Trade Rules & the WTO – Present & Future

By Michitaka Nakatomi

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Introduction

In addition to the World Trade Organization (WTO) and free trade agreements (FTAs), the security perspective of the global trade framework has rapidly gained importance since the late 2010s as a third pillar. It is essential to maintain a balance between free trade and security perspectives, and it is necessary to take measures to prevent the abuse of the "security exception" (GATT Article 21) in the WTO.

On the issue of who has the authority to make decisions on security exceptions, there is a sharp conflict of views between the United States, which says that only the parties concerned can make such decisions, and the WTO panel, which says the WTO dispute settlement framework has the right to decide matters concerning security exceptions. Given the US position, the proposal to treat security exceptions as a non-violation requires serious consideration. In addition, strengthening the WTO's monitoring functions with regard to security cases is an important issue.

The WTO's dispute settlement system has become dysfunctional due to issues relating to its Appellate Body. The 13th WTO Ministerial Conference (MC13) stated that it aims to reach a resolution by the end of 2024, but in restoring the dispute settlement functions, the introduction of not only a two-trial system but also a one-trial system deserves consideration, given the rapid increase of appeals into the void regarding security exceptions and other issues. Restoring the WTO's rule-making functions is required along with the restoration of its dispute settlement functions. The latter can never be restored without the restoration of rule-making functions. With regard to plurilateral agreements, I would like to commend the incorporation into the WTO of the outcome of negotiations on domestic regulations of services at MC13. On the other hand, failure to incorporate the investment facilitation and e-commerce rules into the WTO so far is regrettable. In the future, it will be necessary to strategically analyze the requirements for establishing plurilateral agreements, and to develop and utilize them as a WTO rule-making method.[1]

I Transition of Trade Regimes & Emerging Economic Security Concept

Japan's trade policy has developed on the basis of multilateral trade regimes embodied in the GATT and WTO, but since the beginning of the 21st century FTAs have gained importance as a complementary pillar to the GATT and WTO. Since the latter half of the 2010s, the rapid narrowing of the economic and technological gap between the US and China has led to the perpetuation of US-China confrontation and the introduction of various measures from a security perspective, which has come to be regarded as the third pillar of trade policy. This trend has been accelerated by the Russia-Ukraine conflict of 2022 and the introduction of countermeasures by various countries. While it is indisputable that the security perspective is extremely important as it is a viewpoint that forms the basis of a country's existence, it is also important to harmonize it with the trade policy that has been the foundation of the global economy, and of Japan's prosperity and development. We must not forget to protect and nurture free trade and the global values chains (GVCs) embodied in the WTO which have supported the Japanese economy and the world economy.[2]

1. Transformation of trade policy based on the pillars of free trade and GVCs

(i) Stagnation – from GATT-centrism to WTO + FTA two-wheel principle (2000~)

After the Uruguay Round negotiations were essentially completed in 1993 and the WTO was established in 1995, rule-making in the WTO proceeded smoothly with firm support from member countries until the Information Technology Agreement (ITA) and the Telecommunication and Financial Services Agreement were realized in 1997. But in the 21st century, rule-making slowed down, partly due to the difficulty of the consensus-based WTO decision-making process. The year 2001 saw the accession of China to the WTO and the start of the Doha Round amid the multi-polarization of the world economy, but the Doha Round drifted along and was never settled. On the other hand, from around 2000, FTAs came to be positioned as the wheels of international economic order.

During this period, the WTO's dispute settlement system functioned smoothly, but against a background of sluggish WTO rulemaking, the US in particular began to show strong dissatisfaction with the functioning of the Appellate Body in the 2010s, and in 2019 the Appellate Body ceased functioning as it was unable to secure the necessary members.

(ii) Development of the concept of national security in international trade due to the constant confrontation between the US and China

As China's economy grew rapidly following its accession to the WTO, the conflict over US-China economic hegemony became more serious in the 2010s. In particular, when Donald Trump became President of the US in 2017, he introduced comprehensive restrictive measures against China in trade, investment, and technology, including higher tariffs against China. Even under the administration of his successor Joe Biden, the hardline US stance toward China continued, and in the 2020s the idea of developing a trade policy based on security has been gaining further ground. The measures being implemented are becoming increasingly sharp and include some that cannot be easily justified under WTO rules.

