*, WT/GC/W/770, 26 April 2019.

40 *Joint Statement from President Donald J. Trump and President Jair Bolsonaro* (19 March 2019), <https://www.whitehouse.gov/briefings-statements/joint-statement-president-donald-j-trump-president-jair-bolsonaro/> (accessed 10 November 2019).

41 *South Korea to give up developing country status in WTO talks*, Reuters (25 October 2019), <https://www.reuters.com/article/us-southkorea-trade-wto/south-korea-to-give-up-developing-country-status-in-wto-talks-idUSKBNIX401W> (accessed 5 February 2020).

- Developing countries' unconditional rights to SDT in WTO rules and negotiations must continue.
- Developing countries must be allowed to make their own assessments regarding their own developing country status.
- Existing SDT provisions must be upheld.
- SDT must be provided in current and future negotiations.⁴²

Realistically, there is no viable prospect of reaching a consensus on fundamentally changing the current SDT arrangement in the WTO. It should therefore be asked whether it is good strategy to use up political capital over dealing with an issue which is probably intractable in negotiations. What might happen over time is a process of individual developing members volunteering to forgo their SDT in certain WTO agreements, as we saw with Brazil and Korea.

5. WAYS FORWARD

The outbreak of the Covid-19 pandemic has forced countries to deal with dramatic dilemmas regarding public health safety, economic recovery, and social stability. Largely in response to Covid-19, countries have implemented a wide range of subsidy measures to provide emergency liquidity and broad-based fiscal measures such as tax concessions, loans, and loan guarantees.⁴³ Massive public support is about to arrive for the reconstruction phase. It thus becomes even more important to assess the impact of these subsidy measures on trading partners and explore possible paths for reform of WTO subsidy rules in the post Covid-19 period (Ambaw et al. 2020). In other words, the public money spent during the pandemic and on the post-pandemic recovery may be massive, the impact of the several support measures should be fully evaluated. This should really be the precondition to any discussion about reforming outdated rules and governance.

What is the best process to achieve this? We need to divide the short-term from the long-term. The first phase would involve a robust and politically supported knowledge-gathering initiative, the second phase the start of the negotiations.

In the very short-term, the immediate and concrete focus should be on generating more knowledge about subsidy practices, their objectives, and their effects. As repeatedly noted, this knowledge-gathering exercise, which corresponds to the first two questions of Section 2 above, is the essential prerequisite for paving the way to any diplomatic and negotiating effort. The vehicle of this process could be a sufficiently representative and

⁴² Statement on Special and Differential Treatment to Promote Development: Co-sponsored by the African Group, the Plurinational State of Bolivia, Cambodia, China, Cuba, India, Lao People's Democratic Republic, Oman, Pakistan and the Bolivarian Republic of Venezuela, WT/GC/202/Rev.1, 14 October 2019.

⁴³ OECD (2020), 'Government support and the Covid-19 pandemic, OECD Policy Responses to Coronavirus (Covid-19)'.

dynamic platform such as the G20 (which is broader than, for example, the US-EU-Japan trilateral, and includes China and other key WTO developed and developing countries). As Hoekman and Nelson (2020a,b) suggest, what should be on the agenda is the ‘launch of a work programme to mobilise an epistemic community concerned with subsidy policies, tasked with building a more solid evidence base on the magnitude, purpose and effects of subsidy policies’. Better and high-quality knowledge about subsidies and their spillovers is essential in view of a potential law-reform. So is the role played by stakeholders, experts, and epistemic communities. To be sure, to work properly, a subsidy control regime should be continuously equipped with ‘epistemic capacity’ (Koulen 2016).

While, for the reasons outlined above, this learning exercise should find its stimulus in the G20, if the political willingness is there, it could also be linked to the WTO, perhaps in a second stage. This could be done in various ways. There could be a high profile joint-initiative with the creation of an ad hoc working party, or it could even operate through one of the ‘subsidiary bodies’, which the Subsidies Committee could set up under Article 24.2 (this is just one of the institutional flexibilities of the SCM Agreement which have never been used and could be exploited now).

The goal of this initiative is to create the necessary knowledge base to have an informed (and, if possible, less politicised) discussion about the rules and their changes. Law-reform discussions and negotiations must be prepared, and knowledge-gathering is one of the key prerequisites.

Once this is done, and the time is ripe for the actual rulemaking, two negotiating routes are available in the longer term: a multilateral or a plurilateral approach. Since a multilateral outcome among the whole WTO membership is less foreseeable, at least in the first instance, one can expect that a more flexible negotiation approach should be explored and a more feasible blueprint for improving subsidy rules should be considered (Li and Tu 2020).

5.1 A Revised Multilateral Approach

The renewed attention to subsidy rules may offer a window of opportunity for revitalising subsidy negotiations in the WTO. However, it is hardly expected that such a multilateral move be ambitious in nature, given the current divergent positions across WTO membership. That being said, the possibility of reopening such multilateral negotiation deserves attention and effort, with recalibrated negotiation objectives and well-designed flexibilities that are in accordance with the varying expectations and capacities of WTO members. Several dimensions should be considered.

a. The scope and priority of a possible multilateral subsidy initiative

The rationale of the Single Undertaking modality is that concessions can be exchanged among otherwise unrelated sectors. However, the large scope of the Doha Package did not make negotiations easy. In this regard, it appears more practical that the subsidy rules be negotiated as a stand-alone process and only be tied with progress in related issues. For

example, the industrial subsidy negotiation can be promoted in parallel with agricultural subsidy negotiation, making it possible for negotiation space between developed and developing members. Furthermore, even within the industrial subsidy negotiations, trade-offs can be made between different subsidy categories, i.e. prohibited, actionable and non-actionable subsidies. For the reasons explained above, it may make sense to conduct negotiations on subsidies and state enterprises simultaneously.

Focusing on priorities, the first step should be to increase the transparency of subsidies, launching a work programme to compile information on prevailing subsidies, to assess the spillovers of subsidies, and to diagnose the key gap in extant subsidy rules. This has been identified as the key initiative to carry out in the short-term but, as repeatedly said, the continuous assessment of subsidy policies and their effects should become an integral part of the permanent governance of subsidies. In this regard, the inadequate notifications by WTO members could be partially mitigated through more active involvement of the WTO Secretariat to act as a ‘common agent’ for members in assembling information, adding data from other international organisations and databases to provide a better picture of the subsidies in a sector or a market, with opportunities for those members concerned to verify the information.⁴⁴ Better information on subsidies could facilitate constructive discussions and develop common understandings of where new rules are needed, and which form they should take among WTO members (Hoekman and Nelson 2020b). If necessary, ‘subsidiary bodies’ to the Committee on subsidies could be easily created.⁴⁵

b. The development dimension of a possible multilateral subsidy initiative

A useful lesson could be drawn from the experience in concluding the Trade Facilitation Agreement (TFA) that incorporates an innovative design of different levels of commitments as well as mandatory technical assistance for developing members. The key to adopting a similar asymmetric commitment approach in subsidy rules is how to provide different flexibilities for WTO members while ensuring such ‘differentiation’ of flexibilities would not substantially undermine the effectiveness of the agreement.

The first consideration is how to differentiate among WTO members. The SCM Agreement generally differentiates between three categories of countries, which are developing country members referred to in Annex VII,⁴⁶ other developing country members, and members in the process of transformation into a market economy. Such differentiation is too imprecise. More precise differentiation techniques would require a needs assessment of WTO members. For example, an Expert Group could be established to help evaluate the

44 Shaffer, Wolfe, and Le (2015) analysed how international organisations act as fora for collecting information on subsidies and formulate non-binding guidelines and initiatives on sectoral subsidies, e.g., export credits, shipbuilding subsidies, fisheries subsidies, and fossil fuel subsidies.

45 The power is already there, in Article 24 of the SCM Agreement but it has never been used!

46 The Annex VII of the ASCM refers to: (a) least-developed countries designated as such by the United Nations which are members of the WTO; (b) certain countries whose GNP per capita has not reached \$1,000 per annum.

situation of WTO members claiming they have a capacity gap, and the SCM Committee can provide opportunities for members to specify their obstacles and inspire relevant discussions. This process should be, as much as possible, evidence based.

The second consideration is how to tailor commitments according to the differentiation among WTO members. Since commitments valued in absolute terms tend to favour richer members, commitments valued in relative terms that are more related to the relative position of the member offering concessions *vis-à-vis* other members would be more appropriate to address the individual member's situation and mitigate in part the issue of poorer members.

5.2 A FLEXIBLE PLURILATERAL APPROACH

Besides multilateral negotiations, the WTO offers alternatives for entering into plurilateral negotiations among a part of the membership. By gathering like-minded members to negotiate new rules, such a plurilateral process could be more ambitious and permit to have a broader and deeper agenda, which may draw inspiration from those big laboratories of rule-making that are PTAs. The negotiating parties may thus ask whether some of the new rules (e.g. SOE rules) that are incorporated in regional agreements can be developed under the WTO.

There are two types of plurilaterals, one is the 'open plurilateral', taking place within groups of members with the outcomes being implemented on a most-favoured-nation (MFN) basis, another one is the 'exclusive plurilateral', taking place within groups of members with the outcomes remaining confined only to the signatories. The WTO members have experiences in negotiating both types of plurilateral agreements, with the expanded Information Technology Agreement (ITA) as an 'open plurilateral agreement' and the Government Procurement Agreement as an 'exclusive plurilateral agreement'.

We would argue that for subsidy negotiations the 'open plurilateral' approach could be better than the 'exclusive plurilateral' approach. Subsidy rules are designed to ensure an overall level playing field in one country, which means that subsidy obligations undertaken by signatories of plurilaterals would be non-discriminatory and widely benefit other members. To this end, the 'open plurilateral' approach could better represent this non-discriminatory feature. In addition, 'open plurilaterals' are more transparent and inclusive since the benefits of such agreements are open to the whole WTO membership, encouraging future participation of 'outsiders', who, having observed the benefits of undertaking additional subsidy obligations, would like to follow similar paths for goals such as eliminating their ineffective subsidies and locking in their economic transformation.

The entry into force of the 'open plurilaterals' is conditioned on the commitments of a 'critical mass' of WTO members. Previous plurilaterals regarding market access usually count the 'critical mass' on the basis of world trade proportion. For example, the expanded

ITA consists of participants that accounted for over 97% of world trade in the information technology products covered. However, the same criteria of ‘critical mass’ in market access negotiations such as the ITA may not be applied directly for rule-making negotiations such as subsidies. While how to test the ‘critical mass’ of WTO members with respect to subsidies requires further research, it is clear that without the participation of China, India and other developing countries, no initiative is likely to lead to any reform.

6. CONCLUSIONS

The topic of subsidies is multifaceted for a variety of reasons, ranging from states’ geo-economic positioning, to domestic social considerations. Traditional readings of the benefits and costs of subsidies are less applicable in the current world. The spillovers of subsidies are complex and may be magnified in the frequent cross-border commercial activities, with benefits and costs spreading along global value chains. In light of the changing context and the outdated WTO subsidy rulebook, the issue is where the rules might be heading in a process of WTO reform.

Before turning to legal text-based negotiations, we believe the following questions should be considered. First, what is the ambition of the WTO subsidy rules reform? Should it be a pioneering one only including large WTO members who have capacity to reach a progressive deal to constrain their domestic policy space? Or should it rather be an inclusive and incremental one including as many WTO members as possible and trying to find a balance between the development dividends and the negative spillovers of domestic industrial policies?

Second, what should be the scope of the WTO subsidy rules reform? The US-EU-Japan Trilateral paid much attention to industrial subsidies, while agricultural subsidies remain one of the unsolved Doha issue, and rulemaking of subsidies on investment and services remains barely blank (the EU–China CAI being a notable but limited exception). With different negotiation ambitions, different negotiation scenarios could be attempted, while a potential practical way that deserves to be carefully explored is resorting to ‘open plurilaterals’ in producing outcomes that apply on the MFN basis.

Last, but not least, we have reiterated the suggestion that any law reform exercise should be anticipated by a serious and transparent, open, and expert-based knowledge-gathering effort. The things that we do not know on subsidies are more than those we know. Considering the difficulty and importance of the task ahead (creating international subsidy rules for the twenty-first century), stakeholders should really invest significant efforts in improving our knowledge on subsidy policies and their effects. This would create the necessary learning base to prepare negotiations – before diplomacy and politics kick in. In line with similar suggestions in the literature (Hoekman and Nelson 2020b), we have suggested the G20 as the best forum for launching, in the short-term, a work programme in this direction.

REFERENCES

- Ambaw, D, P Draper, and H Gao (2020), 'Lessons from the pandemic for future WTO subsidy rules', in Evenett, S J and R Baldwin (eds), *Revitalising Multilateralism: Pragmatic Ideas for the New WTO Director-General*, CEPR Press 203-211.
- Cartland, M, G Depayre, and J Woznozski (2012), 'Is Something Going Wrong in the WTO Dispute Settlement?', *Journal of World Trade* 46(5): 979.
- Cosbey, A (2013), 'Green Industrial Policy and the World Trading System', 17 ENTWINED Issue Brief.
- Crivelli, P and L Rubini (2020), "Flying High in a Plane" Appellate Body Report, European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft' (WT/DS316/AB/RW), *World Trade Review* 316-340.
- Hoekman, B (2016a), 'Subsidies, Spillovers and WTO Rules in a Value Chain World', *Global Policy* 7(3): 351-359.
- Hoekman, B (2016b), 'Subsidies, Spillovers and the Trading System', in Rubini, L and J Hawkins (eds), *What Shapes the Law? Reflections on the History, Law, Politics and Economics of International and European Subsidy Disciplines*, European University Institute pp: 21-24.
- Hoekman, B and D Nelson (2020a), 'Subsidies, Spillovers and Multilateral Cooperation' in Hoekman, B and E Zedillo (eds), *21st Century Trade Policy: Back to the Past?*, Brookings Institution.
- Hoekman, B and D Nelson (2020b), 'Rethinking International Subsidy Rules', *World Economy* 43(12): 3104-3132.
- Horlick, G and P Clarke (2017), 'Rethinking Subsidy Disciplines for the Future: Policy Options for Reform', *Journal of International Economic Law* 20: 673-703
- Hufbauer, G C (2021), 'Will Industrial and Agricultural Subsidies Ever Be Reformed?', Peterson Institute for International Economics, Policy Brief pp:21-5.
- Katz, S (2018), 'How the U.S., the EU, and Japan Are Trying to Rein in China's State Capitalism', *Harvard Business Review*, <https://hbr.org/2018/11/how-the-u-s-the-eu-and-japan-are-trying-to-rein-in-chinas-state-capitalism> (accessed 12 December 2019).
- Koulen, M (2016), 'Reflections on the SCM Agreement' in Rubini, L and J Hawkins (eds) *What Shapes the Law? Reflections on the History, Law, Politics and Economics of International and European Subsidy Disciplines*, EUI, 75-80.
- Li, S Q and X Q Tu (2020), 'Reforming WTO Subsidy Rules: Past Experiences and Prospects', *Journal of World Trade* 853 -857.

Mavroidis, P C (2010), 'Remedies in the WTO legal system: between a rock and a hard place', *European Journal of International Law* 11:763-813.

Mavroidis, P C and A Sapir (2021), *China and the WTO - Why Multilateralism Still Matters*, Princeton University Press.

Rubini, L (2010), *The Definition of Subsidy and State Aid*, Oxford University Press.

Rubini, L (2015), 'Rethinking International Subsidies Disciplines: Rationale and Possible Avenues for Reform', E15 Initiative, Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum, 2015. www.e15initiative.org/.

Rubini, L (2017), 'The Age of Innocence. The evolution of the case-law of the WTO dispute settlement. Subsidies as case-study', in Francois, J, M Elsig, B Hoekman, and J Pauwelyn (eds) *The World Trade Organization. Past Performance and Ongoing Challenges*, Cambridge University Press, pp: 276-317.

Rubini L (2019), 'The never-ending story: the puzzle of subsidies', in Crowley, M A (eds) *Trade War - The Clash of Economic Systems Endangering Global Prosperity*, CEPR Press, pp 85-94.

Shaffer G, R Wolfe, and V Le (2015), 'Informal Law's Discipline of Subsidies: Variation in Definitions, Obligations, Transparency, and Organizations', E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum, www.e15initiative.org/.

Shaw, M (2008), *International Law 6th edition*, Cambridge University Press.

Szysczak, E (2007), *The Regulation of the State in Competitive Markets in the EU*, Hart Publishing.

Wolfe, R and T Collins-Williams (2010), 'Transparency as a trade policy tool: the WTO's cloudy windows', *World Trade Review* 9(4): 551-581.

ABOUT THE AUTHORS

Li Siqi PhD, is Associate Professor at the China Institute for WTO Studies, University of International Business and Economics, China. She was also a Visiting Scholar at the School of Social Science, University of Edinburgh (from September 2012 to September 2013).

Luca Rubini is Reader in International Economic Law at Birmingham Law School (UK) and Robert Schuman Senior Research Fellow at the Global Governance Program of the European University Institute. He is a trade and competition lawyer with a special interest in the regulation of the state intervention in the economy.

CHAPTER 8

A Core Proposal for Reforming the WTO's Subsidy Rules

LIU Jingdong

Institute for International Law of Chinese Academy of Social Sciences

The World Trade Organization (WTO) Agreement on Subsidies and Countervailing Measures (SCM Agreement) is no longer suitable for the current situation of the international trade development and should be revised to incorporate the newly developed rules in a timely manner.

In my opinion, the revision should focus on the following aspects:

1. DEFINE 'PUBLIC BODY' IN A MORE PRECISE WAY.

There are major differences among WTO Members on the criterion of 'public body' in the SCM Agreement, which has been illustrated by the huge divergence between China and the United States in *US - AD and CVD* (DS379).¹ In that case, the appellate body overturned the 'government control' criterion of 'public body' set by the panel, and redefined 'public body' as 'entities entrusted with or performing government functions'.

The criterion set by the appellate body is reasonable, and the SCM Agreement should define 'public body' according to the criterion set by the appellate body.

2. NO SPECIAL RULES WITH REGARD TO SOE SHOULD BE PUT INTO THE SCM AGREEMENT.

As a matter of fact, not only state-owned enterprises may cause market distortions through subsidies; private enterprises may also be entrusted with or perform government functions and provide subsidies to downstream enterprises. Therefore, special rules with regard to state-owned enterprises are discriminatory by nature and should not be adopted by the SCM Agreement.

¹ https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds379_e.htm. Accessed on 1 July, 2021.

3. STRENGTHEN RULES REGARDING TRANSPARENCY AND BURDEN OF PROOF, AND URGE MEMBERS TO STRICTLY COMPLY WITH THEIR SUBSIDIES NOTIFICATION OBLIGATION.

At present, the record of subsidies notification under the SCM Agreement is poor, which is reflected in the delay of notification, low quality of notification, and lack of notification ability. The WTO should strengthen the transparency rules in the SCM Agreement, provide relevant procedures to urge Members to strictly fulfil their notification obligations, and make the notification more specific, so that other Members can assess the trade impact, and learn the operation of the notified subsidy scheme.

As regards burden of proof, it should be borne by the claimant when conducting countervailing duty investigations or bringing a case before the WTO dispute settlement mechanism. It makes no sense that the burden of proof reverts to the opposing party.

4. RESTORE NON-ACTIONABLE SUBSIDIES

The SCM Agreement provides that non-actionable subsidies, as ‘green light’ subsidies, shall only apply for a period of five years after the WTO agreement came into force, and the relevant provisions expired years ago. Non-actionable subsidies won’t distort the international trade market, and are very necessary for members in terms of their economic and social development.

Therefore, this policy should be restored in the SCM Agreement, and there needs to be specific rules confirming the legitimacy of subsidies for research and development, environmental protection and disadvantaged regions, etc.

5. INCORPORATE BOTH INDUSTRIAL SUBSIDIES AND AGRICULTURAL SUBSIDIES IN THE PACKAGE NEGOTIATION

Since the expiry of the ‘peace clause’ in 2003, the WTO Agreement on Agriculture does not include specific obligations concerning agricultural subsidies for the Members. Although commitments to eliminating agricultural export subsidies and restricting agricultural export credit have been made at the 2015 WTO Ministerial Conference, developed countries such as the United States and European countries still have a high degree of agriculture subsidies. In addition, there are conflicts between the Agreement on Agriculture and the SCM Agreement. WTO reform should aim to solve the market distortion problems caused by excessive agricultural subsidies provided by some Members, and put forward a negotiation package proposal for both industrial subsidies and agricultural subsidies. When revising the SCM Agreement, developed countries must promise to cut their agricultural subsidies because they have a high-level of ‘Aggregate Measure of Support’ (AMS), which can provide ‘Amber Box’ subsidies that exceed 5% *de minimis* permissible level, leading to the severe distortion of the agricultural product price

in the international market. Hence, developed countries should cancel AMS gradually and remove price distortive measures in agricultural markets, so that the reform of subsidy rules can be fundamentally fair and balanced.

ABOUT THE AUTHOR

LIU Jingdong is Professor and Director of International Economic Law Department at Institute for International Law of Chinese Academy of Social Sciences

CHAPTER 9

What kinds of rules are needed to support digital trade?

153

Martina F. Ferracane and LI Mosi

European University Institute; Shanghai University of International Business and Economics

The prevailing multilateral rules regulating digital trade predate the global internet. Updating them is important, given the trend for countries to embed rules for cross-border trade in digital goods and services in discriminatory free trade agreements. Ongoing negotiations on e-commerce in the World Trade Organization (WTO) on a plurilateral basis offer an opportunity to build on recent regional agreements to agree on rules to support digital trade. Commonalities in the preferences of China and the European Union (EU) on some elements of digital trade policy create prospects for cooperation in this area, thereby helping to keep the WTO relevant in the 21st century.

1. INTRODUCTION

Digital trade is becoming an increasingly important component of global trade, with the Covid-19 pandemic accelerating the pace of digitalisation.¹ The prevailing multilateral rules regulating digital trade predate the global internet as we know it (López González and Ferencz 2018, Ismail 2020), embodied in the WTO's General Agreement on Trade in Services (GATS). Many policymakers, not surprisingly, consider the prevailing rules, negotiated in the early 1990s, to be outdated for the digital era (Wu 2017). An illustration of this is that the classification of services used in the GATS dates to 1991 and is obsolete for the digital era, generating uncertainty whether digital services not included in the GATS list are covered by the commitments undertaken by members. This uncertainty has partially been addressed through dispute settlement, which established that the GATS is technologically neutral. However, there is no explicit language in WTO agreements on data flows, source code, location of computing facilities, and other topics relevant for digital trade.

This situation has paved the way to a wave of 'next-generation' free trade agreements (FTAs) that include binding commitments on digital trade. Two-thirds of the WTO Membership is a party to one or more FTAs that includes e-commerce related provisions (Burri and Polanco 2020). These agreements provide different levels of commitments

¹ Although there is no generally agreed definition, digital trade can broadly be defined as 'the trade of goods and services using the internet, including the transmission of information and data across borders'. Australian government, Department of Foreign Affairs and Trade website. In this paper, digital trade and e-commerce are used interchangeably.

on digital trade, with a variety of rules and formulations resulting in a spaghetti bowl that risks instigating a fragmentation of the rules applied to digital trade. In this setting, multilateral discussions are widely seen as crucial to avoid further fragmentation and to lower costs for all firms, especially Micro, Small and Medium Enterprises (MSMEs), to engage in digital trade.

This chapter starts by presenting the history of multilateral discussions on digital trade, from the adoption of the Declaration on Global Electronic Commerce in 1998, to the recent discussions on a Joint Statement Initiative (JSI) on e-commerce. The EU and China are two of the major players in the JSI discussions. We aim to shed light on the possible outcome of the JSI negotiations by presenting the position of these two key actors, drawing on positions taken in ongoing talks, on EU and Chinese commitments on digital trade in their respective FTAs, and developments in domestic regulation.

2. DIGITAL TRADE DISCUSSIONS AT THE WTO

In 1998, at the second WTO Ministerial Conference, WTO members adopted the Declaration on Global Electronic Commerce. This recognised the need to clarify the relationship between trade rules and emerging online modes for trade, and called for the establishment of a work programme on e-commerce (WTO 1998a). In the same declaration, members also adopted the e-commerce moratorium, a commitment to refrain from imposing customs duties on electronic transmissions. Since then, at every Ministerial Conference, the WTO members have agreed ‘to maintain the current practice of not imposing customs duties on electronic transmissions’.²

The WTO Work Programme on Electronic Commerce, which was established later in 1998, was tasked with exploring WTO rules and the production, distribution, marketing, sale or delivery of goods and services by electronic means (WTO 1998b). This work programme did not lead to new rules for digital trade. The only adjustments to the rulebook made after the entry into force of the WTO affecting digital trade was the Information Technology Agreement (ITA), and its update in 2015.

The ITA is of particular significance to digital trade. The WTO members committed themselves to reduce their tariffs on IT goods in four steps of 25% to reach a tariff-free policy by the year 2000. This obligation pertains to a common list of IT products covering a wide range of some 180 information technology products in five major categories: computers and peripheral devices, semiconductors, printed circuit boards, telecommunications equipment (except satellites), and software. By the year 2015, the ITA covered 95% of the existing world trade in IT goods (WTO 2017a). At the Nairobi

² At the 11th Ministerial Conference in Buenos Aires in 2017, the moratorium was agreed in the final hours of the conference. This was due to debates on the implications of the moratorium on developing countries in terms of loss of tax revenues.

Ministerial Conference in December 2015, over 50 members also concluded the expansion of the ITA, which now covers an additional 201 products valued at over \$1.3 trillion per year.³

Other than the commitments taken on digital goods under ITA, discussions on digital trade did not see any significant progress until the Nairobi Ministerial Conference in 2015, which signalled willingness by many WTO members to explore new approaches to the negotiations (WTO 2015) and calling for e-commerce to be a priority among 'new issues' for discussion and consideration (Ismail 2020).

In parallel, in the 2010s, the US started to pursue new rules, including the upgrade of the moratorium into a permanent commitment and pushing the WTO to change the mandate of the Work Programme from discussions to negotiations (Azmeah et al. 2020, WTO 2011a, WTO 2011b, WTO 2014). The EU joined these efforts, but with more modest objectives. In 2016, the MIKTA group (Mexico, Indonesia, Korea, Turkey, and Australia) issued a statement arguing that the WTO should focus more attention on the digital trade agenda and that the organisation had an important role to play to keep the digital markets open, create a facilitating environment for digital trade, promote consumer confidence, and support small and medium-sized enterprises (SMEs) to engage in digital trade. The group called for efforts to consider both existing and newer e-commerce issues (MIKTA 2016).

In 2017, a 'Friends of E-commerce for Development' group called for more focus on e-commerce as an engine of development and growth.⁴ In particular, the group called for more focus in the WTO and other international organisations on a range of issues, particularly concerning e-commerce readiness and strategy, ICT infrastructure and services, trade logistics, payment solutions, legal and regulatory frameworks, e-commerce skills development and technical assistance, and access to financing (Friends of E-Commerce for Development 2017).

Discussions on e-commerce intensified in the run-up to the 11th Ministerial Conference in Buenos Aires in 2017, which saw the release of a Joint Statement on e-commerce, signed by 71 countries, reaffirming the importance of e-commerce and the goal of advancing e-commerce work in the WTO (WTO 2017b). The group announced the start of exploratory work toward WTO negotiations on trade-related aspects of e-commerce and set the ground for the start of plurilateral negotiations on e-commerce. The argument for starting plurilateral discussions at the WTO is that the high number of WTO members and the complexity of issues make decision-making through the consensus and single undertaking principles highly difficult, which could ultimately weaken the multilateral regime as members enact new rules in bilateral and regional trade agreements.

3 See the WTO webpage on the Information Technology Agreement: https://www.wto.org/english/tratop_e/inftec_e/inftec_e.htm (last accessed in May 2021).

4 This group includes Argentina, Chile, Colombia, Costa Rica, Kenya, Mexico, Nigeria, Pakistan, Sri Lanka, and Uruguay.

This initiative faced strong opposition by some developing countries, including India, South Africa, and the Africa Group in the WTO. The latter argued that ‘it is perplexing that some members are advocating for new multilateral rules on e-commerce’ and that ‘the multilateral rules as they are, are constraining our domestic policy space and ability to industrialise’ (WTO 2017c). These countries also expressed fears on a commitment to free flow of data that would provide free market access to digitally delivered goods and services, depriving developing economies of substantial tariff revenues as more goods are digitized, and threats to their domestic services industry as more services are traded online.

