
Introduction

Current Challenges and Future Scenarios

MANFRED ELSIG, MICHAEL HAHN, AND GABRIELE SPILKER

1.1 The Rationale for the Volume

The global economic system and its governing laws have developed substantially over the past fifty years. Increased economic interdependence and a growing number of countries opening up to international trade have induced most of these changes. The trade regime has been characterized in the period following World War II by an evolving multilateral system, first through successive tariff negotiations in the realm of the General Agreement on Tariffs and Trade (GATT), followed by a deepening and strengthening through the creation of the World Trade Organization (WTO) with all its covered agreements and an independent third-party system to address trade disputes. Next to the creation of the WTO a parallel development has set in, namely the negotiation of bilateral and plurilateral trade agreements which was coined “new regionalism” (Mansfield and Milner 1999). As progress on the “legislative” agenda of the WTO has been limited, preferential trade agreements (PTAs) have become a major platform for further liberalization. In addition, these agreements have served as laboratories for designing “behind the border rules” and addressing non-trade concerns (Dür et al. 2014). To a large degree, this reflects market needs as liberalization today puts less emphasis on the reduction of barriers at the border in forms of tariffs and quotas, but has moved attention to regulatory issues and behind-the-border barriers to trade, such as safety standards or environmental and health regulations. In addition, the appearance of new issues on the trade agenda, such as digital trade, and the interaction between trade and other topics, such as migration or environmental regulation, have further contributed to the evolution of the international trade regime and have created inter-linkages with other policy areas (Dupont and Elsig 2017). The jury is still out on to

what degree PTAs act as complements or substitutes of multilateralism (Allee et al. 2017b), but certainly they have become more important and increasingly politicized over time.

The challenges the trading system faces today are manifold. Challenges, and crises, however, also come with opportunities for developing more coherent sets of rules for global trade. One particular difficulty of global rules is that they are often not reacting in a timely manner to evolving changes: the WTO in particular mainly relies on trade deals that have been agreed upon in the early 1990s. This puts an additional burden on its dispute settlement system that needs to address complaints. Third-party adjudicators are tasked to balance in their interpretations the intentions of the treaty drafters with the realities on the ground twenty years after the conclusions of WTO legal treaties. The past twenty years have shown that adjustments to treaty commitments or the elaboration of new treaties are difficult in the context of an organization that has grown substantially in numbers and still takes decisions by consensus. This has led de facto to an asymmetry between the legislative and the judicial branch of the organization. Other forms of trade arrangements suffer similar fates. Bilateral trade agreements are usually difficult to renegotiate, because often forces that prefer the status quo are very vocal and oppose changes to existing treaties. However, we have seen some mega-regional trade agreement projects, such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), exploring novel approaches to address today's business and civil society concerns including regulatory cooperation, labor rights, the influence of state-owned companies, environmental protection, data protection, competition policy, and promoting global value chains. If such initiatives are successful and new treaty commitments are agreed upon, past research has shown that attractive trade rules and legal texts can diffuse quickly across treaty networks (Allee et al. 2017a).

In the following we outline a number of factors that we expect to shape global trade regulation for years to come. These factors put pressure on trade governance to adapt and to change.

One of the key market-induced changes to the international trading system certainly comes from the emergence of regional and global value chains. As a result of lower tariff barriers and the increasing equivalence of national production standards, numerous firms have followed a strategy to outsource not just the entire production but also specific parts of the production process within the same company across different countries (Baldwin 2016). This has affected the political economy of domestic lobbying with the emergence of a greater number of import-dependent firms

and firms dependent on global value chains (Baccini et al. forthcoming) as well as multinational companies that are able to generate disproportional influence on the course of trade negotiations (Rodrick 2018). As a result of the increasing trade in parts and components and services outsourcing, trade policy initiatives to protect national industries face more domestic opposition than in previous times when the trading system was characterized by inter-industry or even intra-industry trade patterns.

