Research Paper

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Can the World Economy Find a New Leader?

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Summary

- Multilateralism may, in theory, put countries on an equal economic footing. But in practice the concept has often relied on an anchor government to create and preserve global norms. Under the presidency of Donald Trump, the US has accelerated its move away from leadership in global economic governance. This shift threatens the monetary and trading systems that have long underpinned globalization. Does the global economy need – and can it find – another leader to take America's place?
- In the monetary sphere, the US role in providing an internationalized currency has endured relatively well, even though the US's formal anchoring of the global exchange rate system collapsed nearly half a century ago. Governance of the US dollar and of the dollar-based financial system has largely been left to competent technocrats.
- Recent US political uncertainty has encouraged other governments, particularly in the eurozone and China, in their long-standing quest to supplant the dollar. But these economies' internal weaknesses have prevented their respective currencies from playing a wider role. Arguments for a multipolar system exist, yet network effects plus the dollar's superior institutions mean it has retained its dominance.
- In trade, the US role as anchor of the global legal order was already looking unreliable before Trump's election. Washington has faced growing resistance at home to its global responsibilities. This, together with the idiosyncratic rise of countries such as China, has made the US an increasingly unreliable and narrowly transactional leader.
- More recently, hard-to-regulate issues such as foreign direct investment, technology transfer and data flows, often with national security implications, are increasingly undermining the ideal of multilateral global governance. Institutions such as the World Trade Organization, focused on cross-border trade in goods and services, are becoming less relevant.
- Recent US actions against the Chinese technology firm Huawei show the Trump administration's willingness to decouple the US market from China and try to drag other economies with it. As far as possible, other governments should resist taking sides. A complete separation of the global economy into rival spheres is probably unfeasible, and certainly highly undesirable.
- Although future US administrations may be less wantonly destructive, it is not realistic to expect them to resume America's former role. Nor can the US simply be replaced with another power. Instead, coalitions of governments with interests in international rules-based orders will need to form. These coalitions will need to show due deference to issues like investment and national security, especially where attempts to bind governments by multilateral rules are likely to provoke a severe backlash from domestic constituencies.

1. Introduction

Since the Second World War, the US has consistently functioned as the anchor of the monetary system and the rules that underpin international trade, which together enable cross-border commerce for much of the global economy. Growing international economic integration, gradually undoing the protectionism of the interwar years, has accompanied rapid increases in global incomes. In recent decades, global inequality has decreased for the first time since the Industrial Revolution.[1] Yet despite these gains, the principle of globalization is now under attack. A splintering of global trade and finance could inflict serious economic damage by restricting the free movement not just of goods, services and capital, but of data, technology and ideas.

The paradox of multilateralism is that while it involves putting countries of different sizes and stages of development under the same set of laws, it may also require a single nation to lead and, where necessary, incur costs in doing so. The idea with a dominant power is that it wields outsized de facto influence over the rules and leadership of a region, society, culture or, here, global economic order. This actor, although it may be a 'structurally advantaged' leader that makes net gains from the system it underpins, wins widespread legitimacy through embodying a wider consensus.[2]

The US has long played such a role – though not always enthusiastically or indeed universally – in the international trading order. It has also done so, whether formally or informally, in the world monetary system. Without a leader providing coordination, there is a risk that the trade and monetary systems may break. Either the US attempts to become a coercive economic hegemon, wielding dominant power in its own interest, or a free-for-all ensues wherein a variety of larger and more powerful countries dictate terms bilaterally or regionally to those smaller and weaker. The US anchor, certainly as far as the rules-based trading order is concerned, is looking shakier than at any point since 1945.

There was always a tension between the US's respective roles in the international monetary and trading systems. Its role in the former is predicated on being willing to run current-account deficits, if necessary, to supply the world economy with currency. The animating philosophy of the US approach to the latter is mercantilism, with exports regarded as intrinsically 'good' and hence trade deficits as self-evidently 'bad'. That contradiction was always likely to cause difficulties. They have come to a head under US President Donald Trump, who has insisted on trying to use trade tools to affect the fundamentally macroeconomic issue of the current account.

On the monetary front, the administration's contempt for fiscal restraint and its willingness to use the international financial system for political ends may pose a threat to the dominance of the US dollar in trade, global banking and official foreign exchange reserves. In the area of trade, even before Trump's election, there were signs that the US was growing tired of its responsibilities as the protector of the system, and specifically as protector of the World Trade Organization (WTO). Trump has threatened not just to remove that anchor altogether but to turn it into a wrecking ball, destroying the system that earlier generations of US politicians did so much to create.

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[1] Milanovic, B. (2016), *Global Inequality: A New Approach for the Age of Globalization*, Cambridge MA: Harvard University Press, http://www.hup.harvard.edu/catalog.php?isbn=9780674737136 (accessed 14 Jun. 2019).
[2] Stokes, D. (2018), 'Trump, American hegemony and the future of the liberal international order', *International Affairs* 94(1), pp. 133–50, doi.org/10.1093/ia/iix238 (accessed 14 Jun. 2019).

These developments have raised fundamental questions about global economic governance: including not just whether a new leader is required, but whether reliance on a single dominant actor is itself sustainable. In various areas – trade, data, technology, currency – there is a risk that the world will split into two or more regional powers or spheres of influence, reducing the gains from the exchange of goods, services, capital and ideas. For example, US moves to put the Chinese technology firm Huawei on an export blacklist, if sustained, indicate a deliberate shift that goes beyond simply reducing trade deficits to a fundamental decoupling of the global economy. There is a very widespread belief that rules-based systems are preferable to fiefdoms and pure power relations, but it is less obvious how to rebuild and sustain a multilateral system once a mainstay such as the US has gone.

Depending on the particular issue and the diagnosis of the problem, one solution might involve a new power being broadly accepted as an alternative in the US's role. Another would involve a more fundamental change in the way that multilateral rules are set and enforced, and in the institutions that currently perform those tasks. A third potential solution, particularly in the monetary sphere, would entail simply allowing free competition for the role of global anchor rather than trying to manage the system through international cooperation.

This paper will seek first to examine the governance problems in the separate but related areas of the monetary system and global trade and regulation. It will then explore whether issues have indeed arisen because the US has given up its dominant role, and if so how these might be rectified. It will also consider shorter-term solutions to the Trump administration's apparent willingness not just to leave the multilateral edifice but – metaphorically speaking – to destroy the building on the way out. For the moment, the ambitions for multilaterally minded governments may be limited to ensuring that future challenges will involve redesigning the policy architecture rather than sifting through rubble.

At least as regards trade, it is likely that the model of US leadership that has endured for so long is gone for good, not just because of the current state of US politics but because the global economy – and its relation to national security – has fundamentally changed. Unless the world is going to retreat into a system of separate economic spheres of influence, new ways will be needed to renew the multilateral spirit and the institutions that embody it.

To this end, the leading economic powers outside the US must first correctly diagnose the problem. They must then examine their own willingness to undertake the challenges of solving it. This will be a long-term proposition. It seems highly unlikely that an administration headed by Trump will ever be a reliable participant in global economic governance. The challenge will be to prepare an offer that can persuade a future, more internationally minded president to take more responsibility for maintaining an open global economy while protecting her or him against domestic accusations of being exploited by China.

An economic leader may lose its position because the trade-off to that country (or bloc) of managing the system no longer gives it sufficient benefit to justify bearing the costs. Or it may be because the underlying consensus fractures to the point that no single leader can propagate credible and effective rules and norms. Either way, a thorough examination of the principles and institutions of global economic governance is necessary in order to determine whether US leadership needs to be replaced, and – if so – by what.

2. How We Got Here

The monetary system: the enduring dominance of the dollar

Surviving the collapse of Bretton Woods

The US's role in monetary and exchange rate affairs has been somewhat different to its position as a leader of the world trading system. Unlike with trade, the US was given a formal function as the anchor of the Bretton Woods fixed exchange rate system when that regime was created in 1945. The American retreat from this multilateralist role also happened much earlier and in more dramatic fashion, with the collapse of the system in 1971. But nearly five decades later, through the widespread use of the dollar, the US continues to play a powerful facilitating function. The US dollar's pre-eminence has been underpinned by the size of the underlying economy, the depth and efficiency of US financial markets and payments systems, and the availability of a large and liquid pool of safe assets for investors.

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In the first few decades of the post-Bretton Woods era, there were periods when other currencies, notably the Deutsche Mark and the yen, were suggested as rivals to the dollar for use in foreign exchange reserves and international trade.[3] But the authorities in charge of those currencies were either unwilling or unable to do very much to promote that goal. In the 1970s, the German authorities actively discouraged the wider international use of the Deutsche Mark for several reasons. For one, the country was still wary of playing a dominant foreign policy role. For another, Germany's manufacturing sector feared that internationalizing the currency would cause a 'Dutch disease' effect, in which an inflow of money would push up the exchange rate and make its exports uncompetitive. The Bundesbank's focus was instinctively domestic: although the Deutsche Mark became the de facto anchor for the European Monetary System of quasi-fixed exchange rates, the central bank's focus was always on its money supply targets.