In 2019, 76 members signed a second Joint Statement on e-commerce, and formally announced in Davos the willingness to begin the plurilateral negotiation process to advance discussions. Throughout 2019, the group held negotiations, albeit in different settings. Despite the challenges presented by Covid-19, the number of participants in the initiative has grown to 86 WTO members, collectively accounting for over 90% of global trade and representing all major geographical regions and levels of development (WTO 2020). However, participation by least developed countries (LDCs) and members from Africa, Caribbean, and Pacific regions has remained limited. Reasons highlighted for the limited participation include fears of weakening multilateralism and limited benefits for low-income countries (WTO 2019a).

A draft consolidated text was circulated among participants on 7 December 2020. The text is based on members’ proposals that cover the following themes: enabling e-commerce, openness and e-commerce, trust and e-commerce, cross-cutting issues, telecommunications, market access, and scope and general provisions. The negotiation process is being led mainly by Australia, Japan, and Singapore, who are aiming for significant advances in negotiations by the advent of the 12th Ministerial Conference (MC12). The negotiations are not expected to be finalised during MC12, which was postponed to November 2021 as a result of the Covid-19 pandemic. As of yet, there is no agreement on several key issues, and uncertainty also remains concerning the legal form through which any outcome will be integrated in the WTO.

One of the main issues blocking progress on digital trade on the WTO agenda is the question of categorisation. WTO members differ in opinion on whether products which were usually sold as goods due to their link to a physical carrier, and which can now be delivered online (e.g. music or movies), shall be treated as goods under the General Agreement on Tariffs and Trade (GATT) or as services under GATS (Bergemann 2002). If goods delivered online were to be considered goods, they would be subject to trade restrictions such as tariffs (Baker et al. 2001). On the other hand, if goods delivered online were to be considered services, they would be subject to market access barriers and discriminatory domestic regulations. Until the classification debate is resolved, WTO members decided not to impose tariffs on imported electronic transmissions. Other issues

which remain highly controversial include the classification of digital services, restrictions on the transfers of data, requirements for local data processing, and computing facilities and transfers of source code.

3. DIGITAL TRADE IN FTAS SIGNED BY THE EU AND CHINA

Given the lack of progress made in the work programme discussions launched in 1998 on e-commerce, negotiations shifted to bilateral and regional fora.⁵ As a result, the scope and depth of commitments on digital trade in FTAs has expanded to cover a broader range of issues, responding to the enactment of new types of measures imposed by governments (Wu 2017).

3.1 Digital trade in EU FTAs

The EU has actively sought to include e-commerce chapters in their FTAs. The first EU trade agreement to include an e-commerce chapter was the EU-CARIFORUM Economic Partnership Agreement (EPA), which entered into force in 2008.⁶ While other advanced economies have usually sought to include broad-reaching e-commerce chapters in their agreements, the EU represents an exception. The e-commerce sections of the EU's trade agreements tend to focus primarily on information exchange and the promotion of regulatory dialogue, rather than more robust substantive provisions that cater for digital trade (Wu 2017, Micallef 2019). EU agreements usually include an obligation to not impose customs duties on digital products, facilitating commerce in downloadable products such as software, e-books, music, movies, and other digital media. These types of provisions are common among agreements covering e-commerce. In some cases, this represents the only binding commitments on e-commerce in EU agreements, as in the case of the EU-Central America Association Agreement, which additionally contains a provision on establishing a regulatory dialogue (Article 201).

EU trade agreements also include provisions that extend national treatment and MFN disciplines to the digital realm. More recent FTAs also include the principle of technological neutrality to clarify the scope of the commitments to include digital services. This provision first appeared in the EU-Singapore FTA (Article 8.59), noting that measures related to the supply of services using electronic means fall within the scope of the obligations contained in the relevant provisions in the chapter on services, establishment, and e-commerce as a whole.

5 The first FTA to include an explicit standalone chapter to address e-commerce was the one between Australia and Singapore, which entered into force in July 2003. Other agreements in the early 2000s which included e-commerce articles or sections are US-Chile FTA, US-Singapore FTA, US-Australia FTA, and Thailand-Australia FTA.

6 The EC-Chile from 2003 included a limited article covering basic cooperation in e-commerce, but did not have a dedicated chapter.

Provisions on digital authentication and/or e-signatures are also very common in FTAs with an e-commerce chapter. Commitments taken by the EU in this area appear lighter-touch compared to non-EU FTAs. Rather than requiring firm commitments, EU trade agreements seek to establish a dialogue on regulatory issues that includes ‘the recognition of certifications of electronic signatures issued by the public and the facilitation of cross-border certification services’ (Wu 2017).⁷ The EU-Singapore FTA contains a dedicated article (Article 8.6o), in which the parties commit to ‘take steps to facilitate the better understanding of each other’s electronic signatures framework (...) and to examine the feasibility of having in the future a mutual recognition agreement on electronic signatures’.

Provisions on paperless trade are not included in most EU FTAs, the exception being EU-Colombia and EU-Peru (Article 165) and EU-Korea FTA (Article 7.49). These provisions seek to make the process of making trade administration documentation available in digital format and of allowing importers and exporters to submit documentation electronically. Regarding consumer protection online, the primary emphasis of EU FTAs is on regulatory dialogue,⁸ in contrast to non-EU FTAs that have opted for binding commitments on consumer protection online, aiming at curtailing potential harm from online purchases and increasing the trust of consumers in doing business electronically.

The topic of unsolicited electronic messages (spam) is frequently found in EU trade agreements. The provision is consistent across the agreements, and it is limited to maintaining a regulatory dialogue on policies towards unsolicited electronic commercial communications.⁹ EU agreements commonly call out important policy areas in which cooperation is relevant and place major emphasis on regulatory dialogue. In some cases, there are provisions directly addressing the delivery of technical assistance and capacity building from the EU to its trading partner.¹⁰

A key digital trade policy issue is the treatment of data flows. Starting from 2018, when for the first time a ban on cross-border restrictions was agreed in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), several ‘next generation’ agreements have included binding commitments on data flows. This is not the case for the EU, where this issue has been controversial (Yakovlela and Irion 2020). Although the EU agreed to specific commitments on cross-border data flows related to financial services, e.g. in the EU-Korea FTA in 2011,¹¹ strong voices have opposed the inclusion of horizontal binding commitments on free data flows in EU FTAs. Concerns relate to the protection of privacy, as well as market power of US digital firms.¹² An illustration of this, is a report

7 See e.g. EU-Korea FTA (Article 7.49.1), EU-Moldova FTA (Article 255.1).

8 See e.g. EU-Central America Association Agreement (Article 202), EU-Georgia Association Agreement (Article 128).

9 See e.g. EU-Korea FTA (article 7.49), EU-Central America Association Agreement (Article 202).

10 See e.g. EU-CARIFORUM Economic Partnership Agreement, Article 121.

11 Under Annex 13-B, the parties agreed to ‘allow a financial institution of the other Party to transfer information in electronic or other form, into and out of its territory, for data processing where such processing is required in the institution’s ordinary course of business’.

12 While the EU as a whole is generally supportive of the inclusion of binding commitments to free cross-border data flows, France and Germany expressed some concerns (Azmeah et al. 2020). Such lack of support reflected both economic and technological concerns by those countries on the impact of such clauses on the European economy in the context of dominance of large US digital firms and also concerns about implications of such rules on privacy and data protection.

by the French Digital Council, an independent advisory commission on digital issues established by the French President, issued on the negotiation of digital issues in TTIP recommending that Europe should ‘play for time in the negotiations, step up construction of Europe’s digital strategy, and strengthen the European Union’s bargaining capacity’ (CNNum 2017, at 13, as cited by Azmeh et al. 2020). Conversely, other member states have been calling on the European Commission to address cross-border data flows in trade agreements in an ambitious manner.¹³

The initial position of the EU, as reflected in the EU-Japan Economic Partnership Agreement (EPA) and in the negotiations for a FTA with Mexico, was to insert a placeholder on cross-border data flows to enable the parties to revisit the issue in three years. In parallel, internal EU debates resulted in the adoption of horizontal provisions for cross-border data flows and for personal data protection. These provisions, which are designed to be inserted in all EU future FTAs, consist of three articles:¹⁴

- The first commits the parties to ‘ensuring cross-border data flows to facilitate trade in the digital economy’ and outlines four mechanism parties commit not to use: (i) requiring the use of computing facilities or network elements in the party’s territory for processing, including by imposing the use of computing facilities or network elements that are certified or approved in the territory of a party; (ii) requiring the localisation of data in the party’s territory for storage or processing; (iii) prohibiting storage or processing in the territory of the other party; (iv) making the cross-border transfer of data contingent upon use of computing facilities or network elements in the parties’ territory or upon localisation requirements in the parties’ territory. Article A also includes a mechanism to review the implementation of this provision three years after the entry into force of the agreement.
- The second commits parties to recognise that the protection of personal data and privacy is a fundamental right and that ‘high standards in this regard contribute to trust in the digital economy and to the development of trade’. Personal data is defined in the agreement to mean ‘any information relating to an identified or identifiable natural person’. The article allows each party to adopt and maintain the safeguards it deems appropriate to ensure the protection of personal data and privacy ‘including through the adoption and application of rules for the cross-border transfer of personal data’ and stresses that ‘nothing in this agreement shall affect the protection of personal data and privacy afforded by the parties’ respective safeguards’.

13 See for example the letter on data flows to the Vice President of the European Commission, Frans Timmermans, dated 16 May 2017, available at: <https://www.government.nl/documents/letters/2017/05/19/like-minded-letter-on-data-flows-in-trade-agreements>.

14 This text has been tabled for the first time in the trade agreement’s negotiations with Indonesia.

- The third article commits parties to ‘maintain a dialogue on regulatory issues raised by digital trade’, including the recognition and facilitation of interoperable cross-border electronic trust and authentication services, the treatment of direct marketing communications, the protection of consumers in the ambit of e-commerce, and any other issue relevant for the development of digital trade. The focus of such cooperation will be on exchanging information on the parties’ respective legislation on these issues as well as on the implementation of such legislation. Importantly, this article explicitly excludes provisions related to protection of personal data and privacy including on cross-border data transfers of personal data from such dialogue, which follow a different process.¹⁵

Commenting on the decision to grant data adequacy status to Japan, the European Commission stressed that ‘For the EU, privacy is not a commodity to be traded. Dialogues on data protection and trade negotiations with third countries have to follow separate tracks’ (European Commission 2018). Through this mechanism, the EU aims to move toward free flow of data with its trading partners while maintaining its relatively strong measures in the area of privacy and personal data protection.

Despite the prominent domestic debate on the protection of personal information, European negotiators have not proactively sought to include an obligation on this issue in FTAs until recently. Instead, APEC¹⁶ members have taken the lead in pushing for inclusion of such provisions in FTAs (Wu 2017). Some EU agreements use weak or hortatory language on data protection in the trade agreement with Colombia and Peru, which states that the parties ‘shall endeavour, insofar as possible, and within their respective competencies’ to develop or maintain regulations for the protection of personal data (Article 164).

Another issue which is virtually absent from EU FTAs is the requirement for the government to limit the requests of disclosure of source code as a condition for doing business in the country. This requirement is only present in the agreement with Japan (Article 8.73) and with the UK (Article DIGIT.12).¹⁷

All in all, the EU’s approach to digital trade has emphasised regulatory dialogue and does not address a range of issues which can be found in FTAs implemented by other advanced economies such as Australia, Japan, and the US. This has begun to change recently with the EU-Japan EPA building upon in the modernised EU-Mexico Trade Agreement,¹⁸ and the EU-UK Trade and Cooperation Agreement. The EU-Japan EPA addresses for the first

15 The GDPR adequacy decision is adopted through a proposal by the European Commission followed by an opinion of the European Data Protection Board, an approval from representatives of EU countries, and a final adoption by the Commission.

16 Asia-Pacific Economic Cooperation.

17 The Trade and Cooperation Agreement is provisionally applicable from 1 January 2021, after having been agreed by EU and UK negotiators on 24 December 2020.

18 The text has been agreed, but the agreement has not yet entered into force: <https://ec.europa.eu/trade/policy/in-focus/eu-mexico-trade-agreement/>.

time issues such as data transfer and access to source code, including endeavours not to impose prior authorisation on the provision of services by electronic means (Article 8.75), the conclusion of contracts by electronic means (Article 8.76), a binding commitment on electronic signatures (Article 8.77), binding obligations on spam (Article 8.79). Given the fact that the EU is discussing similar language in on-going negotiations, the EU-Japan agreement is expected to serve as a basis for the EU in negotiations under the JSI.¹⁹

3.2 Digital trade in China's FTAs

Before the Regional Comprehensive Economic Partnership (RCEP), China had signed only four FTAs which included e-commerce provisions. These are the China-Korea FTA (2015), the China-Australia FTA (2015), and the China-Singapore FTA Upgrade (2018) and China-Cambodia FTA (2020). The e-commerce provisions in the above-mentioned agreements are mostly shallow rules, dealing with matters such as electronic authentication and electronic signature, online consumer protection, personal information protection, and paperless trading. The provisions are relatively simple, some are only stipulated in principle, and some are not legally binding. The dispute settlement mechanisms do not apply to any dispute arising under the e-commerce chapters in these FTAs.

To date, the RCEP is the highest standard FTA that China has signed. Chapter 12 on e-commerce includes provisions on paperless trading, electronic certification and signature, online consumer protection, online personal information protection, and network security, among other issues. While RCEP membership implies that China has agreed for the first time to provisions on cross-border transfer of information by electronic means and location of computing facilities in an FTA, compared with other recent FTAs such as the CPTPP, RCEP's e-commerce rules are less ambitious. RCEP has no commitments related to source code and permits significant latitude for measures that do not meet the requirements of cross-border free flows of data and prohibition of data localisation.

Both Article 12.14 'Location of Computing Facilities' and Article 12.15 'Cross-Border Transfer of Information by Electronic Means' stipulate that 'nothing in this Article shall prevent a Party from adopting or maintaining any measure that it considers necessary for the protection of its essential security interests. Such measures shall not be disputed by other Parties'. In addition, both Article 12.14 and Article 12.15 include a footnote stating that 'the Parties affirm that the necessity behind the implementation of such legitimate public policy shall be decided by the implementing Party'. The necessity of a measure to achieve a legitimate policy objective is therefore considered to be self-judging. If RCEP signatories cannot resolve a dispute through consultation, the matter is to be addressed by the RCEP Joint Committee (ministerial level). However, the Committee does not have the power to impose any decision (Leblond 2020).

19 The modernised EU-Mexico Trade Agreements also adds an important Article on open internet access for users (Article 10).

The RCEP provisions on digital trade demonstrate that China recognises the importance of policies affecting cross-border data flows and has accepted a number of guiding principles for domestic laws and regulations. The RCEP Chapter on e-commerce is a good harbinger of the kind of agreement that can be expected from the JSI negotiations on e-commerce, providing a baseline for what China could accept in terms of digital trade provisions.

4. DOMESTIC REGULATORY TRENDS

Recent developments in domestic regulation affecting digital trade provide further context on how sensitive issues are being addressed in the EU and China. These show how similar issues are being addressed in different ways, potentially raising costs for businesses to conduct digital trade.

4.1 The EU

The political guidelines for the next European Commission 2019-2024, put forward by Ursula von der Leyen, reflect the political ambition of a 'stronger Europe in the world'. The regulation of digital trade has mostly taken place in a defensive manner, although the EU has taken a proactive approach in addressing complex issues such as data protection and competition issues. In recent years, the EU has started to strongly emphasise 'digital sovereignty'. This approach emerges clearly in the recent Communication on 'A European strategy for data', which states that 'free and safe flow of data should be ensured with third countries, subject to exceptions and restrictions for public security, public order, and other legitimate public policy objectives of the European Union'.²⁰

The EU's defensive stance reflects several factors, including the dominance of US and Chinese firms in the digital sectors, concerns on the ability to ensure the privacy of EU citizens, and the security risks associated with foreign technologies (EPRS 2020a). The EU internal policy is characterised by a number of emerging initiatives that look to reduce fragmentation of the EU and to create a fair and competitive market for EU firms. This section highlights some of the initiatives which help to understand the EU's stance on digital trade.

4.1.1 GDPR and the Brussels effect

The General Data Protection Regulation (GDPR) is one of the most comprehensive frameworks in the world for the protection of personal data.²¹ It builds on the 1995 European Directive on data protection, which already provided extensive regulatory

²⁰ The text continues by arguing that 'this would allow the EU to have an open but assertive international data approach based on its values and strategic interests', European Commission (2020), *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the regions: A European Strategy For Data*, COM(2020) 66, Brussels.

²¹ Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation).

safeguards to ensure a high level of protection domestically and cross-border. The main novelties of the GDPR are the extra-territorial approach and high fines. In fact, even if a company does not have a physical presence in the EU, it has to comply with the GDPR if the business activities include offering digital products/services within the EU or monitoring the behaviour of EU residents (Article 3 (2)). The fundamental approach of the GDPR is that personal data can be transferred and processed outside the EU only if there is full compliance with the privacy rights provided to EU citizens. To that effect, personal data transfers are allowed only to specific countries whose regime is considered 'essentially equivalent' to the GDPR or if the data processor can offer appropriate safeguards including binding corporate rules (BCRs) that allows intra-company transfers, standard contractual clauses (SCC) approved for intra-company transfers or with certification mechanisms. Alternatively, the data can be transferred only if some derogations apply, including the explicit consent of the data subject and the necessity of the transfer for the performance of the contract. These derogations can be used only in specific situations and not for day-to-day transfers.

The EU approach has become a *de facto* global standard for many countries when it comes to designing data protection rules. This 'Brussels effect'²² is reflected in many countries adopting GDPR-like frameworks. This may be in the hope to be accorded adequacy status by the EU in the future, and therefore facilitate the access to the EU market, and/or it may reflect a view that the EU approach constitutes good practice.

4.1.2 *The invalidation of the Privacy Shield*

While the GDPR recognises the importance of cross-border data flows for trade and international cooperation (Recital 101), the recent decision of the European Court of Justice (ECJ) in *Schrems II* raises some doubts about the future of data flows from the EU.²³ The ECJ decision invalidated the *Privacy Shield*, which was a mechanism put in place to provide adequacy to transfers to selected US companies who followed certain rules. In the dispute, the ECJ found that the data surveillance laws in the United States, in particular Section 701 of the Foreign Intelligence Surveillance Act and Executive Order 12333, were not consistent with the GDPR, and therefore the Privacy Shield mechanism was invalid. It also upheld the validity of the Standard Contract Clauses (SCCs), but it provided that companies using SCCs might need to adopt supplementary measures to ensure adequate protections.²⁴

22 See Bradford, A (2020), *The Brussels Effect: How the European Union Rules the World*, Oxford University Press, ISBN: 9780190088583.

23 Judgment of the Court (Grand Chamber) of 16 July 2020, Data Protection Commissioner v Facebook Ireland Limited and Maximilian Schrems, Case C-311/18.

24 For more information, see the EDPB Recommendations 01/2020 on measures that supplement transfers tools to ensure compliance with the EU level of protection of personal data, 11 November 2020.

4.1.3 GAIA X

The recent initiative proposed by France and Germany points to the objective of digital sovereignty in the EU. The project aims to set up ‘high performance, competitive, secure and trustworthy data infrastructure for Europe’²⁵ that achieves ‘high aspirations in terms of digital sovereignty while promoting innovations’.²⁶ In practice, the project aims to enable a federated cloud infrastructure for the European market to facilitate interoperable data exchange in the EU. While foreign companies are not precluded from participating, it is expected that the project will be a tool to boost the EU digital sector and enhance the ability of governments to enforce the adoption of EU data protection standards.²⁷

4.1.4 Data Governance Act

The Data Governance Act (DGA) aims to improve the availability of data and to strengthen data sharing in the EU through mechanisms that facilitate the reuse of public sector data. The strategy argues that ‘the digital transformation of the EU economy depends on the availability and update of secure, energy-efficient, affordable and secure data processing capacities, such as those offered by cloud infrastructure and services, both in data centres and at the edge’ and that the EU ‘needs to reduce its technological dependencies in these strategic infrastructures, at the centre of the data economy’.²⁸ The proposal also contains provisions that restrict the transfer of non-personal data outside the EU. For instance, public data can be transferred outside the EU to countries that provide ‘equivalent measures’ for protecting intellectual property and trade secrets. In the absence of adequate safeguards, transfers could only be conducted if the entity reusing the data undertakes the obligations to protect the data consistent with EU standards and accepts the jurisdiction of the courts of the EU member states regarding any dispute related to compliance. The proposal also recognises that stricter standards may be necessary for transfer of highly sensitive non-personal data such as health data.

25 German Federal Ministry for Economic Affairs and Energy (2019), Project GAIA-X: A Federated Data Infrastructure as the Cradle of a Vibrant European Ecosystem, Executive Summary, 29 October 2019, available at <https://www.bmwi.de/Redaktion/EN/Publikationen/Digitale-Welt/das-projekt-gaia-x-executive-summary.pdf>.

26 See Gaia-X website: <https://www.data-infrastructure.eu/GAIA-X/Navigation/EN/Home/home.html> (last accessed in May 2021).

27 European Council Conclusions, Special meeting of the European Council (1 and 2 October 2020), EUCO 13/20, at point 7, Brussels, 2 October 2020.

28 Proposal for a Regulation of the European Parliament and of the Council on European Data Governance (Data Governance Act), COM/2020/767 final, 25 November 2020, Brussels.

*Other recent proposals*²⁹

The EU has also pushed forward several additional proposals, which are likely to have an impact on the e-commerce negotiations, as they include issues such as the access to source code by government authorities and intermediary liability. The most relevant proposals are the Digital Services Act,³⁰ the Digital Markets Act,³¹ and the Artificial Intelligence Act.³²

4.2 China

The Cyberspace Administration of China is the main regulatory authority for data flows coordinating China's cyber policy. In addition, China has sectoral regulations for certain types of data flows. For example, the People's Bank of China is responsible for regulating financial data and the National Health Commission is responsible for regulating personal health information.

China has moved rapidly to construct a policy and regulatory framework on data flows. The framework covers different policies, laws, and regulations, as well as national standards. In 2016, the State Council launched *Several Opinions on Promoting Information Development and Effectively Protecting Information Security*, requiring that data centres and cloud computing platforms which provide services for the government should be established within China.

In addition, there are several laws and regulations adopted in the past five years. The *Cybersecurity Law* is at the centre. Its implementation rules, such as *Draft Measures on Security Assessment for Personal Information Cross-Border Transfer* and *Draft Regulations on Protecting the Security of Key Information Infrastructure* are still in draft form. In 2020, China adopted the *Data Security Law* and released the *Draft Personal Information Protection Law*. These two laws, together with the *Cybersecurity Law*, will comprise the three pillars for data governance regime in China.

The national standards on data transfer are not legally binding. But regulatory authorities frequently rely on these standards to implement laws and regulations. As the corresponding standard of the *Cybersecurity Law*, the *Draft Guidelines for Cross-Border Data Transfer Security Assessment* (hereinafter referred to as *Draft Security Assessment Guidelines*) provide the relevant processes and standards that will apply when conducting security assessments before transferring personal information outside of China.

29 For a summary of recent proposals, see also Congressional Research Services (2021), *EU Digital Policy and International Trade*, R46732, 25 March 2021.

30 Proposal for a Regulation of the European Parliament and of the Council on a Single Market for Digital Services (Digital Services Act) and amending Directive 2000/31/EC, COM/2020/825 final.

31 Proposal for a Regulation of the European Parliament and of the Council on contestable and fair markets in the digital sector (Digital Markets Act), COM/2020/842 final.

32 Proposal for a Regulation of the European Parliament and of the Council Laying Down Harmonised Rules on Artificial Intelligence (Artificial Intelligence Act) and Amending Certain Union Legislative Acts, COM/2021/206 final.

The *Cybersecurity Law* and its implementation rules not only cover personal information, but also so-called ‘important data’. According to the *Draft Security Assessment Guidelines*, ‘important data’ means data that is very closely related to China’s national security, economic development, or societal public interests. Pursuant to Annex A of the guidelines, important data tends to be relevant in several industries, including energy, environment, manufacturing, and military.

The *Data Security Law* shall apply to all data activities carried out within China. It will also establish extraterritorial jurisdiction over foreign entities that engage in data activities inside and outside of China, that harm national security or public interest. Since security is a consistent theme of the law, it has established a national security review system to review any data activities that affect, or may affect, national security. The law also implements export control on data that are controlled items related to the fulfilment of international obligations and national security. To identify what kind of data that are controlled items need to refer to the *Export Control Law*, which was also adopted in 2020

Releasing the *Draft Personal Information Protection Law* is a high-profile move, since there is no overarching personal data protection law in China yet. The draft law includes some provisions on cross-border data transfer, including security assessment requirements under specified circumstances, which is aligned with the *Cybersecurity Law*. The draft law also provides for extra-territorial application. It shall apply not only to the processing of personal information within China, but also to cross-border processing activities of personal information of Chinese citizens. Overseas processors are required to establish a specialised agency or appoint a representative within China.

There are several sector specific laws and regulations covering data flows, including financial data, personal health data, online services data, and others. As for financial data, the regulations provide that the credit information and personal financial data shall be stored, processed, and analysed within China. Similar requirements apply to personal health information. Online services data covers online publishing, internet maps, online taxi booking, etc. The main policy rationales for these requirements appear to be cybersecurity, personal information protection, data security, and government access to data. However, it is likely that the main concerns of the Chinese government are internet governance capability, domestic regulatory framework, and jurisdiction.

Firstly, the internet governance capabilities need to be strengthened. Although China is seeking to build a comprehensive cyber governance system, it is far from effective and strong enough. China’s cyber governance has arguably received the fiercest criticism for maintaining government control of cyberspace. But in fact, it is about the regulatory capability of addressing substantial cybersecurity challenges, such as cyber attacks, cyber scams, and personal data breaches. Just take data breaches, for example, where internet

users suffer the most serious data breaches. According to a report by China Consumers Association, over 90% of mobile apps collect too much data, and more than 85% of China's app users have had their data leaked.³³

Secondly, the domestic legal system needs to be improved. Several relevant and important laws remain under development, which leaves legal uncertainties for data flows. There is no overarching personal data protection law in China yet. In 2020, China released the *Draft Law on Personal Information Protection*, which requires conducting security assessments when critical information infrastructure operators transfer personal information across the border. China has also released the *Draft Law on Data Security Law*, stipulating that China will promote the safe and free flow of data across borders.

Thirdly, there are difficulties in exercising jurisdiction. The key issue is how to exercise jurisdiction if there is no local presence. In theory, companies doing business in a country have a legal 'nexus' with that country, which puts the company in that country's jurisdiction. But when it comes to online cross-border supply, the nexus is not strong enough. Law enforcement authorities are unable to easily enforce their decisions, because those decisions require cooperation from relevant actors from other jurisdictions. Mutual legal assistance and law enforcement cooperation is often time-consuming and unpredictable. Extraterritorial jurisdiction, like the *US Clarifying Lawful Overseas Use of Data Act*, will inevitably lead to a conflict of jurisdiction with the country where the data is located.

5. POSITIONS IN THE WTO E-COMMERCE NEGOTIATIONS

5.1 EU

In April 2019, the EU released its proposal on WTO disciplines and commitments related to e-commerce and telecommunication services under the JSI. The proposal is ambitious in ensuring functional data flows for businesses, improving market access and regulatory predictability, while remaining committed to consumer protection and data protection, and includes the following elements (EPRS 2020b):

1. In terms of enabling e-commerce, in particular for SMEs, the EU proposes common rules for improving the recognition of e-contracts and e-signatures.
2. The principle of open internet access, subject to applicable rules, as well as reasonable and non-discriminatory network management. The EU proposal seeks to balance the free flow of data for business purposes with a commitment to personal privacy, which it considers a fundamental right. Enterprises should

33 <https://www.sixthtone.com/news/1003278/90-percent-of-chinese-apps-surveyed-over-collect-data>

not be restricted by requirements to localise data or computer facilities in a given member's territory. At the same time, members need to be free to adopt rules that protect personal data and privacy, as they deem necessary.

