

# Dancing with the dragon: can the EU and China rescue the WTO?

Comprehensive WTO reform has never been more urgent. Bart Broer argues that the Sino-European relationship could safeguard the world's trading regime

**T**he World Trade Organization, conceived in 1994 by no fewer than 124 ambitious nations endeavouring to liberalize and regulate global trade flows for decades to come, is broken. Once a beacon of hope for the value-based multilateral order, the organization has recently come under renewed pressure.

On the western front, Donald Trump has instituted a protectionist economic policy, not shying away from imposing import duties on US partners and competitors alike – culminating in the ongoing ‘trade war’ with Beijing.

On the eastern front, China’s authoritarian state-led economy continues to raise questions of inconsistency with pivotal WTO principles of transparency and national treatment. Other members of the organization, such as the European Union, the other BRICS countries and Japan, keen on preserving the WTO’s status as the legal backbone of international trade, find themselves caught in a consequential geopolitical struggle between the world’s two largest economies.

### **The WTO, a long way from home**

Criticism on the functioning of the WTO is not a novelty. Rather, ever since its inception, participating members have discussed pathways for reform. Multilateral trade negotiations under the WTO essentially came to a standstill after the completion of the Uruguay Round, negotiations for which lasted from 1986 to 1993.

The latest round to liberalize global trade flows, known as the Doha Development Round, failed principally because of insurmountable differences between developed nations and developing countries on a range of issues, most crucially of which the provisions on special and differentiated treatment (SDT). These provisions grant developing countries flexibility in implementing their obligations under WTO law whilst authorizing developed nations to treat the former more favorably than other WTO nations.

The Doha negotiations, having commenced in 2001 and still ongoing, have proven largely unsuccessful as no significant trade liberalization measures were agreed upon. As annual negotiation sessions continued to fail, the divide between the developed nations and developing countries widened. The WTO came under increased scrutiny from both sides of this divide.

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The advent of a protectionist-mercantilist US foreign and economic policy, as well as the growing self-assurance with which China is asserting itself on the global economic stage, have fanned the flames even more: comprehensive WTO reform has never been this imperative and urgent. Broadly speaking, the WTO is considered to urgently require modernisation on two fronts: first, on the breadth of its rulemaking competence, and second, on its operational working arrangements.

### **Europe taking the plunge**

The EU has been most proactive and outspoken both in vocalizing what it considers dysfunctional about the WTO and in proposing concrete pathways for reforms. It released a concept paper in September 2018 enumerating pathways for substantive as well as procedural modernisation. In *substantive* terms, the EU holds that there is a need to broaden the WTO's negotiation mandate, as illustrated by the repeated failure of the aforementioned negotiation rounds.

Like-minded nations should more freely initiate 'plurilateral' negotiations within the framework of the WTO on topics of common interest – eg. investment facilitation, small and medium-sized enterprises, e-commerce, transparency, and opening up the financial and services sectors.

Once an agreement amongst like-minded states has been struck, it will be enforced by the participating states and open to voluntary accession by other WTO members. Such a process was followed with the Government Procurement Agreement (GPA) and allows for the WTO to escape the Doha deadlock. However, it also risks disintegrating the legal framework of the organization, with different groups of nations being subject to divergent trade liberalization regimes.

Fuelled by the alleged inconsistencies between China's state-planned economy and the principles of transparency and national treatment under WTO law, the EU urges members to consider reforms to "*rebalance the system and level the playing field.*" European businesses continue to face considerable challenges in accessing the Chinese market due to Beijing's longstanding provision of subsidies to some its economy's most critical sectors, the institution of joint venture requirements, and the limitations placed on foreign ownership.

Moreover, the EU calls for a revision of transparency rules, allowing WTO members to adequately establish whether certain subsidy provisions qualify as trade distortions. Likewise, rules to establish whether a private entity is pursuing private or government-supported economic aims must be updated. SDT, currently claimed by over two-thirds of the WTO membership, is at risk of diluting calls of those countries in real need of development assistance.

It must, therefore, be fine-tuned to ensure that the privileges claimed under SDT are as targeted as possible. Countries claiming these privileges must also be widely encouraged to 'graduate' to the status of a developed nation.

### **Brussels' extended hand**

The *procedural* reforms the EU is advocating must be understood in the context of demands originating in Washington. The Trump administration claims that the WTO Appellate Body (AB), a panel of seven judges empowered to review decisions by the first-instance Dispute Settlement Body (DSB), is inefficient and ineffective, lacks judicial independence and applies inconsistent legal reasoning – to the detriment of the United States.