Japan initially had similar concerns to those of the German authorities – that wider use of the yen would threaten its export-oriented growth strategy. In the 1970s and 1980s, Japan was slow to liberalize capital flows and deregulate its financial sector, both prerequisites for spreading the use of the currency. By the time Japan grasped the potential for internationalization in the 1990s and began promoting the yen abroad, it was too late. The Japanese financial market and housing crash of the 1990s, and the painfully slow recovery in the decade following, meant that the yen's international usage stalled, and in fact went into reverse.

[3] Frankel, J. (2012), 'Internationalization of the RMB and Historical Precedents', *Journal of Economic Integration*, 27(3): pp. 329–65, https://sites.hks.harvard.edu/fs/jfrankel/RMBintnztnJEI2012pg329~365.pdf (accessed 26 Jul. 2019).

The continuing disproportionate use of the dollar relative to the size of the US economy is striking. The currency's share in invoicing and settling – which gives an advantage to companies that operate in dollars and thus do not need to hedge – is 4.7 times higher than the share of US goods in global imports.[4] The equivalent ratio for the euro is roughly one-to-one. Non-US companies borrowing from banks and the bond market often do so in dollars, creating a currency mismatch that will hurt their earnings if the US currency appreciates.

The de facto links between the trading and monetary systems are obvious, not just in requiring a widely used and trusted invoicing and trading currency for goods and services, but also in facilitating the flows on the capital account that are a central feature of modern globalization. There is, however, a marked institutional division between the governance of the two, especially since the collapse of the Bretton Woods system in the 1970s. There are far fewer rules governing monetary affairs and currencies than there are for trade, and governments can aggressively pursue policies in one area while neglecting the other. Indeed, the US's central role in the monetary system, which encourages it to run current-account deficits to satisfy the demand for dollars, stands at odds with its position in the mercantilist trade policy framework, which holds that exports are intrinsically 'good'.

Part of the US's increasing disconnection from trade policy during the 2000s, for example, can be attributed to its obsession with its trade deficit with China, and in particular to its pressing of Beijing to stop intervening to hold down the renminbi. The administration of George W. Bush – as did its successor, Barack Obama's – focused its diplomatic resources on currencies rather than on subsidies and tariffs. (This, at least, made some economic sense: not the least of Trump's follies is attempting to solve a current-account problem through an instrument – trade policy – that at most affects the *composition* rather than the *level* of deficits.)

A similar approach, to some extent, to that adopted by the Bush and Obama administrations had worked before. In the Plaza Accord of 1985 the US, running twin fiscal and current-account deficits, corralled the world's five big advanced economies – itself, Japan, France, Germany and the UK – into a coordinated effort to weaken the dollar to improve the US's trade balance. At that point, global economic governance was dominated by a small number of largely like-minded countries on the same side in the Cold War, with the non-US players in this arrangement relying on American strategic and military backing. Geopolitical hegemony may not map directly to economic dominance, but in this case the US found it relatively easy to assemble and cajole a group of countries into a shift in global macroeconomic management through exchange rates.

In the 2000s and 2010s, the US found China much less amenable to such persuasion. It largely failed to get China to sign up to specific commitments on exchange rate liberalization or current-account deficits, either bilaterally or multilaterally – for example, in the latter case, by rounding up a posse of currency warriors in the G20 or turning the International Monetary Fund (IMF) into an enforcement agency for dealing with policy misalignments. Ironically, though the US policies may not have prevented Chinese competitive devaluation, China's currency interventions and consequent piling up of vast foreign exchange reserves were testament to the continued role of the dollar as by far the world's pre-eminent internationalized currency.

[4] Gopinath, G. and Stein, J. C. (2018), *Banking, Trade, and the Making of a Dominant Currency*, NBER Working Papers 24485, National Bureau of Economic Research, https://scholar.harvard.edu/files/gopinath/files/dominantcurrency.pdf (accessed 14 Jun. 2019).

The dollar and the global financial crisis

On top of the accumulated credibility of many decades, the dominance of dollar-based financial systems more recently owes a great deal to the US Federal Reserve – more, in fact, than it does to the White House and Congress. Whatever role the dominance of the dollar and the resulting capital inflows played in creating a financial and housing bubble in the US, events during the global financial crisis showed that the Fed was by far the most competent actor in diagnosing and treating the problem.

The dollar liabilities of non-US banks are about the same as those of US banks: the Bank for International Settlements estimates that 62 per cent of the foreign-currency local liabilities of banks are denominated in dollars.

As the crisis hit in 2008 and 2009, most public attention focused on the often chaotic attempts by governments to rescue their banking systems with bailouts and to counter the sudden stop in private demand with fiscal expansion. The back-and-forth in Congress with the Troubled Asset Relief Program (TARP) rescue package was a case in point. Yet perhaps the most important work to save the international banking system and even the global economy was being undertaken by the Federal Reserve, in particular via the swap lines that it extended to other central banks.[5]

The dollar is extensively used as a funding currency outside the US. The dollar liabilities of non-US banks are about the same as those of US banks: the Bank for International Settlements estimates that 62 per cent of the foreign-currency local liabilities of banks are denominated in dollars.[6]

The reliance on dollar funding by non-US banks created liabilities that central banks could not have met on their own. The willingness of the Federal Reserve to create a large-scale swap system was of pivotal importance in maintaining global financial stability. Having international banks dependent on a particular foreign currency for funding is not ideal. However, it is hard to imagine that, for example, the European Central Bank – which recklessly tightened monetary policy in 2011 while the aftershocks of the crisis were still acute – would have reacted as quickly or as decisively.

The politicization of the dollar

The political threats within the US to the dominance of the dollar are obvious, particularly in terms of the provision of safe assets and the quality of policymaking generally. Even before Trump's election, the repeated stand-offs over the US 'debt ceiling' between Congress and the White House, with the former threatening to push the US into default on Treasuries, could have been taken as a signal that the US was no longer a serious country and that its government bonds were now unsafe. But following Adam Smith's principle that there is 'a great deal of ruin in a nation', including in relation to its reputation for fiscal competence, the episodes seem to have had almost no impact on the credibility of the dollar as a safe haven.

More recently, another potential hazard has arisen: the Trump administration's increasingly explicit use of the dollar-based international system as a targeted instrument of foreign policy. The US has long been able to use its influence over the international payments architecture, including the network

[5] Tooze, A. (2018), *Crashed: How a Decade of Financial Crises Changed the World*, New York: Viking, https://www.penguinrandomhouse.com/books/301357/crashed-by-adam-tooze/9780670024933/ (accessed 14 Jun. 2019).
[6] Gopinath and Stein (2018), *Banking, Trade, and the Making of a Dominant Currency*.

of US-based correspondent banks and the SWIFT payments system, to enforce financial sanctions on countries such as Iran. In 2014, well before Trump's election, the French bank BNP Paribas had its access to dollar clearing restricted for breaching sanctions against Iran.[7]

Trump, who has brought this issue into sharper relief by pulling out of the nuclear deal with Iran, has gone further. His willingness, in effect, to weaponize the payments system has been underlined by the arrest of Huawei's chief financial officer for allegedly breaching sanctions on Iran.

The case for multipolarity

The role of the dollar as a dominant currency has hitherto been reasonably safe, but the question still arises as to whether having a single pre-eminent monetary authority is a good thing at all. Certainly, there are arguments for a multipolar world in which several major currencies are more or less equally widely used. But these arguments are frequently overstated, and good reasons also exist to think that the dominance of a single currency in the international monetary system is a natural, or at least logical, state of affairs.

The term frequently employed for a widely used unit is 'reserve currency' – something of a throwback to the days of fixed exchange rates when capital flows were much more closely related to underlying trade. The share of dollar-denominated assets in official foreign exchange reserves is frequently taken as a measure of the dollar's importance. This share has been drifting down, though not dramatically.

But commercial as well as official decisions determine the dominance of a currency. Indeed, the causation probably runs from the private sector to the public sector rather than the other way around. As Gita Gopinath, now chief economist at the IMF, and Jeremy Stein at Harvard University have pointed out, the use of a currency for trade invoicing in private transactions complements its role as a safe store of value, both in the private sector and in official reserves.[8] Network effects mean that trade and global banking can cluster around the use of one currency even though a rival may be backed by an economy with equally strong fundamentals. For example, it took several decades for the US dollar to replace sterling as the pre-eminent international currency, despite the US economy and its financial markets having overtaken their UK counterparts long before.[9]

The theoretical arguments for multipolarity rest largely on the contention that it is inherently risky to have one supplier of a global currency. The arguments hold that such a situation creates a continual demand for currency from the issuer country, which in turn expands that country's current-account deficit and encourages its government to borrow excessively.

Such arguments often reference the original warning about the instability of a world with a single reserve currency made by Robert Triffin, a Belgian-US economist, in 1960.[10] But the original 'Triffin dilemma' referred specifically to the fact that, under the Bretton Woods system, the dominant currency was backed by gold. Continual demand for dollars caused gold to drain out of the US. Eventually, the US's fiscal profligacy of the late 1960s and early 1970s, accommodated by the Federal Reserve, allowed inflationary pressure to rise and exacerbated the balance-of-payments deficit, making the US's link with gold untenable.