3. To build trust in e-commerce, the EU proposes to improve consumer protection by requiring measures against unsolicited emails (spam). The EU suggests that members also put in place measures against fraudulent and deceptive practices, and potentially measures that require traders to act in good faith, provide accurate information, and grant consumers access to redress.
4. On cross-cutting issues, the EU proposes to improve transparency and regulatory predictability.
5. With regard to telecommunications, the EU proposes to revise rules for telecommunications services, such as tackling anti-competitive practices and enabling interconnectivity between suppliers, and to improve market access for computer services.
6. A prohibition on governments requiring the transfer of, or access to, source code (human-readable programmes), except in special cases such as the enforcement of intellectual property rights or for competition law purposes.
7. A commitment to refrain permanently from imposing customs duties on electronic transmissions (e.g. movies, emails, software).
8. Greater participation by WTO members in the ITA and its product coverage expansion.
9. Exclusion of cultural and audio-visual issues from the scope of the negotiations to protect cultural diversity.

The Trade Policy Review communication published in February 2021 by the European Commission makes clear that digital trade is a priority for EU trade policy, and that the EU intends to play a central role in shaping the global rules under the WTO.³⁴

5.2 China

China has elaborated its position regarding the WTO e-commerce negotiations in its communications to the WTO. China stressed that 'the negotiation should set a reasonable level of ambition with full consideration of members' right to regulate, strike a balance among technological advancement, business development, and legitimate public policy

³⁴ European Commission (2021), Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Trade Policy Review - An Open, Sustainable and Assertive Trade Policy, COM(2021) 66 final.

objectives of members, such as internet sovereignty, data security, privacy protection, etc., and reach a balanced, pragmatic outcome reflecting all members' interests through equal consultation' (WTO 2019b).

China's proposal focuses on the discussion of cross-border trade in goods enabled by the internet, together with relevant payment and logistics services, while paying attention to the digitalisation trend of trade in services, and exploring the way to develop international rules for e-commerce centring on a sound transaction environment and a safe and trustworthy market environment.

There are four action areas in China's position in the WTO negotiations under the JSI:

1. Clarify the definition of trade-related aspects of e-commerce and future rules' scope of application, including the trade-related aspects of e-commerce, electronic transmission, etc.
2. Establish a sound environment for e-commerce transaction, including facilitating cross-border e-commerce, paperless trading, electronic signatures and electronic authentication, electronic contracts, moratorium of customs duties on electronic transmissions.
3. Create a safe and trust-worthy market environment for e-commerce, including online consumer protection, personal information protection, unsolicited electronic commercial messages, cyber security, and transparency.
4. Promote pragmatic and inclusive development cooperation, including to bridge the digital divide, support research, training and communication and e-commerce for development programmes.

China has noted that issues such as cyber security, data safety, and privacy are increasingly highlighted, bringing unprecedented security risks and regulatory challenges to members. China has argued that associated issues such as data flow, data storage, and treatment of digital products need more exploratory discussions before being incorporated into WTO negotiations, to allow members to fully understand their implications and impacts, as well as the related challenges and opportunities.

6. CONCLUSIONS

The prevailing multilateral rules regulating digital trade predate the global internet. Updating them is important, given the trend for countries to embed rules for cross-border trade in digital goods and services in discriminatory free trade agreements. The launch of WTO e-commerce JSI negotiations on a plurilateral basis should be seen as major progress in WTO e-commerce discussions, which reflects the new demands for international trade rules on e-commerce. These ongoing negotiations offer an opportunity to build on recent regional agreements to agree on rules to support digital trade.

While the EU and China have different starting points on the WTO e-commerce negotiations, the respective approaches seem to point towards scope for convergence on several topics. These commonalities in the preferences on some elements of digital trade policy create prospects for cooperation in this area. Yet, whether the two major trade powers can help address obvious differences among the parties in the JSI negotiations remains to be seen. Some topics remain contentious, such as permanent moratorium of customs duties on electronic transmissions, non-discrimination treatment of digital products, cross-border free data flow, and transfer of source code. The divergences not only reflect the conflicts between trade liberalisation and non-trade goals, but also the interrelationship between digital trade policies and broader internet governance challenges.

While the JSI can play an important role in confirming key principles and good practices, which have been embodied in 'next-generation' FTAs, such as CPTPP, Digital Economy Partnership Agreements, and the ASEAN e-commerce agreement, an ambitious agreement covering issues such as data flows and source code seems unlikely given the large number of countries involved in the JSI discussions and the diverging positions of China, the EU, and the US on key subjects. Reconciling the positions of the major players in the negotiations is essential to the success of the e-commerce talks.

Even if some issues cannot be resolved, the JSI negotiations can improve the governance of digital trade by promoting transparency, enhancing predictability, and establishing a mechanism for regulatory cooperation on interoperability and, eventually, greater harmonisation of regulatory regimes. To this end, the following points might be considered:

1. The agreement should promote transparency. This can be done through the publication of current measures and proposals relating to e-commerce and by offering the opportunity to members to comments on those measures.
2. In order to reduce ambiguity, the negotiators should clarify the definition and scope of e-commerce and shed light on whether the rules will take the form of a self-standing agreement (and if so, its relationship with existing WTO agreements) or will instead entail a modification of existing provisions. The accession mechanism should be clarified, and it should be ensured that the market access and national treatment commitments are compatible with GATS. A positive list approach might support the multilateralisation of the agreement, while a negative list would require further thought on how to make the system compatible with current commitments. Several developing countries have pointed out that a negative list approach can bring them considerable challenges, and that the establishment of a separate agreement would create uncertainty on how the GATT, the GATS, and other related agreements apply to e-commerce.

3. To support the inclusion of LDCs, the negotiations could establish an open plurilateral agreement, which, in contrast with an exclusive agreement, is implemented on the basis of most-favoured-nation (MFN) treatment. An open agreement would enable all countries outside the current negotiations, which are mostly developing and least-developed countries, to enjoy the benefits of the agreement, while not having to assume corresponding obligations. This would help them integrate into global e-commerce and global value chains and would be in line with the objective of the WTO e-commerce negotiations to ‘further enhance the benefits of e-commerce for businesses, consumers and the global economy’ (WTO 2019a).
4. Regulatory cooperation, whether in form of structured dialogue or ad hoc conversations, should be encouraged to allow members to address the cross-border nature of e-commerce, and can contribute to the exchange of good practices. Cooperation is the starting point for clarifying different regulatory regimes with the view of promoting harmonisation.
5. Efforts for harmonising and consolidating digital trade rules can be crucial to reap the benefits of digitalisation in the coming years. As already stipulated in the Agreement on Technical Barriers to Trade (TBT), relevant international standards such as International Organization for Standardization (ISO) and Institute of Electrical and Electronics Engineers (IEEE) can be the basis for creating digital trade rules. Therefore, collaboration in standard setting activities can be an important component in the overall architecture of the JSI. Involvement of business and international organisation should also be considered, given that certain issues can be very technical in nature.
6. Where harmonisation is not practical or politically feasible, finding bridging mechanisms between different regimes may be useful to find common ground. Promoting interoperability between the approaches brought forward by heterogeneous members would be a good first step.
7. For sensitive issues on which negotiators cannot agree, soft law provisions could be a viable option, leaving a gradual transition to hard law provisions in the future.
8. Considering the differences in the level of development, technical level, and regulatory capabilities of the participants, some participants proposed that the negotiations should adopt a flexible commitment framework. Japan suggested a two-tier approach to e-commerce commitments with some members taking deep commitments and other taking shallower commitments. The EU has advocated the adoption of an *à la carte* negotiation framework to adapt to the demands of different participants, who would be able to choose the provisions they are willing to accept. The two-tier approach might be more conducive to maintaining the relative unity of the negotiation framework and facilitate the parties to reach an agreement.

9. Any agreement should include technical assistance provisions to effectively address the concerns of the developing countries and LDCs on the implementation capacity, so that more WTO members could join the agreement.³⁵ These countries could be supported in the formulation of relevant domestic laws and regulations and the establishment of law enforcement agencies to implement e-commerce provisions, such as electronic signatures and certification, paperless trade, online consumer protection, and personal information protection.
10. The agreement should promote predictability by clarifying the coverage of the exceptions, including by offering a definition of what constitutes a legitimate policy objective and an essential security interest. If anything, members should have the possibility to discuss how a certain measure is expected to achieve a specific policy objective and provide information of possible alternatives which are less trade restrictive. This dialogue would also be greatly enriched by the contribution of regulatory authorities, practitioners, academics, and private sector representatives.
11. The system agreed should try to accommodate future developments. One reason for ITA's success in meeting technological changes is the use of narrative definitions of products, for which it was not possible to identify the HS code.³⁶ Similarly, members of the negotiations on e-commerce should seek similar approaches to clarify the coverage of the commitments, for example by endorsement classification tools, such as the Understanding on Computer and Related Services (S/CSC/W/51), which clarify the sectoral coverage of services commitments.

The WTO e-commerce negotiations cover a significant portion of the WTO membership, and it is expected that more members will continue to join, providing a unique opportunity for building e-commerce rules in the 21st century. Bridging the gaps in the positions of the participants and finding a compromise which is open, inclusive and facilitates the participation of the least developed members would help to revive the WTO's relevance for the 21st century global economy.

REFERENCES

- Azmeh, S, C G Foster, & J Echavarri (2020), 'The International Trade Regime and the Quest for Free Digital Trade', *International Studies Review*, 22(3): 671-692.
- Baker, A S, P Lichtenbaum, M D Shenk, and M S Yeo (2001), 'E-Products and the WTO', *International Lawyer* 35: 5-7.

35 The WTO Trade Facilitation Agreement was the first agreement in the history of the multilateral trading system to include technical assistance clauses and stipulates that 'donor members agree to facilitate the provision of assistance and support for capacity building to developing country and least-developed country Members on mutually agreed terms either bilaterally or through the appropriate international organizations'.

36 Harmonized Commodity Description and Coding System.

Bergemann, K L (2002), 'A Digital Free Trade Zone and Necessarily-Regulated Self-Governance for Electronic Commerce: The World Trade Organization, International Law, and Classical Liberalism in Cyberspace', *Marshall Journal of Computer and Information Law* 20: 595-601.

Burri, M and R Polanco (2020), 'Digital Trade Provisions in Preferential Trade Agreements: Introducing a New Dataset', *Journal of International Economic Law* 23(1): 187-220, <https://doi.org/10.1093/jiel/jgz044>.

CNNUM (2017), 'Strengthening EU's Negotiation Strategy to Make TTIP a Sustainable Blueprint for the Digital Economy and Society: Opinion of the French Digital Council', French Digital Council.

European Commission (2018), 'Questions & Answers on the Japan adequacy decision', MEMO/18/4503, https://ec.europa.eu/commission/presscorner/detail/en/MEMO_18_4503.

EPRS (2020a), 'Digital sovereignty for Europe', EPRS Ideas Paper: Towards a more resilient EU, European Parliamentary Research Service, [https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/651992/EPRS_BRI\(2020\)651992_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/651992/EPRS_BRI(2020)651992_EN.pdf).

EPRS (2020b), 'WTO e-commerce negotiations', At a Glance, European Parliamentary Research Service, [https://www.europarl.europa.eu/RegData/etudes/ATAG/2020/659263/EPRS_ATA\(2020\)659263_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/ATAG/2020/659263/EPRS_ATA(2020)659263_EN.pdf).

Friends of E-Commerce for Development (2017), 'Developing countries launch roadmap for international trade and development policy' (Press release): <https://www.ip-watch.org/weblog/wp-content/uploads/2017/04/Press-Release-FED-MinisterialMeeting-25.04.17-002.pdf>.

López González, J & J Ferencz (2018), 'Digital trade and market openness', OECD Trade Policy Papers, No. 217: <http://dx.doi.org/10.1787/1bd89c9a-en>.

MIKTA (2016), MIKTA e-commerce workshop reflections, <http://www.mikta.org/document/others.php?at=view&idx=235&ckattempt=1>.

Ismail, Y (2020), 'E-commerce in the World Trade Organization: History and latest developments in the negotiations under the Joint Statement', International Institute for Sustainable Development and CUTS International, <https://www.iisd.org/sites/default/files/publications/e-commerce-worldtrade-organization-.pdf>.

Leblond, P (2020), 'Digital Trade: Is RCEP the WTO's future?', Centre for International Governance Innovation.

Micallef, J A (2019), 'Digital Trade in EU FTAs: Are EU FTAs Allowing Cross Border Digital Trade to Reach Its Full Potential?', *Journal of World Trade* 53(5): 855-870, <https://kluwerlawonline.com/journalarticle/Journal+of+World+Trade/53.5/TRAD2019034>.

WTO (1998a), 'Declaration on Global Electronic Commerce', adopted on 20 May 1998, Ministerial Conference Second Session, WT/MIN(98)/DEC/2.

WTO (1998b), 'Work Programme on Electronic Commerce', adopted by the General Council on 25 September 1998, WT/L/274.

WTO (2011a), Work Programme on Electronic Commerce: Communication from the European Union and the United States, S/C/W/338.

WTO (2011b), Work Programme on Electronic Commerce: Communication from the United States: Ensuring that Trade Rules Support Innovative Advances in Computer Applications and platforms, such as Mobile Applications and the Provision of Cloud Computing Services, S/C/W/339.

WTO (2014), Work Programme on Electronic Commerce: Communication from the United States, S/C/W/359.

WTO (2015), Nairobi Ministerial Declaration, WT/MIN(15)/DEC.

WTO (2016), Working programme on electronic commerce: Non-paper from the United States, JOB/GC/94.

WTO (2017a), 20 Years of the Information Technology Agreement https://www.wto.org/english/res_e/booksp_e/ita20years_2017_chap2_e.pdf.

WTO (2017b), Joint Statement on Electronic Commerce, WT/MIN(17)/60.

WTO (2017c), Working programme on e-commerce, Statement by the Africa Group, WT/MIN(17)/21.

WTO (2019a), Joint statement on electronic commerce: Communication from Côte D'ivoire, INF/ECOM/49.

WTO (2019b), Communication from China, Joint Statement on Electronic Commerce, INF/ECOM/19.

WTO (2020), Joint Statement Initiative On E-commerce: Co-conveners' Update, https://www.wto.org/english/news_e/news20_e/ecom_14dec20_e.pdf.

Wu, M (2017), *Digital trade-related provisions in regional trade agreements: Existing models and lessons for the multilateral trade system*, ICTSD.

Yakovleva, Sand K Irion (2020), 'Pitching trade against privacy: reconciling EU governance of personal data flows with external trade', *International Data Privacy Law*, 10(3): 201-221.

ABOUT THE AUTHORS

Martina F. Ferracane is a Post-Doctoral Researcher focusing on digital trade and data flows at the European University Institute and she acts regularly as a consultant for several organizations including the UN, the WEF and the WB. Martina also manages FabLab Western Sicily, an NGO that brings creative digital education to Sicilian kids.

LI Mosi is a Research Professor at Shanghai University of International Business and Economics (SUIBE), China. She serves as an expert on the National Digital Trade Expert Working Group and National Informatization Expert Consultation Committee. She was a Visiting Scholar at Georgetown University Law Center in 2016-2017.

CHAPTER 10

Updating the General Agreement on Trade in Services¹

177

Bernard Hoekman and SHI Jingxia

EUI & CEPR; Renmin University

Since the establishment of the World Trade Organization (WTO) in 1995, members have done little to adapt and expand the rules of the game for policies that affect trade in services. Structural transformation trends that are increasing the role of services in economic activity have not been accompanied by revision of WTO rules and coverage, reducing the salience of the organisation. Ongoing talks among groups of WTO members on e-commerce and domestic regulation of services will help to fill the gap, but need to be complemented by action to update and expand the coverage of the General Agreement on Trade in Services (GATS). China and the European Union (EU), for different reasons, have a strong interest in expanding services trade, as do India and the United States (US), providing the basis for a China-EU led plurilateral initiative to resuscitate talks on trade in services in the WTO.

INTRODUCTION

Since 1995, services have become steadily more important in global economic activity, driven by a mix of increasing average real incomes in many countries and managerial and technological changes. Services are particularly important for the EU, accounting for some 66% of GDP for the EU27 as a whole. This is very similar to the services share of GDP in China, at 65%. The two trading powers differ, however, in terms of trade specialisation and openness to trade in services. For the EU27, trade in services (exports plus imports) is some 27.3% of EU27 GDP, the figure is much lower for China at 5.3% of GDP. This is associated with much larger nominal values of services trade – the EU27 in 2019 exported (imported) €1.055 billion (€942 billion) worth of services to (from) the rest of the world, running a trade surplus. China, in contrast, runs a substantial global trade deficit in services, with exports (imports) of €255 (€450) billion.² In part, the difference in absolute size of trade in services reflects differences in average levels of per capita income, while the services trade deficit reflects China's relative specialisation in merchandise.

¹ The project leading to this paper received funding from the European Union's Horizon 2020 research and innovation programme under grant agreement No 770680 (RESPECT).

² Data sourced from European Commission and World Bank, converted into Euros at average nominal exchange rate in 2019.

Negotiated more than 25 years ago, the GATS filled a major gap in the 1947 General Agreement on Tariffs and Trade (GATT), which applied only to trade in goods. Expanding the multilateral trading system of rules to encompass services was a major achievement of the Uruguay Round negotiations. Since then, WTO members have done little to adapt and expand the rules of the game for policies that affect trade in services. Efforts to expand the coverage of the GATS have been unsuccessful. Ongoing plurilateral talks launched in 2017 on e-commerce and domestic services regulation offer a prospect for updating of rules in key policy areas, but these do not encompass many market access-restricting policies across a wide range of services sectors. The stylised facts on the role of services in aggregate trade of the EU suggest services should be an important 'offensive' interest in commercial policy terms. From the mercantilist perspective that informs trade negotiations, the large services trade imbalance suggests this is more likely to be a 'defensive' interest for China. However, services imports can be expected to increase as the Chinese economy transitions away from being based on export-driven development towards a more domestic consumption driven growth model. Whatever the underlying political economy drivers of services trade policies, the premise underlying this chapter is that the continued relevance of the multilateral trading system hinges on the ability (willingness) of large WTO members to revisit and expand the coverage of the GATS.

THE STATE OF PLAY

As mentioned, GATS rules and commitments date back to the mid-1990s. New technologies, notably the internet and the associated shift towards a digital economy, have made the GATS increasingly outdated. Starting in 2000, talks commenced to expand the coverage of the agreement. These subsequently became part of the Doha Development Agenda (DDA), the multilateral trade round launched in 2001. The DDA services negotiations did not result in a successful outcome. In part, this was because services were initially put on the back burner in the DDA. The priority was given to agriculture and trade in manufactures, reflecting relative disinterest by many developing countries in services trade and the complexity of service liberalisation compared with trade in goods. Parallel talks on domestic regulation of services and on e-commerce – both initiated in the late 1990s – sought to address specific dimensions of the complex policy framework affecting trade in services. Consensus on a way forward in either area proved elusive. Aside from a waiver to permit WTO members to grant services trade preferences to the group of least developed countries (LDCs), adopted in 2011 and extended in 2015, WTO members have made no additional liberalisation commitments since the GATS came into force.

Instead, many WTO members focused efforts on negotiating preferential trade agreements (PTAs) that covered services trade.³ Many of these PTAs go beyond the GATS, not only in terms of coverage of market access commitments, but also in terms of approaches and rules (Adlung and Roy 2005). An example is the use of a negative list approach to determining sectoral coverage, under which commitments apply to all services unless explicitly excluded. GATS market access commitments use a positive list approach: they apply only to those sectors and activities that are scheduled. Once it became clear that DDA talks among the WTO membership had become deadlocked, the experience with PTA-based approaches motivated a small group of 23 WTO members⁴ to launch negotiations on a Trade in Services Agreement (TiSA) in 2013. Whether the outcome of these talks would be structured as a PTA under Article V of the GATS (which permits stand-alone Economic Integration Agreements among subsets of WTO members if these have substantial sectoral coverage) or instead would have been included in WTO members' GATS schedules and applied on a most favoured nation (MFN) basis was never determined. The TiSA talks ceased at the end of 2016 because the Trump administration did not support the initiative.

At the December 2017 WTO Ministerial Conference in Buenos Aires WTO members launched four 'joint statement initiatives' (JSIs) spanning e-commerce, domestic regulation of services, investment facilitation, and measures to enhance the ability of micro and small and medium enterprises (MSMEs) to utilise the trade opportunities.⁵ All four of these JSIs encompass elements affecting services trade. The e-commerce JSI talks involve 80+ WTO members, mostly middle- and high-income nations. The focus of deliberation is on a mix of trade restrictive policies and digital trade facilitation.⁶ The former include regulation of cross-border data flows and data localisation requirements, the latter include issues like electronic signatures, e-invoicing, facilitating electronic payment for cross-border transactions, and cooperation on consumer protection (e.g. combatting fraud). Services domestic regulation talks involve 60+ WTO members and center on matters associated with authorisation and certification of foreign services providers (licensing, qualification, and technical standards), not on substance of regulations. The aim is to reduce the trade-impeding effects of domestic regulation by:

- Enhancing transparency of policies through national enquiry points.
- Adopting good practice timeframes for processing of applications.
- Acceptance of electronic applications by service providers.

3 By the end of March 2021, there were 174 PTAs that include provisions on trade in services, of which two are services-only agreements. See <http://rtais.wto.org/UI/publicsummarytable.aspx> (last visited April 1, 2021).

4 Australia, Canada, Chile, Chinese Taipei, Colombia, Costa Rica, the EU, Hong Kong (China), Iceland, Israel, Japan, Liechtenstein, Mauritius, Mexico, New Zealand, Norway, Pakistan, Panama, Peru, South Korea, Switzerland, Turkey, and the US.

5 https://www.wto.org/english/news_e/news17_e/minis_13dec17_e.htm.

6 For a summary of the issues tabled by different participants, see <https://etradeforall.org/wto-members-submit-proposals-aimed-at-advancing-exploratory-e-commerce-work/> and Ismail (2020).

- Ensuring national authorising bodies are independent, impartial and use objective criteria.
- Establishing mechanisms for foreign providers to request domestic review of decisions.

Both the e-commerce and domestic services regulation subjects have been discussed at the WTO since the late 1990s. A WTO work programme on e-commerce was initiated in 1998, and a Working Party on Domestic Regulation was established in 1999.⁷ These work programmes were anchored in existing WTO treaties. The mandate of the working party on domestic regulation of services was to develop horizontal (cross-sectoral) disciplines called for in Art. VI GATS. E-commerce touches on matters addressed by all three of the major WTO multilateral agreements – GATT, GATS, and TRIPS.⁸

The characteristics of services (intangibility and non-storability) often means provision requires a physical presence (mode 3), making investment facilitation highly relevant to services trade, whereas many MSMEs provide or sell services. The MSME and investment facilitation JSIs differ from e-commerce and services regulation in not being tied to existing WTO agreements. The aim of the MSME JSI, which includes some 90 WTO members,⁹ is to identify measures that governments can take to support the internationalisation of small firms. Any agreement will be applied on a voluntary basis.¹⁰ Talks on investment facilitation, launched by some 70 WTO members in Buenos Aires, have grown to encompass more than 100 participants.¹¹ The talks cover all sectors, goods, and services, and centre on ‘good regulatory practices’ such as transparency of investment-related policies, streamlining administrative procedures, and information sharing. The agenda excludes liberalisation of inward FDI policies, measures related to protection of foreign investors and investor-state dispute settlement. The focus on facilitation as opposed to liberalisation is very similar to – and builds on – the Doha Development Agenda agreement on trade facilitation.

Taken together, if successful, the JSIs will move participating WTO members in the direction of a proposal to facilitate trade in services put forward by India in 2016 to the WTO Working Party on Domestic Regulation (Government of India 2016a, 2016b). This aimed to discuss and agree on measures to facilitate trade in services, with a focus on enhancing transparency, streamlining procedures, and removing redundant red tape and bottlenecks associated with the administration of regulatory policies that apply to services trade. India’s proposal presumed any agreement to facilitate trade in services

7 A precursor Working Party on Professional Services agreed in 1998 on a set of principles for regulation of licensing of accountants and accountancy services. These were adopted by the Council on Trade in Services in 1998 but did not enter into force because of linkage to a successful conclusion of the Doha round negotiations.

8 The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

9 https://www.wto.org/english/news_e/news20_e/msmes_05nov20_e.htm.

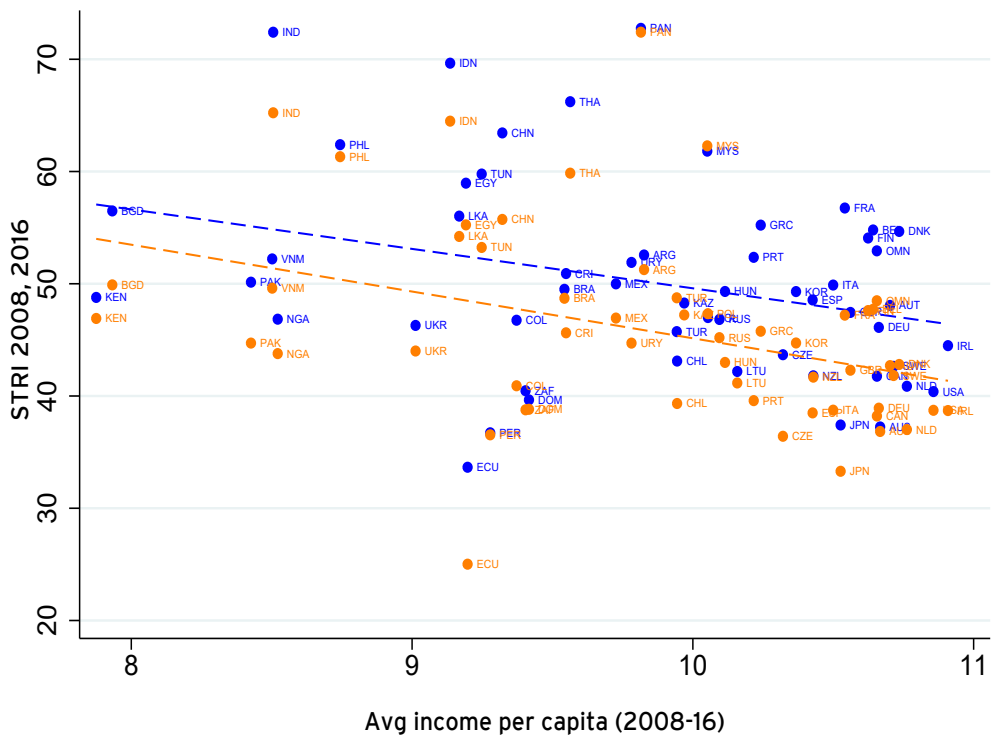
10 See Campos-Leal et al. (2020).

11 https://www.wto.org/english/news_e/news19_e/infac_05nov19_e.htm. See Baliño et al. (2020).

would be multilateral in the sense of applying to all WTO members, analogous to the Trade Facilitation Agreement (TFA). It would also emulate the TFA by not focusing on the substance of market access restricting policies.

Much, if not most, of what may emerge from the JSI talks will apply on an MFN basis because they do not encompass market access liberalisation (discriminatory policies). The e-commerce talks are the exception, in that policies constraining mode 1 trade are on the table (Section F of the leaked consolidated text in December 2020), but attention focuses mostly on data-related policies. Discriminatory trade measures more generally, including mode 3 and mode 4 restrictions, are not on the table in any of the JSIs. Taken together, if successful, the joint initiatives will facilitate trade and investment in services, but they will do little to open markets to greater competition by foreign services suppliers. Services trade restrictiveness indicators compiled by the World Bank and the WTO, and the OECD, illustrate that barriers to trade in services remain significant in many countries. There has been some reduction in the average level of trade restrictiveness since the late 2000s, but trade in services often remains more constrained by policy than trade in goods (Figure 1). Monitoring of trade policy dynamics since 2009 by the Global Trade Alert reveals very little in the way of measures to liberalise trade in services.¹²

FIGURE 1 STRI 2016 VS. STRI 2008

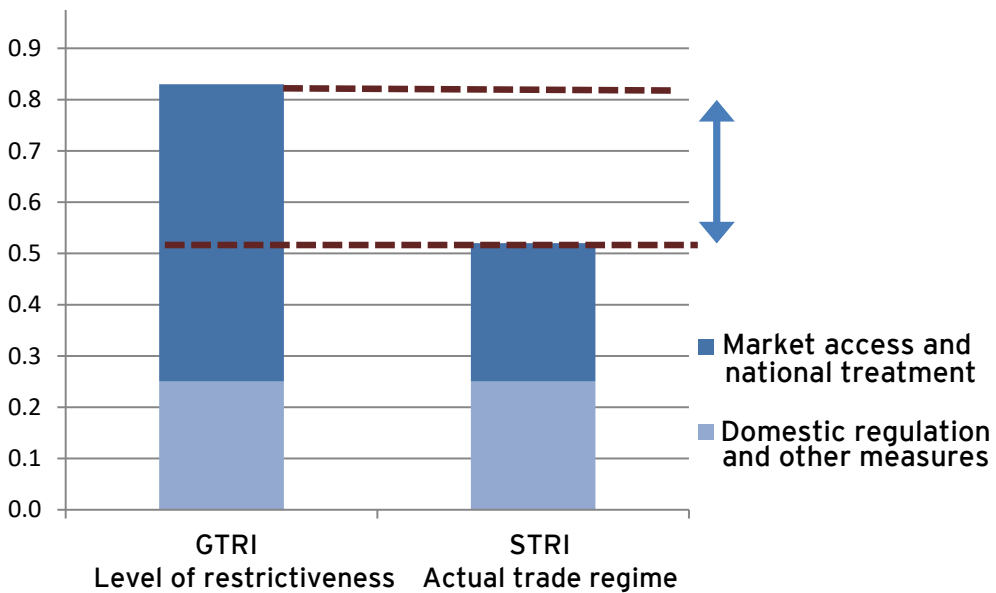


Source: Borchert et al. (2020).