These measures are not necessarily limited to China. For example, the US has introduced measures to increase tariffs on steel and aluminum under Section 232 of the Trade Expansion Act, based on the security exception in GATT Article 21.

(iii) Russia-Ukraine conflict and countermeasures (from 2022)

With the outbreak of the Russia-Ukraine war in 2022 and the imposition of extensive sanctions against Russia by the US, European nations, Japan, and other like-minded countries, the status of security exception clauses such as GATT Article 21 is coming under close scrutiny.

In other words, the scope of application of Article 21 has expanded greatly, and a situation is emerging in which the rules of contingency are eroding and replacing the rules of peacetime.

The active use of the Article 21 exception by the US is particularly conspicuous. It is necessary first to accurately grasp the current situation in which the security exception, which was an "exception" in the first place and not considered for active use, is rapidly expanding its meaning and being used more and more frequently.[3]

2. The need for "balance" between free trade and security: basic directions in the WTO

There is a tension between free trade and security regulations. While GATT Article 21 allows for exceptions as necessary for security reasons, it does not mean that any security measure is acceptable. As trade measures for security reasons are expanding, as analyzed below, it is necessary to find a balance by comprehensively discussing the status of security from each aspect of the WTO's legislative, judicial, and monitoring and surveillance functions.[4]

II Security Exceptions & the WTO

To look at the relationship between the security exception and the WTO, it is necessary to analyze the relationship from the aspects of rule-making, monitoring, and dispute settlement.

Let us look at the replacement of peacetime rules by contingency rules and the measures that should be taken to prevent the abuse of the security exception under GATT Article 21.

1. Putting a stop to contingency rules by improving and expanding peacetime rules

The cause of the abuse of the security exception is the inability of WTO rules to discipline economic reality. GATT Article 21 is a trump card, so to speak, that need not be used if the WTO's peacetime rules are functioning. The use of Section 232 of the US Trade Enlargement Act and the citation of the security exception is due to the fact that the WTO's peacetime rules have not been properly developed through negotiations. These rules have not developed mainly because of the WTO's consensus principle and developing country status (China is also treated as a developing country), but also because member countries have not always been enthusiastic about rule-making. For example, the US has not been active in revising the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement) and the anti-dumping and subsidy rules since the establishment of the WTO.[5]

The chaos in the dispute settlement function of the WTO due to the lack of a functional Appellate Body was also, in a sense, predictable: it is impossible to discipline economic issues in the 21st century with the Magna Carta,[6] and the WTO's dispute settlement mechanism has been overburdened. To restore this function, it is essential to develop rule-making in light of economic and trade realities, and even if the dispute settlement function is provisionally restored without this, it would not last long. In particular, as is clear from the debate over the Appellate Body, it will be essential to revise the rules on anti-dumping and subsidies etc. in order to avoid placing an excessive burden on judicial proceedings. As countries introduce aggressive domestic industry subsidy measures, such as the Inflation-Reduction Act (IRA), the development of rules for trade remedy measures is an essential task.

Looking at the outcomes of MC13, a certain amount of progress has been made on the basis of plurilateral agreements in the Joint Statement Initiative (JSI), such as domestic regulations of services. But commitment to core trade rule-making, such as subsidy rules, is still insufficient. Japan, in cooperation with the US, the European Union, and other like-minded countries, should play an active role in rule-making in these areas.

2. Utilizing the monitoring function of the WTO

Along with the legislative and judicial functions of the WTO, monitoring the implementation of WTO rules is one of its important functions. In particular, in areas such as security exceptions, where the details of the rules are not clear, it will be important for the relevant committees to discuss the actual situation, background, and necessity of the measures and to monitor them to ensure that excessive or protectionist measures do not prevail.

Each WTO committee plays an important role in monitoring the actual implementation of rules. In particular, the role played by the Technical Barriers to Trade (TBT) Committee[7] and Sanitary and Phytosanitary Measures (SPS) Committee often attracts attention, but other committees and bodies, such as the Trade Facilitation Committee, also function effectively. Member countries should consult with each other to determine which committee or body would be most efficient.