President Trump has therefore moved to block AB appointments. In December 2019, two out of the three current judges are set to retire, thereby failing to meet the minimum threshold of three judges required to deliver a judgment.

Aiming to accommodate US concerns, the EU has proposed a series of procedural reforms that can be effectuated with relative ease and swiftness. AB members should be appointed for a longer period of time to guarantee their independence; their position should be full-time, rather than part-time; and the AB must publish its final decision within 90 days of the lodging of the appeal unless agreed otherwise by all Parties. The EU furthermore suggests an annual exchange session between WTO members and the AB, allowing members to comment on the AB's jurisprudence and its procedural functioning.

Lastly, the EU proposes to change the text of the Dispute Settlement Understanding (DSU), annexed to the 1994 Marrakesh Agreement, to include that an outgoing AB member shall "*complete a pending appeal in which a hearing has already taken place during that member's term*" – a practice that has become custom in recent years, prompting the US to speak of a 'sweeping' of AB competences.

Brussels' proposals draw heavily on longstanding US concerns – in particular with regard to the alleged overstretch and deficiency of the AB. The Trump administration has declared AB reform non-negotiable – yet procedural reform is not an independent objective per se: Trump is holding the AB hostage as a means to generate additional leverage and political clout for *substantive* reforms.

Even though the US has been less outspoken than the EU in advocating these substantive reforms, both the EU and the US share concerns about China's authoritarian, state-led economy. They both characterize China as a 'non-market economy', heavy on industrial subsidies and trade-distorting measures, and as such seemingly inconsistent with WTO obligations.

### **Shared concerns, divergent strategies**

Indeed, both Brussels and Washington view the economic rise of China with great unease. This unease is

exacerbated by fears of the gradual rise of an alternative, Sino-centric global trade order through the founding of the Asian Infrastructure Investment Bank (AIIB) and the coming into being of alternative means of bilateral dispute settlement. Bilateral, Belt and Road Initiative (BRI)-inspired MoUs have included pathways for the resolution of international commercial disputes under Chinese law – outside the conventional WTO framework.

What sets Brussels and Washington apart, however, is their response. President Trump has chosen to apply maximum pressure on Beijing and instigate a 'trade war' through the imposition of tariffs on Chinese imports, whilst so far rejecting any meaningful proposal to reform the WTO. Trump anticipates that supporting Brussels' proposals may put his negotiation position vis-à-vis Beijing at risk – in case Beijing endorses EU proposals, Beijing would no longer feel pressured to the greatest possible extent.

Brussels, having found Washington reluctant to commit to WTO modernisation, has opted to follow a reconciliatory course of action. In late November 2018, the EU circulated two proposals to the WTO General Council. The first of these, submitted jointly with China, Canada, India, Norway, New Zealand, Switzerland, Australia, the Republic of Korea, Iceland, Singapore, and Mexico, was aimed at breaking the deadlock in the AB.

It reflected many elements the EU had put forward in its concept paper two months earlier: a proposal to clarify that the legal issues on which the AB is competent to rule do not include the meaning of 'domestic legislation'; to hold annual exchange sessions; and to ensure that the AB publishes its findings within the 90-day timeframe.

The second proposal was submitted jointly with China and India and is somewhat more audacious. It proposes that the selection process of AB members start automatically when a position becomes vacant. This suggestion unquestionably throws down the gauntlet to Washington.

## **Sino-European proposals: taking the back road**

It must be noted that both communications allude to procedural reform alone. Crucial reform issues are sidestepped, illustrating the considerable differences between the EU-led group of 'developed countries' and the China-led group of 'developing nations'.

Nonetheless, the EU and China have managed to agree on procedural reforms, as both parties have a strong interest in securing the short-term survival and functioning of the WTO. China, the world's largest exporter and second-largest importer of goods and services, has a clear interest in a functional WTO that guarantees unhampered trade. It also has an interest in a functional and effective dispute settlement system in order to defend itself from mostly western claims it regards as unsound and politically motivated.

Similarly, by cooperating with the EU, it intends to create goodwill to prevent Brussels from siding with Washington in the trade conflict: a European-American multilateral imposition of tariffs against Beijing will inflict even greater damage on the Chinese economy – and on the legitimacy of the Chinese Communist Party.

Lastly, China has an interest in conserving the privileged status of developing WTO members; in ensuring that decisions on reforming the WTO continue to require consensus; and in impeding developed nations from 'fighting our state-owned enterprises in the name of WTO reform'.