[7] Arnold, M., Scannell, K. and Stothard, M. (2014), 'BNP Paribas nears $8.9bn settlement with US', *Financial Times*, 27 June 2014, https://www.ft.com/content/6dff57de-fe19-11e3-b4f1-00144feab7de (accessed 24 Jul. 2019).
[8] Gopinath and Stein (2018), *Banking, Trade, and the Making of a Dominant Currency*.
[9] Chitu, L., Eichengreen, B. and Mehl, A. (2012), 'When Did The Dollar Overtake Sterling As The Leading International Currency? Evidence From The Bond Markets', Working Paper Series No. 1433, Frankfurt am Main: European Central Bank.
[10] Triffin, R. (1960), *Gold and the Dollar Crisis*, New Haven: Yale University Press.

The analogy with a modern fiat currency system based on floating exchange rates, and focusing on the current rather than the capital account, is far from precise.[11] Net indebtedness under a floating-rate fiat system is not intrinsically unstable or subject to the equivalent of a bank run, as was the gold-backed Bretton Woods system. Countries can in any case borrow dollars from non-resident entities as well as from the US.

Certainly, the US has run chronic current-account deficits since the early 1990s, and it would appear that the dollar's status as an internationalized currency plays some role in that.[12] But to some extent this situation was caused by foreign governments, particularly China, which built up dollar-denominated reserves as the by-product of intervention to hold down their own currencies and boost exports. It was not demand for precautionary reserves as such, as under the Triffin model, that increased demand for dollars from the US.

One of the great ironies of the 1990s and the 2000s was that, at the same time that economies such as China were complaining of the dominance of the US currency, they were helping to entrench its position by accumulating vast reserves of dollar-denominated assets for reasons unrelated to financial stability. A global economy with a single dominant internationalized currency may not be optimal, but nor is it necessarily a path to a crisis such as that which ended the Bretton Woods system.

In fact, one of the strongest arguments for a multipolar currency world is strategic rather than economic – that is, the potential for the political abuse of the dollar payments system, using the techniques seen with the Iran sanctions and particularly the Trump administration's pursuit of Huawei. China and the EU have long had economic reasons to resent the widespread use of the dollar; they now have a foreign policy and security imperative as well. Thus far the US's explicit use of the payments system for political ends is limited. It may grow as time goes on.

Trade: A rusting US anchor goes adrift

Post-war beginnings

Another irony lies in the US dominance of the post-war global trading system. Initially, the US proposed an institutional structure and then abandoned it. In recent years, having subsequently created a less systematic but nonetheless effective governance framework, the US has similarly regarded the evolution of this with rising disaffection and has threatened not just to leave but also to destroy it.

As part of its remodelling of the global order after the Second World War, along with the establishment of the IMF and the World Bank, the US led the creation of a powerful International Trade Organization (ITO), designed to arrest and reverse the protectionism of the 1930s. But, not for the last time, domestic political constraints made the US an unreliable anchor. Congress refused to approve the US joining the ITO, and governments had to be content with a weaker arrangement, the General Agreement on Tariffs and Trade (GATT).

[11] Bordo, M. D. and McCauley, R. N. (2017), *Triffin: dilemma or myth?*, BIS Working Papers No. 684, Basel: Bank for International Settlements, https://www.bis.org/publ/work684.pdf (accessed 14 Jun. 2019).
[12] Ibid.

Nonetheless, the US was the driving force behind the GATT – the European customs union was not yet in existence (nor would be until 1968). The GATT brought down average tariff levels via successive negotiating rounds of liberalization. The US was also instrumental, during negotiations for the Uruguay Round in 1994, in tackling the unfinished business of the post-war settlement, and in creating the World Trade Organization (WTO) as an independently constituted formal body in 1995.

The GATT, which had 128 member countries by the time it transmuted into the WTO, was a system largely dependent on voluntary cooperation among its members. Its enforcement mechanisms were weak. Under pressure from the US, which wanted stronger enforcement, the WTO acquired a quasi-judicial state-to-state dispute settlement process, complete with an appellate body. This system had the power to authorize retaliatory trade restrictions against countries deemed in breach of WTO law. Since 1995, the WTO's membership has expanded to 164 states and territories, covering more than 96 per cent of world trade, its numbers swelled by countries emerging from the former Soviet Union. China's turn towards market economics during the 1980s and 1990s was rewarded by WTO membership in 2001.

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Yet in retrospect, even by the time of Chinese accession, the WTO was beginning to lose credibility as a policymaking body in Washington. During the 2000s, the performance of the trading system itself and the functioning of trade policymaking had become increasingly at odds. In the decade before the global financial crisis, world trade in goods grew around twice as fast as GDP.[13] Yet despite this new 'golden age' of trade, the apparatus of policy – certainly at a multilateral level with the WTO – was ceasing to function. By the time the financial crisis hit in 2008, the WTO's legitimacy was in serious doubt.

The system seizes up

The failure of global trade governance – and of the US's ability to lead – was embodied in the fate of the Doha Development Agenda (the 'Doha Round'), launched in 2001. Badged as an attempt to spread the benefits of trade to lower-income countries, it was in practice conceived and launched by the two advanced-economy giants, the US and the EU.

The Doha Round broke down seven acrimonious years later, riven by unbridgeable gaps between emerging markets, particularly India, and the US. Doha's collapse severely damaged the WTO as an effective forum for negotiation and liberalization. Since then, and indeed since its creation in 1995, the WTO has concluded just one multilateral agreement, a largely declarative and aspirational deal to facilitate the movement of goods across borders.

The US squarely blamed India and other emerging markets (China played a largely passive role until the very end) for failing to acknowledge that they too had to offer concessions on liberalization to make the Doha Round work. Although there may be some truth in that charge, the reality was that the US failed to acknowledge that it had weakened the system by its inconsistent attachment to multilateralism and its failure to recognize its own responsibilities.

[13] World Trade Organization (2015), 'Trade in goods and services has fluctuated significantly over the last 20 years', *International Trade Statistics 2015*, https://www.wto.org/english/res_e/statis_e/its2015_e/its15_highlights_e.pdf (accessed 14 Jun. 2019).

In retrospect, the era of GATT cooperation had always fallen well short of providing a broad-based system that could forge common agreement out of a large and diverse group of economies. As one academic has noted, the success of the GATT reflected 'a relatively slim agenda, club-like decision making dominated by a handful of developed countries (especially the US and EU), and the glue of Cold War alliance politics'.[14]

Leading such a group was comparatively straightforward, and did not involve many sacrifices. Deals under the GATT were in effect stitched up by a small group of like-minded advanced economies known as the 'Quad' – the US, the EU, Japan and Canada, with the US playing a dominant role – and then pressed on to the rest of the membership. The arrangement allowed the US to aggressively pursue its own interests inside the multilateral framework. Controversially, and ultimately to the detriment of the system's credibility, the US started to introduce its own companies' interests – particularly around the protection of intellectual property rights – into the GATT process, even though policy in these areas had little to do with conventional trade liberalization.

Discontent about the multilateral governance of trade rose further among developing countries – and helped to provoke the emergence of a strong anti-globalization movement in the US and Europe – after the WTO was created, even before the launch of the Doha Round. This was notably expressed at the disastrous Seattle ministerial meeting in 1999. At least in part, this discontent reflected a concern that, rather than advancing consensus views, the US was using the organization to further its particular goals.

No doubt much of the collapse of Doha can be blamed on the recalcitrance of some emerging markets, particularly India. While they formed some effective lobbying groups, such as the G20 of developing nations that organized within the agriculture talks (as distinct from the global G20 of leading economies, which addresses mainly financial issues), they also demonstrated that they had no wish to take over a positive leadership role in the WTO from the US.

What also clearly emerged was that the US, which met far more resistance in this round than it expected, was ultimately not prepared to confront its own domestic constituencies sufficiently to achieve agreement. A deal focused on agriculture, an area of prime interest to developing countries, required more cuts in farm subsidies than the US was willing to make, given the disproportionate strength of the US farm lobby. More broadly, the image of trade deals was soured by a perception that the North American Free Trade Agreement (NAFTA) with Mexico and Canada, which came into force in 1994, and China's 2001 accession to the WTO were leading to US job losses and inequality.

Countervailing forces among export-oriented American businesses were too feeble to overcome the interests more hostile to imports. US companies during the 2000s focused more on domestic tax cuts and regulation than on opening new markets. The US proved to be vulnerable to domestic forces opposed to the animating spirit of the WTO, and thus the country's international leadership role was weakened.

By the time the Doha Round collapsed in the summer of 2008, it was the US more than any other country that was longing for the death of the talks that it had itself started. Even before the collapse, the US had retreated into bilateralism and regionalism, including entering into negotiations for the establishment of the Trans-Pacific Partnership (TPP) of 12 Asia-Pacific nations. The US, in other

[14] Sally, R. (2007), *The Political Economy of Trade Liberalisation: What Lessons for Reforms Today?*, Trade Policy Report No. 18, Johannesburg: South African Institute of International Affairs, http://www.lse.ac.uk/internationalrelations/centresandunits/itpu/docs/sallytradeliberalism.pdf (accessed 14 Jun. 2019).

words, was already retreating from leadership in the very multilateralist institutions that it had created. After the WTO had broadened to begin to match the expansive US rhetoric of a truly global advance of trading rules, the US itself found that it could not keep up with its growing obligations.