Another trend is the increasing progress and diffusion of technology. As a further driver of trade liberalization, it comes with many important regulatory challenges related to intellectual property rights, consumer protection, data privacy, and market concentration and dominance. In addition, technological progress and changing consumption patterns impact on today's and future work environments. Pressures on job security are not only related to international competition and outsourcing, but also to automation and the increasing use of robots and artificial intelligence in more and more industries. Research using US household data shows that many jobs are being lost to robots and such factors often outpace employment effects related to trade liberalization (Acemoglu and Restrepo 2018).

The rapid changes through trade and technology are also increasingly resonating in domestic political systems. In particular, in developed countries we have witnessed that economic openness and economic interdependence have been accompanied by increasing public discontent. While many left and green parties have been skeptical vis-à-vis trade liberalization for decades, we observe today an increasing polarization on the right. In particular, we witness how new actors question the benefits of international cooperation, object to (regional) integration (e.g. in the context of the European Union), and are speaking out against trade agreements. In consequence, protectionist pressures have increased and the return of mercantilist thinking has become more virulent. In particular, US President Trump has campaigned on an anti-trade platform, lamenting that international trade agreements have been unfair to the United States. He has called to renegotiate these agreements or abandon them altogether and has rediscovered unilateral trade policies that have been largely absent in the United States since the 1980s. The current development is a substantial U-turn from past US involvement in building today's global economic system. The founders of the system based on liberal rules currently seem to undermine the rules they had a strong hand in negotiating.

The above-mentioned challenges currently dominate discussions on the trading system and relegate other long-term trends to the background,

many of which involve trade-related issues. What stand out as long-term trends are climate change, continued development challenges, and increased influence by emerging economies, all of which will affect future governance of trade.

In terms of climate change, trade negotiators have been exploring how the multilateral system or the dense network of trade agreements can be used to address challenges related to climate change either in the form of easing trade for environmental goods and services or by protecting the climate by using border measures, such as a border carbon adjustment tax. From this perspective, trade can be seen more as a part of the solution rather than the problem and this opens the door for new initiatives. In any event, the pressure due to climate change to develop new trade measures will certainly increase in years to come as climate change will further dominate global politics.

As to development, it has become increasingly accepted to use trade instruments to leverage growth. We have seen a “rapprochement” between the development and trade communities through agreeing on programs such as “aid for trade” in the context of international economic organizations. Some consensus among trade and development experts has emerged that support is needed to address countries’ supply-side constraints to increase competitiveness. Building economic infrastructure and streamlining processes related to trade have moved up on the development priority list of many countries. On the international level, developing countries are also actively involved in shaping the content of trade agreements and developmental needs become more prominent through trade facilitation initiatives. Besides supply-side challenges, however, issues such as the continued use of domestic and export subsidies in highly industrialized countries as well as the reluctance to increase labor mobility from developing countries will continue to inhibit the true growth potential. A new grand bargain (Ostry 2002) will thus be needed.

On the geopolitical front, the ascent of emerging economies will likely continue and their attempts to move from rule-takers to rule-makers in the global economy will intensify. This will further shape trade regulation. With the United States currently holding back leadership in global rule making, a vacuum has built up. This will create new opportunities for developing countries but also established powers, such as the European Union, to step in and push for global rules. However, increasing geopolitical ambitions by countries, such as China, will also intensify regional initiatives and pressure to build regional spheres of economic influence. We have already seen increasing protectionism in Group of

Twenty (G20) countries and reliance on unilateral measures to become more accepted. This is another trend that will create challenges to global trade regulation when single countries set unilateral standards and try to impose these.

1.2 Content of the Book

In this edited volume, we strive to evaluate in some detail how each of these factors (or a combination of these) currently influence the trading system and how the respective relationship could evolve in the near future. Particular interest lies in the development of what we call future scenarios, in which the various authors of the chapters describe potential developments in their area of expertise and how policymakers could take action to meet the various, sometimes immense challenges to the international trading system.