The EU portrays itself as a staunch supporter of the multilateral trading system and aims to ensure that the power vacuum created in the WTO by the retreat of Washington is not filled by Beijing exclusively. The EU is keen to prevent that rules are replaced by might. As such, it has an interest in shielding the multilateral trading system from attacks regardless of their geographic origin.

It has filed cases at the WTO against the US on the imposition of metal tariffs as well as against China for unfair technology transfers and a failure to uphold and enforce intellectual property rights. Above all, the EU is keen on employing the WTO to address the many inconsistencies of the Chinese economy with international commercial law, and to apply pressure on the Chinese government to undertake meaningful, substantive reforms to truly open up its domestic market to foreign operators.

### **Let's get serious: pathways for genuine modernisation**

China and the EU are now the world's two largest economies that remain committed – in one way or another – to investing in a resilient and sustainable WTO. The question therefore begs itself whether Sino-European cooperation on genuine, long-term and substantive WTO reform is conceivable.

Prima facie, it appears inconceivable for Beijing to endorse Brussels' 'wish list' for substantive WTO modernisation. Fundamental differences in the structures of the Chinese and European economy seem to not allow for cooperation on substance. Yet a number of avenues for cooperation that surpasses procedural reform can be identified.

The EU and China may seek to initiate plurilateral negotiations within the framework of the WTO on issues of likeminded interest. Largely uncharted WTO territory of common concern to both the EU and China may include investment facilitation, small and medium-sized enterprises (SMEs), e-commerce, the implementation of the Trade Facilitation Agreement, and the opening up of the global financial services sector.

With China and the EU being ardent proponents of the Paris Agreement, plurilateral efforts on the employment of the WTO for the realization of the Sustainable Development Goals is conceivable. Naturally, opting for the plurilateral path may bring the EU and China to terms, but simultaneously risks fragmenting the multilateral trade regime. By excluding the US from these discussions, the existence of the WTO may be called into question.

A reasonable path forward may be to initiate discussions on issues in which the US has a clear interest to participate, such as the effective enforcement of intellectual property rights, the liberalization of e-commerce, and the role of SMEs.

In the event of a dispute arising, the EU and China may invoke Article 25 DUS, which provides for Parties to a dispute to agree to *“expeditious arbitration within the WTO as an alternative means of dispute settlement of certain disputes that concern issues that are clearly defined by both parties which shall agree on the procedures to be followed.”*

Article 25, worded rather vaguely, thus allows for the creation of alternative, case-by-case arbitration systems. Theoretically, it can be envisaged that the EU and China opt to settle their disputes under Article 25 in such a way that precisely mirrors the existing WTO dispute settlement mechanism. If successful, other WTO members may agree to use the arbitration terms under which the EU and China apply Article 25 as a blueprint for the resolution of their respective disputes.

This would yield the EU and China considerable political leverage against the US, whilst maintaining – albeit in a roundabout way – the WTO as the pillar of international trade. A potential risk of such a course of action would, evidently, be the lack of enforcement under Article 25 as well as great legal uncertainty for the settlement of future disputes.

The EU and China may use their annual High-level Economic and Trade Dialogue, or lower-level equivalents, to strengthen mutual understanding about some of the ‘elephants’ straining the Sino-European relationship, such as European agricultural subsidies, subsidies in the Chinese steel and aluminum industries, and lack of national treatment for European companies operating in China.

Even though agreement on these issues may be inconceivable, cooperation on less sensitive issues (eg. cooperation on the connectivity agenda to fill the infrastructure investment gap in Central Asia) may also serve to create goodwill on both sides.

### **Next up: a delicate balancing act**

In any case, Sino-European collaboration on relatively insensitive aspects to WTO reform such as improving the efficiency of the Appellate Body, allocating additional resources to the WTO Secretariat, and organizing yearly exchange moments between the AB and the WTO members, may serve to build confidence and mutual trust.

Even though cooperation on structural issues, such as the role of state-owned enterprises or transparency in the provision of subsidies, may be many bridges too far, both sides stand to gain from continuing their work. The endeavours of the recently established EU-China Vice-Ministerial Working Group on WTO Reform are welcome in that regard.

The EU's economic, political and security dependency on the US greatly limits its margin of discretion to team up with China on WTO reform. Nonetheless, partnering with Beijing on issues of procedural relevance may enable Brussels to guarantee the short-term functionality of the WTO whilst not aggravating Washington.

Frank and downright discussions with Beijing on structural economic issues straining the Sino-European relationship and the future of the WTO is not only possible – it may be the best shot Europe has at safeguarding the continuity of the world's trading regime. ■

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