The same was increasingly true of the WTO's binding dispute settlement system, which the US had been instrumental in creating.[15] For more than two decades the system, in which governments could litigate against each other for breaches of WTO obligations before first a dispute panel and then an appellate body, functioned reasonably well. Indeed, it was often asserted by scholars that WTO dispute settlement was one of the very few multilateral institutions which the US allowed itself to be bound by. Even after the organization's negotiating function seized up with the collapse of the Doha Round, the system continued to retain credibility. The US used it extensively as a complainant, including trying to hold China to the commitments the latter had made in its WTO accession agreement in 2001.

As time progressed, however, Washington was increasingly alarmed about judicial activism in the system, particularly when the appellate body repeatedly ruled against the US use of trade defence measures such as anti-dumping and countervailing duties. The absence of new negotiated rules meant that dispute settlement was increasingly used to fill the gap.

Although it continued to use the system, the US sometimes displayed a bad habit of ignoring rulings it did not like. Brazil won a ground-breaking victory against the US in 2004 over American cotton subsidies, which the panel and appellate body ruled were pushing down the international price of cotton and hurting farmers in Brazil. Given the large number of poor cotton farmers in sub-Saharan Africa, the case became a symbol of the ability of developing countries to use WTO dispute settlement to constrain trade-distorting behaviour by the rich nations.

> During the 1990s and 2000s, the US model of trade leadership was not one of supporting liberalization to achieve new agreements and faithfully enforcing the laws that the multilateral rules-based system had already created. America was increasingly willing to block pacts that it did not like, and to challenge the legitimacy of courts whose rulings it disagreed with.

But successive US administrations stalled on implementing the ruling for a decade, deterred politically from confronting US cotton farmers who wielded disproportionate political power in the Senate. Finally, Washington simply bought off Brazilian growers with payments totalling $750 million,[16] in effect bribing its way out of following the ruling. Brazil was satisfied, but the spirit of the WTO was violated and the cotton farmers of Africa continued to suffer.

During the 1990s and 2000s, the US model of trade leadership was not one of supporting liberalization to achieve new agreements and faithfully enforcing the laws that the multilateral rules-based system had already created. America was increasingly willing to block pacts that it did not like, and to challenge the legitimacy of courts whose rulings it disagreed with.

[15] Lawrence, R. Z. (2007), *The United States and the WTO Dispute Settlement System*, The Bernard and Irene Schwartz Series on American Competitiveness, CSR No. 25, New York: Council on Foreign Relations, https://www.files.ethz.ch/isn/31773/2007-03_WTO_CSR25.pdf (accessed 14 Jun. 2019).

[16] Ikenson, D. J. (2014), 'Unsettling Cotton Settlement at the WTO', Cato Institute, 8 October 2014, https://www.cato.org/blog/cotton-tobacco-settlements-will-expedite-wtos-corrosion (accessed 14 Aug. 2019).

More recently, a new and destabilizing force has arisen to stoke further US discontent with the multilateral trading system. When China joined the WTO in 2001, the accession agreement, while more stringent than for previous WTO entrants, was essentially predicated on the country moving ever closer to becoming a market economy. In reality, although China has reduced conventional means of protectionism such as simple goods tariffs, the country has developed a whole array of more sophisticated forms of intervention. These take the form of regulations, subsidies and the use of state-owned enterprises to pursue policies such as forced technology transfer. The WTO, its rulebook last substantially updated in 1995, is ill equipped to constrain such activity. China has violated in spirit, if not always in letter, the principles of the organization.

Furthermore, Chinese industrial policy has become increasingly intertwined with the security functions of the Chinese state, blurring the lines between economics and geopolitics. Under President Xi Jinping, China's commitment to both establishing a lead in high-tech sectors and extending the power of the security state has increased. For the US, this makes a body such as the WTO and policy that focuses purely on international trade look increasingly incomplete.

As international business has moved away from a focus on traditional cross-border trade in goods and services and into foreign direct investment (FDI), so it has entered a sphere where international rules are already much weaker and where domestic legal regimes can more easily be manipulated for political ends. Past attempts, usually backed by the US, to build rules in these areas have failed. The Multilateral Agreement on Investment proposed in the OECD, for example, was designed to agree a common approach to investor protection treaties but collapsed in 1998. Attempts to agree antitrust rules promoting competitive markets were thrown out of the Doha Round, at the behest of developing countries, after the disastrous WTO ministerial meeting in Cancún in 2003.

The US: from blocker to wrecker

The Trump administration has taken US discontent with the multilateral trade system to new extremes, but such sentiment is not new. In at least three areas – its attacks on the WTO itself, its inclination towards preferential rather than multilateral deals, and its willingness to compromise principles of free trade for national security ends – the current White House has merely accelerated trends that were already in place.

The Trump administration – and particularly Robert Lighthizer, the US Trade Representative (USTR) – has made the alleged judicial overreach of the WTO appellate body one of its main complaints against the institution. The US is in the process of jamming up the system altogether by refusing to appoint new appellate body members when the terms of existing judges expire in December 2019.

Yet this is only a more extreme version of an existing policy, reflecting a long-standing and increasingly strident critique held by successive US administrations and lawmakers. While it did not seek to undermine dispute settlement by refusing to appoint any members at all to the appellate body, for example, the Obama administration blocked the reappointment of judges that included Jennifer Hillman, a highly respected US academic and former chief legal counsel to the USTR.

Similarly, the Obama administration was prepared to let the Doha Round die and to turn to smaller trade deals that it could more easily control, such as the TPP. Many economists regard such a move as a retrograde step. Deals dictated by the US typically contain elements that economists regard as antithetical to free trade, such as intellectual property rights protections. Under Trump, the US has taken that shift much further, regarding even some regional deals as an unacceptable dilution of its power. Trump withdrew the US from the TPP in favour of using US economic heft directly to win bilateral concessions from the pact's member states, such as Japan.

Such bilateral bullying, backed by unilateral tariffs or the threat of them, is often more about diverting and distorting trade rather than liberalizing it. The proposed deal currently being negotiated between the US and China is one example of how a shift from the multilateral to the bilateral – and in particular a shift to the short-term fix – is a malign development. Part of China's negotiation strategy, a larger-scale version of one already trialled by the EU, is to buy off the US by shifting procurement of commodities and other goods to American exporters. This will do nothing for the global economy except create inefficiency and move deficits from one place to another.

National security is a third area in which Trump has taken the more moderate concerns expressed by former US administrations and used them as an excuse for blatant mercantilist protectionism. US foreign policy before the Obama era was already moving towards redefining China as one of America's principal strategic adversaries. A shift occurred in the first few months of the George W. Bush administration, masked for a long time after the 9/11 attacks by the US's diversion of political and policy energy to the so-called 'war on terror'.

By the end of the 2000s, the separation between pure economics and pure politics in US international affairs had increasingly been challenged, even by the more liberal Obama administration, with a clear focus on China.[17] As secretary of state from 2009 to 2013, Hillary Clinton adopted the doctrine of 'economic statecraft' – the use of geopolitical diplomacy to further US commercial interests and vice versa.[18]

In addition, the fact that trade is increasingly intertwined with technology in ways that have clear national security implications – such as the Chinese record on cybertheft and surveillance – underlines the need to take a more strategic approach to international economic and regulatory governance.[19] Even in the EU, which has taken a less aggressive view of Chinese intentions, there has been a serious debate about access to critical infrastructure networks with national security implications, such as 5G telecommunications. European governments have acknowledged the US arguments over the security implications of letting Huawei into those networks, and have taken a variety of more or less measured responses.

But part of Trump's aim is to stop other countries from straddling the US–China divide in this way – not just trying to decouple the US from China, but to pull other economies with him. His vision of economic statecraft is Manichean. When the US forced Mexico and Canada to rewrite NAFTA into the US–Mexico–Canada Agreement (USMCA), one provision contained a 'poison pill' designed to deter either of the signatories from starting trade talks with Beijing in the future (Article 32.10).[20] Similarly, Trump's assault on Huawei has now escalated beyond a proportionate response to a specific security threat into a full-scale attempt to drive the company – and most likely Chinese producers in general –

[17] Harding, R. and Harding, J. (2017), *The Weaponization of Trade: The Great Unbalancing of Politics and Economics*, London Publishing Partnership, http://londonpublishingpartnership.co.uk/weaponization-of-trade/ (accessed 14 Jun. 2019).
[18] Blackwill, R. D. and Harris, J. M. (2017), *War by Other Means: Geoeconomics and Statecraft*, Cambridge MA: Harvard University Press, http://www.hup.harvard.edu/catalog.php?isbn=9780674979796 (accessed 14 Jun. 2019).
[19] Roberts, A., Choer Moraes, H. and Ferguson, V. (2018), 'The Geoeconomic World Order', Lawfareblog, 19 November 2018, https://www.lawfareblog.com/geoeconomic-world-order (accessed 14 Jun. 2019).
[20] USMCA Article 32.10: https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/32_Exceptions_and_General_Provisions.pdf (accessed 14 Jun. 2019).

out of technology supply chains worldwide. Governments and companies in Europe and Japan, mindful of the extent to which they rely on Huawei and other Chinese companies, are hoping not to have to choose between US and Chinese spheres of technology influence.