¹² <https://www.globaltradealert.org/>.

Abstracting from lowering the level of barriers to trade in services implied by policies applied by countries, there is also much scope to reduce policy uncertainty for businesses engaged in international trade. The GATS is an instrument to lower such uncertainty through sector- and mode-specific commitments designed not to increase market access barriers above a specified level and/or to apply the national treatment principle to specified services activities. The main purpose of the GATS, as well as PTAs that cover services, is to bind services trade policies. PTAs often cover more services than the GATS, providing an opportunity to include the commitments made by PTA members in the GATS. That was one negotiating goal of TiSA talks, which largely centred on expanding the coverage of policy bindings as opposed to further liberalisation. Research has shown that even deep PTAs like the agreement on Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) entail limited liberalisation, instead acting more as a device to lock-in (bind) applied policies.¹³ This is of value, because reducing uncertainty increases investment by firms (Ciuriak et al. 2020). The difference in coverage of the GATS and applied services trade policies suggests a useful first step would be to expand the coverage of GATS by doing more to make commitments not to raise current levels of services market access restrictions (Figure 2).

FIGURE 2 DIFFERENCE BETWEEN GATS COMMITMENTS AND APPLIED POLICIES.



Source: Miroudot and Pertel (2015).

¹³ See e.g. Roy (2011), and Gootiiz and Mattoo (2017).

MOVING FORWARD: TWO POTENTIAL PATHS

There are two potential paths to update the coverage of the GATS. One is to expand participation in deep PTAs such as the CPTPP or for like-minded countries to negotiate a new PTA that brings together countries that have been concluding deeper PTAs. The other is for like-minded countries to launch negotiations on an open plurilateral agreement (OPA) on trade in services – i.e. to emulate the groups of WTO members using JSIs to engage on matters of common interest. The OPA path is in our view the more desirable one. Both potential paths entail engagement by and among a subset of the WTO membership, but a major difference is that the OPA route requires a critical mass of WTO members making commitments that would apply on an MFN basis, whereas the PTA track would result in a discriminatory arrangement.¹⁴

China has recently signed the Regional Comprehensive Economic Partnership (RCEP), which includes services, as does the recently concluded China-EU Comprehensive Agreement on Investment (CAI). China has also signalled potential interest in engaging with CPTPP members. If China, the EU, and the US were to join the CPTPP this would come close to critical mass, but would not be sufficient, given that the countries involved can be expected to be concerned by free riding by India – the main large services exporter not included in such a CPTPP+ grouping. Thus, the CPTPP+ route would continue to involve discrimination and take the form of a PTA.

In our view, a critical mass OPA under auspices of the WTO that applies on a non-discriminatory basis is more desirable from both an economic and systemic perspective than expansion of PTAs. Although we are fully cognisant of the challenge of negotiating a meaningful MFN-based agreement, the major trading powers all have an interest in improving market access conditions for services. Joint action to pursue services trade reform in the WTO would be consistent with the importance accorded to multilateralism and the strong support for the WTO by both the EU and China.¹⁵ The Article V GATS PTA route is always available as an outside option if critical mass (free rider) constraints bind. The investments made in determining the potential contours of an agreement will not be lost if the OPA route proves infeasible, insofar as a subset of the countries that can agree, could always create a PTA framework to harvest the results of discussions, excluding the countries that are not willing to join them.

14 See Hoekman and Mavroidis (2015) and Hoekman and Sabel (2021) for further discussion of plurilaterals in the WTO and the OPA concept. See Gallagher and Stoler (2009) and Winslett (2018) on critical mass.

15 The latter was demonstrated *inter alia* by the participation of China in the Multi-Party Interim Appeal Arrangement (MPIA), the contingency measure to respond to the Appellate Body crisis suggested by the EU.

A CHINA-EU SPONSORED JSI ON TRADE IN SERVICES IN THE WTO

Both the EU and China have revealed an interest in cooperating on services trade policies. The CAI contains a significant number of services commitments, providing a foundation for continued cooperation in this regard between China and the EU. As importantly, the CAI demonstrates the willingness on the part of China to engage on services trade issues and improve regulatory frameworks for services sectors, including enhanced transparency and disciplines on state-owned enterprises (European Union 2020). A China-EU drive to launch an initiative to expand on the GATS by negotiating an OPA on services could build on the mode 3 services market access liberalisation agreed between the EU and China in the CAI,¹⁶ as well as the successful conclusion of the RCEP negotiations. Although some WTO members, notably India and South Africa, oppose JSIs, arguing these are legally inconsistent with WTO rules (WTO 2021), the US, the EU, and others defended the legitimacy of these plurilateral negotiations during a General Council meeting in early March 2021, with the US holding that the JSIs are an important part of keeping the WTO relevant (Monicken 2021).

As the world's second largest economy, China represents a huge market with potential demand for services and associated liberalisation arising from the ongoing process of economic transition and structural change. The market potential offers China opportunities to pursue offensive interests and negotiate market access and non-discrimination treatment for Chinese services exported overseas. On the other hand, China's defensive interests mainly concern sensitive sectors such as online cultural products and those services concerning critical infrastructure, cybersecurity, or even wider national security. While the latter are important, they do not necessarily preclude that a compromise among the EU, China, and other WTO members is not possible. Geopolitical tensions and ideological and cultural differences among the US, the EU, and China¹⁷ do not mean there is no scope for joint gains from cooperation on trade. The e-commerce JSI discussion on digital trade matters, the CAI, and RCEP illustrate this. The prospects for success may seem dim given current tensions between China and the US, and past opposition by the US to accept China as a participant in the TiSA negotiations, but convergence on a range of issues suggests this is a path worth pursuing.

Cross-border data flows provide an example. The US has long been advocating the principle of data flow in trade agreements subject to very limited exceptions. The EU has a more conservative attitude towards data flows, reflecting a desire to protect privacy (Ferracane and Li 2021). In the JSI negotiation on e-commerce, the EU seeks to ban data localisation measures and while conditioning data flows on regulatory standards and protecting privacy as a fundamental right (WTO 2019). As is reflected in the CAI and the

16 Should the CAI not be ratified by the European Parliament, the OPA route offers an opportunity to go beyond a bilateral arrangement and integrate core elements of what was agreed into a plurilateral agreement that encompasses more countries.

17 See e.g. Huntington (1993), Wu (2020).

RCEP e-commerce chapter, China has shown a willingness to revisit what were considered redline issues such as data flows. The CAI allows data flow of financial information¹⁸ and RCEP includes data flow disciplines as well.¹⁹ Although the CAI does not address data flows in all sectors and RCEP excludes data flow-related matters from dispute settlement, these developments indicate that China does not regard these sensitive issues as redlines anymore. Domestically, Hainan Free Trade Port has put data flow into test already.²⁰ The relevant domestic laws and draft texts are currently being reviewed, with a view to preparing for a potential application to join the CPTPP.

A similar observation applies regarding state-owned enterprises. As discussed by Kurtz and Gong, and by Hoekman and Sapir in their contributions, the inclusion of provisions on SOEs in the CAI suggests China may accept disciplines concerning some sensitive issues if there is policy room to maintain its freedom to regulate services sector activities. These examples of convergence on key issues among major players certainly do not mean negotiations will be successful but they provide a basis for the large services trade powers to sit at the negotiating table. A necessary condition is that the ability to regulate complements flexibility in the form of negative lists and hybrid scheduling. Assuring the freedom to regulate is a matter of common concern, given regulatory preferences and approaches differ across countries. How to understand the term 'legitimate public policy objective' will be an important element of any negotiation (Desierto 2015), including how such concepts relate to general exceptions and security exceptions. The well-developed WTO jurisprudence, including on GATS Article XIV (General Exceptions), has demonstrated how difficult it is to satisfy the two-tier test (Mishra 2020).²¹ After all, an exception is an exception which is not supposed to be treated as a normal right of all WTO members. On the other hand, the exception route leaves room to safeguard genuine legitimate public policy objectives, which makes it a useful tool in striking the delicate balance between service liberalisation and the legitimate right to regulate if appropriately employed in practice.

LESSONS FROM THE TISA NEGOTIATION

The US rejected China's application in September 2013 to join in the TiSA negotiations, despite support from the EU,²² Korea, and Singapore, among others.²³ The US was concerned that China's participation would result in a watering down of ambition and

18 EU-China Comprehensive Agreement on Investment, Section II, Investment Liberalization, Sub-Section III, Financial Services, Article 1 (*Scope and Definition*), paragraph 3, (a) (B) 11 (*provision and transfer of financial information, and financial data processing and related software*).

19 Regional Comprehensive Economic Partnership (RCEP), Chapter 12 (*Electronic Commerce*).

20 The Central Committee of Chinese Communist Party & The State Council of China: Master Plan for Hainan Free Trade Port, Section II (*Institutional Design*), sub-section 6 (*dataflow with security and order*), June 1, 2020. The draft Law on Hainan Free Trade Port released on January 1, 2021, in its Article 42, also provides that Hainan establish a secure, orderly, and convenient data flow system.

21 See also WTO Analytical Index, GATS - Article XIV (Jurisprudence), https://www.wto.org/english/res_e/publications_e/ai17_e/gats_art14_jur.pdf (last visited April 27, 2021).

22 EU Backs China Joining Talks on Trade in Services Agreement (TiSA), March 31, 2014, <https://www.neweurope.eu/article/eu-backs-china-joining-talks-trade-services-agreement-tisa/> (last visited April 4, 2021).

23 For discussions of the TiSA negotiation, see Di Lieto and Treisman (2018) and Raza et al. (2018).

drive talks to a dead end (Viola 2020). While to some extent understandable, given the major differences between the US and China on several issues, the developments noted above suggest a re-assessment is in order. China's participation in any services trade negotiation is critical, given the size of the Chinese market and internal and external demands for structural transformation of the economy towards services. Any proposal to engage in plurilateral negotiations on services – whether based on a PTA or an OPA track – that does not include China, will greatly reduce the potential benefits of whatever is agreed.

A new JSI negotiation on services should focus on expanding the coverage of GATS (Delimatsis 2020). In this regard, TiSA negotiators first tried to exchange the best commitments that the participants had undertaken in their PTAs. Reportedly, this approach made substantial progress in generating market access offers that went well beyond GATS commitments (Marchetti and Roy 2013). This approach may still serve as a reasonable starting point for a new JSI negotiation on services. For example, the CAI covers services market access liberalisation via mode 3 (commercial presence) and provides an example of China's best services commitments thus far in most services sectors. In principle it should be feasible for China to extend its CAI commitments to many other participants, because of the importation of substantive treatment via MFN clauses contained in the treaties concluded between China and those countries, unless provided otherwise.²⁴ Furthermore, CAI is an investment agreement rather than a trade agreement, implying neither China nor the EU can invoke GATT Article XXIV or GATS Article 5 to prevent the spillover of the benefits contained in the CAI to other parties. As noted, insofar as the prospects for ratification of the CAI by the EU have been affected negatively by recent political developments, the incentive to pursue an OPA on services under WTO auspices increases for other WTO members.

Beyond exchanging best PTA and investment agreement commitments, the liberalisation modalities used in the negotiation, i.e. negative vs. positive list approach to scheduling commitment, or a combination of both, is an important factor (Adlung and Mamdouh 2014). The flexibility of the hybrid scheduling method adopted in the TiSA negotiations may help attract more WTO members to join the negotiation. The TiSA hybrid approach builds on the GATS, providing for commitments on national treatment for all services sectors based on a negative list, and market access commitments on a positive list.²⁵ Recent PTAs, including RCEP, China-Korea FTA, and China-Australia, adopt different types of hybrid approach, allowing concluding parties to use different scheduling methods within a prescribed period. This approach offers flexibility where necessary.

24 There have been an array of controversies regarding whether and how the standard of treatment in investment treaties can be exported to other treaty parties via MFN clauses, in particular as regards their scope of application. See e.g., Batifort and Benton Heath (2018).

25 See Marchetti and Roy (2013), European Parliament (2013).

CONCLUSION

The WTO membership has started to move down the path of plurilateral cooperation, a mechanism that was part of the GATT, and then largely abandoned in conjunction with the creation of the WTO and the associated Single Undertaking approach in the Uruguay Round negotiations. Reflecting the steady expansion in WTO membership over time and the resulting increase in the heterogeneity of the membership, in conjunction with the rapid growth and increasing share of global output and trade accounted for by emerging economies, progress in the WTO became ever more difficult. The shift back to plurilateral negotiations implies a shift back to the past (Hoekman and Mavroidis 2021).

A feature of the Doha Round negotiations is that these focused primarily on issues other than services, notwithstanding the increasing role of services in economic activity across all countries. The CAI, RCEP, and the JSI talks on e-commerce and services domestic regulation suggest an open plurilateral agreement on trade in services should be considered by China and the EU. Such an initiative would need to attract the US and other major economies to be meaningful and to be feasible. But our presumption is that an initiative to this effect, that is jointly supported by China and the EU, should attract interest among the signatories of recent deep PTAs and the countries that were engaged in the TiSA talks. This can build on the sectoral offers that were tabled in TiSA and in the exploratory market access discussions on different clusters of services that are currently underway in informal open-ended meetings of the WTO Council on Trade in Services, including on logistics, financial, tourism, environmental, and agriculture-related services (Drake-Brockman et al. 2021).

A fundamental challenge confronting any plurilateral initiative on services trade that encompasses market access is to achieve a critical mass of participation, thus permitting the outcome to apply to all WTO members on an MFN basis. If so, the outcome of plurilateral talks can simply be included in participating WTO members' GATS market access and national treatment schedules and/or under GATS Article XVIII insofar as an agreement includes additional commitments. The GATS' design permits extension on a plurilateral basis, in contrast to the GATT, greatly facilitating incorporation of an OPA on services into the WTO.

If an insufficient number of countries participate and critical mass is not obtained, so that (some elements of) the agreement can only be applied on a discriminatory basis, the sole option currently available to the countries involved is to embed the outcome of talks in a PTA. As argued by Hoekman and Mavroidis (2015), this is inferior to incorporating the outcome of discussions into the WTO as an Annex 4 agreement. The latter ensures greater transparency and scrutiny, both at the time of conclusion of draft agreements, and over time, following implementation of the agreement. Moreover, incorporation under Annex 4 assures the option for any WTO member to join the agreement at a later stage, something that most PTAs do not do. However, the need for explicit consensus by all WTO members for incorporation of new agreements under Annex 4 of the WTO makes this an

unlikely option. Should an agreement result in a PTA this might help motivate an overdue deliberation in the WTO on the consequences of the very high bar now confronting new Annex 4 agreements. Agreeing on criteria that should apply to enable groups of WTO members to cooperate on a discriminatory basis under the umbrella of the WTO, as opposed to encouraging them to go outside the WTO, could reduce the incentive for WTO members to negotiate ever more PTAs.

REFERENCES

Adlung, R and H Mamdouh (2014), 'How to Design Trade Agreements in Services: Top Down or Bottom-Up?', *Journal of World Trade*, 48(2): 191-218.

Adlung, R and M Roy (2005), 'Turning Hills into Mountains? Current Commitments under the General Agreement on Trade in Services and Prospects for Change', *Journal of World Trade* 39(6): 1161-94.

Azmeh, S, C Foster, and J Echavarri (2020), 'The International Trade Regime and the Quest for Free Digital Trade', *International Studies Review* 22: 671-678.

Batifort, S and J B Heath (2018), 'The New Debate on the Interpretation of MFN Clauses in Investment Treaties: Putting the Brakes on Multilateralization', *American Journal of International Law* 111(4): 873-877.

Benz, S, J Ferencz, and H Nordås (2020), 'Regulatory Barriers to Trade in Services: a New Database and Composite Indices', *The World Economy* 43, 2860-79.

Borchert, I, J Magdeleine, J Marchetti, and A Mattoo (2020), 'The evolution of services trade policy since the Great Recession', Policy Research Working Paper No. 9265, World Bank.

Ciuriak, D, A Dadkhah, and D Lysenko (2020), 'The Effect of Binding Commitments on Services Trade', *World Trade Review* 19(3): 365-378.

Delimatisis, P (2020), 'Negotiation of Specific Commitments Under the GATS – A Legal Commentary on Article XIX GATS', TILEC Discussion Paper No. 2020-028.

Desierto, D (2015), 'Balancing National Public Policy and Free Trade', *Pace International Law Review* 27(2): 582-84.

Di Lieto, G and D Treisman (2018), 'Regulatory Implications of Multilateral Trade Liberalization for the Global Services Market: The Case of the Trade in Services Agreement', KIEP Research Paper, World Economy Brief, pp: 18-33.

Drake-Brockman, J et al. (2021), 'Digital Trade: Top Trade Negotiation Priorities for Cross-Border Data Flows and Online Trade in Services', T20 Policy Brief, forthcoming.

European Parliament (2013), 'The Plurilateral Agreement on Services', at: https://www.europarl.europa.eu/RegData/etudes/workshop/join/2013/433722/EXPO-INTA_AT%282013%29433722_EN.pdf (last visited April 6, 2021).

European Union (2020) 'Key Elements of EU-China Comprehensive Agreement on Investment, Press Release' https://ec.europa.eu/commission/presscorner/detail/en/IP_20_2542.

Gallagher, P and A Stoler, (2009), 'Critical Mass as an Alternative Framework for Multilateral Trade Negotiation', *Global Governance* 15: 375-392.

Gootiiz, B and A Mattoo (2017), 'Services in the Trans-Pacific Partnership: What Would Be Lost?' World Bank Policy Research Paper 7964.

Hoekman, B and P Mavroidis (2015), 'Embracing Diversity: Plurilateral Agreements and the Trading System', *World Trade Review*, 14(1): 101-16.

Hoekman, B and P Mavroidis (2021), 'WTO Reform: Back to the Past to Build for the Future', *Global Policy*, 12(S3): 5-12.

Hoekman, B and C Sabel (2021), 'Plurilateral Cooperation as an Alternative to Trade Agreements: Innovating One Domain at a Time', *Global Policy*, 12(S3): 49-60.

Huntington, S (1993), The Clash of Civilizations, *Foreign Affairs*, 72(3): 1-22.

Marchetti, J and M Roy, (2013), 'The TiSA Initiative: An Overview of Market Access Issues', WTO Staff Working Papers ERSD-2013-11.

Miroudot, S and K Pertel (2015), 'Water in the GATS: Methodology and Results', OECD Trade Policy Papers, No. 185, <https://doi.org/10.1787/5jrs6k35nnfi-en>.

Mishra, N (2020), 'Privacy, Cybersecurity, and GATS Article XIV: A New Frontier for Trade and Internet Regulation', *World Trade Review* 19(3): 341-364.

Monicken, H (2021), 'US, EU, Others Defend Plurilaterals after Criticism from India, World Trade'. <https://insidetrade.com/daily-news/us-eu-others-defend-plurilaterals-after-criticism-india> (last visited April 4, 2021).

Raza, W, B Tröster, and R von Arnim (2018) 'Assessing the Claimed Benefits of the Trade in Services Agreement (TiSA)', Australian Foundation for Development Research, https://www.oefse.at/fileadmin/content/Downloads/Publikationen/Studien/6_Assess_TiSA.pdf (last visited April 5, 2021).

Roy, M (2011), 'Services Commitments in Preferential Trade Agreements: An expanded Dataset, World Trade Organization, Economic Research and Statistics Division', Staff Working Paper ERSD - 2011-18.

Viola, L (2020), 'US Strategies of Institutional Adaption in the Face of Hegemonic Decline', *Global Policy*, Vol. 11, Supplement 3, pp: 33-34.

Winslett, G (2018), 'Critical Mass Agreements: The Proven Template for Trade Liberalization in the WTO', *World Trade Review*, 17(3): 405-426.

WTO (2019), 'Joint Statement on Electronic Commerce, EU Proposal for WTO Disciplines and Commitments Relating to Electronic Commerce, Communication from the European Union', INF/ECOM/22.

WTO (2021) General Council 1-2 March 2021, The Legal Status of 'Joint Statement Initiative' and their Negotiated Outcomes, WT/GC/W/819.

Wu, X (2020) 'The China Challenge: Competitor or Order Transformer?', *The Washington Quarterly*, 43(3): 99-114.

ABOUT THE AUTHORS

Bernard Hoekman is Professor and Director, Global Economics, at the Robert Schuman Centre for Advanced Studies, European University Institute, where he also serves as the Dean for External Relations. He is a CEPR Research Fellow. His research focuses on commercial policy, trade in services, public procurement, and global trade governance.

SHI Jingxia is Professor (International Business & Economic Law) at the School of Law, Renmin University of China (RUC). Professor Shi earned her BA & LLB in 1992, PhD in International Law (1998) from Wuhan University, China. She also holds a LLM degree (2007) and a JSD degree (2011) from the Yale Law School.

CHAPTER 11

The EU-China Comprehensive Agreement on Investment: A Model for Investment Coverage in the World Trade Organization?

Jürgen Kurtz and GONG Baihua

European University Institute; Fudan University

Historically, foreign investment policies have been a fiercely contested issue for the international trade regime. The launch of discussions on investment facilitation under World Trade Organization (WTO) auspices suggests greater willingness among some WTO members to discuss investment issues. The China-EU Comprehensive Agreement on Investment (CAI) provides a possible basis for negotiating investment policy disciplines in the WTO on a plurilateral basis. While the prospects for ratification of the CAI by the European Union (EU) are uncertain, the CAI provides a baseline for possible investment rules in the WTO. Investment rules anchored both against the CAI outcomes and structured on a plurilateral basis are a logical part of a WTO resuscitation strategy.

1. INTRODUCTION

Historically, foreign investment has been a fiercely contested issue for the international trade regime. Within the WTO, there is currently only piecemeal coverage of foreign investment, largely in the form of mode III (commercial presence of service supplier) commitments in the General Agreement on Trade in Services (GATS) and express limitations on some (though not all) performance requirements imposed on foreign investors (under the Agreement on Trade-Related Investment Measures). An expansion of that baseline to include foreign investment as a new negotiating item was strongly opposed by developing countries at the 1996 Singapore WTO Ministerial Meeting. Investment issues are regulated instead through a dense (though heterogeneous) network of over 3000 bilateral investment treaties (BITs) and increasingly, investment chapters in Free Trade Agreements (FTAs).¹

¹ For an overview of the distinct historical trajectories of these two systems, see Kurtz, J (2016), *The WTO and International Investment Law: Converging Systems*.

Important political economy shifts indicate possible greater willingness among some states parties to consider the inclusion of investment issues within the WTO. The form and nature of investment flows (and their relationship to both trade and development outcomes) has shifted considerably since the late 1980s. Foreign investment in that earlier period was often a simple substitute for trade as a means of accessing external markets. But since the late 1990s, the global economy has been characterised by international fragmentation of production represented by intensive cross-border exchange of intermediate goods and services.² For global value chains (GVCs), investment and trade are deeply complementary modalities. Economic actors engaged in GVCs require policy stability across a whole trade, investment, services, and intellectual property nexus.³ For developing countries, the unbundling of production facilities embedded in GVCs can be a significant opportunity. Participation in a GVC brings the promise of development spillovers at a lower entry cost than past strategies, particularly those focused on industrialisation.⁴ Some of those same countries are also increasingly dissatisfied with the BIT network (as are powerful actors like the EU), especially with an assumption of pro-investor structural incentives and outcomes of investor-state arbitration.

Against this backdrop, we seek to explore whether the conclusion of the Comprehensive Agreement on Investment (CAI) between China and the EU can offer a platform for framing negotiations on investment issues in the WTO. The instinctive appeal of the CAI is the significant achievement of reaching a negotiated conclusion on foreign investment issues between such sizeable counterparties as China and the EU. Of course, foreign investment issues have clearly become politically controversial in some developed states, not least during the Trump administration in the United States. Nevertheless, at least some of those concerns (including both treatment of foreign investors in China and the impact on non-trade values such as labour standards and environmental protection) are covered within the CAI, suggesting the possibility of some common foundation for a significant set of states parties (China, the EU, and the US). That said, the recent outbreak of mutual sanctions between China and the EU casts serious doubt on its likely conclusion and ratification. Counterintuitively perhaps, this may well create a greater opportunity to externalise key aspects of its framework to a broader constituency such as the membership of the WTO. Indeed, the risks associated with *not* building on the CAI are considerable. Despite (or because of) the long standstill in multilateralism and the illiberal tendencies unleashed by both the Trump administration and the urgency of the Covid-19 health response, some states parties (especially in South and East Asia) have emphasised regional rulemaking. Some have argued that initiatives like the *Regional Comprehensive Economic Partnership* (RCEP) will fundamentally reorient trade and economic ties away from global linkages to regionally focused relationships in East Asia, particularly in the face of uncertain conditions in other leading states.⁵

2 Baldwin, R (2016).

3 Findlay, C and B Hoekman (2020).

4 Baldwin, R (2016), Chp. 9.

5 Petri, P and M Plummer (2020).

We begin this chapter with an assessment of both the market access provisions, and the post-entry guarantees of competitive conditions in the CAI (in sections 2 and 3). Both conditions are, in our view, fundamentally necessary to the likelihood of any outcome on investment in the WTO. Section 4 then turns to the sustainable development provisions (particularly on labour standards and environmental protection) that reflect, in large part, the desire of the EU to act as a norm entrepreneur. The significance of achieving agreement on these highly sensitive issues with a major counterparty such as China should not be easily discounted, though we would expect some concern among civil society groups within Europe. Section 5 assesses the continued discretion given on securitisation of foreign investment policy in the CAI. Section 6 turns to dispute settlement and the limits of the judicial legalisation strategy publicly pursued by the EU. Section 7 explores existing pathways for cooperation on these issues within the WTO, especially through continuing dialogue on trade and investment facilitation. Section 8 concludes with some thoughts on the modalities of using the CAI to shape new rules within the WTO.

2. THE VITAL PROMISE OF MARKET ACCESS

Market access is a vital condition for both the successful completion and instrumental justification of any contemporary treaty negotiation on foreign investment. Prior to CAI, during the fifth meeting of the US-China Strategic and Economic Dialogue⁶ in July 2013, China agreed to begin substantive negotiations with the United States on an investment agreement. Those negotiations were premised on a commitment to secure pre-establishment national treatment (market access) and a negative list approach (to specify reservations to market access), both of which are a critical feature of US investment treaty practice.⁷ This expansive liberalisation model encompasses *every* part of a state's economic system and national laws unless specifically (negatively) exempted.⁸ To prepare the negative list for the draft China - US BIT, China established an inter-ministerial mechanism in the state council and reviewed tens of thousands of rules governing foreign investment in China. Unfortunately, China and the United States failed to agree on the items of the negative list in 2018, losing the last chance to conclude a BIT during the term of the Obama administration. Nevertheless, China had already carried out domestic reform on foreign investment regulation based on the negative list approach, beginning in October 2013 in the Shanghai Free Trade Pilot Zone.

At the commencement of the CAI negotiations with the EU, China had still hoped to prioritise completion of the China-US BIT negotiations. But with the breakout of the Sino-American trade war during the term of the Trump administration, China pivoted its

6 On April 1, 2009, former Chinese President Hu Jintao and U.S. President Barack Obama agreed to establish the mechanism of China-US Strategic and Economic Dialogue during their first meeting in London on the sidelines of the G20 financial summit. Since then, five rounds of the dialogue have been held, with the first in Washington in July 2009, the second in Beijing in May 2010, the third in Washington in May 2011, the fourth in Beijing in May 2012, and the fifth in Washington in July 2013.

