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Nakasone Yasuhiro
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NAVIGATING THROUGH TURBULENCE: TAKING A MULTI-TRACK APPROACH TO SAFEGUARD THE RULES-BASED ORDER

Naoko Munakata

- Former President Trump's proposals to revoke China's MFN status and impose high tariffs on Chinese goods appears to be motivated by widespread frustrations regarding trade that have evolved since China's accession to the WTO, caused by the failure to check China's state-led economic policies despite the promises it had made.
- While concerning, such drastic proposals could serve to change the negotiating dynamics surrounding trade policy and might open the door to a sustainable solution. In the meantime, Japan should take a multi-track approach to pursuing WTO reform, WTO plurilateral agreements on new issues, and regional and bilateral FTAs, as well as economic revitalization at home that would support its sustained leadership in the international trade system.

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- The CPTPP's role in spreading the rule of law is crucial for preserving the rules-based trade system, the rigor of its accession process being the key to the forum's success. Cooperation between the CPTPP and the EU is worth pursuing.

A Gathering Storm in the Trade Landscape

The global trade system has weathered numerous challenges, including US-China tensions, the pandemic, and ongoing wars. The malfunction of the World Trade Organization (WTO) has only added to the instability.

Amidst these challenges, the proposals from former President Donald Trump to revoke China's Most Favored Nation (MFN) trade status and impose 60% or higher tariffs on imports from China, along with a 10% across-the-board tariff, forebode an even greater upheaval. A bipartisan report also recommends reverting to annual renewal of China's MFN status to restore the US's economic leverage. Former United States Trade Representative Robert Lighthizer, an advocate for what he terms 'strategic decoupling' from China, sees the repeal of China's MFN status as pivotal in rectifying the errors associated with China's accession to the WTO¹.

More than two decades since joining the WTO in 2001, China has emerged as the world's second-largest economy and a major trading partner for many countries, leading to such significant interdependence that China occasionally weaponizes its trade partners' dependence. Moreover, it has evolved into a military superpower with the aim of reshaping the international order and challenging the status quo. In this complex landscape, what steps should Japan take to uphold the rules-based trade system amidst intensifying great power competition?

Frustration with the Current System

Underlying the drastic proposals above are strong frustrations about China's exploitation of the current system. Despite joining the WTO in 2001, it has failed to transition into a market-oriented economy and instead expanded state-led economic policies, including massive subsidies, forced technology transfer, and discrimination against foreign companies in strategic sectors by exploiting gaps in WTO rules. The

¹ Robert Lighthizer, *No Trade Is Free: Changing Course, Taking on China, and Helping America's Workers*, Broadside Books, 2023

WTO has been unable to prevent these developments and has thus helped accelerate China's growth without prompting the promised reforms.

In fact, the WTO's three core functions —updating rules through negotiations, monitoring compliance, and settling disputes— have not been effective. First, updating rules through negotiations is hindered by consensus-based decision making, giving each member veto power. This is especially problematic in addressing market-distorting practices by state-owned enterprises (SOEs). Second, monitoring compliance is hampered by low levels of notification compliance, allowing new market-distorting measures to go unnoticed. Third, proving rule violations in dispute settlement is challenging in countries with low transparency. This can be exacerbated by the WTO Appellate Body (AB)'s judgments. For example, the AB's interpretation of "public body" that has raised the hurdle of determining an entity as such has undermined the effectiveness of subsidy rules, especially in a non-transparent environment. Criticized for its judicial activism, the AB has ceased to operate due to the US blocking reappointments. Hence, there is a growing risk of trade disputes escalating into full-blown trade wars with retaliatory measures.

The issue is not just with China. There is a strong sense of unfairness in the United States that free trade did not lead to improved labor standards and environmental protection even as countries grew wealthier; instead, it prioritized maximum efficiency over these concerns to the detriment of middle-class jobs and the fabric of local communities on the importing end. Such frustrations led to the Biden administration's rejection of trade agreements involving tariff reductions in favor of agreements without them – e.g., the Indo-Pacific Economic Framework for Prosperity (IPEF) – and may underlie former President Trump's proposal of a 10% universal baseline tariff. To help restore confidence in and support for free trade in the United States, the problems that imbue such frustrations need to be addressed.

Possible Shock Therapy?

For all its challenges, the WTO's reach spans almost the entire world, serving as the foundation of the global trade system. Many free trade agreements (FTAs) rely on it for both substantive disciplines and enforcement mechanisms. In the United States, stakeholders such as farmers benefit from the WTO and oppose policies that undermine its functioning. Even critics of the current trade system such as Mr. Lighthizer have acknowledged its importance, reportedly stating, "If the WTO didn't exist, we would

have to invent it." With no viable replacement on the horizon, it is imperative that its members persist in their efforts to reform and strengthen the WTO.