Whatever the justification for applying security rationales to trade policy in high-tech sectors, Trump has taken the approach to absurd extremes, undermining its credibility. On spurious national security grounds, his administration has imposed steel and aluminium tariffs on imports from trading partners including long-standing foreign policy allies such as the EU, Japan and South Korea, and has threatened similar moves with cars. Those tariffs have also been used to force governments such as those in Canada, Mexico and the EU to the negotiating table to push for other agreements.

3. Looking for Solutions

Monetary affairs

The demands from Europe and China

Whether a multipolar system involving more than one international currency is desirable is a theoretical question. In practical terms, no other currency has made much headway in supplanting the US dollar – though certainly countries outside the US have often expressed the desire for such a shift. Governments, notably in Europe and particularly in France, have long complained about what Valéry Giscard d'Estaing, as French finance minister in the 1960s, called the 'exorbitant privilege' of the dollar.

Given the extent to which the US government can borrow more cheaply than other advanced-economy governments, the annoyance is understandable. Moreover, companies that operate in dollars benefit from being relatively insulated from movements in exchange rates.

Despite the envy of other governments over the US privilege, so far their efforts to replace the dollar have betrayed a lack of comprehension about what is needed to establish a dominant currency, as well as a lack of political will. The authorities overseeing the two most likely rivals to the dollar – the renminbi and the euro – appear to believe that a switch can be achieved by government fiat, whether unilaterally or as part of a collective international decision. They have failed to take the domestic actions necessary to encourage the private sector to use their currencies.

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Both the Chinese authorities and European governments have repeatedly made overt calls for the dollar's dominance to be reduced. In the aftermath of the 2008 financial crisis, both Zhou Xiaochuan, at the time the governor of the People's Bank of China, and President Nicolas Sarkozy of France argued that the pre-eminence of the US currency was a destabilizing influence in global markets. More recently Jean-Claude Juncker, as president of the European Commission, called for greater internationalization of the euro in his 'State of the European Union' speech of September 2018, designed to set priorities for the last year of his presidency.[21]

Yet attempts to achieve currency internationalization by top-down administrative action have gone nowhere. Sarkozy's plans, from which he rapidly retreated, seemed to be more rhetorical than practical. China's were somewhat more substantive. Zhou, in a widely read essay in 2009, argued for greater reliance on Special Drawing Rights (SDRs), the quasi-currency used at the IMF, as this would lead to diversification out of the dollar.[22] As part of this, he argued for governments and central banks to be able to exchange dollars for SDRs through the IMF. US officials briskly dismissed Zhou's

[21] Juncker, J.-C. (2018), 'The Hour of European Sovereignty', State of the Union 2018, European Commission, https://ec.europa.eu/commission/sites/beta-political/files/soteu2018-speech_en_0.pdf (accessed 14 Jun. 2019).
[22] Zhou, X. (2009), 'Zhou Xiaochuan: Reform the international monetary system', *BIS Review*, 41/2009, https://www.bis.org/review/r090402c.pdf (accessed 14 Jun. 2019).

arguments, pointing out that this would essentially constitute a way of subsidizing Chinese efforts to diversify the vast dollar-denominated reserves that Washington had tried to stop it from amassing in the first place.

Beijing then expanded its focus from the multilateral to the bilateral, and from the diplomatic to the practical.[23] It embarked on a campaign to encourage use of the renminbi, developing overseas markets in renminbi-denominated bonds and recruiting offshore clearing banks to settle renminbi payments outside China. Mimicking the US Federal Reserve, China also signed a series of swap arrangements with other central banks.

These efforts were rewarded with a modest rise in the use of the renminbi – and with its addition to the SDR basket of currencies in 2016. However, the change is little more than symbolic for the moment: the SDR as a unit is barely used outside the official system, a recent issuance of SDR-denominated bonds by the World Bank notwithstanding.

More important than international bureaucratic tokenism is the fact that full liberalization of China's capital account, and with it currency movements, would be a risky and reversible process given the fragile Chinese financial system. After rapid capital outflows and market turbulence in 2015, China imposed capital controls to calm the renminbi. Unsurprisingly, the use of the currency for cross-border trade settlement promptly fell back to levels seen four years earlier.[24] Beijing's efforts at internationalization ran straight into domestic constraints.[25]

China's great economic statecraft plan to extend its political influence and export its industrial overcapacity, the Belt and Road Initiative, has similarly had difficulties in extending the international use of the renminbi.[26] To meet contractors' requests to be paid in dollars, China has had to run down its international reserves, which was not exactly the point of the exercise.

For the eurozone, the perennial irritation at dollar dominance has been exacerbated by the recent events over Iranian sanctions and Washington's use of the payments system to force European companies in effect to implement US foreign policy. The EU is setting up a special-purpose vehicle to bypass the dollar-dominated payments system. But this will be a barter mechanism matching Iranian oil and gas exports against purchases of European goods, not a rival payments system *per se*. In any case, many European companies have complied with the sanctions rather than risk losing access to dollar funding.

Similarly, the EU has called on energy companies in Europe to use euros rather than dollars when purchasing imports. However, as long as the exporting countries themselves want dollars in their reserves, or want to buy their own imports from elsewhere, it seems unlikely that this 'euro-ization' of energy pricing will occur, unless the EU offers large incentives to producer countries. EU governments bullying or, in effect, bribing domestic companies to price energy in euros is not a credible or sustainable approach to currency internationalization.

[23] Cohen, B. J. (2017), *Renminbi Internationalization: A Conflict of Statecrafts*, Research Paper, London: Royal Institute of International Affairs, https://www.chathamhouse.org/sites/default/files/publications/research/2017-03-20-renminbi-internationalization-statecraft-cohen.pdf (accessed 14 Jun. 2019).
[24] Otero-Iglesias, M. (2018), 'Renminbi internationalisation: stuck in mid-river – for now', Real Instituto Elcano, 4 July 2018, http://www.realinstitutoelcano.org/wps/portal/rielcano_en/contenido?WCM_GLOBAL_CONTEXT=/elcano/elcano_es/zonas_es/asia-pacifico/ari84-2018-oteroiglesias-renminbi-internationalisation-stuck-mid-river-for-now (accessed 14 Jun. 2019).
[25] Eichengreen, B. (2017), 'The Renminbi Goes Global. The Meaning of China's Money', *Foreign Affairs* March/April 2017 Issue, https://www.foreignaffairs.com/reviews/review-essay/2017-02-13/renminbi-goes-global (accessed 14 Jun. 2019).
[26] Citi GPS (2018), *China's Belt And Road At Five. A Progress Report,* https://www.citibank.com/commercialbank/insights/assets/docs/2018/Chinas_Belt_and_road_at_five.pdf (accessed 14 Jun. 2019).

These emphases on short-term fixes ignore the long-term structural problems that hold back the widespread use of the euro.[27] The eurozone continues to lack the unified capital market and banking system needed to back a global currency. Nor does it have a pool of safe assets that remotely rivals the US Treasury market for depth and liquidity, reducing the euro's attractiveness to reserves managers. The situation is not helped by Germany's reluctance to create jointly issued euro-denominated bonds. Bunds are not a substitute for Treasuries. Moreover, Germany's obsession with export-led economic growth and its unwillingness to run current-account deficits contribute to the shortage of euro-denominated safe assets.

France and Germany, the two dominant actors in eurozone affairs, are divided on the issue. France, the country particularly exercised about the dominance of the US dollar, wants to create pan-eurozone institutions and instruments, including joint bonds that might make the euro more appealing to international banks and companies. Germany, its parochialism over international economic policy far from dissipated since the 1970s, has blocked any substantial move in that direction.

The dollar may well be an imperfect global currency, especially given the risks to the US federal government's solvency and the threat of further politicization of the international dollar-based payments system. But the status quo is thus far a natural and largely unchallenged one. The means to supplant the dollar are within the hands of its potential rivals. Their own domestic political constraints, rather than US diplomatic cunning or an absence of global governance, are preventing them from doing so.

Trade

Replacing sole leadership with coalitions

Any solution to the US withdrawal from global trade leadership needs multiple strands. First, faith and leadership need to be restored in the multilateral system, particularly the WTO. At the very least, the US needs to be stopped from acting as a destructive force. Second, any solution needs to use that system to nudge countries such as China back towards a consensus on the merits of free and open trade. Third, economic diplomacy needs to accommodate increasing concerns about trade-distorting behaviour – often allied with technology theft, spying and violations of cybersecurity – by China and other countries, without allowing such issues to become excuses for protectionism. Any solution needs to recognize that newer forms of globalization such as FDI and cross-border flows of data, as opposed to conventional trade in goods and services, have become major spheres of contention, and that the WTO and other international institutions have only weak tools to protect cross-border commerce and prevent distortions.