7 Vandevelde, K (1997).

8 Gómez-Palacio, I and P Muchlinski (2008).

negotiation focus to the EU. After 35 rounds of negotiations over seven years, China and the EU reached agreement on the CAI at the end of 2020, with the EU gaining a higher level of market access from China than the standard reached during the BIT negotiations with the United States. The strength of the CAI's market access commitments will bring greater investment opportunities for both Chinese and European enterprises. These instrumental benefits are critical to the justification of extra-domestic constraints on state sovereignty vis-à-vis foreign investment. Empirical studies have sought to identify whether there is a causal relationship between state entry into BITs and an increase in inbound foreign investment.⁹ The early literature was characterised by methodological weakness, in that investment treaties were treated as black boxes. More recent empirical research that disaggregates treaties based on form and content finds that the specific content of investment treaties matters a great deal in attracting foreign investment. Of the various provisions in investment treaties, pre-establishment market access (via national treatment) offers the greatest potential for increasing foreign investment flows. One study has estimated that a host country can increase its share in total FDI flows by almost 30% in the hypothetical case of switching from particular investment treaties without pre-establishment national treatment commitments to those with such provisions.¹⁰

The CAI's market access obligations follow a negative list approach with specific non-confirming measures on obligations of national treatment, most-favoured-nation treatment, movement of senior management and board of directors, and performance requirements listed in specific annexes ('schedules').¹¹ Critically, both parties commit not to discriminate across sectors unless a specific reservation is included to that end in the schedule of commitments. More generally, both parties take commitments not to impose quantitative restrictions (unless reserved in a relevant schedule) and will not limit the legal form of an investor or require a joint venture arrangement with a domestic company (again, unless reserved in a schedule). The draft China and EU schedules have recently been released and are presented as annexes to the agreement.¹² The binding of the liberalisation commitments is done in a dynamic way (so called 'ratcheting'). Any future relaxation of existing restrictive measures included in the schedules will be automatically bound.

9 For a comprehensive overview of the principal empirical studies, see Yackee J W (2010) and Allee, T and C Peinhardt (2011).

10 Berger, A et al. (2013).

11 EU - China Comprehensive Agreement on Investment (CAI), Agreement on Principle, available <https://trade.ec.europa.eu/doclib/press/index.cfm?id=2237>, Secn. II (Liberalisation of Investment), Arts. 2 (Market Access) and 7 (Non-Conforming Measures and Exceptions).

12 For China's schedule of commitments and reservations, see https://trade.ec.europa.eu/doclib/docs/2021/march/tradoc_159483.pdf. For the EU's schedule of commitments and reservations, see https://trade.ec.europa.eu/doclib/docs/2021/march/tradoc_159482.pdf.

Compared with its other BITs¹³ or FTAs,¹⁴ China has not made such far-reaching market access commitments with any other treaty partner. The EU has negotiated further and new market access openings and commitments such as the elimination of quantitative restrictions, equity caps or joint venture requirements in a number of important sectors. In particular, China has made comprehensive commitments on manufacturing with only very limited exclusions (in particular, in sectors with significant overcapacity). Approximately half of EU FDI in China is located in the manufacturing sector (such as in transport and telecommunication equipment, chemicals, and health equipment). For the vital automotive sector, China has agreed to phase out joint venture requirements, a long-standing concern of some EU companies operating in China. For investments by foreign investors in the manufacture of complete automobiles (passenger cars), the current shareholding percentage of the Chinese party shall not be less than 50%. But after 2022, investments by foreign investors in the manufacture of passenger cars will not be subject to restrictions on shareholding percentage. One foreign investor may establish less than two (included) equity joint ventures that manufacture complete automobiles of the same category (passenger cars) within the territory of China, however, such limitation of two enterprises does not apply to the circumstance where the foreign investor acquires other domestic automakers jointly with the Chinese party to the equity joint venture. Once again, after 2022, China will no longer reserve these non-conforming measures. These non-conforming measures do not apply to investments by foreign investors in the manufacture of new (green) energy automobiles and special purpose automobiles.¹⁵

The scheduled market access commitments that have been released by the parties go beyond investment in goods manufacture to encompass important service sectors. Turning to China's commitments, a number of these service sectors could be of commercial interest to EU investors in China.¹⁶

- **Financial services:** China had already started the process of gradually liberalising the financial services sector and will grant and commit to keep that opening to EU investors. Joint venture requirements and foreign equity caps have been removed for banking, trading in securities and insurance (including reinsurance), as well as asset management.
- **Health (private hospitals):**¹⁷ Though investments by foreign investors in medical institutions may be made only in the form of joint venture, the EU Investors are permitted to establish wholly foreign owned privately funded hospitals and clinics,

13 Since the first BIT was signed between the Chinese government and the Swedish government in 1982, a large number of BITs have been signed between China and foreign governments in the past 30 years. By the end of 2020, China has signed 126 BIT agreements with other countries and regions (108 of which have come into force), and 23 other agreements including investment clauses (such as free trade agreements), 19 of which have come into force.

14 Currently, China has 24 FTAs under construction, among which 16 Agreements have been signed and implemented already. For the details, see MOFCOM: China FTA Network, available at <http://fta.mofcom.gov.cn/english/index.shtml>.

15 CAI, above no. 11, Annex I Entry 6 - Manufacture of Transportation Equipment Sector.

16 For further information, see https://ec.europa.eu/commission/presscorner/detail/en/IP_20_2542.

17 CAI, above No. 11, Annex I Entry 18 - Medicine.

excluding traditional Chinese medicine hospitals and clinics in Beijing, Tianjin, Shanghai, Nanjing, Suzhou, Fuzhou, Guangzhou, Shenzhen, and the whole island of Hainan. The majority of doctors and medical personnel of the joint venture and wholly foreign owned hospital and clinics shall be of Chinese nationality. Foreign investors may not invest in the development and application of human stem cells, or the development and application of genetic diagnosis or treatment technology.

- **R&D (biological resources):**¹⁸ China requires approval of the research and development activities conducted by foreign invested enterprises utilising the biological resources (including human, animal, plant, and microbe resources) originated from, and protected by China. China also requires the foreign invested enterprises to conduct the aforesaid activities in the form of cooperation with Chinese institutions, and to share with its Chinese partners the benefits generated from such research and development as well as subsequent applications and commercialisation.
- **Telecommunication/Cloud services:** China has agreed to lift the investment ban for cloud services. They will now be open to EU investors subject to a 50% equity cap.
- **Computer services:** China has agreed to bind market access for computer services – a significant improvement from the current situation. Also, China will include a ‘technology neutrality’ clause, which would ensure that equity caps imposed for value-added telecom services will not be applied to other services such as financial, logistics, medical, etc. if offered online.
- **Environmental services:** China will remove joint venture requirements in environmental services such as sewage, noise abatement, solid waste disposal, cleaning of exhaust gases, nature and landscape protection, sanitations, and other environmental services.

In contrast to the expansive (negative list) strategy to market access for foreign investment in the CAI, the WTO is both less comprehensive and structurally more conservative. Currently, the WTO only regulates foreign investment in the services sectors through the provisions of the GATS. The GATS distinguishes between four modes of supplying services: cross-border trade, consumption abroad, commercial presence, and presence of natural persons. Commercial presence (FDI) implies that a service supplier of one member establishes a territorial presence, including through ownership or lease of premises, in another member’s territory to provide a service. When it comes to market access, and in contradistinction to the CAI, the GATS adopts a hybrid structure engaging elements of a conservative bottom-up approach. Using a positive-list method, WTO members only opt in to legal coverage by either making horizontal commitments

18 Ibid. Annex I Entry 19 – Protection of Biological Resources.

(across all services sectors) or sector-specific commitments (which cover a particular economic sector) to both the market access¹⁹ and national treatment²⁰ obligations in the GATS.²¹ Each WTO member is required to have a schedule of specific commitments, which identifies the services sectors for which the member guarantees market access and national treatment and any limitations that may be attached.

This structure provides WTO members with significant latitude in determining when, and in what manner, to open up their service sectors to foreign competition. Indeed, analyses of commitments scheduled under the GATS show that developing countries have utilised this structure to significantly control the extent of their liberalisation efforts in the services area,²² which has included scheduling sectoral commitments by reference either to domestic laws on FDI and/or their BIT obligations.²³ There is however, a justifiable critique that the positive list structure in the GATS provides insufficient incentives for states to extend and deepen their liberalisation efforts. Given the tensions between these liberalisation structures, this further evidences the manner in which the ‘CAI Model’ for a WTO investment initiative is better positioned as a stand-alone (opt-in) agreement, rather than one embedded in the conventional single undertaking approach to WTO rules.

The CAI as an international agreement will bind China’s progress in the liberalisation of foreign investment that has taken place over the last 20 years and, in that way, prevent backsliding of the reform process. For the first time, China has made a market access commitment in the form of negative list in all sectors, including service and non-service sectors, so as to achieve a comprehensive docking with the foreign investment negative list management system established in the Chinese foreign investment law (FIL). This will make the conditions of market access for EU companies clear and independent of China’s internal policies. Prior to 2020, foreign investments in China were regulated by a set of fragmented and long-outdated laws. China adopted its unified Foreign Investment Law (FIL) in 2019,²⁴ which came into effect in January 2020. Article 3 of the new FIL states: ‘the State shall implement policies on high-level investment liberalisation and convenience, establish and improve the mechanism to promote foreign investment, and create a stable, transparent, foreseeable and level-playing market environment’. The new FIL takes a pre-establishment negative listing approach similar to the CAI provisions. This means that, unless the foreign investors and their investments fall within the sectors listed in the negative list, the new FIL commits to national treatment and equal

19 General Agreement on Trade in Services, 15 April 1994, Marrakesh Agreement Establishing the World Trade Organization, 33 I.L.M. 1197 (1994) (GATS), Article XVI.

20 Ibid. Article XVII.

21 Ibid. Article XX; WTO, Revision of Scheduling Guidelines (SC/CSC/W/19, 5 March 1999).

22 Hoekman, B (1996) ‘Assessing the General Agreement on Trade in Services’ in Martin, W and Winters L A (eds.), *The Uruguay Round and the Developing Countries*, pp: 88-124.

23 Adlung, R, P Morrison, M Roy, and W Zang (2011).

24 <https://npcobserver.com/legislation/foreign-investment-law/>.

protections in their establishment and operation in China.²⁵ The new FIL positions the norm of ‘pre-establishment national treatment’ as a general principle applicable in all ordinary circumstances, whereas it treats the application of the ‘negative list’ system as a noteworthy exception.

Before signature of the CAI and during the legal scrubbing, China will update the reference to Special Administrative Measures for Market Access of Foreign Investment (negative list, 2019 edition) in this Schedule, in light of its latest edition. Currently, China has already issued the 2020 edition of the negative list and will soon issue the 2021 edition later this year.

3. POST-ENTRY COMPETITIVE CONDITIONS: TOWARDS ‘FIT FOR PURPOSE’ GUARANTEES?

In recent years, despite China’s extensive commitments in its accession protocol to the WTO, concerns have arisen as to the competitive conditions facing foreign investors when operating in China. Some of these concerns relate to the equality of the competitive position of foreign investors operating against Chinese state-owned-enterprises (SOEs) (and often by extension, the provision of subsidies to those SOEs). Others relate to claims made by foreign investors on perceived ‘unfair’ practices such as forced technology transfer.

Many of these issues are deeply sensitive from the perspective of one or both parties. From a Chinese standpoint, SOEs are an inherent part of the Chinese economic model that has been so successful in delivering historical development gains to its citizens. Yet capital exporting states to China, including but not limited to the member states of the EU, are increasingly wary of the unevenness of the competitive conditions within China. From their perspective, those variances go beyond the usual frictions of operating in a foreign jurisdiction but are instead seen as being the product of active manipulation by a host state.

Against this baseline of inter-state sensitivity, it is significant that the Chinese and EU negotiators reached agreement on some of these contested points which may well offer a useful platform for future WTO negotiations, particularly on the WTO’s limited coverage of SOEs. While China’s right to pursue its own economic model based on SOEs is explicitly guaranteed in the CAI,²⁶ the agreement adopts a definition of ‘covered entity’ which extends beyond conventional approaches to defining a SOE (which often

²⁵ Article 4 of the FIL provides: The State shall implement the management systems of pre-establishment national treatment and negative list for foreign investment. For the purpose of the preceding paragraph, pre-establishment national treatment refers to the treatment given to foreign investors and their investments during the investment access stage, which is not lower than that given to their domestic counterparts; negative list refers to special administrative measures for the access of foreign investment in specific fields as stipulated by the State. The State shall give national treatment to foreign investment beyond the negative list. The negative list will be issued by or upon approval by the State Council. If more preferential treatment concerning access is offered to a foreign investor under any international treaty or agreement that the People’s Republic of China concludes or joins in, relevant provisions in such treaty or agreement may prevail.

²⁶ CAI, above note 11, Section II (Liberalisation of Investment), Article 3bis(2)(a).

revolve around liberal notions of ownership or control interests) to encompass broader mechanisms such as where a state power ‘has the power to legally direct the actions’ of an enterprise.²⁷ It is important to recognise here that the CAI is the first international agreement in which China has made detailed commitments on SOEs. Where an entity falls within this expanded definition of an SOE, then a state party is required to ensure that it acts ‘in accordance with commercial considerations’ and in a non-discriminatory fashion on the purchase and sale of goods and services.²⁸

Interestingly, there is a provision that resembles a type of discovery mechanism whereby a party can request information around a covered entity if it believes its interests ‘are being adversely affected by the commercial activities’ of that entity.²⁹ Yet this seems to have been something of a redline in the negotiation, as there is no direct obligation on the receiving party to comply with the provisions of the request. On the other hand, there is a sharp and binding prohibition on the use of technology transfer conditions,³⁰ which is arguably broader than that concluded in the China-US phase one deal.³¹ To some degree however, there is a distinct unevenness in the levels of legalisation of commitments in this sensitive area.³²

Subsidisation is a case in point. The CAI breaks some new ground in requiring transparency of services subsidies.³³ This stands in contrast with the almost Sisyphean task of continuing the WTO-style model of focusing mainly on industrial subsidies and then trying to deductively classify permitted or other forms of subsidisation. At the very least, a starting point of transparency would allow the states parties to focus on the highest points of contemporary friction that affect economic actors. The CAI merely allows consultation between the parties if one state party considers that a subsidy granted by the other ‘has or could have a negative effect on its investment interests’. Where the requested party finds merit in that claim it need only ‘use its best endeavours to find a solution’. Most strikingly perhaps, this sensitive area of state conduct is expressly exempted from the purview of third-party adjudication.³⁴

Reviewed against the corpus of international economic law, two systemic points should be noted. Firstly, some of these provisions seek to address problematic gaps and omissions in the law of the WTO, not least the original failure to overtly limit the use of technology

27 *Ibid.* Article 3bis(1)(a)(b).

28 *Ibid.*, Article 3bis(3).

29 *Ibid.* Article 3bis(4).

30 *Ibid.* Article 3(1)(f). On the issue of technology transfer conditions generally, see Zhou, W, H Jiang and Q Kong (2020).

31 As one example, consider Article 3(3) of the CAI: ‘Neither Party shall directly or indirectly require, force, pressure, or otherwise interfere with the transfer or licensing of technology between natural persons and enterprises of a Party and those of the other Party. Such transfer or licencing of technology shall be based on market terms that are voluntary and reflect mutual agreement’ (emphasis added). *Ibid.*, Article 3(3). CAI, above note 11. While there is somewhat similar language in the U.S-China Phase One Deal, there is no exact equivalence of these highlighted terms which taken together suggest a more expansive operation for the CAI. By contrast, see Economic and Trade Agreement between Government of the United States of America and the Government of the People’s Republic of China, 15 January 2020, Article 2.1(2), 2.2 and 2.3.

32 For a conceptual account on the dimensions and value of legalization, see Abbott, K W, et al. (2001).

33 CAI, above note 11, Section III (Regulatory Framework), Arts. 8(1)-5).

34 *Ibid.*, Arts. 8(7), 8(6) and 8(10).

transfer conditions in the Agreement on Trade-Related Investment Measures (TRIMs) and the general failure to discipline SOEs in the WTO. To that extent, they represent a natural foundation for the possibility of developing a collective commitment to remedying those limitations in any future set of WTO investment negotiations. Secondly, the negotiators here have elected to move beyond the generic forms of investment protection that are typically covered in a BIT (such as the broad guarantee of ‘fair and equitable treatment’ obligation) to focus instead on tailored provisions directed at the specific causes of trade and investment disputes between China and the EU. This reveals a welcome break from the path dependency that typically characterises BIT negotiations (though it will naturally prompt opposition from those vested interests (including professional advisers) who have abundant incentives to defend the current expansive model of investment protection found in most BITs). That said, there are still problematic gaps and omissions such as protections against expropriation, which would need to be considered in the WTO (given the vitality of that protection for the property rights of investors) and are flagged as future negotiating items in the CAI.³⁵

4. FOREIGN INVESTMENT AND SUSTAINABLE DEVELOPMENT NORMS

The CAI is notable in its express inclusion of provisions dealing with the relationship between foreign investment and ‘sustainable development’, particularly in relation to potential impacts on labour and environmental standards.³⁶ There may well be a tendency to dismiss this aspect of the CAI as limited in strategic ambition, but any critique should be assessed against both the depth of internal commitment within the EU to sustainable development norms, as well as the achievement of reaching an agreement with such a significant counterparty as China. Sustainable development concerns are an essential (offensive) interest for the EU in its commercial treaty negotiations. The EU’s quasi-constitutional conditions prioritise those values under the ‘common commercial policy’ changes imposed by the Treaty of Lisbon.³⁷ External trade and investment agreements concluded by the EU must, along with all other embodiments of its external relations, promote a set of EU values and interests including the express promotion of ‘sustainable development’.³⁸

In recent years, the European Commission has escalated its enforcement of a broad array of FTA and EU Association Agreements often in connection with so-called ‘non-trade values’ (though this framing itself is deeply flawed). Most notably, this has included the decision to launch a claim against the Republic of Korea for breach of a range of labour commitments (many of which are echoed in the CAI) under the EU-Korea Free Trade Agreement. While the Panel of Experts in that dispute did not entirely rule in favour of the

35 CAI, Section VI (Institutional and Final Provisions), Sub-section 2, Article. 3 (Negotiations on Investment Protection).

36 Ibid. Section IV (Investment and Sustainable Development).

37 Articles. 206-207, Consolidated Version of the Treaty on the Functioning of the EU [2012] OJ C 326/47.

38 Articles. 3(5) and 21, Consolidated Version of the Treaty on the EU (2012) OJ C 326/13. See also Directorate-General for Trade, ‘Trade for All: Towards a More Responsible Trade and Investment Policy’ (European Commission, 2015).

EU (including on the question of whether Korea had complied with its obligation to make ‘continued and sustained efforts’ for the ratification of key ‘fundamental’ conventions of the International Labour Organization’),³⁹ they did find fault with Korea’s failure to respect principles surrounding freedom of association under the FTA.⁴⁰ Consider for one moment the significance of achieving even some agreement with China on these points, given the sensitivity surrounding issues of labour practices in China.

Importantly, the EU’s commitment on these non-economic values mirrors, at least facially, the revealed preferences of other large, developed countries. The United States is especially important here, given that any substantive WTO reform agenda on investment issues modelled on the CAI would be unlikely without American support. Like the EU, the US has also begun to enforce labour provisions under its FTAs. One of the key labour provisions in the CAI is a set of obligations (in Article 2) designed to ensure the parties both set high levels of labour protections and enforce them. These exact issues were litigated in a claim brought by the US against Guatemala under the Dominican Republic–Central America–US Free Trade Agreement.⁴¹ And most recently, a group of Mexican migrant women have filed the first labour dispute under the US–Mexico–Canada Agreement, arguing that sex-based discrimination in recruitment and hiring processes for US jobs bar them from obtaining necessary work visas.⁴²

Historically, developing countries have been fiercely resistant to these types of non-economic provisions given the fear that they (especially labour protections) would be used as cover for protectionism in developed counterparties. This is by no means an unreasonable concern given the political economy temptation for politicians to use foreign trade and investment to avoid responsibility for their own domestic failings to deal with pressing issues on dislocation of workers (including through higher levels of automation) and growing levels of income and wealth inequality. Not surprisingly, we see express acknowledgment of the dividing lines in this debate within the CAI.⁴³

It is important to note that the sustainable development provisions in the CAI also tackle the vitally important issue of environmental protection. Formally at least, both China and the EU have evinced shared rhetoric and goals in this area, illustrated by China’s recent pledge to become carbon-neutral by 2060, and the fact that the EU has long been recognised as a green policy pioneer and is home to the world’s first major carbon market. Given its rapid and ongoing industrialisation, coupled with the ability to deploy state power to pursue strategic objectives, there is a powerful argument that China is the *only* state capable of anchoring a rapid transformation that would limit global

39 Panel of Experts Proceeding Constituted under Article 13.5 of the EU-Korea Free Trade Agreement, Report of the Panel of Experts (20 January 2021), p. 79.

40 Ibid. pp. 78-79.

41 In the Matter of Guatemala - Issues Relating to the Obligations under Article. 16.2.1(i) of the CAFTA - DR, Report of the Panel (26 June 2017).

42 ‘Mexican Migrant Women file First USMSA Labor Complaint against U.S’, Inside U.S Trade (24 March 2021), <https://insidetrade.com/daily-news/mexican-migrant-women-file-first-usmca-labor-complaint-against-us> (accessed, 25 April 2021).

43 CAI, above note 11, Sub-Section 3 (Investment and Labor), Article. 2(6).

temperature increases to the critical baseline position of 2 degrees Celsius.⁴⁴ Yet many of the provisions on environment in the CAI are pitched at a fairly general level, including the requirement that both parties strive for ‘high levels of environmental protection’, and ensure that investment is not incentivised by either weakening domestic standards or failing to enforce those standards.⁴⁵ There is however, a notable and specific endorsement of the United Nations Framework Convention on Climate Change (UNFCCC) and the Paris Agreement, which requires both parties to implement those commitments.⁴⁶ For China, this endorsement is a significant concession given the constant development challenge of balancing environmental protection with growth and energy security. However, the real challenge may lie elsewhere. Momentum is building in both the US and the EU towards both higher climate change mitigation targets coupled with some form of carbon border taxes targeted at imports from countries that are seen as lagging behind on climate action.

5. SECURITISATION OF FOREIGN INVESTMENT POLICY: ENTRENCHMENT OF THE STATUS QUO?

In recent years, there has been a trend among Western states to ‘securitise’ economic policy directed at foreign trade and investment.⁴⁷ This has been particularly the case in the technology sector. We have seen a range of countries ban China’s Huawei from running their telecommunications networks. India has also banned the Chinese-owned social media app TikTok following border clashes between the two countries. The US has blocked semi-conductor exports, while China has explored the possibility of limiting US access to rare earth minerals, which are essential to the manufacture of many tech products.⁴⁸

More generally, there has been a greater focus on investment screening with significant delegation of power to vet incoming investments. Of course, national security flexibility has long been a feature of domestic regulatory frameworks for reviewing foreign investments. Nonetheless, there is a perception that the 2019 establishment of a framework for the screening of FDI into the EU⁴⁹ was undertaken principally to target Chinese investors. The screening regulation encourages EU members to adopt measures based on ‘security or public order’ to tighten entry choices around foreign investment. That said, there are similar provisions operating in China, such as Article 6 of the Chinese FIL, which provides: ‘Foreign investors and foreign-funded enterprises carrying out investment activities within the territory of China shall observe the Chinese laws and regulations and shall not impair China’s security or damage any public interest’.

44 See Drahos, P (2021).

45 CAI, above note 11, Sub-Section 2 (Investment and Environment), Article 2.

46 Ibid. Article 6.

47 For analysis on this dimension in the context of contemporary U.S trade policy *vis-à-vis* China, see Aaken, A v and J Kurtz (2019).

48 On the above, see John Thornhill, ‘Technology Wars are Becoming the New Trade Wars’, *Financial Times* (22 April 2021).

49 Regulation (EU) 2019/452 of the European Parliament and of the Council of 10 March 2019.

There has long been flexibility in both the law of the WTO and international investment law. to respond to security-related matters. In fact, security exceptions in many treaties afford *greater* discretion to governments than general exceptions (for policy objectives such as health or environmental protection), by permitting a government to adopt a measure that ‘it considers necessary’ in the circumstances, or by appearing to make the invocation of the provision entirely self-judging. This is especially the case in the law of the WTO. For example, Article XXI(b) of the General Agreement on Tariffs and Trade (GATT) lends itself to an affirmative defence in WTO disputes, which means that the defendant responds to a challenge by claiming that the provision authorised it to derogate from other GATT 1994 obligations. In other words, rather than maintain that its measures comply with WTO rules, a member can argue that any alleged deviation was backed by the exception provision.⁵⁰

The proliferating use of the national security argument combined with the end of members’ self-restraint related to Article XXI litigation puts the WTO in a position of great vulnerability.⁵¹ Although the GATT’s Contracting Parties had invoked GATT’s security exception in various disputes prior to the inception of the WTO, the exception was not raised in a WTO dispute until 2016.⁵² Faced with a difficult and politically charged task, the WTO Panel in *Russia – Traffic in Transit* sought to achieve a delicate balance between two important objectives: (1) to ensure that members can derogate from their obligations if necessary to protect essential security interests and (2) to contain the risks for abuse in the argument, which would otherwise undermine the effectiveness and credibility of the WTO itself. In international investment law, disputes involving national security exceptions have for the most part arisen under the Argentina-US BIT, concerning measures adopted by Argentina in response to its economic crisis of 2001-2002.⁵³ Much has been written about these disputes.⁵⁴ The continued expansion of national security as a basis for rejecting investment applications not only threatens levels of economic integration, allowing international tribunals to review these decisions by ruling on this exception may well be suboptimal.⁵⁵

Various states parties have exhibited some concern with the tendency towards securitisation of economic policy. For example, in its May 2019 WTO reform proposal,⁵⁶ China asked for greater disciplines to curb abuse of the national security exception. China first complained that certain WTO members had imposed unwarranted tariffs on steel and aluminium products, and threatened to raise tariffs on auto and auto parts to protect its domestic industries, using national security as a pretext. China also argued that WTO members should act in good faith and exercise restraint in invoking provisions

50 Prazeres, T L (2020).

51 Weiß, W (2020).

52 Panel Report, *Russia - Measures Concerning Traffic in Transit (Russia-Traffic in Transit)*, WT/DS512/R.

53 See generally, Kurtz, J (2010).

54 For a recent example, see Henckels, C (2020)..

55 Knight, L and T Voon (2020)..

56 China’s Proposal on WTO Reform: Communication from China, 13 May 2019, WT/GC/W/773.

related to national security. China argued that it is necessary to enhance the notification requirements on measures such as imposing import tariffs on the ground of national security exceptions, and carry out multilateral reviews on such measures.

Despite these concerns, the CAI does not substantively constrain state ability to control incoming investment on the basis of security concerns. In general terms, the CAI has been complemented by a set of horizontally applicable exceptions based on the WTO approach, consisting of general exceptions, security exceptions, taxation flexibilities, balance of payments safeguards, as well as carve out for prudential measures to protect integrity and stability of the financial systems. For the specific issue of security exceptions, the CAI essentially replicates the WTO legal position in GATT Article XXI.⁵⁷ It is difficult not to see this entrenchment of the status quo as a significant lost opportunity to write new and better rules to shape this increasingly contentious aspect of contemporary economic policy. On the flipside however, this may be an issue simply too politically sensitive to subject to greater legal oversight. In the end, it seems that the status quo may well have been a pragmatic choice (and cost) to secure the overall agreement in the CAI.

6. LIMITS OF LEGALISATION AND REFORM CHOICES ON DISPUTE SETTLEMENT

Historically, international investment law has adopted a different model of third-party dispute resolution than in the WTO. The system of investor-state arbitration in most BITs confers standing rights on foreign investors (as non-state actors) to commence a claim for treaty breach against a respondent (host) state. Those procedural rights are, in most cases, remarkably extensive, with little requirement to consider or engage domestic institutions or remedies in a host state. The WTO, by contrast, reserves standing rights only to states parties. A political calculus (at least for smaller states) will often *de facto* limit the likelihood of invocation especially given the possibility of reciprocal invocation of WTO proceedings.