Part I of the book, “New and Old Challenges,” deals with four topics that have over the last decades persistently turned out to challenge and thus shape the development of international trade regulation. In particular, these are public backlashes against trade liberalization, the digitalization of trade, rules of origin, and firm-level strategies to deal with anti-globalization sentiment. While these issues are definitely not the only challenges to the trade system, they illustrate the various angles from which challenges to the trade system can arise and thus are highly illuminating for the broader development of trade regulation.

First, by discussing public resentments vis-à-vis international trade, Nguyen and Spilker provide a perspective on how trade liberalization is challenged from below. The authors start with the question of whether the large public backlash observed against various trade agreements in recent years, such as the Trans-Pacific Partnership (TPP), the Transatlantic Trade and Investment Partnership (TTIP), or the Comprehensive Economic and Trade Agreement (CETA), constitutes a paradigm shift in public perception of world trade and what determines people’s attitudes towards international economic integration more generally. Next to providing an overview of the major determinants of support for or opposition to trade liberalization in general and PTAs in particular, the chapter discusses how much room to maneuver policymakers may have in designing such agreements. In particular, Nguyen and Spilker argue that whereas public skepticism against trade liberalization initiatives presents a major challenge to the international trading regime, it also provides strong impulses to policymakers to re-evaluate

and potentially redesign trade liberalization in ways more consistent with the public will. This assessment then builds the basis for three different future scenarios of trade liberalization and the potential impacts for public opinion.

Taking off where the previous chapter ends, Curran and Eckhardt analyze the ways trade-dependent firms are responding to this rising skepticism on the merits of free trade and globalization. What strategies do trade-dependent firms mobilize to persuade the public and their political representatives of the merits of openness? To answer this question the authors present an analytical framework of market and non-market business strategies in times of rising protectionism and explore empirically – through survey data and interviews – in how far recent responses of European import-dependent firms are consistent with this framework. Their contribution shows how corporate strategies can adjust to rising discontent with globalization.

Next to the challenges posed by the public backlash and the responses firms could potentially use to counter them, Part I of the book deals with two challenges that arise out of finding suitable solutions to particular trade barriers, namely in the context of digital trade and with respect to rules of origin. In particular, Burri in her chapter starts from the premise that digital technologies have had disruptive effects on many sectors of the economy and spurred a significant amount of innovative activity. For a growing number of countries – both developed and developing – digital goods and services have become an important engine of economic growth and a clear priority in their future-oriented economic strategies. Yet, neither the rapid technological developments associated with digitization, nor their increased societal significance have so far been reflected in international economic law in a comprehensive manner. The law of the WTO in particular has not reacted proactively. PTAs have compensated for the lack of progress under the WTO and become a platform for new digital trade rules, ultimately leading to the creation of a tailored regime that is unevenly spread and influenced by few regulatory models. The chapter seeks to contextualize and assess the impact of PTAs on the burgeoning digital economy by looking at the most advanced model of the CPTPP and by highlighting the positive as well as the negative sides of proactive, power-driven norm-setting. The chapter ultimately asks whether there are better ways to address the data-driven economy and what the essential elements of such a model should be.

In the fourth chapter in Part I, Freund deals with the role of rules of origins and analyses these technical rules in light of political economy

considerations. She shows that the rules of origin, which are meant to protect against the transshipment of foreign goods in free trade areas, are instead being used to promote particular industries. Namely, strict rules of origin add to production costs by forcing firms to use more expensive parts and pay administrative costs. They also prevent firms from exporting to markets governed by different trade agreements and disproportionately hurt small firms. The ongoing renegotiation of the North American Free Trade Agreement (NAFTA) highlights the potential to expand the use of rules of origin as a form of trade protection. The chapter further suggests that the WTO currently has only limited disciplines on rules of origin and she pledges for clear and enforceable international regulations that help thwart the spread of complex rules.