For TBT, the legal basis for the procedures is set forth in the TBT Agreement 13.1, but the procedures are quite well established, based on the history of implementation from the Standard Code in the GATT era. The basis is the submission of questions on Specific Trade Concerns (STCs) by member countries and their responses, which are shared with the committee at the same time. Informal consultations are held among the countries concerned on the STCs reported, and if no resolution is reached, the matter is placed on the agenda of the TBT Committee for discussion. The concerns expressed range from further clarification of measures, unnecessary barriers to trade, transparency, legitimacy of measures, international standards, discriminatory treatment, and timeframes for implementation. The basis for the declaration of STCs is the fulfillment of notification obligations under the Agreement, and it is critical that countries fulfill their notification obligations.

Looking at the track record, according to Kateryna Holzer, between 1995 and 2017, there have been 548 STCs raised by countries in the TBT Committee. The STC consultations are expected to have the following effects: clarification of technical standards, improvement of technical standards, sharing of experiences and best practices, resolution of issues that also pertain to other agreements, and resolution of inexpensive trade friction.

According to Holzer, there have been many cases in which formal WTO dispute procedures have been avoided as a result of the STC process,[8] and only 15 of the above STC cases have been brought before the formal WTO dispute procedures. The established procedures for handling STC cases in the TBT Committee and other bodies can be used as a reference and be utilized in the handling of security cases. In particular, for security exceptions where the details of the rules are not clear, the exchange of views in the relevant committees would contribute greatly to understanding and resolving the issues. In addition, it is considered politically difficult in many cases to actually withdraw security-related measures once they have been taken due to their nature, and it would be necessary to discuss compensatory measures (e.g., suspension of concessions or compensatory payments) in order to achieve a balance between countries taking the measures and countries affected by the measures.[9]

The idea of a committee (National Security Committee) to concentrate on such security-related measures (e.g., Lester)[10] is an extremely interesting and worthwhile proposal. The establishment of such a committee, based on transparency, would contribute to the clarification of security exceptions, the understanding of facts and the reconciliation of interests of the parties regarding security-related measures, the establishment of best practices, and rebalancing among the parties. Regarding the non-trade objectives (NTOs), including security measures, it is recommended that, in addition to these committee discussions, the WTO utilize the framework of plurilateral agreements and clubs inside and outside the WTO, based on transparency and the active exchange of views.[11]

3. Dispute resolution functions and security

The WTO's Dispute Settlement Panel has accumulated a certain number of cases on the security exception, such as DS512, the 2019 Russian traffic in transit case. In particular, on the issue of the right to decide on the security exception under GATT Article 21 (whether the dispute settlement body has the right to decide), there has been a sharp conflict between a series of panel decisions that the WTO has the right to decide and the US position that only the parties have the right to decide, with the US expressing dissatisfaction with the panel decisions in the Article 232 case, the Hong Kong origin case, and others. The US has expressed dissatisfaction with the panel's decision in the cases of Article 232 , the Hong Kong case of origin, etc., and has filed an appeal into the void to the Appellate Body, which has ceased functioning, to block the panel's decision.

The US has stated that the issue of the security exception is an essential requirement for the restoration of the WTO's dispute settlement function,[12] and it is considered essential for the restoration of this function to take the US position into account with regard to the security exception.

On the other hand, prevention of abuse and black-boxing of the security exception is an essential issue. W. Maruyama and A. Wolff (2023),[13] while taking into account the position of the US government that the right to decide on security exceptions rests with the parties, propose a non-violation remedy for the other party. Appeals into the void, including national security cases, are detrimental to the WTO's dispute settlement procedures, and measures to prevent such appeals need to be considered.

4. FTAs and security exceptions

Although security exception clauses in FTAs generally follow GATT Article 21 in their provisions, many recent FTAs, especially those involving the US, including the FTAAP (TPP11), have provisions that could possibly be interpreted to mean that only the parties have the right to determine security exceptions. The development of FTAs will also need to be closely monitored, as security exceptions may be determined in the dispute settlement procedures of FTAs in the future.