Indeed, there is quiet but widespread admission among trade officials from a variety of countries that, although Trump has pursued his policy agenda in an aggressive and destructive fashion, some of the underlying critiques of the current settlement are valid. Whatever future part the US plays, the multilateral system's rules – and possibly its entire management – will need to be rethought.

Of all potential strategies for re-establishing the multilateral system, perhaps the least promising is the idea that the US can simply be plugged back into its former role in unreformed institutions by a future, more internationally minded White House. As we have seen, the US was already drifting away from

[27] Eichengreen, B. (2019), 'The euro at 20: An enduring success but a fundamental failure', The Conversation, 4 January 2019, http://theconversation.com/the-euro-at-20-an-enduring-success-but-a-fundamental-failure-108149 (accessed 17 Jun. 2019).

its anchor role before Trump's election, particularly with regard to engagement with the WTO and dispute settlement. The Trump administration's policy represents a very rapid acceleration of this trend but not a complete aberration. No future administration will want to leave itself vulnerable to accusations of being a soft touch and of anchoring a rules-based system abused by China.

Admittedly, it is true that the US has tested the system before, first by addressing a perceived problem unilaterally and then by using the sense of crisis to push forward multilateral integration. In the 1980s, in a foreshadowing of the Trump administration's dealings with China, the US addressed the perceived unfairness of competition with Japan in steel and cars by in effect imposing quotas. In a realization that such an approach was risky and unsustainable, Washington then turned to the multilateral system and toughened rules against subsidies as part of the Uruguay Round of trade talks, which concluded in 1994 and led to the creation of the WTO.

But China is regarded as a far bigger and more enduring competitor than Japan – in security as well as economic terms – and it will take a great deal to persuade the US that Beijing can be constrained purely by multilateral means. The perception that globalization has hollowed out US manufacturing and increased inequality will also deter future administrations from developing policies that could be interpreted as selling out to foreigners.

An arrangement to replace the current era of US dominance needs to be more flexible and creative. It needs to preserve the best of the system and find ways to extend a rules-based order through coalition rather than unipolarity.

Pleasant though it may be to imagine that multilateralism is driven by altruistic sentiment, in reality large and powerful economies need to feel that their return from membership of such organizations is worth the sovereignty they have given up in exchange. It is quite likely that simply no deal is possible that will persuade the Trump administration that it is worth restoring the WTO to its former role in global trade governance. But it is quite possible to imagine a future president prepared to make a new trade-off between rights and responsibilities. The big trading economies that say they want to preserve the WTO system, particularly the EU, China and Japan, need to prepare a package that a more internationally minded White House could adopt.

An arrangement to replace the current era of US dominance needs to be more flexible and creative. It needs to preserve the best of the system and find ways to extend a rules-based order through coalition rather than unipolarity. It also needs to be humble and recognize that some of the newer issues in globalization are likely to be less amenable to binding international rules. In the meantime, there remains the challenge of shielding as much of the current framework as possible from the Trump wrecking ball to prevent other governments from drifting off and making other arrangements.

Critically, any agreements that aspire to global coverage will inevitably need to involve China as a cooperative member. This contrasts sharply with the pre-WTO era, when the ideological and strategic opponent of the US was economically isolated. During the Cold War, opposition to the Soviet Union provided a coalescing force for GATT members. But that was relatively straightforward when dealing with a bloc that had deliberately distanced itself from international trade. In the West, during the Cold War, economics and politics pulled in the same direction. In dealings with China, the economic and security imperatives are at odds. This complicates the challenge of assembling a critical mass of countries to create a genuine coalition of authority rather than relying on the old system of one leader and a host of followers.

Rescuing the WTO

The WTO is currently in the same position as other institutions that have found that a system they were set up to govern has fundamentally changed around them. The IMF, for example, had its *raison d'être* largely evaporate when the Bretton Woods fixed exchange rate system imploded in 1971. It cast about for a new task for some time, and then found it as a rescue lender during the debt crises in Latin America, sub-Saharan Africa and other developing regions in the 1980s, a role it has continued to play. The lesson of the IMF's experience is instructive. It retained credibility by preserving and developing a function with very few close substitutes – something akin to an international lender of last resort backed by the credit of the major economies, including the US.

The WTO could retreat from being an institution that facilitates the creation and enforcement of rules to performing a softer role that might involve setting norms and giving technical advice to countries on meeting them. That would make it more like the OECD or an agency such as the United Nations Conference on Trade and Development (UNCTAD).

A potentially rewarding, but difficult, option would be to find a way of adapting the WTO to preserve and extend its precious rule-setting and enforcement functions.

Certainly, there is a lot of technical expertise in the WTO secretariat that could help it play the more limited role of a policy forum and advisory body. But that would be a waste of an organization that has hitherto had been able to exercise an exceedingly rare function, as a multilateral institution whose laws and rulings the US has generally allowed itself to be bound by. There are, of course, other representative bodies that set global standards, such as the International Telecommunication Union in internet governance. But sooner or later, governments trying to write enforceable rules on international commerce tend to find themselves at the WTO. A potentially rewarding, but difficult, option would thus be to find a way of adapting the organization to preserve and extend its precious rule-setting and enforcement functions.

For the moment, some authorities – initially the EU and Canada, which launched their initiative in July 2019 – are considering a procedural manoeuvre to keep a version of the WTO's dispute settlement system going, despite the US refusing to appoint new judges to the appellate body.[28] But this will essentially be a holding operation. Any attempt to force the appointment of new judges over the US's objections, such as by invoking rarely used provisions for qualified majority voting rather than unanimity, seems highly dangerous.

The main task, then, is to restore the dispute settlement system's standing, particularly in the eyes of the US. Dispute settlement, which is the WTO's clear comparative advantage, is the best test of whether governments can keep the system going and effect enough change to get the US – more likely a future administration than the current one – back on board.

[28] European Commission (2019), 'Joint Statement by the European Union and Canada on an Interim Appeal Arbitration Arrangement', 25 July 2019, http://trade.ec.europa.eu/doclib/press/index.cfm?id=2053 (accessed 14 Aug. 2019).

A flourishing cottage industry in WTO renovation has now sprung up, with a variety of countries either individually or collectively producing blueprints for a more efficient and transparent architecture.[29] But the US has roundly rejected such proposals as inadequate. In its view, they do not address the insufficient scope of current rules in terms of constraining subsidies, nor do they counter the jurisprudential philosophy of the appellate body regarding trade defence. Such policy blueprints currently fall into the unfortunate category of technocratic fixes to political problems. Indeed, Lighthizer's particular animus against WTO dispute settlement seems to be rooted in a preference for a GATT-style system where agreements are enforced bilaterally through diplomatic means. No reasonable reform process can accommodate such a philosophical difference.

What would longer-term dispute settlement reform look like? Most likely, it would only be partly centred on the process itself. Completely changing the nature of the system, such as abolishing the appellate process altogether or simply appointing judges based on how they are likely to rule on certain subjects, would hugely undermine its credibility. The solution is most likely to involve not changing the judicial approach but giving the panels and appellate bodies more rules to apply to those aspects of trade-distorting behaviour that they currently cannot influence. This would in turn diminish the need for the WTO's judicial branch to create law itself, and should address some of the US concerns about overreach.

It is not just the US that has become frustrated with the scant coverage of WTO agreements. The EU and Japan are also exercised about subsidies, and in particular the apparent inability of the WTO to address market distortions created by China's state-owned enterprises. The EU and Japan, like the US, are also concerned about foreign companies that have invested in China being compelled, either formally or informally, to hand over technology as a condition of doing business in the country.

Japan, which has been playing a historically atypical leadership role in the absence of US direction, has corralled the US and the EU into a trilateral initiative to try to address the inadequate coverage of subsidies under the current WTO agreement, which presupposes a clearer distinction between government and private companies than in reality exists in China.

Japan, the EU and the US have also started coordinated litigation at the WTO against China over technology transfer, despite the US dislike of the dispute settlement system. It seems quite likely that some of the US's complaints about the judicial philosophy of WTO dispute settlement will quieten down if Washington can use it to challenge Chinese state subsidies and other distortions more aggressively.

Inside and outside the WTO

Any gathering of leading governments needs to be prepared to write rules among its members rather than rely on the WTO's labyrinthine consensus-based negotiating processes. Realistically, the era is over of multi-stranded 'single undertaking' WTO deals, in which a wide array of subjects – manufactured goods, agriculture, services, intellectual property – are negotiated simultaneously among the organization's entire membership. The apparatus is too unwieldy, and the variability in stages of development among its members too wide, for this to be a viable mechanism in the modern world of trade governance.

[29] WTO General Council (2018), 'Communication from the European Union, China, Canada, India, Norway, New Zealand, Switzerland, Australia, Republic of Korea, Iceland, Singapore and Mexico to the General Council', WT/GC/W/752, 26 November 2018, http://trade.ec.europa.eu/doclib/docs/2018/november/tradoc_157514.pdf (accessed 17 Jun. 2019).