The final chapter in Part I focuses on the WTO's current crisis, most visibly manifested in the forced vacancies on the Appellate Body and the foreseeable disappearance of what used to be described as the "jewel in the crown" of the WTO: at the end of 2019, only one of the seven Appellate Body member slots will be filled. Hahn is of the opinion that this crisis will only end if the Members can agree on a number of reform steps relating to the broader governance of the system. The author predicts that without those changes, the organization will wither away like a picture of Dorian Gray. Hahn deems it likely that unless the following points are addressed, there will be no (relevant) WTO, sooner rather than later: the WTO has to create a space for enhanced forms of cooperation between interested partners ("variable geometry/multi-speed WTO"); an organization with 164 sovereign states as members can only succeed if the general rules address foundational questions, whereas substantive issues need to be taken up by a critical mass of interested parties, always mindful of the fact that these sub-regimes should enhance the value of the overall system and not endanger it. This would allow the WTO to claim the role as premier forum of trade negotiations that it should be pursuant to the WTO-Agreement. Also, the status of developing country must be based on objective criteria; the practice of self-declaration is no longer acceptable to significant parts of the electorate in the developed world, which find it unacceptable that economic sectors of a comparable (or even superior) health and competitiveness get preferential treatment just because their state can declare itself to be developing. The multifaceted appropriation of foreign intellectual property by China is a topic that will also need addressing to ensure the continuing existence of a relevant world trade organization. While Hahn deems changes in antidumping and anti-subsidies law desirable, he suggests the unlocking of the potential that the Safeguard Agreement offers.

The latter's focus on the situation of the country that suffers disadvantages as a consequence of imports may allow to partially avoid a discussion that could be too difficult to solve: how to bring one of the most competitive market economies that happens to be an instrument for a totalitarian government into the structures of the WTO that are built on the premise that state and society are not identical, many exceptions notwithstanding. Hahn suggests that the Appellate Body-specific issues are comparably easy to solve once the previously mentioned subject matters are dealt with in a satisfactory manner.

In Part II of the book, "Trade Policy and Trade-Related Concerns," we move from challenges to the trade system in a narrow sense, to challenges that are a consequence of trade and how they might be regulated in trade agreements. In particular, this part of the book focuses on concerns of inequality, environmental regulation, social standards, and climate change.

Shaffer starts the discussion of trade-related concerns with his analysis of how trade agreements affect inequality. He works on the assumption that international trade law has been oblivious to social inclusion. Although not the cause of the weakening of the US economy and entrenchments of poverty, it is nevertheless blamed on them, including the shutting of factories, joblessness, and even homelessness. Although not primarily to blame for these conditions, it is not wholly innocent. International trade law plays a powerful role in fomenting the conditions under which people are able to thrive, implicating social equality and inclusion. This chapter addresses why international trade law needs to be structured in ways that support social inclusion if society is to turn the tide against rising neo-nationalism, racism, and authoritarianism. The chapter presents a scenario on how international economic law can and should be retooled. By doing so, it can: (1) help combat harmful tax competition, avoidance, and evasion; (2) aid domestic social security and job retraining; (3) support labor protection; (4) dis-incentivise social dumping; and (5) enable industrial policy experimentation for development.

Moving from inequality to climate change, Odell argues that, because the climate crisis has reached alarming proportions, each country that imposes positive net taxes on fossil fuel use at home should now extend the same treatment to all goods the country imports, unilaterally if necessary. It should set a default border carbon adjustment (BCA) on an imported product equal to net carbon energy taxes imposed on the competing home good in any jurisdictions along its supply chain. The importing government should reduce this default surcharge for a particular