III Early Restoration of the Dispute Settlement Function

The WTO's Appellate Body has been non-functional since 2019. Although the panel is functioning, the losing party can file an appeal to the Appellate Body that simply goes into the void. As a result, the WTO's dispute settlement procedures have lost their automatic adoption function, returning to the pre-WTO situation where parties can refuse to adopt the outcome of the panel.

Appeals into the void on security exception cases (e.g., Article 232 cases) are likely to occur frequently in the future due to the political nature of security issues. A resolution of the Appellate Body issue is urgently needed to restore the dispute settlement function. Although MC13 also stated the goal of restoring the dispute resolution function by 2024, there has been no progress on a concrete path towards it. There is some support for a Multi-Party Interim Appeal (MPIA) arbitration, but the likelihood of US participation in it is slim.

While we look forward to further progress in discussions toward restoring the dispute settlement function in full, in light of the stalemate it is suggested that not only a two-trial system, but also a one-trial system be considered as an option.[14]

First, we would need to share an understanding that a framework that allows parties to block the panel's conclusions (the pre-WTO framework) is not one we should pursue. In addition, it is necessary to consider the current situation where coordination for restoration of the Appellate Body has been stalled for a long time, as well as the position of the US on the Appellate Body.

In view of avoiding a stalemate with respect to the Appellate Body, the US position, and the prevention of appeals into the void (in a one-trial system, of course, there are no appeals into the void), it is necessary to keep in mind the option of a one-trial system in addition to restoring the full functions of the Appellate Body (a two-trial system).

The one-trial system is considered to be beneficial as a framework for avoiding conflicts of views regarding the Appellate Body and for preventing appeals into the void.

Further continued confusion in the dispute settlement function is a crisis for the WTO and the trade framework.[15]

IV Restoration & Strengthening of Rule-Making Functions & Plurilateral Agreements

The rule-making function of the WTO is based on the principle of consensus: not only Annex 1 (agreements involving all members) but also Annex 4 (e.g., government procurement agreements which obligates only participating members) require consensus among WTO members in order to be established.

After the realization of the ITA, Financial Services, and Telecommunication Services Agreement in 1997, rule-making in the WTO stagnated. A series of rounds (Tokyo, Uruguay, Doha) were organized to support consensus building, but the Uruguay Round, which ended in 1993, was the last to produce results. The Doha Round could not be concluded. Due to the increase and diversity of member countries and the participation of developing countries (Doha is defined as a "development round"), the current situation is such that a package deal for the round cannot be concluded.

Under the circumstances where negotiations have to be conducted on each individual case basis, the only multilateral outcomes are the Agreement on Trade Facilitation (agreed in 2013, to enter into force in 2017) and the Agreement on Fisheries Subsidies (agreed in 2022).[16] In order to reach agreement on each individual case basis, it is practical to use a plurilateral framework based on the cooperation of like-minded countries (e.g., ITA expansion negotiations, trade facilitation).

On the other hand, standardized methods for incorporating the outcomes of plurilateral agreements into WTO agreements have not been established. For market access for goods, a standardized method (e.g., ITA and its expansion negotiations) has been developed using the formation of a critical mass and MFN extension of benefits from the agreement to non-members.[17]

As for rulemaking, there is no such established method, and we are still groping for a method to achieve consensus building (or framework formation to prevent veto triggering). For example, the methods taken in trade facilitation include (1) general consideration for developing countries, (2) consideration of implementation period (especially for developing countries), (3) phased implementation, and (4) provision of technical assistance. In addition, a cautious approach has been taken in introducing mandatory provisions.

As for the outcome of the Joint Statement Initiative (JSI), which has been negotiated among multiple countries, a detailed analysis of the outcome of the MC13 is necessary, but I will attempt a general evaluation at this point in time.