Embedding plurilateral agreements in the WTO can be a way of keeping the overall spirit of the system going. In theory, such agreements could take place on a regional basis. In reality, though, such deals are likely to be too small to replace multilateral rules, and they could be sabotaged or dominated by a local power with its own interests mainly in mind. The remaining 11 TPP countries that resurrected the deal after the US pulled out, for example, have created a new set of rules potentially providing a framework for trade in the Asia-Pacific and even beyond. But with the US's departure from the TPP, the share of global GDP covered by the agreement immediately dropped from 38 per cent to 13.5 per cent. Japan's bilateral free-trade agreement with the EU covers around twice as much economic activity; an emerging Japanese deal with the US will be even larger in size.[30]

As the Association of Southeast Asian Nations (ASEAN) has exemplified in the shallow deals that it signs, regional agreements covering economies at substantially different stages of development tend to sink to a 'lowest common denominator' in terms of commitments to liberalization. Notwithstanding the fact that countries trade relatively more with neighbours than with more distant nations, assembling a critical mass of economic heft is more important than pursuing geographical contiguity. A plurilateral deal that covers the main economies in the world is preferable to a regional one that could carve up the global trading system into geographical blocs.

> Although European industry wants a tougher line on China, it is strongly against the EU cutting itself off from the rest of the world. Whether inside or outside the WTO, trading powers need to work within a web of alliances, not a series of fiercely opposed camps.

Whatever Trump thinks about repatriating supply chains, particularly in the technology sector, any solution to the economic governance problem that involved splitting the world into strategic spheres of influence – and dividing the global economy and trading system to match – would be economically highly damaging, and most likely unrealistic. The EU and Japan may have joined in the trilateral initiative, but separately they have established bilateral diplomatic channels with China to discuss reform of the global trading system. Although European industry wants a tougher line on China, it is strongly against the EU cutting itself off from the rest of the world.[31] Whether inside or outside the WTO, trading powers need to work within a web of alliances, not a series of fiercely opposed camps.[32]

Plurilateral talks among 'coalitions of the willing' under the aegis of the WTO are a more promising avenue for this kind of agile, even opportunistic, trade diplomacy. The WTO's Agreement on Government Procurement (GPA), which has 47 member countries, has functioned reasonably well since it was created in 1996. In January 2019, 76 WTO members launched plurilateral talks on e-commerce – potentially a tentative step towards bringing disciplines on data flows into the multilateral sphere. Any proposals on subsidies that emerge from the Japan–EU–US trilateral format should also be pursued through a WTO plurilateral process in the first instance.

[30] European Parliament (2018), *The EU – Japan Economic Partnership Agreement*, https://bruegel.org/wp-content/uploads/2018/10/EXPO_STU2018603880_EN.pdf (accessed 2 Oct. 2019).
[31] BDI (Federation of German Industries) (2019), *Partner and Systemic Competitor – How Do We Deal with China's State-Controlled Economy?*, BDI Policy Paper, https://e.issuu.com/embed.html#2902526/66954145 (accessed 17 Jun. 2019).
[32] Hu, W. and Pelmans, J. (2017), *China-EU Leadership in Globalisation: Ambition and capacity*, CEPS Policy Insights No. 2017/18, May 2017, https://www.ceps.eu/ceps-publications/china-eu-leadership-globalisation-ambition-and-capacity/ (accessed 24 Jul. 2019).

The advantage of this single-issue, small-group approach is that it is easier and quicker to get deals off the ground, as there are fewer WTO members to consult, and as trade-offs between different strands of a negotiation are not required. By allowing later entrants, the system also accommodates members whose economies and trade interests are still developing, and enables them to see the agreement in action before deciding to commit to accession.

The GPA is a 'closed' plurilateral agreement, where the benefits accrue only to members who have joined the deal and made their own commitments to open markets. But if enough of the big economies are on board to reduce free-riding, plurilaterals can also take an open form in which the benefits are extended on a most-favoured-nation (MFN) basis to all members of the WTO. An example is the Information Technology Agreement (ITA), launched in 1996 to reduce tariffs on high-tech products to nil, which now has 81 members covering about 97 per cent of trade in IT products. Because the zero tariffs apply on an MFN basis, the open plurilateral essentially functions as a means for individual countries to bind themselves into tariff commitments rather than gain market access.

For that reason, it is likely to be easier to sell closed plurilaterals to countries which must make significant commitments to liberalization to join them, in order to give their governments a sense of reciprocity. This means that a plurilateral that extends disciplines on industrial subsidies, such as the deal that the US–Japan–EU troika would like China to agree, will be a difficult task, since subsidies by their nature apply on an MFN basis. China will receive little in return, unless it makes progress with its own ideas to use such an agreement to introduce new disciplines on the advanced economies' agricultural subsidies. Still, there is little alternative if the rules on subsidies are to be extended.

Indeed, it is important to clarify what plurilaterals can and cannot do. They can operate more quickly and easily without a large mass of countries that have little direct interest in the subject being discussed, or, in the case of a closed plurilateral, whose resistance to liberalization is such that they would rather not participate. They can focus discussion on one particular subject, rather than negotiating several strands simultaneously. They can concentrate expertise both from within the governments concerned and from industry and campaign lobbies to enable a more informed discussion.

But increasing the ease of negotiation does not remove the need for governments to display political will. China, for example, has been negotiating accession to the GPA for more than a decade, but has always baulked at the commitments involved.

For plurilateral formats to gain widespread acceptance as the only realistic way forward, leaders need first to accept that the multilateral system is incapable of producing meaningful single agreements covering a full spectrum of issues. This realization is currently missing from the governments of several leading middle-income countries, whose acceptance, even if it falls short of enthusiastic engagement, will be necessary to make the system work.

India and South Africa, for example, have emerged as opponents to the plurilateral route inside the WTO, believing that it gives too much power to the larger members and hankering instead after the broad, multilateral 'single undertaking' of the Doha Round. India, in particular, is a large user of agricultural and other subsidies; no agreement extending rules on subsidies will be feasible without India's support and participation. Emerging markets need to accept that the old, multi-stranded, full-membership agreements are no longer realistic.

More generally, middle-income countries – including China – are repeating precisely the errors that led to the collapse of the Doha Round. Rather than fashioning themselves into a constructive bloc inside the system, they cling to the 'special and differential treatment' privileges that arise from being classed as developing countries in the WTO.

Certainly, middle-income countries can argue for new rules, for example on subsidies, to be crafted in a way that gives more policy space to economies in earlier stages of development. But for that they need to be engaged inside plurilaterals, not criticizing from the outside and hoping that the whole idea collapses. A pluralistic world cannot drag along unwilling emerging-market passengers. No amount of structural changes to the negotiation processes will remove the need for governments to summon up the political will to make hard decisions.

Global governance starts at home

For the big trading economies, one major obstacle to constructing these governing coalitions is resistance from domestic constituencies to the policies that need to be offered abroad. If China and the EU, for example, are to create a new bargain for WTO membership, they will need to overcome constraints on their own freedom to manoeuvre.

This is most obvious in China's case. Any attempt to write new WTO rules on subsidies and technology transfer will run straight into Xi Jinping's 'Made in China 2025' strategy to establish a leading position for China in a series of high-tech sectors. Beijing has a reasonable record of complying with WTO rulings. But its endlessly creative ways of intervening to subsidize certain industries, force the transfer of technology and otherwise exploit foreign companies operating in China are insufficiently constrained by the organization's current law.

More generally, for China to play a responsible role will involve the big wrench of no longer regarding itself as a developing country that can claim immunity from unwanted WTO disciplines. President Xi does not face an electorate, but his economic strategy involves both a nationalistic desire to develop a visible lead in cutting-edge industries and the imperative to create jobs beyond traditional manufacturing industries. Allowing global rules to impinge on that approach means taking risks with China's new development model.

For the EU's part, although it has worked hard to overcome some constraints from domestic public opinion, others remain. Like the US, the EU faced opposition to trade deals, particularly those with Canada and the US itself. In Europe's case, the objections were largely driven by perceptions of the excessive power of multinational companies and the threat to public services and public health, rather than by concerns about job losses and inequality. To pass the Comprehensive Economic and Trade Agreement (CETA) with Canada, and a subsequent bilateral agreement with Japan, the European Commission has undertaken apparently successful outreach work to improve the transparency of its processes and emphasize the compatibility of trade agreements with environmental protection and human rights.

But problems with domestic resistance to trade agreements remain. The EU's most obvious weakness is its inability to agree substantive rules guaranteeing the cross-border flow of data. The ability to send information easily between countries is an essential part of modern services industries – and, increasingly, of manufacturing supply chains – and the interoperability of data regimes is an important element of this.[33]

Over the past few years, a patchwork of data protection and privacy rules has emerged from bilateral and regional trade agreements,[34] reflecting clear differences in attitudes to privacy, particularly between the US and the EU.[35] The US-led TPP, for example, had relatively forceful provisions requiring signatories to prove a public policy requirement if they were to enact laws restricting the flow of data abroad. Even after the US pulled out of the TPP, those rules remained, largely at the behest of Japan.