In fact, the Trump proposal could change the negotiating dynamics surrounding the WTO. Recall the Nixon shock, when the US introduced a 10% import surcharge. In exchange for its elimination, an agreement was reached to depreciate the dollar and to conduct trade negotiations that included a reduction in non-tariff barriers (a non-starter until then), leading to the launch of the Tokyo Round. Chaos in the international monetary system and fears of trade protectionism made governments more receptive to new initiatives in international trade policy².

The Imposition of the import surcharge at that time was essentially a US demand for rebalancing burden sharing. It wanted its trading partners to bear more of the economic adjustment costs attendant on international trade. Today in the United States, high-tech companies are growing rapidly, exports of IT services are expanding, and the overall economy is booming. The significant widening inequality and opposition to free trade there are seen by other countries as consequences of its inadequate social policies.

However, at a time when authoritarian states are seeking to rewrite the international order to their liking, it is urgently necessary to rebuild unity between the US and other countries that are committed to restoring the health of the international trade system, an important pillar of the rules-based international order. Authoritarian states seeking to change the existing order are at the same time benefiting from it, and thus their position is inherently fragile. It is hoped that the rise of protectionism in the US will be a blessing in disguise and eventually lead to an understanding of shared interests.

A Multi-track Approach to Upholding the Rules-based Order

In the meantime, Japan should actively pursue plurilateral agreements open to all WTO members on e-commerce and other matters of interest. Discussions to explore common ground are useful for subjects less amenable to convergence such as "trade and environmental sustainability." Japan has also joined the Multi-Party Interim Appeal Arbitration Arrangement (MPIA) to ensure an independent appeal process in the absence of a functioning AB. FTAs with emerging economies and regional FTAs such as the Regional Comprehensive Economic Partnership (RCEP) can also complement the WTO.

² Gilbert R. Winham, *International Trade and the Tokyo Round Negotiation*. Princeton University Press, 1986. P.15

More fundamentally, however, Japan should aim to reinstate the function of trade agreements in promoting market-oriented economic reforms and upholding the rule of law. During the Diet deliberations for approval of the Trans-Pacific Partnership (TPP) Agreement, the late Prime Minister Shinzo Abe emphasized that “the TPP will serve as a catalyst for economic reform in each member, thereby expanding the reach of the rule of law.” He underscored the importance of the rule of law as the foundational principle for the TPP’s ‘coalition of the willing.’ This concept extends beyond the TPP framework. Preserving an international order based on universal values, particularly in the face of authoritarian ambitions, necessitates broad-based cooperation among diverse countries. Even those not embracing democracy rely on the rules-based international order for stability and growth.

Japan should work hard to preserve the effectiveness of the Comprehensive and Progressive Agreement for TPP (CPTPP), formed after the US’s withdrawal, and avoid repeating the mistakes of the WTO, where members can evade accountability for non-compliance and exploit veto power to stall progress. The rigor maintained throughout the process of the United Kingdom (UK)’s accession to the CPTPP sets the example to be followed in the future.

In addition, to help alleviate the negative impact of any drastic measures that the United States might take to further hamper the WTO, Japan, in close cooperation with like-minded partners such as the EU, the UK, Canada, and Australia, should discuss what can be done through plurilateral and bilateral frameworks. For example, they should explore the possibility of cooperation between the EU and the CPTPP. The IPEF is also an important forum for developing the idea of free and fair rules as well as incentives for countries in need of heavy lifting to comply with them.

At home, Japan should work to revitalize its economy, promote investment and innovation in areas crucial for solving social challenges such as environmental sustainability and digital transformation, and keep its products and technologies indispensable to the rest of the world. A strong domestic economy is vital to sustaining its leadership in the international trade system. After all, “a nation can be no stronger abroad than she is at home.”³

³ Remarks Prepared for Delivery At The Trade Mart in Dallas, TX, November 22, 1963 [UNDELIVERED]
<https://www.jfklibrary.org/archives/other-resources/john-f-kennedy-speeches/dallas-tx-trade-mart-undelivered-19631122>

Conclusion: Navigating Forward

In the face of unprecedented challenges, Japan plays a crucial role in safeguarding the rules-based order. By championing the rule of law, addressing the root causes of frustration, and pursuing a multi-track trade approach, Japan can lead the way to a more stable and equitable global trade landscape. 

Naoko Munakata is a professor at the Graduate School of Public Policy, The University of Tokyo.