E-Commerce

In the area of e-commerce, Japan, Australia and Singapore took the lead in the negotiations, but postponed the resolution of difficult issues such as the three TPP principles regarding data free flow, non-localization of servers and forced transfer of source codes, etc. Instead, the negotiating parties reached agreement on 13 basic principles for e-commerce.[18] The agreement concentrated on items where there is little need for developing countries to express their concerns from a policy perspective. While it may not be a high-level agreement, it is significant that useful basic principles for e-commerce and data flow have been established. We hope that efforts to formulate more difficult rules, including the three TPP principles, will be made in the future.

However, although at MC13 there did not seem to be explicit argument on the incorporation of the agreement into the WTO[19], it is expected that discussions on this issue will be held as soon as possible, referring to the success of domestic regulations of services agreement. In terms of content, I would like to see discussions develop on difficult items such as cross-border movement of data, server installation, and prohibition of mandatory source code disclosure requests as items for future discussion.

Domestic Regulations of Services

Negotiations on domestic regulations of services were concluded early on, and their legal status was clarified as a reference document in the WTO in MC13. In a sense, this is an agreement equivalent to the TBT in the services sector and a landmark agreement. As with trade facilitation, this was made possible by (1) general consideration of developing countries, (2) consideration of implementation period (for developing countries), and (3) provision of technical assistance. In addition, the domestic regulation of services was a built-in agenda of the Services Agreement, and India's emphasis on trade in services is seen as having influenced its success.

Investment Facilitation

Negotiations on investment facilitation rules have been led by South Korea and Chile, focusing on the perspective of promoting investment facilitation in developing countries. However, at MC13, India and other countries strongly opposed to incorporating the result as an Annex 4 Agreement in the WTO, and its incorporation into the WTO Agreement was not realized.

These developments in the Joint Statement Initiative (JSI), especially in the domestic regulation of services, will be of great significance for the future formation of a plurilateral agreement and its incorporation into WTO legal frameworks. I look forward to strategic development of a rule-making approach based on plurilateral agreements within the framework of the WTO.

It is extremely regrettable that MC13 did not achieve incorporation of investment facilitation and e-commerce into WTO rules, but it is expected that strategic efforts for WTO incorporation will continue. On the other hand, as for the framework aiming to create various important trade rules, such as trade and investment rules, and trade and environmental rules, it must be said that the hurdles to multilateralization remain high, as seen in the above difficulties in forming plurilateral agreement.[20]

The use of plurilateral agreements has been recommended for a long time, but current outcome of domestic regulation of services is groundbreaking as it opens up new possibilities for the future. The concept of an open plurilateral agreement (based on the participation of countries that meet the conditions of the agreement) should also be further considered and utilized in the future.[21]

V Transformation & Utilization of FTAs & Regional Frameworks

Japan has concluded FTAs with major countries and regions, including the RCEP, FTAAP, and the EU-Japan FTA. With an FTA coverage rate of 80%, the development and utilization of FTAs is an asset for Japan's trade policy. FTAs are valuable as a pillar supporting the WTO, and it is necessary to continue aiming to conclude new FTAs (such as the JCK FTA), as well as to expand members and deepen the quality of FTAs.

From a qualitative aspect, there are great expectations for the role of FTAs, given the current situation where rule-making in the WTO is very difficult under the consensus principle. It is also important to respond to the emergence of diverse FTAs and RTAs (DEPA, IPEF) and participate in such initiatives with a positive and flexible attitude.

Regarding the addition of member countries, the accession of the US and India to the FTAAP will be a particularly important issue. Interconnection of broad FTAs (FTAAP and EU-Japan FTA) should also be considered. Although not an FTA, revitalization of APEC, which has had a major impact on liberalization in the Asia-Pacific region, its strategic utilization (e.g., liberalization), and utilization of ERIA will also be important issues.

VI Comprehensive Use & Dissemination of Trade Tools

In summing up, I hope that Japan will continue to strategically utilize and disseminate a trade framework, especially the WTO, to contribute to the maintenance and expansion of free trade and GVCs in the future. Although I have not addressed these issues here due to

space limitations, comprehensive efforts to deepen trade policy, including regulatory harmonization, responding to international standards and other soft rule-making, and modernization of trade tools, are necessary and beneficial, and comprehensive examination and utilization of these tools should be pursued.[22]

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