Both of these legal systems are under considerable stress in the contemporary setting. In particular, there are growing levels of state dissatisfaction with the outputs of investor-state arbitration. These concerns traverse not only outcome factors (including issues of preference and the integrity of the underlying reasoning deployed by tribunals) but also questionable inputs into that process (such as the notorious practice of ‘double hatting’ where individuals act as both arbitrators and counsel). The EU sits at the apex point of opposition to this regime with its bold and ambitious proposal to replace investor-state arbitration altogether with a WTO-influenced judicial model.⁵⁸ To be clear, even under the EU’s trustee court model, foreign investors would still have standing rights to pursue

57 CAI, above note 11, Section. VI (Institutional and Final Provisions), Article 10 (Security Exceptions).

58 Dietz, T, M Dotzauer and E Cohen (2019).

a claim for breach of the treaty (thereby departing from a fundamental precept of the WTO dispute settlement system). That new system is now being rolled out with select counterparties, including Canada and Vietnam.

In understanding the EU's positioning, it is important to be mindful of the pivotal role of judicialised dispute settlement in driving integration within the EU legal order.⁵⁹ This has led to a (some might say naïve) belief of the EU in the central role of third-party dispute resolution when it comes to public international law. Certainly, as we survey the contemporary landscape of international economic law, there are relatively few states that entirely share the EU's normative preferences on third-party adjudication (absent the formidable condition of accessing the sizeable EU market). Of course, it is tempting to dismiss, say, US objections to the WTO dispute settlement system – which have left that vital system in standstill – as a regrettable last gasp of Trumpian trade policy. Yet US objections to the WTO legal system have deeper and longer roots than the 2016 election of President Trump.⁶⁰ In other settings too – such as the Regional Comprehensive Economic Partnership – there is a general reluctance of states parties to delegate sovereign authority to third-party decision-makers.⁶¹

The CAI starkly reveals the limits of the EU's capacity to act as a norm entrepreneur in this contested area. China has only agreed to state-to-state dispute settlement, thus departing from the EU's preferred baseline of extending standing rights to foreign investors.⁶² Moreover, the CAI adopts a remedy structure modelled on the WTO, which requires ensuring the measure in breach is brought into conformity with the CAI, and absent compliance or some other agreement, the successful party can then resort to prospective suspension of concessions.⁶³ By contrast, a damages system (such as exists in China's BITs as well as in the EU's new investment court model) would directly compensate foreign investors for the harm caused by state conduct in breach of operative conditions. At best, the CAI's dispute settlement provisions represent a confusing distillation of some (but not all) of the WTO dispute settlement model. Pointedly, the absence of any appellate review (which exists both in the WTO and in the EU's investment court system) reveals the limits of the EU's preference of a trustee court model to a counterparty such as China.

7. PATHWAYS FOR COOPERATION: TRADE AND INVESTMENT FACILITATION

The parallels between trade and investment facilitation – besides the obvious similarities in name, and the shared background in terms of the Singapore issues – are limited in theory and practice.⁶⁴

59 See, e.g. Maduro, M (1998).

60 McDougall R (2018).

61 For an account of a principled commitment to a non-Western, delegatised model of investment treaty commitments among the ASEAN states (being the architects of the RCEP negotiations), see Cho S and J Kurtz (2018).

62 CAI, above note 11, Section V (Dispute Settlement).

63 Ibid. Article 16.

64 Calamita, N J (2020).

WTO members concluded negotiations at the 2013 Bali Ministerial Conference on the landmark Trade Facilitation Agreement (TFA), which entered into force on 22 February 2017 following its ratification by two-thirds of the WTO membership. The TFA contains provisions for expediting the movement, release, and clearance of goods, including goods in transit. It also sets out measures for effective cooperation between customs and other appropriate authorities on trade facilitation and customs compliance issues. It further contains provisions for technical assistance and capacity building in this area.⁶⁵

Trade facilitation involves what happens to goods as they cross national borders. The TFA measures focus on issues such as the release and clearance of goods. Investment facilitation goes well beyond border issues and relates to the establishment and subsequent operation of an enterprise, potentially involving a wide range of regulatory issues as diverse as environment, labour, consumer protection, competition, transportation, anti-corruption, taxation, health, and safety, among others.

Since 2017, WTO members have been engaged in structured discussions aimed at agreeing on a multilateral framework on investment facilitation for development. Two groups convened informal meetings and workshops throughout 2017 on whether and how the WTO could be a place for considering ‘measures that members could take to facilitate investment’. That effort led to the adoption of a Joint Ministerial Statement on Investment Facilitation for Development at the 11th Ministerial Conference in Buenos Aires at the end of 2017, with 70 members announcing the launch of ‘structured discussions with the aim of developing a multilateral framework on investment facilitation’. To address some members’ concerns about an attempt to develop multilateral rules on investment liberalisation and protection, the group clarified that this work would exclude market access, investment protection, and investor-state dispute settlement (ISDS).⁶⁶

The participants in the negotiations for an agreement on investment facilitation for development held a negotiating meeting on 8-9 March 2021.⁶⁷ Members continued the negotiations on the future agreement based on the latest version of the informal consolidated text. Participants discussed the establishment of a ‘business obstacle alert mechanism’ to resolve problems faced by investors and addressed the issue of ‘responsible business conduct’ based on text proposals from different members. The discussions addressed measures against corruption based on text proposals on this subject submitted by several members. Provisions to combat corruption would contribute to creating a transparent, efficient, and predictable environment for facilitating foreign direct investment, and thus contribute to sustainable investment and development. Participants engaged in a discussion on a revised proposal on domestic supplier databases, with proposals on general exceptions, security exceptions and financial exceptions also discussed.⁶⁸

65 For an overview of these developments, see https://www.wto.org/english/tratop_e/tradfa_e/tradfa_e.htm

66 Gabor, E, and K P Sauvat (2021).

67 For the latest negotiation news, see https://www.wto.org/english/news_e/events_e/events_e.htm

68 https://www.wto.org/english/news_e/news21_e/infac_09mar21_e.htm

One of the objectives of the CAI is to ‘create a better climate to facilitate and develop trade and investment between the Parties’. Section III of the CAI on ‘regulatory framework’ includes a comprehensive set of transparency rules for regulatory and administrative measures enhancing legal certainty and predictability, as well as on procedural fairness and the right to judicial review. Many of these provisions mirror key articles on investment facilitation in the new Chinese FIL.⁶⁹ Moreover, the CAI’s provisions are basically similar to most of the draft investment facilitation agreement. Section III of the CAI will ensure that licensing and qualification requirements and procedures are publicly available, easily understandable, and reasonable, so that they do not act as a barrier to investment. The relevant provisions are inspired by similar provisions in the GATS and the ongoing multilateral process such as the Joint Initiative on Services Domestic Regulation.

8. CONCLUSION

Many of the CAI provisions are fundamentally WTO-plus in nature and orientation. This is a characterisation that follows almost by definition, given the paucity of investment rules in the WTO. Substantively, the CAI represents a significant negotiating outcome on a range of deeply contested issues that span market opening issues to a complex values dimension. No doubt however, there will be interest groups within the EU that will decry the level of ambition in the CAI. In our view, this type of critique ignores both the sizeable outcomes in the CAI and the historic achievement of reaching agreement with a counterparty such as China. Yet, it may well be that the CAI is destined for a holding pattern, at least in the short term, given the outbreak of mutual sanctions imposed by China and the EU. To our mind, that limitation should not impact the value of using the CAI baseline as an exploration of possible investment rules in the WTO.

The WTO is in a significant moment of legislative crisis. WTO members are voting with their feet and diverting their negotiating capital into bilateral and regional trade agreements. Investment issues are front and centre in these new embodiments of international economic law. There is then an urgent need to divert state appetite from FTAs to resuscitate the WTO. As argued in other contributions to this volume, the key here could be a philosophical shift to variable geometry and away from the rigidity of the single undertaking approach within the WTO.⁷⁰ Investment rules anchored both against the CAI outcomes and structured on a plurilateral basis are a logical part of this resuscitation strategy.

69 China FIL, Articles. 10, 15-16, 19, and 26.

70 See also Hoekman, B and C Sabel (2021).

REFERENCES

- Aaken, A van and J Kurtz (2019), 'Beyond Rational Choice: International Trade Law and the Behavioral Political Economy of Protectionism', *Journal of International Economic Law* 22: 601, 616-619
- Abbott, K W, R O Keohane, A Moravcsik, A-M Slaughter, and D Snidal (2001), 'The Concept of Legalization' in Goldstein, J L, M Kahler, R O Keohane, and A-M Slaughter (eds), *Legalization and World Politics*, University of Cambridge Press.
- Adlung, R, P Morrison, M Roy, and W Zang (2011), 'FOG in GATS Commitments: Boon or Bane', World Trade Organization: Staff Working Paper, ERS-2011-04, pp: 10-11.
- Allee, T and C Peinhardt (2011), 'Contingent Credibility: The Impact of Investment Treaty Violations on Foreign Direct Investment', *International Organization* 63: 401.
- Baldwin, R (2016), *The Great Convergence: Information Technology and the New Globalization*, Pt. III, Harvard University Press.
- Berger, A, M Busse, P Nunnenkamp, and M Roy (2013), 'Do Trade and Investment Agreements Lead to More FDI? Accounting for Key Provisions Inside the Black Box', *International Economics and Economic Policy* 10(2):247.
- Calamita, N J (2020), 'Multilateralizing Investment Facilitation at the WTO: Looking for the Added Value', *Journal of International Economic Law* 23(4): 973-988.
- Cho S and J Kurtz (2018), 'Legalizing the ASEAN Way: Adapting and Reimagining the ASEAN Investment Regime', *American Journal of Comparative Law* 66:233.
- Dietz, T, M Dotzauer and E Cohen (2019), 'The Legitimacy Crisis of Investor-State Arbitration and the New EU Investment Court System', *Review of International Political Economy* 26(4): 749-772.
- Drahos, P (2021), *Survival Governance: Energy and Climate in the Chinese Century*, Oxford University Press.
- Findlay, C and B Hoekman (2020), 'Value Chain Approaches to Reducing Policy Spillovers on International Business', *Journal of International Business Policy*.
- Gabor, E, and K P Sauvat (2021), 'Facilitating Sustainable FDI for Sustainable Development in a WTO Investment Facilitation Framework: Four Concrete Proposals', *Journal of World Trade* 55(2): 261-286.
- Gómez-Palacio, I and P Muchlinski (2008), 'Admission and Establishment' in Muchlinski, P, F Ortino, and C Schreuer (eds), *The Oxford Handbook of International Investment Law*, pp: 239-245.

Henckels, C (2020), 'Permission to Act: the Legal Character of General and Security Exceptions in International Trade and Investment Law', *International and Comparative Law Quarterly* 69:557-584.

Hoekman, B and C Sabel (2021), 'Plurilateral Cooperation as an Alternative to Trade Agreements: Innovating One Domain at a Time', *Global Policy*, 12(S3): 49-60.

John Thornhill, 'Technology Wars are Becoming the New Trade Wars', *Financial Times* (22 April 2021).

Knight, L and T Voon (2020), 'The Evolution of National Security at the Interface Between Domestic and International Investment Law and Policy: The Role of China', *Journal of World Investment & Trade* 104-139.

Kurtz, J (2010), 'Adjudging the Exceptional at International Investment Law: Security, Public Order and Financial Crisis', *International and Comparative Law Quarterly* 59: 325, 341-51.

Maduro, M P (1998), *We the Court: The European Court of Justice and the European Economic Constitution*, Bloomsbury.

McDougall R (2018), 'The Crisis in WTO Dispute Settlement: Fixing Birth Defects to Restore Balance', *Journal of World Trade* 52:867.

Petri, P and M Plummer (2020), 'Trade War, RCEP and CPTPP: Will East Asia Decouple from the United States?', available at <https://ssrn.com/abstract=3630294>.

Prazeres, T L (2020), 'Trade and National Security: Rising Risks for the WTO', *World Trade Review* 19(1): 137-148.

Vandevelde, K (1997), *U.S Investment Treaties: Policy and Practice*, pp: 58.

Weiß, W (2020), 'Adjudicating Security Exceptions in WTO Law: Methodical and Procedural Preliminaries', *Journal of World Trade* 54(6): 829 - 852.

Yackee J W (2010), 'Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence' *Virginia Journal of International Law* 51: 405-414.

Zhou, W, H Jiang and Q Kong (2020), 'Technology Transfer Under China's Foreign Investment Regime: Does the WTO Provide a Solution?', *Journal of World Trade* 54(3): 455-480.

ABOUT THE AUTHORS

Jürgen Kurtz is Professor of International Economic Law jointly in the Robert Schuman Center for Advanced Studies and the Department of Law at the European University Institute. He researches and teaches in the various strands of international economic law including the WTO and international investment law.

GONG Baihua is Professor of International Law at the Law School of Fudan university and is also chair of International Law at the Shanghai Law Society. Professor Gong teaches on international public law, international investment and finance law, and drafting of international commercial contracts at the Law School.

CHAPTER 12

State-Owned Enterprises and International Competition: Towards Plurilateral Agreement¹

211

Bernard Hoekman^{a,b} and André Sapir^{b,c,d}

^aEUI; ^bCEPR; ^cULB; ^dBRUEGEL

Concerns about the behaviour and role of Chinese state-owned enterprises (SOEs) is a source of rising geo-economic tensions. This is not a matter pertaining only to China. Many World Trade Organisation (WTO) members, including European Union (EU) member states, have SOEs. Recent bilateral and regional agreements signed by China, the EU, and the United States (US) include provisions on SOEs and offer a basis on which to build, suggesting the possibility of negotiating a plurilateral agreement among major WTO members. Preparing the ground for such an effort calls for developing a solid evidence base on the prevalence of SOEs, their economic performance, and associated cross-border competition spillover effects.

INTRODUCTION

SOEs may be used to provide essential goods and services, or as an element of industrial policy or development strategy. Insofar as SOEs are used as instruments in the pursuit of economic development goals, they will generally affect competition on markets, and thus may have repercussions for international competition. The prospect of cross-border spillovers provides a rationale for rules to be included in trade agreements. Trade agreements can act as a commitment device for beneficial policy reforms by leveraging the interest of trading partners to reduce the adverse cross-border spillover effects of large SOEs (Brou and Ruta 2013). Trade agreements can also provide a mechanism to ensure a policy framework that supports competitive neutrality and improve the availability of data on the prevalence and operation of SOEs.

The stylised fact here is that increasingly, preferential trade agreements (PTAs) go beyond the WTO in including provisions that address the potential anticompetitive implications of the operation of SOEs. Concerns about the behaviour and role of Chinese SOEs are a source of rising geoeconomic tensions. While this is not a matter pertaining only to China, as many other WTO members have SOEs, the size and international presence of Chinese

¹ The preparation of this paper was supported by the European Union's Horizon 2020 research and innovation program under grant agreement 770680 (RESPECT).

SOEs puts the spotlight on China. Recent bilateral and regional agreements signed by China, the EU, and the US, include provisions on SOEs and offer a basis on which to build. Preparing the ground for such an effort requires developing a solid evidence base on the prevalence of SOEs, their economic performance, and associated cross-border competition spillover effects.

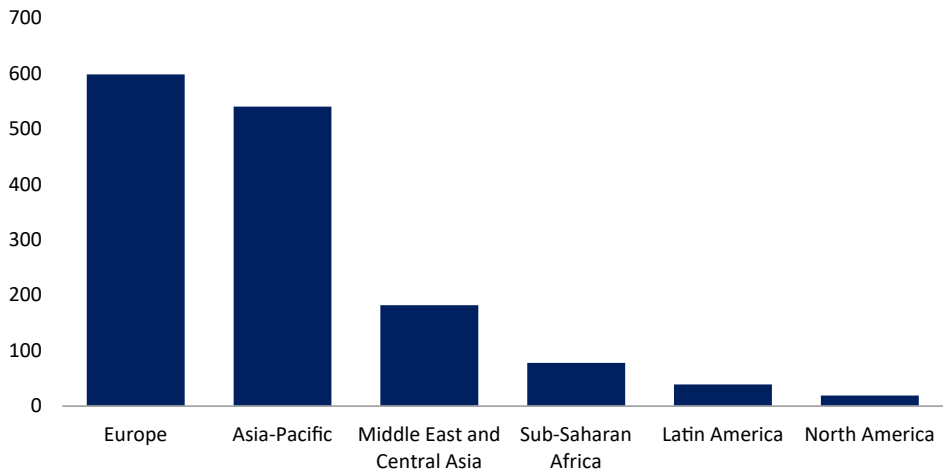
The structure of the chapter is as follows. Section 1 presents some stylised facts on SOEs and discusses why SOEs matter for the trading system. Section 2 discusses the coverage of SOEs in the WTO and recent trade and investment agreements. Section 3 summarises two alternative – perhaps complementary – paths to bolster disciplines on SOEs in the WTO and argues that a first step could be for China and the EU to take the lead in the WTO to improve the information base on SOEs as a first step towards negotiating a plurilateral agreement under WTO auspices. Section 4 concludes.

1. WHY SOES MATTER FOR THE TRADING SYSTEM

An essential element of China's development strategy is direct engagement of the State in the operation of the economy through SOEs. At the same time, China's economy has a strong market orientation (McMillan and Naughto, 1996, Lardy 2014) and relies heavily on international trade (Branstetter and Lardy 2008, Zheng 2004). Chinese SOEs operate on both the Chinese and international markets and engage in vigorous competition with other firms in their respective sectors, whether Chinese or foreign. Insofar as SOEs engage in commercial activity and benefit from state support that provides them with a competitive advantage (e.g. benefiting from lower cost of credit, guarantees or transfers from the government to cover losses) the operation of SOEs may pose a problem for the trading system by tilting the playing field in their favour. A key worry in this regard has been an increasing emphasis on SOEs by China (Lardy 2019) and the opaque nature of potential subsidies provided to, or by, SOEs, which is distinct, at least in principle, from the direct fiscal transfers that are associated with government subsidy programmes.

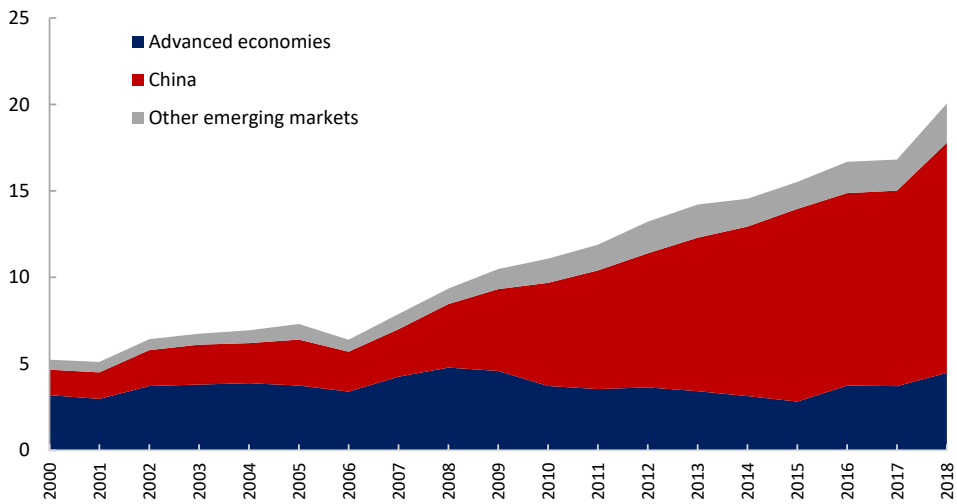
Concerns about the potential for SOEs to distort competition reflect views that SOEs are effectively subsidised (through soft loans, guarantees, preferential access to factor inputs other than directed credits, such as energy and land) and may indirectly subsidise downstream firms in both home and foreign markets through below-market pricing for their goods and services. In addition, SOEs may benefit from protection from foreign competition (e.g. reflected in FDI restrictions, joint venture requirements, preferential access to public procurement markets, etc.). From a global competition perspective, what matters is the extent to which SOEs are large and operate internationally. Europe and the Asia-Pacific region dominate the global SOE landscape (Figure 1). SOEs in other regions tend to be less multinational, suggesting more of a focus on local markets. Chinese non-financial SOEs account for a large share of the Asia-Pacific total. They have become steadily larger in the last two decades, reflected in a rising share of the total assets held by the largest 2000 firms globally (Figure 2).

FIGURE 1 NUMBER OF MULTINATIONAL SOEs BY REGION, 2019



Sources: IMF (2020).

FIGURE 2 SHARE OF NON-FINANCIAL SOEs IN TOTAL ASSETS HELD BY LARGEST 2000 FIRMS GLOBALLY (%)

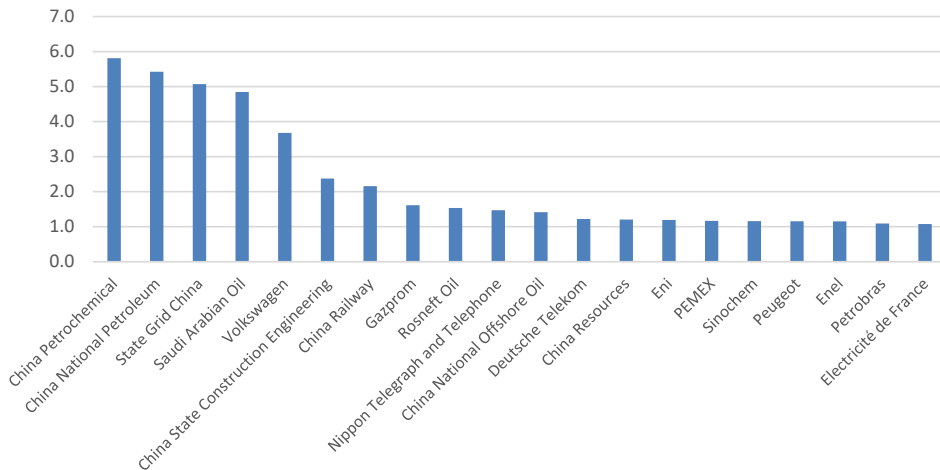


Sources: IMF (2020).

An estimated 22% of the world's largest 100 firms are effectively under state control (OECD 2016). In 2018, Chinese firms accounted for almost one-quarter of the largest 500 firms globally.² The five largest Chinese companies on the list are all SOEs. Figure 3 reports the 20 largest non-financial global companies with state ownership by revenue share in 2018. The list includes eight Chinese SOEs, as well as several large European companies and state-owned natural resource/energy companies in different parts of the world. These companies differ greatly in terms of public ownership. In some instances, this is low – e.g. Peugeot, with public ownership following its merger with Fiat currently standing at 6.2%, in others it is 100%. This illustrates that any effort to negotiate new rules for state-owned or controlled enterprises must consider the criteria that determine the coverage of an agreement. This should go beyond ownership and include factors associated with the potential for significant cross-border competition spillovers.

There has been relatively little research on the effects of SOE operations from a competition perspective. To some degree, potential cross-border spillover effects can be inferred from economic studies of the performance of SOEs relative to comparable privately owned and managed firms in their sectors. Empirical evidence for Chinese SOEs documents that they have a lower cost of capital (reflected in lower interest rates on their debt) and that privatised SOEs continue to benefit from government support relative to private enterprises (Harrison et al. 2019, Wood 2019). More generally, cross-country evidence suggests that SOEs are less profitable and less productive than private firms in their respective sectors (see Kowalski et al. 2013, IMF 2020).

FIGURE 3 TOP 20 GLOBAL NON-FINANCIAL COMPANIES WITH STATE OWNERSHIP



Source: IMF (2020).

Note: (percent of revenues relative to total revenues of largest 2000 firms).

2 See <http://fortune.com/global500/list/filtered?hqcountry=China>.

2. THE COVERAGE OF SOES IN THE WTO AND TRADE AND INVESTMENT AGREEMENTS

The WTO Agreement has few obligations on SOEs. The General Agreement on Tariffs and Trade (GATT) Article XVII on state-trading enterprises (STEs) dates back to the 1940s, and addresses a specific type of SOE: ‘Governmental and nongovernmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports’.³ Note that there is no mention of ownership. What matters is exclusivity or special privilege. The right of WTO members to maintain or establish STEs, or to offer exclusive privileges, is not limited. The basic obligation imposed on STEs is to make purchases or sales on a non-discriminatory manner (Article XVII:1a), which requires that STEs make purchases or sales solely in accordance with commercial considerations (Article XVII:1b). Case law has interpreted these provisions as simply requiring non-discrimination, i.e. if STEs do not act in accordance with commercial considerations but this does not result in discrimination there is no violation of Article XVII.⁴ China, when acceding to the WTO, agreed to considerably reduce the use of STEs operating in industrial goods and to eliminate import STE monopolies for agricultural products such as wheat, rice, and corn. Similar commitments were undertaken by Vietnam (Hoekman and Kostecki 2009).

The WTO Agreement on Subsidies and Countervailing Measures (ASCM) is more recent than GATT Article XVII, reflecting the situation (and thinking) prevailing in the 1990s regarding subsidies. The ASCM covers subsidies granted to any type of firm, independent of ownership. The definition of covered subsidies includes financial contributions provided by ‘any public body’ and not just government agencies. Under China’s Protocol of Accession (and the Report of the Working Party) China made commitments that go beyond the ASCM, including binding commitments on SOEs and state-invested enterprises (SIEs). Examples are provisions in the protocol stating that subsidies provided to SOEs will be regarded viewed as specific if the SOE(s) are the main recipients or the amounts granted are large, and that purchases by SOEs/SIEs will not be considered government procurement (and thus are subject to the national treatment rule). These are China-specific obligations. No such requirements apply to SOEs from other WTO members.

3 Understanding on the Interpretation of Article XVII of the General Agreement on Tariffs and Trade 1994. At https://www.wto.org/english/docs_e/legal_e/08-17_e.htm.

4 An implication of the case law is that operating on the basis of commercial considerations is not an independent obligation under Article XVII. There are problems associated with both elements of the rules on STEs as discrimination may make economic sense and thus be consistent with acting on commercial considerations - after all, price discrimination can and often is a feature of profit maximisation strategies of private firms - while acting on a commercial basis may negatively affect the ability of STEs to achieve their mandates and thus requiring them to do may undercut the ability of governments to regulate. See e.g. Hoekman and Trachtman (2008), Matsushita and Lim (2020) and Mavroidis and Sapir (2021).

The dysfunction was evident in the heightened interest rate volatility in the bond market, reflecting the reduced liquidity even in the US Treasury market. There were wide bid/offer spreads, and bond dealer inventories were large and constrained by capital and risk considerations. As a result, the Bank bought bonds across the maturity spectrum out to ten years. Since early May 2020, as market conditions improved the RBA ceased purchases for this reason.

Following China's accession, WTO members did not use the dispute settlement mechanism to challenge alleged violations of provisions of the protocol pertaining to SOEs/SIEs – only 2 out of 22 subsidy-related cases brought against China had a SOE dimension (Mavroidis and Sapir 2021). Instead, the focus of dispute settlement turned on actions against exports of Chinese firms that allegedly received benefits (direct or indirect subsidies) from SOEs. The crux of the matter here, was whether SOEs are 'public bodies' – an issue on which China's Protocol of Accession is silent. In cases brought by China challenging the imposition of countervailing duties by the US, the Appellate Body took the view that SOEs were not necessarily public bodies.⁵

In contrast to the WTO, some regional integration agreements explicitly regulate the behaviour of SOEs. One important extension found in such agreements relative to the WTO is that disciplines span services as well as goods – GATT Article XVII and the ASCM only cover merchandise trade. The most far-reaching example is the EU, where the goal of creating an integrated 'single' market is pursued in part through disciplines on state aids (subsidies) and SOEs through a common competition policy. Four criteria apply for state aid to be illegal in the EU: (i) state resources (subsidies, including tax expenditure) lead to (ii) a selective advantage for a firm or activity that (iii) distorts competition and (iv) affects trade between member states. These disciplines apply to both governments and firms, including undertakings (firms) to which member states have granted special or exclusive rights, i.e. SOEs. A public services provision (Article 106 TFEU) specifies that undertakings 'entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly' are subject to the general competition rules insofar as their application does not obstruct the performance of their public tasks. Consistent with the OECD Guidelines on Corporate Governance of State-Owned Enterprises, the EU framework focuses on identifying and removing competitive advantages of SOEs with respect to taxation, financing costs and regulation (Capobianco and Christiansen 2011). As discussed below, while the supra-national nature of enforcement of competition policy disciplines makes the EU *sui generis*, elements of the approach may inform inter-governmental cooperation under the auspices of the WTO.