shipment to the extent that costs due to net carbon energy taxes, or other measures that are comparable in effectiveness in reducing greenhouse gas emissions, have already been paid on the imported good in any jurisdiction along its own supply chain. The immediate goal of this proposal is to drive exporter industries in high-emitting countries to lobby for more effective domestic carbon mitigation so their goods will gain exemption. As long as those governments delay, the new surcharges will discourage carbon leakage through trade. The BCAs should exempt all exports from countries whose CO₂ emissions per capita are low. Additional research is needed to flesh out such a policy fully. In an illustration, low emissions are defined as less than the Organization for Economic Cooperation and Development (OECD) median, 7.15 tons per capita. This case would likely mean new carbon surcharges on exports of 33 countries today, including the United States, China, Russia, Canada, and other oil producing countries. The chapter suggests a way to administer this policy so as to impose the smallest possible additional transaction costs on domestic and international trade. Odell argues these trade measures can and should be designed to qualify for the GATT Article XX exemption.

Staying in the context of environmental regulation but taking on a somewhat broader perspective, Morin, Brandi, and Berger start from the premise that the WTO agreements' approach to environmental concerns is out-dated. While GATT Article XX b) and g) exceptions are still fundamental pillars of the trade and environment interplay, PTAs concluded over the last twenty-five years cover a much wider diversity of specific environmental clauses, including on genetic resources, climate changes, fisheries, endangered species, and forestry. This chapter compares five different scenarios for a potential multilateralization of PTAs' environmental clauses: (1) The "consensual scenario," i.e. a compilation of clauses accepted at least once by a high number of WTO members; (2) The "routine scenario," i.e. a compilation of the most frequent clauses; (3) The "trendy scenario," i.e. a compilation of the clauses that are becoming increasingly popular; (4) "The power-game scenario," i.e. a compilation of clauses supported by the United States and the EU; (5) The "appropriate scenario," i.e. a compilation of clauses typically included in North/South agreements with a large membership. The chapter contrasts the political, economic, and environmental implications of each scenario. Although they are ideal types unlikely to materialize, their comparison offers insights into how the multilateral trade system can move forward.

Finally, Lechner provides an overview of all these different non-trade issues (NTIs) in PTAs, ranging from civil and political rights, economic

and social rights, environmental protection, to security issues. This chapter presents an original dataset on the design of non-trade issues in PTAs. Covering 265 data-points in 645 PTAs signed between 1945 and 2016, the data shows large variation over time, across countries, and issue areas. Whereas security issues, civil and political, are the most traditional norms, environmental protection represents the most modern aspect in PTAs. European countries tend to push for civil and political rights, North America for economic and social rights as well as environmental protection, Asia for ecological aspects, and Arab countries for security issues. Plotting regional and chronological trends of non-trade issues (NTIs) in PTAs leads to new research questions that cover political economy puzzles, but also go far beyond the International Political Economy (IPE) literature. The data set is of particular relevance in studying issue-linkage, institutional design, foreign policy strategies, diffusion, and compliance. The chapter ends with outlining avenues for future research on NTIs in PTAs.

Part III of the book, “Development Angles,” deals with issues in trade regulation from different development angles. Development concerns have been voiced early in the global trading system. Since the proclamation of a new international economic order in the 1960s and the creation of the United Nations Conference on Trade and Development (UNCTAD) in the 1970s, the need to make the trading system more development-friendly has been at the forefront of many initiatives. In Part III the book zooms in on three areas that include migration, intellectual property rights, and foreign investment, and discusses challenges and opportunities ahead.

In their chapter, Jurje and Lavenex map the trade-migration nexus at the multilateral, regional, and bilateral level and highlight in particular the innovative role played by emerging countries, most prominently China and India, in seizing trade agreements as a venue for advancing migration policy goals. Ongoing power shifts in the global economy are likely to sustain these trends, thus suggesting a further expansion of labor mobility provisions in trade agreements – notwithstanding restrictive trends in immigration policy. The analysis in this chapter draws on primary data coded from multilateral, regional, and bilateral trade agreements as well as extensive field research conducted within various regional integration frameworks from Europe, the Americas, and Southeast Asia and across emerging markets.

Moving from migration to intellectual property rights, Serrano and Burri sketch in their chapter future scenarios for the implementation of the