In the EU, concerns about privacy, particularly in Germany and in the justice directorate of the European Commission, have prevented negotiators from offering anything but weak rules on data flows in their bilateral trade deals, despite the wishes of a coalition of smaller member states and the commission's trade directorate. The EU's model trade agreement provisions offer little constraint on trading partners that want to impose data localization requirements or other forms of digital protectionism.

The EU's opposition to robust provisions on data flows looks distinctly like an overabundance of caution, indeed a lack of courage, in the face of overly anxious public opinion.

When the Doha Round collapsed in 2008, the big trading economies shifted some of their effort towards the plurilateral Trade in Services Agreement (TiSA), which acquired 23 members. TiSA went into indefinite abeyance after Trump's election, reflecting his administration's general dislike of all broad international agreements. But even before then, the deal was in danger because of other members' frustration with the EU for its flat refusal to incorporate rules guaranteeing cross-border data flows. Similarly, the plurilateral e-commerce talks in the WTO that started in early 2019 will struggle to achieve anything but a shallow agreement if the EU continues to hold that position.

The EU's opposition to robust provisions on data flows looks distinctly like an overabundance of caution, indeed a lack of courage, in the face of overly anxious public opinion. After all, although the Japanese government believes in strong data flow provisions in trade deals, the EU has had no problem signing a bilateral adequacy agreement with Japan, acknowledging that Japan's data protection laws are sufficiently strong to permit the transfer of data between the two countries.

As in other areas of rule-setting, the EU believes that its sheer size as a trading partner means its own laws – in this case the General Data Protection Regulation (GDPR) – will automatically be adopted by other countries without the need for international agreements, a phenomenon known as the 'Brussels effect'. There is already some evidence that the European model of data protection and privacy is being thus exported. But if the EU wants to resurrect the multilateral trading and regulatory system, it should have serious conversations about efficient global governance rather

[33] Aronson, S. A. (2018), *Data Is Different: Why the World Needs a New Approach to Governing Cross-border Data Flows*, CIGI Paper No. 197, Centre for International Governance Innovation, https://www.cigionline.org/publications/data-different-why-world-needs-new-approach-governing-cross-border-data-flows (accessed 17 Jun. 2019).
[34] Wolfe, R. (2018), *Learning About Digital Trade: Privacy and E-Commerce in CETA and TPP,* Robert Schuman Centre for Advanced Studies Research Paper No. RSCAS 2018/27, http://dx.doi.org/10.2139/ssrn.3188158 (accessed 17 Jun. 2019).
[35] Ciuriak, D. (2018), *Digital Data: Is Data Treaty-Ready?*, CIGI Paper No. 162, Centre for International Governance Innovation, https://www.cigionline.org/sites/default/files/documents/Paper%20no.162web.pdf (accessed 17 Jun. 2019).

than simply hoping to disseminate sometimes sub-optimal rules by virtue of its sheer economic weight. Establishing dominance by default because of the size of one's consumer market is not the act of a leader in global economic governance.

What could China and the EU get in return for changing their domestic policies? China has already made one request, which is for a WTO investment facilitation agreement (like the trade facilitation agreement launched in 2017) to ease the process of businesses buying foreign companies or setting up their operations overseas. Now that China has become a big overseas investor thanks to its Belt and Road Initiative, it cares about such things. Realistically, however, this is likely to be a fairly minor contribution to the management of FDI.

Ultimately, China's main gain will simply be to keep the system going. The outcome of the current US–China confrontation will be important in establishing trade-offs between freedom of manoeuvre at home and access to the world economy. If Beijing thinks the pain it has suffered from US tariffs is worse than accepting some calibrated constraints on its industrial policy, it will be more willing to compromise in the WTO.

The EU, similarly, has an interest in keeping a rules-based system operative. Like the US, it also has complaints against China's trade-distorting behaviour. Unlike the US under Trump, the EU has little taste for direct bilateral trade conflict based on power relations, and would prefer to deal with such problems through the WTO. The struggle within the EU to allow data flows to be fully addressed in trade agreements is not over; it is possible that the sceptics might give way as the price of keeping multilateralism alive.

The new challenge of national security

The final question of how to set rules on trade and FDI – and all the new issues around globalization – is particularly tricky when these are bound up with issues of national security. Governments should try to delineate carefully where security arguments can be used. But realistically it is going to be very hard to have binding disciplines. A WTO dispute settlement panel striking down US tariffs or other actions on the grounds that it can judge better than the White House what will damage US national security will instantly blow up the system.

The related issue of national security considerations in respect of FDI is also probably better left to each country's judgment. The most that countries can do acting collectively is to create a set of global standards to which governments can aspire, more likely through an advisory and coordinating policy body such as the OECD than a set of binding disciplines in the WTO.

This seems an uncomfortably minimalist attitude to take in the face of an administration such as Trump's. The White House is using national security arguments in absurd contexts, such as in relation to car imports from Europe and Japan. Even in sectors where this does at least make some sense, such as communications and internet technology, national security rationales are being used disproportionately. Reassessing the role of Huawei equipment in 5G networks is a perfectly reasonable thing to do. Trying to drive the company out of supply chains worldwide through export blacklisting, especially given that its technology is so embedded in the basic functioning of 5G, is a hugely disproportionate response.

Unfortunately, this is an area in which tactical avoidance of a definitive choice between different spheres of influence is probably the only realistic course of action. European governments have so far shown a variety of calibrated responses to US pressure to exclude Huawei from their 5G networks: the European Commission has made non-binding suggestions about the best way to approach the matter, rather than trying to force an outcome. If the Trump administration succeeds in driving the company out of the sector altogether, so be it. Governments outside the US and China will have to make the best choice of technology and regulation possible, and use whatever limited diplomatic room they can find to try to mediate the dispute.

It is hard to see anything with a strong national security component directly being constrained by a particular set of rules. Governments will hopefully conclude that the benefits of the global system are sufficiently large that such measures need to be used sparingly. Any attempt to force those decisions is likely to backfire.

Designing a new system of trade governance is fiendishly difficult, not least because the old one was already beginning to break down. It only takes either the US or China to sabotage any attempts at creating another rules-based framework. The obvious solution of replacing one linchpin with another is not an option. New arrangements also need to recognize that many parts of modern cross-border commerce do not fit inside traditional legal frameworks, and that indeed attempting to constrain them is likely to create a backlash.

The new global economy will be far harder to regulate than the old one. Governments need to keep the existing institutions going when they can, and spread appropriate principles on international economic cooperation and coexistence by whatever means necessary when they cannot. A new consensus on trade and economic governance is clearly needed across a range of areas. But even if one emerges, it is highly unlikely to be underpinned by a single country embodying those principles and underwriting the system.

4. Conclusion

There is no doubt that the US's retreat from international economic governance has given the global trading system its biggest shock for decades, perhaps since the liberal order was constructed in the aftermath of the Second World War. There is also a danger, probably less immediate, that wayward policymaking in Washington means the US dollar will cease to underpin the international banking and trading systems.

Is it obvious that the world needs a new leader in both areas? If so, how could one emerge and operate? In monetary affairs, the need is not pressing and the path forward for potential rivals reasonably clear, if of uncertain length. Trade is much trickier. The old game of a dominant player enforcing consensus values in the trading system, which in any case never really delivered a truly global multilateral arrangement, is very likely gone. No future government is likely to take up that role again. The big powers need to be more flexible and imaginative. They need to replace a single anchor with a set of stays to hold the global system upright, make that system more flexible, and aim to cover new areas as well as possible rather than bring them under the same set of institutions.[36]

In the meantime, leading economies such as Japan, China and the EU need to find any way they can, however ad hoc and partial, to prevent the US from destroying institutions such as the WTO dispute settlement system. The important thing is not to preserve all organizations as they currently are. Indeed, the US assault on institutions such as the WTO has underlined their vulnerability and their need for renewal, which should include wider coverage for their rules and nimbler governance.

The task of leading economies – including of future, more cooperative US administrations – is to use creativity and coalition-building. The challenge is to carry forward the principles of rules-based trading without again relying on a single country to bear an outsized part of the burden of translating them into practical governance.

[36] Pisani-Ferry, J. (2018), 'Should we give up on global governance?', Bruegel, 23 October 2018, http://bruegel.org/2018/10/should-we-give-up-on-global-governance/ (accessed 17 Jun. 2019).

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Acknowledgments

The author would like to thank the staff at Chatham House who helped to conceive and supported this research paper, including Bernice Lee, Sarah Okoye and Roxanne Bildan. He would also like to express appreciation for attendees at a Chatham House seminar to discuss the paper, and in particular the formal reviewers, Jim Rollo and Alan Wheatley.

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Cover image: An employee counts money at a branch of the Industrial and Commercial Bank of China, Anhui Province, 26 July 2011.

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ISBN 978 1 78413 354 2

This publication is printed on FSC-certified paper.

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Typeset by Soapbox, www.soapbox.co.uk

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