⁵ See Ahn (2021) for an in-depth discussion. The resulting controversy became a major factor in the US decision to force the Appellate Body to cease operations by refusing to accept new appointments as sitting adjudicators reached the end of their term.

Less far-reaching economic integration agreements go beyond the ASCM by including more subsidies in the prohibited category, e.g. in specifying that state guarantees and support to insolvent or ailing companies are prohibited and banning the provision of state support on non-commercial terms to the commercial activities of SOEs (Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)).⁶ Two-thirds of the 283 PTAs assessed by Rubini and Wang (2020) include language requiring SOEs to behave in accordance with commercial considerations and 70% of these PTAs include subsidy disciplines that apply to SOEs. Recent PTAs have more provisions and stronger disciplines on SOEs. The CPTPP, the US–Mexico–Canada Agreement (USMCA), and EU–Japan all treat SOEs as public bodies. A distinct feature of the CPTPP and USMCA – inspired by US dissatisfaction with the WTO Appellate Body rulings mentioned in footnote 5, is a focus on ownership and control in defining the coverage of disciplines. The CPTPP defines SOEs as for-profit entities with at least SDR 200 million annual turnover in which the government owns more than 50% of the shares of the SOE, has control through ownership interests of the exercise of more than 50% voting rights, or has the power to appoint the majority of the board members. SOEs are required to behave on a commercial basis and are prohibited from providing subsidised inputs or engaging in anti-competitive practices. SOEs must act in a non-discriminatory manner and governments are to put in place an impartial regulatory and institutional framework for SOEs (Licetti, Miralles, and Teh 2020).

A somewhat different approach was pursued in the 2020 China–EU Comprehensive Agreement on Investment (CAI). This does not refer to SOEs but uses a broader concept of ‘covered entities’ to define coverage. Article 3bis, Section II, requires that covered entities act according to commercial considerations, a commitment that is enforceable through dispute settlement (Dadush and Sapir 2021).

Covered entities comprise enterprises in which one of the parties to the CAI directly or indirectly owns more than 50% of the share capital; controls, through ownership interests, more than 50% of the voting rights; holds the power to appoint a majority of members of the board of directors; or holds the power to control the entity’s decisions through other ownership interest. Covered entities also encompass enterprises in which a party has the power to legally direct the actions or otherwise exercise an equivalent level of control in accordance with its laws and regulations as well as any entity, public or private, granted the right as the sole supplier or purchaser of a good or service in a relevant domestic market.

This conceptualisation reflects a combination of Chinese and EU approaches in that they do not focus on SOEs *per se* and do not equate covered entities to public bodies in the sense of the ASCM. The focus is on undertakings: agreeing on a set of entities to which agreed disciplines apply. The approach is somewhat akin to that used in the

6 Both EU PTAs and the CPTPP subsidy disciplines exclude activities of SOEs associated with providing public services in their domestic markets.

WTO Agreement on Government Procurement (GPA), which goes beyond government agencies to include commitments that pertain to utilities, railways etc. that are privately owned in some countries. Importantly, CAI Article 3bis does not prevent establishing or maintaining covered entities, and does not apply to activities conducted in the exercise of governmental authority.

Similar to GATT Article XVII, each party to the CAI commits to ensure that, when engaging in commercial activities, its covered entities will:

- Act *in accordance with commercial considerations* in their purchases or sales of goods or services in the territory of the party.
- Accord, in their purchases of goods or services, to goods or services supplied by investors of the other party and the covered enterprises *treatment no less favourable* than they accord to like goods or like services supplied by investors and enterprises of the party.
- Accord, in their sales of goods or services, to investors of the other party and to the covered enterprises *treatment no less favourable* than they accord, in like situations, to investors and enterprises of the party.

The CAI also draws on GATT Article XVII in defining ‘commercial considerations’ as the price, quality, availability, marketability, transportation, and other terms and conditions of purchase or sale, or other factors that would normally be considered in the commercial decisions of an enterprise, in the relevant business or industry, that are profit-based, and disciplined by market forces.

Article 3ter demands that each party ensures that any regulatory body or any other body exercising a regulatory function that the party establishes or maintains acts *impartially* in like circumstances with respect to all enterprises that it regulates, including the covered entities. Moreover, each Party must ensure the enforcement of laws and regulations in a *consistent and non-discriminatory manner*, including on the covered entities. This is more in the spirit of EU state-aid rules than WTO rules. EU law applies to all undertakings, independent of ownership.

Commitments concerning covered entities are enforceable. In case a party considers that a measure by the other party violates the CAI’s commitments, it can request arbitration. If the panel rules in favour of the complainant, and the respondent fails to abide by the decision of the panel within a reasonable period of time, the complaining party may retaliate by adopting a measure that has an equivalent effect.

3. MOVING FORWARD

The key to resolving problems related to SOEs is to introduce disciplines to ensure that they act in accordance with commercial considerations. Two possible approaches can be envisaged to do so in the WTO context. One option is to agree on a new ASCM understanding, which equates SOEs with public bodies, with findings of subsidy if SOEs do not act in accordance with commercial considerations. This option is elaborated in Mavroidis and Sapir (2021). Another option is to negotiate a new understanding on SOEs that revisits GATT Article XVII by broadening its coverage beyond STEs and extends disciplines to entities that operate in services sectors. This could build on the approach followed in the CAI and focus on defining a category of ‘covered entities’, and clarifying the distinction (relationship) between non-discrimination and operating in accordance with commercial consideration.⁷

Any deal on SOEs would require participation of the US, the EU, and the People’s Republic of China. Framing the rationale for stronger disciplines on SOEs as a need to ‘reform’ China is doomed to fail. Conversely, China must accept that it has to play a central role in the development of a new regime for SOEs. All three players should accept that (i) their political economies are consistent with market-based competition, and (ii) will remain profoundly different from one another. As noted by Sabine Weyand, EU Director-General for Trade at an event celebrating the 25th anniversary of the WTO: ‘...the WTO is not the place to drive systems change. It is not about regime change. This is about dealing with the consequences of certain economic systems and to make sure that these are being dealt with in a manner that everyone can live with. And that requires compromise on all sides’ (Monicken 2020).

A first step should be to collect and analyse information on the operation and impacts of SOEs. As is the case for subsidies (Hoekman and Nelson, 2020), there is much sound and fury around Chinese SOEs, but too little focus on the activities of SOEs. While it is relatively straightforward to compile information on the prevalence of SOEs, a more serious challenge is to compile data on SOE operations and their effects on market competition. Governments do not know enough about the cross-border competitive spillover effects of SOEs. Only one-third of PTAs that include SOE provisions have notification requirements, and only 10 out of 283 foresee collaboration in generating information on the operations of SOEs (Rubini and Wang 2020). In practice, therefore, PTAs appear to do relatively little to address the need for up-to-date information on SOEs, which in turn is necessary to assess cross-border spillover effects, and more importantly from a domestic policy perspective, evaluation of the effects of these types of instruments.

7 See, e.g. Ding (2020) and Qin (2004) for arguments in favor of a broader approach akin to that included in the CAI.

This is something that can be addressed in the WTO. In the Uruguay Round, it was agreed to bolster disciplines on – and surveillance of – STEs. The Council for Trade in Goods established a Working Party on STEs in February 1995. Governments were required to notify all STEs for review by the Working Party, apart from imports intended for consumption by government bodies or STEs themselves. Notifications must be made, independent of whether imports or exports have in fact taken place, and WTO members may make counter-notifications. The Working Party reports annually to the Council for Trade in Goods. The Working Party developed a questionnaire on state trading, based on a draft Illustrative List of State Trading Relationships and Activities that was adopted in 1999. A total of 58 WTO members notified the existence of STEs as of 1995. In 2006, the Working Party reviewed a total of 17 notifications, some of which date back to 2002. Some 75% of STEs notified to WTO operate in the agricultural sector (Hoekman and Kostecki 2009).

A similar effort is needed to prepare the ground for agreement on new rules that are mutually beneficial to all parties. This is useful not just to determine the extent of the problem, magnitude, and incidence of possible negative competitive international spillovers. As important, is the role that greater transparency (better data) can play as an input into analysis of performance of SOEs, their implications for public sector debt, government budgets, financial stability, and understanding whether social goals are being realised efficiently (see, e.g. Musacchio and Pineda Ayerbe 2019, IMF 2020, Wolfe 2017). As noted previously, the limited extant evidence suggests SOEs often have much lower productivity than other firms operating in the same sector.

Such work will need an institutional anchor. The WTO is the obvious candidate. Even though it may seem unlikely that the membership will be willing to give the secretariat a mandate to take on the type of analytical role played by the OECD secretariat, the WTO can, and should, provide a platform for a concerted effort to improve the information base. This could take the form of a Working Party or a ‘Joint Statement Initiative’ along the lines of those launched in 2017 at MC11.

Would such an exercise be possible? We believe it will be challenging but recent engagements spanning all three major powers (and many other countries) suggest it may be feasible. An illustration is the Global Forum on Steel Excess Capacity (GFSEC), with ministerial meetings taking place once a year since November 2017. This focuses on one sector, steel, where subsidies are held to be a major factor distorting international competition. It aims at improving the extant information base on supply conditions and investment, drawing on the expertise at the OECD on the sector. A weakness of the GFSEC is that it does not seek to establish a comprehensive baseline dataset spanning all steel-related policy support provided by different levels of governments in a country. A consequence is an inability to assess the effects of policies. In the SOE context such analysis is important to clarify to what extent SOEs act in accordance with commercial considerations and evaluate the magnitude and incidence of cross-border effects on competition.

4. CONCLUDING REMARKS

Many OECD member governments have made it clear that they consider large, for-profit SOEs to constitute a problem for the trading system. They have also argued that one element of a solution is to agree that SOEs should be considered as a ‘public body’ for purposes of the application of WTO rules (the ASCM). Most prominent has been the ‘trilateral’ group – the EU, Japan, and the US – which has held a series of meetings starting in 2018 to identify ways to strengthen disciplines on subsidies and SOEs. One result has been the suggestion to expand the list of prohibited subsidies in the WTO to include SOEs and preferential pricing for inputs.⁸ Recent PTAs provide valuable information on the types of disciplines that may be considered in augmenting extant WTO rules. Expanding the coverage of such rules to China is important for the continued salience of – and support for – the trading system, given that SOEs have become a major source of trade tensions. However, reliance on PTA-based disciplines is clearly insufficient and may even be counterproductive insofar as they give a competitive advantage to SOEs based in jurisdictions that are not members of the respective PTAs (Lefebvre et al. 2021).

Drafting exercises to clarify and extend the ASCM that build on disciplines negotiated among signatories of the CPTPP, USMCA, EU-Japan etc. appear to be a pragmatic response to changed circumstances. Doing so has the advantage of probably being more feasible in a multilateral WTO context than revisiting and extending the current rules on STEs. But the China-EU CAI illustrates that there is an alternative option, one that goes beyond a focus limited to state-ownership and viewing matters through the lens of subsidies to and by SOEs. A non-negligible consideration here is that the CAI approach has been agreed by two of the big three WTO trade powers, whereas the CPTPP and USMCA were developed and agreed by signatories without participation by China, reflecting the desire to define the rules of the game for China. The associated political baggage may reduce the prospects that China will engage in a process that starts from the premise that the CPTPP provides a good template for deliberation in the WTO setting. This bolsters the case for exploring the possibility of using elements of the CAI as a basis for plurilateral engagement on SOEs. On the other hand, while perhaps more politically feasible, a WTO agreement based on the CAI would probably provide less discipline on SOEs than if it were based on the CPTPP and USMCA.

Whatever approach is pursued, WTO members currently do not have sufficient information to develop a common understanding of where new rules may be needed, as opposed to tweaking existing WTO provisions on STEs and subsidies. A first step could be for the EU and China – probably the two main jurisdictions where SOEs are headquartered – to take the lead on creating a WTO Working Party on SOEs to prepare the ground for a negotiation on new rules for SOEs. Such a negotiation should be

8 See, e.g. Joint Statement on Trilateral Meeting of the Trade Ministers of the United States, Japan, and the EU, 9 January 2019. At: <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/january/joint-statement-trilateral-meeting> and https://trade.ec.europa.eu/doclib/docs/2020/january/tradoc_158567.pdf.

conceptualised as a plurilateral effort along the lines of the ‘joint statement initiatives’ launched in 2017 at the 11th WTO Ministerial Conference. Agreement among all 164 WTO members is not necessary, as most WTO members’ SOEs do not create systemic spillovers. What is necessary is that the three major players – China, the EU, and the US – cooperate with the aim of promoting a solution within the multilateral WTO legal order.

REFERENCES

Ahn, D (2021), ‘Why Reform Is Needed: WTO “Public Body” Jurisprudence’, *Global Policy*, 12(S3): 61-70.

Branstetter L and N Lardy (2008), ‘China’s Embrace of Globalization’, in Brandt, L and T Rawski (eds), *China’s Great Economic Transformation*, Cambridge University Press, 633-82.

Brou, D and M Ruta (2013), ‘A Commitment Theory of Subsidy Agreements’, *B.E. Journal of Economic Analysis and Policy*, 13(1): 239-70.

Capobianco, A and H Christiansen (2011), ‘Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options’, OECD Corporate Governance Working Papers, No. 1.

Christiansen, H (2011), ‘The Size and Composition of the SOE Sector in OECD Countries’, OECD Corporate Governance Working Paper No. 5. Paris: OECD.

Dadush, U and A Sapir (2021), ‘Is the European Union’s Investment Agreement with China Underrated?’, Bruegel Policy Contribution No. 09/21.

Ding, R (2020), ‘Interface 2.0 in Rules on State-Owned Enterprises: A Comparative Institutional Approach’, *Journal of International Economic Law*, 23: 637-663.

Harrison, A, M Meyer, P Wang, L Zhao, and M Zhao (2019), ‘Can a tiger change its stripes? Reform of Chinese state-owned enterprises in the penumbra of the state’, NBER working paper 25475.

Hoekman, B and M Kostecki (2009), *The Political Economy of the World Trading System*, Oxford University Press.

Hoekman, B and D Nelson (2020), ‘Rethinking International Subsidy Rules’, *The World Economy*, 43(12): 3104-32.

Hoekman, B and J Trachtman (2008), ‘Canada-Wheat: Discrimination, Non-Commercial Considerations, and the Right to Regulate through State Trading Enterprises’, *World Trade Review* 7(1): 45-66.

IMF (2020), ‘State-Owned Enterprises: The Other Government’, Chapter 3 of the April Fiscal Monitor, IMF.

Kowalski, P, M Buge, M Sztajerowska, and M Egeland (2013), 'State-Owned Enterprises: Trade Effects and Policy Implications', OECD Trade Policy Paper 147.

Lardy N (2014), 'Markets over Mao: The Rise of Private Business in China', Peterson Institute for International Economics.

Lardy, N (2019), 'The State Strikes Back: The End of Economic Reform in China?' Peterson Institute for International Economics.

Lefebvre, N Rocha and M Ruta (2021), 'Containing Chinese State-Owned Enterprises? The Role of Deep Trade Agreements', World Bank Working Paper.

Licetti, M, G Miralles, R Teh (2020), 'Competition Policy', in Mattoo, A, N Rocha, and M Ruta (eds), *Handbook of Deep Trade Agreements*, World Bank.

McMillan, J and B Naughton (1996), *Reforming Asian Socialism: The Growth of Market Institutions*, University of Michigan Press.

Matsushita, M and C Lim (2020), 'Taming Leviathan as Merchant: Lingering Questions about the Practical Application of Trans-Pacific Partnership's State-Owned Enterprises Rules', *World Trade Review*, 19: 402–423.

Mavroidis, P C and A Sapir (2021), *China and the WTO: Why Multilateralism Still Matters*, Princeton University Press.

Monicken, H (2020), 'For U.S., WTO reform hinges on economic model 'convergence'', World Trade Online, <https://insidetrade.com/daily-news/us-wto-reform-hinges-economic-model-%E2%80%98convergence%E2%80%99>.

Musacchio, A and E Pineda Ayerbe (Eds) (2019), 'Fixing state-owned enterprises: new policy solutions', Inter-American Development Bank.

OECD (2016), 'State-Owned Enterprises as Global Competitors: A Challenge or an Opportunity?', OECD.

Qin, J (2004), 'WTO Regulation of Subsidies to State-owned Enterprises (SOEs)—A Critical Appraisal of the China Accession Protocol', *Journal of International Economic Law*, 7(4): 863-919.

Rubini, L and T Wang (2020), 'State-owned enterprises', in Mattoo, A, N Rocha and M Ruta (eds), *Handbook of Deep Trade Agreements*, World Bank.

Wolfe, R (2017), 'Sunshine over Shanghai: Can the WTO Illuminate the Murky World of Chinese SOEs?', *World Trade Review* 16(4): 713-32.

Wood, A (2019), 'China: Long-Term Development Issues and Options, Past and Present', University of Oxford, TMCD Working Paper Series, No. 079.

Zheng Y (2004), *Globalization and State Transformation in China*, Cambridge University Press.

ABOUT THE AUTHORS

Bernard Hoekman is Professor and Director, Global Economics, at the Robert Schuman Centre for Advanced Studies, European University Institute, where he also serves as the Dean for External Relations. He is a CEPR Research Fellow. His research focuses on commercial policy, trade in services, public procurement, and global trade governance.

André Sapir is Professor at Université Libre de Bruxelles (ULB), Senior Fellow of Bruegel and CEPR Research Fellow. He was Economic Advisor to European Commission president Romano Prodi. He has authored many publications on trade policy, including *China and the WTO*, a book co-authored with Petros Mavroidis recently published by Princeton University Press.

CHAPTER 13

Climate Change, Trade Policy, and the WTO

225

ZHANG Jianping and XIE Zhiyu

Chinese Academy of International Trade and Economic Cooperation; Peking University

China aims to achieve 'peak carbon' by 2030 and carbon neutrality by 2060 through a variety of policies. The Chinese example illustrates the need for the World Trade Organization (WTO) to recognise and support the use of a range of measures to reduce carbon emissions and strengthen the governance of trade-climate policy. Developed and developing countries disagree on the equitable allocation of carbon emission reduction obligations and the legality of carbon border adjustment taxes. A prominent example is the European Union's (EU) planned introduction of a carbon border adjustment mechanism, which may result in discrimination against developing countries. From a trade-climate perspective, the WTO should conclude negotiations to liberalise trade in low-carbon and environmental products and launch discussions on alternative approaches to address climate issues.

INTRODUCTION

The achievement of sustainable development, including the 17 objectives defined in the global Sustainable Development Goals (SDGs), requires the gradual improvement of the global sustainable development governance system. Sustainable development is rich in connotation, and sustainable governance includes global economic governance, environmental governance, social governance, and other interrelated components. Global trade, investment and financial governance together constitute the three pillars of the global economic governance structure, reflected in the Bretton Woods system led by Western countries after the end of World War II – represented by the International Monetary Fund, the World Bank, and the General Agreement on Tariffs and Trade (GATT) (now the World Trade Organization (WTO)).

The WTO has played an important role in promoting the sustainable development of the global economy. Trade has been an effective driver of economic development. International trade expands production possibilities, allowing the specialisation and fragmentation of production through regional and global value chains, which in turn greatly improves the production capacity of enterprises and the welfare of consumers. The WTO is the mainstay of global trade governance, supplemented by regional trade agreements. It provides a platform for the negotiation and implementation of international multilateral

trade rules to maintain the openness and fairness of global trade. The rapid development of international trade calls for the upgrading and reform of the global trade governance system, serving a fairer and freer global trade environment.

The challenges facing the multilateral trading system have become increasingly severe, making WTO reform imperative. Since China joined the WTO, it has been an active participant and firm defender of the multilateral trading system. China supports the WTO to carry out necessary reforms to improve its ability to maintain and promote trade liberalisation (Tu 2021). In 2019, China submitted to the WTO the ‘Proposal Document of China on the Reform of the World Trade Organization’, which argued that WTO reforms should adhere to three basic principles:

1. To maintain the core values of non-discrimination and openness of the multilateral trading system.
2. To ensure the protection of developing members development interests.
3. To follow a consensus decision-making mechanism

The proposal highlights several key areas for WTO reform. The first is to resolve key and urgent issues that endanger the survival of the WTO, notably breaking the deadlock in the selection of Appellate Body members, tightening disciplines on the use of national security exception measures (strengthening requirements pertaining to notification and multilateral deliberation) and bolstering disciplines on unilateral measures that do not comply with WTO rules. A second area for action is to resolve the problem of unfair disciplines on agricultural support,¹ improving rules on trade remedies (measures to countervail the effects of subsidies and anti-dumping), completing negotiations on fishery subsidies, promoting the open and inclusive development of e-commerce negotiations, and promoting multilateral discussions on new topics. The proposal also notes the need to improve the operational efficiency of the WTO, including strengthening the implementation of member notification obligations, the importance of respecting the rights of developing country WTO members to enjoy special and differential treatment and adhering to the principle of fair competition in trade and investment.

Global trade governance is an indispensable part of the global sustainable development governance system. This Chapter reflects on one potential area for WTO reform: global governance of the use of trade measures as part of national programmes to address climate change. Liberalising trade in clean energy, low-carbon products, and other green products and technologies can support lower carbon emissions. Although the WTO has provisions for exceptions and exemptions for the use of trade policy to achieve environmental goals, as discussed below, imposing climate-motivated trade barriers runs the risk of treating countries differently, violating the core nondiscrimination rules of the WTO.

1 This has a climate dimension. See Haberli (2018).

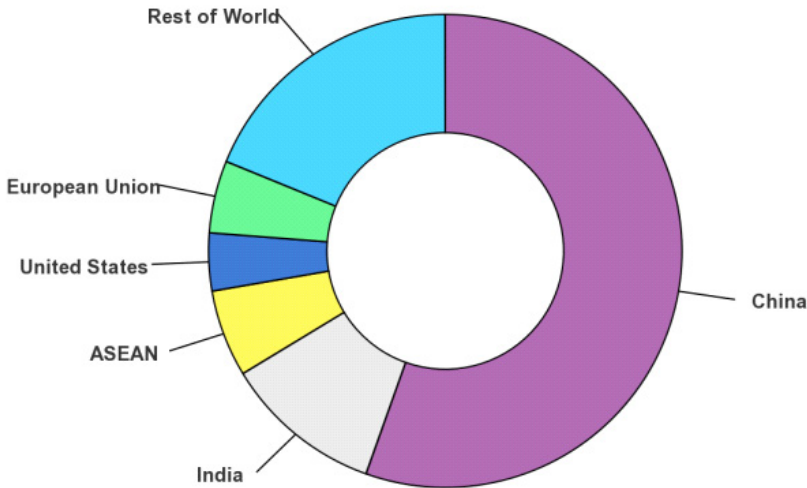
Sections 1 and 2 discuss China's carbon reduction measures and related international climate-related engagement. Section 3 turns to carbon border taxes and the WTO, focusing in particular on the EU proposal to put in place a carbon border adjustment tax. Section 4 briefly discusses the Environmental Goods Agreement negotiations to liberalise trade in clean-energy and environmental products. Section 5 concludes with suggestions on a path forward at the WTO on climate change issues.

1. CHINA'S CARBON REDUCTION TARGETS AND MEASURES

The global climate change situation is becoming ever more perilous. The frequent occurrence of extreme weather events, the melting of glaciers, and the rising sea level threaten human survival. Most of the problem is caused by greenhouse gas emissions, that is, carbon emissions. China's carbon emissions are mainly caused by energy intensive industries. Following the reform and opening-up of China's economy, energy intensive industries have been a major driver of growth, generating a large number of jobs across a wide range of sectors.

However, the environmental pollution caused by energy-intensive industries is serious. The Chinese government is aware of the importance of carbon reduction and has the determination to implement Paris Agreement commitments and to significantly reduce carbon emissions. As a continuation of the theory of 'green water and green mountains are golden mountains and silver mountains' proposed by General Secretary Xi Jinping, China plans to achieve 'peak carbon' by 2030 and "carbon neutrality" by 2060. However, China is still in the developing stage, reflected in a certain gap in the degree of industrial development between China and high-income countries. China is the world's most populous country. With the further development of the country's industrialisation and rise in urbanisation, demand for fossil energy is still increasing. In 2020, China accounted for 56% of global coal consumption (Figure 1). In China's domestic primary energy consumption structure, coal consumption accounts for 60%. Therefore, China still has a long way to go to reduce carbon emissions.

FIGURE 1 SHARE OF GLOBAL COAL CONSUMPTION IN 2020



Sources: International Energy Agency at <https://www.iea.org/data-and-statistics/charts/share-of-coal-consumption-of-different-countries-and-regions-2020>.

China attaches great importance to the implementation of the ‘carbon neutral’ plan. As early as 2009, China formulated measures to reduce emissions in accordance with the Copenhagen Accord, and achieved a reduction in carbon emissions per unit of GDP by at least 40% by 2020. The proportion of non-fossil energy will increase to 15%, the forest stock will increase by 1.3 billion cubic meters, and the forest coverage will increase by 40 million hectares. In the 2021 Government Work Report, it is clearly stated that a specific implementation plan for ‘carbon peaking’ will be issued before the end of the year, and it has received positive responses from various Chinese ministries, commissions, and provinces.

China is also making efforts to upgrade and reform the industrial structure, and has clarified several major directions for future emission reductions. One axis for action is to adjust the energy structure and accelerate clean-up. This encompasses energy infrastructure construction and development, promotion of equivalent substitution of coal consumption, a focus on renewable energy production and energy storage, and gradually increasing policy support for new energy vehicles, photovoltaic and wind power generation, UHV² and other industries. This lays a solid foundation for future energy reforms. Another policy focus is to promote industrial low-carbon transformation, starting from emission-intensive production sectors, strictly formulating energy consumption and environmental protection standards, and transforming, upgrading, merging, and reorganising high-energy-consumption and heavy-polluting industries

2 Ultra-high-voltage electricity transmission.

such as electricity, heating, steel, chemicals, and metallurgy. Optimising the allocation of resources through industry consolidation and eliminating outdated and excess capacity will reduce carbon emissions per unit of capacity.

Another measure is to establish a carbon emission trading system as soon as possible, promoting the development of the carbon trading market from pilot to popularisation, and supporting green finance, carbon sink trading, and the carbon sink capacity of the ecosystem. In parallel, ecological environmental governance nationwide will be strengthened, promoting national land greening activities within the country, vigorously restoring vegetation and accelerating the development of carbon capture, utilisation and storage technology, and related infrastructure.

China's carbon market construction and carbon trading system

Carbon emission trading ('carbon trading') is a market-oriented means to control the total amount of carbon emissions and promote low-carbon transformation of industries. The carbon emission trading market (referred to as 'carbon market') is to promote the implementation of the long-term goal of 'carbon neutrality'. The EU Emissions Trading System (ETS) is currently the world's largest and most widely covered carbon market and is a reference paradigm for the construction of carbon emission trading systems in various regions of the world. Other developed economies such as the United States, Canada, Japan, and Australia have also established relatively complete carbon emissions trading systems.

The Chinese government attaches great importance to low-carbon emission reduction and is actively exploring the construction of a carbon trading system. As an important way to deal with global climate change, China's exploration of the construction of a carbon market can be roughly divided into three stages, from joining a relatively mature international carbon trading system as a participant to conducting pilot projects for the construction of a domestic carbon market, and then steadily advancing the construction of a unified national carbon market.

Domestic carbon trading pilot projects include eight provinces and cities in Beijing, Shanghai, Tianjin, Chongqing, Hubei, Guangdong, Shenzhen, and Fujian, which mainly cover carbon emission-intensive industrial industries such as electricity, petrochemicals, and steel. As of March 2021, carbon trading encompassed nearly 3,000 key emission companies, with cumulative carbon emissions of 240 million tons and a cumulative transaction value of RMB 5.86 billion. After years of pilot work on carbon trading, the construction of a national carbon market has been accelerated. A national carbon emission trading system and registration system will be launched in Shanghai and Wuhan, with the electric power industry the first to be included. A total of 2225 companies obtained carbon allowances, and the first compliance cycle was launched in the national carbon market in January 2021. Following the completion and regular operation of the national carbon trading system, China's carbon market will become the world's largest.

Gaps remain between China's carbon market construction and those in developed economies (Schwartz 2016). Carbon trading is a means to control carbon emissions by introducing a market mechanism. The market oriented operation of carbon trading requires the mandatory binding force of relevant laws and regulations. Developed economies started to practice carbon market construction earlier, and their basic laws and regulations are relatively complete. For example, the EU's 'Greenhouse Gas Emission Permit Trading Directive',³ New Zealand's 'Climate Change: The Response Act' (2002), Australia's 'Clean Energy Future Act', and California's 'Global Warming Response Act' (2006) are all regional carbon markets under the guidance of public law. During the pilot period of the carbon market in China, the laws and regulations of the local governments in the pilot areas proved to be the main constraints. The local laws and regulations lacked mandatory and limited binding force. China has not yet promulgated the upper-level law on carbon emissions trading, and the legal attributes of carbon trading cannot be clearly defined at the national level. The 'Measures for the Administration of Carbon Emission Trading (Trial)' cannot explain the 'laws to be followed', and there is a gap between China and developed economies on the legal basis of carbon trading.

Constructing China's carbon market involves action on several fronts. First, improving the national carbon market laws and regulations. A national carbon market requires a unified national legislation, including more rapid introduction of laws and regulations related to carbon trading (e.g. defining the rights and responsibilities of carbon trading and clarifying the legal status of the carbon market) and accelerating the improvement of the 'Regulations on Carbon Emission Trading Management' to promote coordination and cooperation among provinces, cities, and other authorities to refine the design of rules for quota control, carbon emission verification, and enforcement.

Second, improve the national carbon trading mechanism and promote the scientific and reasonable operation of China's carbon market. On the one hand, combining the goals of 'carbon peak' and 'carbon neutrality' with Chinese economic development, this requires determining the total amount of national carbon allowances, reducing the total amount of allowances and the proportion of free allowances, optimising the allocation of allowances, and making carbon trading an increasingly important feature of controlling carbon emissions and promoting low-carbon transformation of enterprises. On the other hand, the pilot carbon trading situation made obvious a trend of 'hot market before the compliance period and deserted trading after the period' of carbon trading. It is expected that there will be insufficient carbon trading liquidity at the beginning of the establishment of the national carbon market. This suggests exploring innovative trading products, promoting the construction of the carbon financial market, and steadily incorporating more industries and trading entities to increase activity on the carbon market.

3 DIRECTIVE 2003/87/EC, establishing a scheme for greenhouse gas emission allowance trading within the community and amending Council Directive 96/61/EC.

Third, capacity building of carbon trading participants is needed to foster consensus for the long-term sustainable development of China's carbon market. The participation of carbon trading entities is an important support for the smooth and long-term operation of the national carbon market. The steady expansion of coverage is inevitable for the development of the national carbon market, which places higher requirements on the working capabilities of government departments such as the Ministry of Ecology and Environment, but more importantly, the ability of companies to participate in market transactions. According to the experience of carbon trading pilots, carbon trading in the carbon market is still dominated by compliance trading, which shows that the main body of enterprises have insufficient understanding of the carbon market. This calls for strengthened industry-tailored training and education on carbon market participation, as well as establishing a long-term education system related to carbon market construction and key high emission industries such as steel and cement.

Finally, stronger cooperation with developed economies to lay the foundation for the internationalisation of China's carbon markets. Global climate change is a common problem faced by people all over the world, and 'carbon neutrality' is the consensus of all countries worldwide. After the formation of the national carbon market, China is the world's largest carbon market. Following the establishment of the domestic institutional framework, China is bound to actively seek carbon emission reduction exchanges between regions and strengthen project cooperation between the Chinese carbon market and other carbon trading systems.⁴

2. CHINA'S CONTINUOUS EFFORTS ON TRADE-RELATED CLIMATE AND ENVIRONMENTAL ISSUES

As an important participant and leader in the construction of global ecological civilisation, China has made other efforts and contributions in terms of trade-related climate and environmental issues. One attempt has been to actively carry out international cooperation and exchanges and promote green trade through the 'Belt and Road' initiative. As the initiator of the 'One Belt One Road' initiative, China has experienced the environmental pollution problems brought by low-end downstream industries in the process of gradually integrating into the global value chain, and can provide countries along the route with experience and practice to achieve coordinated environmental and economic upgrades. (Zhou Yamin 2019). Since the 'Belt and Road' initiative was put forward, China has helped countries along the route improve their ability to respond to climate change through various forms of cooperation – including green infrastructure, green energy, green transportation, and green finance. In 2015, China issued the 'Vision and Actions for Promoting the Joint Construction of the Silk Road Economic Belt and the 21st Century Maritime Silk Road'. In terms of facility connectivity, China proposed to strengthen the

4 See Keohane, Petsonk and Hanafi (2017).

green and low-carbon infrastructure construction and operation management and make full use of it in the construction. Taking into account the impact of climate change, the document also pointed out that the concept of ecological civilisation should be emphasised in investment and trade, and cooperation in the ecological environment, biodiversity and climate change should be strengthened to jointly build a green silk road.

In 2017, China issued the ‘Guiding Opinions on Promoting the Construction of Green “One Belt and One Road”’ and the ‘One Belt and One Road’ Ecological Environmental Protection Cooperation Plan. The guidance points to the need to:

- Promote the construction of green infrastructure, increase ecological and environmental protection services and support for major infrastructure construction projects along the Belt and Road.
- Support the development of green trade by increasing the level of environmental protection and expanding the import and export of green products and services.
- Strengthen green supply chain management, environmental management of foreign investment, promoting international cooperation in green supply chains and the development of green financial services.
- Bolstering green guidelines for corporate behaviour and encouraging environmental services companies to explore markets along the Belt and Road and ‘go out’ in clusters.

China has also promoted the establishment of an environmental-related rule system in the negotiation of relevant international conventions, free trade agreement negotiations, and investment agreement negotiations. First, in response to global climate change, China has actively participated in international conventions such as the United Nations Framework Convention on Climate Change, the Kyoto Protocol, and the Paris Agreement, and signed joint declarations on climate change with the United States, France, Australia, the EU, and Japan. China has sought to earnestly fulfil the obligations stipulated in the conventions and declarations. Secondly, to facilitate the development of green trade, China has integrated environmental protection requirements into free trade agreements, and actively negotiated and implemented environmental and trade related agreements. These include the China-Korea FTA, China-Singapore FTA, China-Switzerland FTA, China-New Zealand FTA, The China-Iceland FTA, China-Chile FTA, and China-Georgia FTA, which all clearly stipulate environmental and trade related issues. Third, climate issues have also received increased attention during the investment agreement negotiations. For example, the China-Europe Comprehensive Agreement on Investment (CAI) has made relevant commitments on the environment and climate, including the effective implementation of the Paris Agreement.

Finally, China is strengthening the ecological and environmental protection of pilot free trade zones and promoting high quality economic development. In April 2021, the executive meeting of the Ministry of Ecology and Environment reviewed and approved in principle the ‘Guiding Opinions on Strengthening the Ecological Environment Protection of Free Trade Zones and Promoting High-quality Development’. The opinions aim to create a demonstration of synergistic promotion of high quality economic development and high-level protection of the ecological environment. The meeting also pointed out that it is necessary to fully implement the overall requirements for pollution reduction and carbon reduction, strengthen international cooperation, and actively explore new models of mutual support between the environment, trade, and investment.

3. CARBON TRADING, CARBON TAXES, AND THE WTO RULES

The WTO is not a global environmental protection organisation. Its capabilities are limited to ‘trade-related environmental policies’ (Baron and Garrett 2017, Santarius et al. 2004). In 2001, the Doha Ministerial Conference agreed to negotiations on three trade-environment issues:

1. The relationship between existing WTO rules and specific trade obligations set out in multilateral environmental agreements (MEAs) to which WTO members are a party.
2. Procedures for regular information exchange between MEA Secretariats and the relevant WTO committees, and the criteria for the granting of observer status.
3. The reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services.

Under the WTO framework, discussions related to trade and climate change have never stopped. The main topics of the negotiations include the definition of environmental products and tariff concessions, border tax adjustments, carbon labels, intellectual property rights, and subsidies. Among these issues, border tax adjustment measures have always attracted the attention of WTO members. After the EU launched the carbon border adjustment mechanism (CBAM), the levy of carbon border adjustment taxes has once again triggered controversy.⁵ The focus of the debate is whether carbon border adjustment conflicts with WTO rules. Another area of focus is to support trade in environmentally friendly products and services by eliminating or reducing barriers to trade in such products.

5 See for example RECAP (2021).

China produces for the world, should consuming countries pay for carbon emissions?

On March 10, 2021, the European Parliament passed a proposal on the CBAM, which means that the EU is getting closer to implementing carbon tariff policies. Such policies are also being considered by other developed countries. In the United States, according to the agenda issued by the Office of the United States Trade Representative, the Biden administration is considering imposing a 'carbon border tax' or 'border adjustment tax' aimed at increasing import tariffs on products that the United States considers to be responsible for climate change. At the same time, the British Prime Minister Boris Johnson proposed to use his role as the chairperson of the Group of Seven to promote the coordinated collection of carbon border taxes among member states.

The purported purpose of such proposals is to limit 'carbon leakage', but this will be at the cost of developing countries that are at the stage of energy intensive industrial development and are seeking to increase their share of global industrial and manufacturing production. On the one hand, developed countries want to enjoy the benefits of cheap production costs in developing countries, which may have been associated with relocation of high-polluting, high-energy-consuming industrial manufacturing companies to developing countries. A side effect is to reduce their own environmental pollution and improve their own environment and climate without improving global emissions. Measures to prevent such 'carbon leakage' require developing countries to switch production methods at a high cost. This is typical vested interest thinking.

China has always actively supported global carbon reduction and emission control and has always been in a leading position concerning global climate governance. It has also established an institutional framework for carbon trading at home. China has made great efforts in environmental and climate governance. Achieving the long-term goal of 'carbon neutrality' implies continuing to abandon high-energy-consuming industries that have generated huge economic benefits since the reform and opening-up of the economy starting in the late 1970s. This clearly reflects China's determination to contribute to climate governance. However, China opposes the establishment of trade barriers against developing countries under the guise of climate governance, because this is a unilateral measure to safeguard the interests of developed countries, at the expense of developing countries. Developed countries often have the highest per capita energy consumption in the world. Many final consumer goods are manufactured using energy consumed in developing countries and then exported to developed countries. The actual energy consumption occurs in developed countries. Therefore, a 'carbon border tax' is an unreasonable type of trade barrier. Developing countries such as China should not pay for global carbon emissions, but the developed countries in the EU should bear the main cost of carbon emissions.

China, India, and other developing countries are opposed to carbon tariffs, because the collection of carbon tariffs may seriously affect the import and export trade of developing countries. The export manufacturing industries of developing countries are mostly at the middle and low end of the international industrial chain, which consume a lot of energy and emit high carbon emissions. The implementation of carbon tariffs may put a lot of pressure on many export companies in developing countries.

Thus, generally speaking, the major developed economies are supportive of carbon tariffs, while the developing economies are more opposed. From the perspective of developing countries, the global warming problem is caused more by the original accumulation process of developed countries. In the past century of uncontrolled emissions, about 80% of greenhouse gases have been produced by developed countries' national emissions. Nowadays, the economic development of developing countries is going through the heavy industrialisation stage that developed countries have gone through, which will inevitably increase carbon emissions. Therefore, the implementation of carbon tariffs is obviously unfair to developing countries.

In general, Chinese experts, environmental policy researchers, or government officials have not had much discussion on the subject of a CBAM. The Chinese government has not yet formally discussed this issue with the EU. Some scholars, e.g., Zhang and Gong (2020), have pointed out that the EU Green Agreement, the introduction of ETS in China, and how the EU's Nationally Determined Contributions (NDCs) will be adjusted, and other more pressing and broader climate action issues that require discussion by representatives of China and the EU. The main reason why the EU CBAM has not become a topic of discussion is that other matters have taken precedence in bilateral discussions and that the EU has not yet announced the specific details of how the mechanism will be implemented.

From an economic point of view, most stakeholders in China regard EU CBAM as a tax on exported goods, which will always be considered negative. If the EU CBAM only applies to selected products, this view may even be strengthened, because the EU seems to be choosing industries that are less competitive. From a legal point of view, there are few precedents related to a CBAM. If China opposes the EU's CBAM measure, not only because of its potential impact on exports, but also because if the EU does not fully and actively negotiate with other stakeholders, the measure will be a unilateral measure.

The CBAM aims to protect European industries from imports of cheap carbon-intensive goods from abroad. Its main goal is to restore fair competition conditions with EU manufacturers and prevent 'carbon leakage' in EU industries. This has resulted in factories being moved to countries that do not incur carbon costs for production. China has recently stated that more discussions are needed before implementing the mechanism. Moreover, according to a survey from Asian policymakers, Asian countries – including China – regard the EU carbon border tax as a form of protectionism.

China's steel production accounts for half of the world's total output, so it is easily affected by CBAM, and CBAM may include this commodity in the initial range. As early as 2019, the Chinese government expressed concern about the carbon border tax, saying it would undermine the global fight against climate change. However, according to the China Dialogue,⁶ people's reactions at home are more complicated, because some companies produce very small carbon footprints. These companies can use CBAM as an opportunity to engage in business opportunities in Europe. However, other measures must be adapted quickly and can be helped by the government's implementation of emissions trading for commodities covered by CBAM.

WTO rules and carbon trading tools

To analyse the compliance of carbon trading tools with WTO rules, it is first necessary to determine the nature of carbon trading tools. The EU has claimed that the design of the CBAM mechanism will be compatible with the WTO. Whether it is compatible or not will depend on the final design of the CBAM mechanism, as this will determine whether it is a tariff, a domestic tax or charge, or another type of measure. From the perspective of the form and content of the proposed CBAM, it appears it does not have the relevant form and connotation of a tariff, and is more appropriately characterised as a domestic tax or domestic charge.

The nature of the mechanism will determine the applicable provisions under the WTO legal framework. If it is defined as a tariff, then Article 1 of the GATT (MFN) shall apply, and if it is defined as a domestic tax or fee, Article 3 of the GATT (national treatment) shall apply. The WTO national treatment rule requires all members to treat domestic and imported products equally. According to this principle, an EU carbon tax on imported products cannot exceed the domestic carbon tax paid by its domestic enterprises for carbon emissions. However, due to the large differences between the EU and other members in carbon emission accounting systems, and significant differences in the carbon pricing mechanism and price level across WTO members, the operation of a CBAM in practice may violate the national treatment principle. Discrimination may also arise if the EU completely or partially exempts trading partners that have the same or similar taxes in their carbon trading system. Whether a country imposes a carbon border tax on imported goods or a compulsory carbon emissions trading requirement (a proportional purchase of carbon allowances), the specific mechanism and criteria used to determine its application can easily give rise to discrimination in practice and become a tool for implementing trade protection on the grounds of climate change.

The EU proposal to impose a CBAM has caused widespread controversy. One aspect of the dispute is the legitimacy of the CBAM under WTO rules – whether the mechanism violates the principle of non-discrimination under the WTO framework. The EU claims

⁶ <https://chinadialogue.net/en/>.

that if some countries that trade with the EU cannot comply with carbon emission regulations, the EU will impose carbon tariffs on imports from these countries. Many countries believe that the EU is using this climate agenda to set up new trade barriers. Many developing countries are in the initial stage of industrial development. Industrial production consumes high energy and emits high emissions. In the future, when importing and exporting with the EU, it will inevitably be affected by the EU's CBAM, this EU move may trigger a new round of trade wars.

Whether CBAM complies with the exception provisions in the WTO – GATT Article XX(b) and (g) – has aroused extensive discussion. Article XX(b) requires measures to meet the two requirements of ‘protecting the life or health of humans, animals, and plants’ and ‘necessary’. There is no doubt that the control of climate change and carbon emissions is in the common interest of protecting the life and health of all mankind. GATT Article XX(g) requires that measures should protect available natural resources and be implemented together with equivalent restrictions on domestic production. If CBAM measures can ensure that carbon taxes inside and outside the EU are implemented in accordance with EU law, it is still very likely to be deemed as compliant with the Article XX(g) exception principle. Those who deny this claim believe that, according to WTO dispute settlement cases and practices, the ‘necessary’ in Article XX(b) should be interpreted as having the smallest trade restriction effect under the corresponding circumstances. However, CBAM does not meet this requirement. The trade restriction effect of carbon tariffs is significant. Compared with the EU's current measures to encourage emission reduction, tariffs obviously do not meet the minimum trade restriction effect.⁷

4. China's contribution to climate trade policy at the WTO

In 2014, 14 WTO member states announced in Geneva the launch of the ‘Environmental Products Agreement (EGA)’ negotiation based on the APEC environmental product list. The purpose is to achieve free trade and investment in environmental products by eliminating tariff barriers on environmental products to create trade Convenience, environmental benefit and development benefit the ‘win-win situation of the three’. The 2016 G20 Leaders’ Summit was held in Hangzhou, China. Article 27 of the Summit Communiqué clearly stated that ‘Participants in the negotiations of the G20 Environmental Products Agreement welcome the “landing zone” negotiated in the WTO Environmental Products Agreement.’ In December of the same year, the WTO Ministerial Meeting of the ‘Environmental Products Agreement’ was held in Geneva, and ultimately failed to reach consensus on issues such as the list of products covered by the agreement. During the negotiation process, China made great efforts to break the deadlock, including submitting a list of products that showed flexibility and tried to address the core concerns of all parties.

⁷ Emerson and Moritsch (2021) discuss how to make carbon border taxes WTO compliant.

In the current mutual supportive negotiations on open trade with the environment, WTO members are working hard to eliminate trade barriers in goods and services that are conducive to the environment. Promoting the convenient circulation of environmentally friendly products and services on a global scale can help improve energy efficiency, reduce greenhouse gas emissions, and have a positive impact on air quality, water, soil, and natural resource protection. The successful outcome of negotiations on environmental goods and services will bring three wins to WTO members: a win-win situation for the environment, a win-win situation for trade, and a win-win situation for development.

The list of environmental products has always been the core issue in the negotiation of the 'Environmental Products Agreement'. It is difficult for countries to reach a consensus on the list due to significant differences in interests. As one of the initiators of the negotiation of the Environmental Products Agreement, China has always participated in various consultations in a positive and constructive manner, is one of the active advocates of the negotiations, and has made important contributions to the progress of the negotiations. Annex C of the APEC Leaders' Declaration adopted at the 20th APEC meeting in September 2012 published a list of 54 environmental products with low energy consumption, low carbon, and green products. 54% of the products in the list were proposed by China. The list of environmental products proposed by China not only considers its own development stage, but also considers the interests of developing countries, how environmental products can be used by developing countries, and the prevention of green barriers. In June 2014, based on actual conditions and international experience, and fully considering the interests of members of developing countries and least developed countries, China put forward the 'common list' and 'development list' at the special meeting of the WTO Trade and Environment Committee. The 'Layer List' and 'Development List' give developing countries and least developed countries (LDCs) the opportunity to enjoy special and differential treatment tariffs (Zhang 2014), in order to bridge the differences between developed and developing countries as much as possible, and to seek space for win-win cooperation .

CONCLUSION

We end with three suggestions:

1. The WTO should encourage member countries to build carbon markets.

Emissions trading systems (ETSs) are one of the main tools for pricing greenhouse gas emissions. For the emissions trading mechanism, governments of various countries have set a cap on total emissions. This cap will continue to tighten over time. Allocators must submit emission caps for each ton of greenhouse gases and allow participants to communicate with each other. Exchange these emission units. In theory, ETS should promote cost-effective emission reductions, because the emission unit is a scarce

commodity and has an opportunity cost. Therefore, entities with relatively low emission reduction costs will reduce emissions to a greater extent and contribute to reducing emissions. Entities with relatively high costs sell residual subsidies.

As countries seek cost-effective emission reduction solutions, the carbon market is expected to continue to play a key role in emission reduction efforts. In the past few years, 40 countries and more than 20 sub-national jurisdictions have issued carbon pricing plans, covering 13% of global greenhouse gas emissions. When considering the current plan, this proportion has risen to 25%. Emerging and developing economies are increasingly participating in this development, especially through bilateral cooperation or initiatives, such as the World Bank's Partnership for Market Readiness,⁸ which helps countries pilot projects. So far, 56 jurisdictions have used ETS to price carbon. These 56 jurisdictions account for 40% of global GDP and cover 9% of global greenhouse gas emissions. With the formulation, planning or consideration of several new plans, the share of emissions covered by ETSs alone will rise to 13%, and the share of GDP will rise to 49% (ICAP 2016). Most notably, China is preparing to launch a national carbon emissions trading mechanism in 2017, which will surpass the EU carbon emissions trading mechanism and become the world's largest carbon market, which will have an important impact on the development of the global carbon market.

2) The climate problem resolution tool must not conflict with WTO principles.

Up to now, international environmental law and trade law have not conflicted, but there may be conflicts between multilateral environmental agreements and WTO regulations, such as the United Nations Framework Convention on Climate Change (UNFCCC) and the Kyoto Protocol. Except from the transfer of emissions between governments, no further measures are authorised to achieve the goal of reducing greenhouse gas emissions. However, for the 'United Nations Framework Convention on Climate Change' to fulfil their commitments, it is clear that a series of measures must be taken at the national level. In the case of adopting these climate measures, there may be conflicts with WTO laws.

No matter what form it takes, the EU CBAM must comply with WTO rules. Russia has complained that the EU's border adjustment tax violates WTO rules, and that the EU is using the climate agenda to create new trade barriers. Whether CBAM complies with WTO principles will depend on its specific provisions. For example, imposing tariffs will be difficult to pass the WTO because it will cover importers who have no relationship with the EU itself. If a CBAM must be introduced to solve the climate problem facing the EU, it must meet WTO principles. At the same time, some countries have used controversial industrial policies to create short-term investment returns in the field of low-carbon energy. If these policies conflict with WTO regulations, they may cause adverse long-term

8 <https://www.thepmr.org/>.

sectoral impacts. If climate problem resolution tools conflict with WTO principles, this may affect the normal operations of the WTO in the future and impact on the climate in the future.

Regarding the unfair treatment of developed and developing countries in protecting the environment and mitigating climate change, it is expected that the WTO will hold discussions on the ability to support weak and poor countries to benefit from the rapidly developing green economy. The weaker and poorer the country is, the smaller the impact on climate change will be, but the environmental costs it bears are disproportionate. Therefore, the WTO should launch environmental-related trade remedies related issues to help developing countries reduce the pressure to participate in the protection of the global environment and delay climate change. This should also encompass environmental-related intellectual property rights. The Doha Declaration instructed the WTO Trade and Environment Committee to conduct research on environmental and intellectual property issues, but there was no progress in negotiations. The WTO Agreement on Trade-Related Intellectual Property Rights has too many general provisions on technology transfer and lacks substantive restrictions on technology transfer. Therefore, how to revise existing agreements to make them more applicable to climate issues should be the focus of future WTO negotiations.

3) The use of low-carbon technology transfer mechanisms is a more constructive approach.

Technology development and transfer are not only the core conditions for mitigating and resisting climate change, but also the core conditions for broader sustainable development and green growth. Academia and policy circles generally believe that if low-carbon and climate-resilient technologies are prioritised on a global scale, and technology development and transfer policies are carefully selected, developing countries will be more capable of realising their economies, and social development goals, in a more climate-responsive manner. The experience of a series of developing countries and newly industrialised countries also shows that their own technological capabilities, such as institutional capabilities and the knowledge to innovate on transferred technologies, play an important role in promoting technological change and supporting development. Due to the gap between developing countries and developed countries in terms of carbon emission reduction technologies, if developed countries can transfer low-carbon technologies to developing countries, it will be conducive to adapting to and mitigating global climate change.

Contrary to what might be expected, the absorption of low-carbon technologies in developing countries is less constrained by cost and more constrained by the domestic environment (Lewis 2015). The role of policy in inducing technological change – the case of climate change and the electricity sector. Evidence from China shows that domestic policies play the most critical role in promoting the implementation of climate technology in any country. From an enterprise perspective, low-carbon technological innovation

has high sunk costs, high R&D risks, and strong spillovers. Enterprises have insufficient motivation and ability to carry out low-carbon technological innovation and application and are often inefficient or even unsustainable.

REFERENCES

Baron, R and J Garrett (2017), 'Trade and Environment Interactions: Governance Issues', At <https://www.oecd.org/sd-roundtable/papersandpublications/Trade%20and%20Environment%20Interactions%20FINAL.pdf>.

De Coninck, H and A Sagar (2015), 'Making sense of policy for climate technology development and transfer', *Climate Policy* 15:1–11. <https://doi.org/10.1080/14693062.2014.953909>.

Emerson, C and S Moritsch (2021), 'Making Carbon Border Adjustment proposals WTO-compliant', At: <https://assets.kpmg/content/dam/kpmg/xx/pdf/2021/03/making-carbon-border-adjustment-proposals-wto-compliance.pdf>.

Haberli, C M (2018), 'Potential Conflicts between Agricultural Trade Rules and Climate Change Treaty Commitments', *SSRN Journal*, <https://doi.org/10.2139/ssrn.3123036>

ICAP(2021), 'Emissions Trading Worldwide: Status Report 2021', https://icapcarbonaction.com/en/?option=com_attach&task=download&id=723.

Keohane, N, A Petsonk, and A Hanafi (2017), 'Toward a club of carbon markets', *Climatic Change* 144, 81–95. <https://doi.org/10.1007/s10584-015-1506-z>.

Lewis, J I (2015), A comprehensive look at technology transfer. *Climate Policy* 15, 177–179. <https://doi.org/10.1080/14693062.2013.777517>.

Pigato, M, S J Black, D Dussaux, Z Mao, M McKenna, R Rafaty, and S Touboul (2020), 'Technology Transfer and Innovation for Low-Carbon Development', World Bank. <https://doi.org/10.1596/978-1-4648-1500-3>.

RECAP (Regional Project Energy Security and Climate Change Asia-Pacific). 2021. Perception of the Planned EU Carbon Border Adjustment Mechanism in Asia Pacific--An Expert Survey. Hong Kong: RECAP. <https://www.kas.de/documents/265079/265128/EU+Carbon+Border+Adjustment+Mechanism.pdf/fed1d5a4-4424-c450-a1b9-b7dbd3616179?version=1.1&t=1615356593906>.

Santarius, T, H Dalkmann, M Steigenberger, and K Vogelpohl (2004), 'Balancing trade and environment: an ecological reform of the WTO', Wuppertal Institute for Climate, Environment, Energy. At <https://epub.wupperinst.org/frontdoor/deliver/index/docId/1872/file/WP133e.pdf>.

Swartz, J (2016), China's National Emissions Trading System, Geneva ICTSD. At https://www.ieta.org/resources/China/Chinas_National_ETS_Implications_for_Carbon_Markets_and_Trade_ICTSD_March2016_Jeff_Swartz.pdf.

Zhang, M and J Gong (2020), 'European Green Deal and the Prospects of EU-China Climate Change cooperation', *Global Economic Observer*, 8(2): 82-93.

ABOUT THE AUTHORS

ZHANG Jianping is Director General, Center for Regional Economic Cooperation and Director General, Institute of West Asia and Africa at the Chinese Academy of International Trade and Economic Cooperation, MOFCOM.

XIE Zhiyu is an Undergraduate Student majoring in International Studies and International Public Policy at Peking University. He has expertise in international economics and international trade, as well as experience in international institutions.

CENTRE FOR ECONOMIC POLICY RESEARCH



Rising geopolitical and geoeconomic tensions among major trade powers are undermining the rules-based multilateral trade order. In principle, the World Trade Organization (WTO) is the institution where trade-related conflicts should be resolved, but the organisation no longer provides an effective dispute settlement mechanism. Joint leadership by China and the EU to establish a balanced work programme spanning old and new issues of interest to all WTO members is necessary to safeguard the rules-based trade order.

This book, a product of a Horizon 2020 research project (RESPECT), is a collaboration between the Robert Schuman Centre for Advanced Studies, European University Institute and the China Institute for WTO Studies, University of International Business and Economics. It brings together essays written by teams of European and Chinese trade policy experts, who explore possible paths to revitalise the WTO. They stress the importance of improving the operation of the organisation and negotiating agreements on a core set of areas where national policies create negative spillover effects. Pursuit of issue-specific cooperation on a plurilateral basis is part of the solution but does not remove the need for balance in the choice of issues put forward for deliberation and negotiation and for systemic WTO reform.

ISBN: 978-1-912179-48-0

ISBN 978-1-912179-48-0



9 781912 179480

33 Great Sutton Street | LONDON EC1V 0DX | UK
TEL: +44 (0)20 7183 8801 | FAX: +44 (0)20 7183 8820
EMAIL: CEPR@CEPR.ORG
WWW.CEPR.ORG