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REINVIGORATING TRADE TO SUPPORT GROWTH: A PATH FORWARD[1]

Reinvigorating trade integration should be a key component of the global policy agenda to boost growth. Trade policy's new frontiers such as services, regulatory cooperation, and trade and investment complementarities carry high potential to bolster efficiency and productivity. But with governments differing on whether to continue the WTO Doha Round, there is an urgent need to identify a path for the global trading system in today's more complex trade policy landscape. A long interregnum without a path forward would risk fragmenting the global trade system and undermining its governance. Tackling trade policy issues important to the global economy may require flexible approaches to multilateral negotiations, including modalities such as plurilaterals. Enhanced coherence efforts are also needed to ensure that regional trade agreements and multilateralism coexist productively.

REINVIGORATING TRADE INTEGRATION: KEY PILLAR OF AN AGENDA TO BOOST GLOBAL GROWTH

Six years after the world economy emerged from a deep recession, a return to broad-based, robust global economic growth remains elusive. The global economy is becoming scarred from growth that has been too slow for too long, and concern is mounting that a sustained recovery – with the expected higher employment, higher living standards, and declining debt levels – may not be delivered. Getting the global economy back on track requires a more potent policy mix across macroeconomic and structural policies.

The long-term slowdown in trade has coincided with weaker productivity growth that is an important factor behind disappointing economic performance. While the trade slowdown has several recent factors, much of it represents a longer-term structural phenomenon: trade volumes grew at some 7 percent annually during the 1990s – more than double the rate of global GDP growth – but decelerated markedly as the ratio of trade growth to GDP growth fell to 1.5 during 2001-07 and to unity since 2008.

This has occurred while major trade policy reforms have matured and new initiatives lagged. Developing countries' unilateral reforms in the 1980s/90s and such initiatives as EU expansions, the conclusion of the Uruguay Round (1994) and creation of the WTO, and China's WTO accession (2001) strengthened the global trade policy landscape and promoted the growth of global value chains. The pace of new trade policy initiatives at the global level has slowed notably since 2001. At the same time, new trade restrictions imposed since the global financial crisis have begun to weigh on global trade.

[1] Prepared by the Staff of the International Monetary Fund. Does not necessarily reflect the views of the IMF Executive Board.

Regional trade agreements (RTAs) alone are not enough. RTAs that open trade and advance policy cooperation can be helpful when progress at the multilateral level is slow. But narrow country coverage and the discriminatory application of tariff reductions and other market access provisions limit the benefits. While the application of RTA provisions on a non-discriminatory basis (often with respect to services trade and regulatory cooperation) is welcome, the many different RTAs can develop diverging rules. With RTAs proliferating, this risks evolving into a two-pole system – with traditional trade matters overseen in the multilateral trading system (MTS) while regulatory and other "frontier" trade matters are negotiated outside it, in a system of bilateral and regional agreements that may lack coherence.

For over a decade there has been too little progress in multilateral negotiations but for some recent productive steps using alternative approaches. The Doha Round begun in 2001 and envisioned as a large-scale "single undertaking" has largely been stalled since 2008. In 2015, WTO members could not agree to continue the Round and many have expressed interest in looking for new approaches and addressing issues beyond the Doha mandate. It is important to work quickly to define a path forward, as a long interregnum without one risks undermining the MTS and reducing the benefits of other structural efforts to boost global growth. Those areas that have progressed have relied on alternative formats (see WTO, 2016) and offer a glimpse into the possibilities from alternative engagement modalities in a context where trade policy issues and challenges have become more complex.

- ***Multilateral agreement.*** The *Trade Facilitation Agreement* (2013) aims to enhance customs practices and will take effect when two-thirds of members complete their approval processes; it is binding on all WTO members, allows for multi-speed implementation by developing countries, and provides for implementation assistance.

- ***Plurilateral agreement.*** The revised *Agreement on Government Procurement* (GPA), which took effect in 2014, opened the procurement markets of its 45 members to suppliers from other GPA parties, but not necessarily to all WTO members.

- ***Critical mass agreement.*** The *expanded Information Technology Agreement* (2015) commits its 53 participants (accounting for 90 percent of world trade in the covered products) to eliminate all tariffs (i.e., on an "MFN" basis) on a further 201 products. It did not, however, move to a 'negative list' agreement, requiring continued updates.

- ***Ministerial decision.*** Members agreed to eliminate farm export subsidies (2015).

A PATH FORWARD: KEY ISSUES

Trade policy's new frontier areas carry especially high potential to bolster efficiency and productivity gains and increase medium-term growth. While traditional issues such as industrial tariffs and agriculture remain important for many countries, including through further unilateral reforms, several "new" areas could bring dynamic gains through such channels as greater investment, technology transfer, and integration into GVCs. These new trade areas, which often complement and

augment other structural reform efforts, cover reduction of trade costs associated with NTBs, including regulatory cooperation; exploiting complementarities between investment and trade, including by common minimum standards for protecting physical and intellectual investment; and promoting competition practices, including a commercial orientation in government activities (SOE, procurement). Such actions would be key for the increasingly important role of services and new production modalities in economic activity (in the new and old economy; in AEs and EMs) and in trade (directly and embedded in goods).

A. Lowering Trade Costs in the New Global Economy: Regulatory Cooperation

The large trade frictions resulting from regulatory diversity have led negotiators to begin to bring regulatory cooperation matters into trade agreements. WTO rules contain meaningful provisions, but regional agreements have evolved further to include mechanisms to promote active regulatory cooperation. There is scope to improve these provisions and to bring them into the multilateral system to be applied more broadly on a multilateral or plurilateral basis.

While regulatory cooperation often does not depend on "reciprocity," it can be difficult to achieve because it involves multiple domestic agencies, procedures rooted in domestic legal systems, and legitimate differences in domestic policy priorities. As such, provisions in trade agreements can range

from dialogue and transparency provisions to recognizing the equivalency of others' regulatory processes, such as in mutual recognition agreements (Mavroidis, 2016). Global priorities could include: (i) strengthened transparency of national regulatory mechanisms, (ii) involving affected parties early in the regulatory process and using that input to fine-tune regulation, (iii) encouraging countries to use international standards and justify deviations from them, and (iv) building capacity among LIDCs to meet standards in their potential export markets and to participate in standard-setting.

B. Complementarities between Investment and Trade

Sales by FDI affiliates are roughly equal to recorded exports of goods and services, indicating the importance of FDI in international commerce. With the rise of global value chains (GVCs), trade and investment decisions are increasingly complements, rather than substitutes. Policy barriers still obstruct much FDI and its governance is fragmented with over 3000 bilateral investment treaties (BITs) and other international investment agreements without a common template. This results in a confusing landscape for investors and governments (Gonzalez, 2013). The WTO General Agreement on Trade in Services (GATS) has important, if incomplete, obligations pertaining to some investments in services.

A universal approach to international investment would go far in setting holistic rules critical in a GVC world. Although a global deal was elusive in the past, there is room for agreement now that the north-south divide on investment seems to have narrowed. An agreement could establish core standards for investor protection, provide for non-discriminatory treatment of established foreign investments, and establish a framework under which governments can commit to opening to new investments. The dispute settlement and other unique institutional features of the WTO could provide the best foundation for such an agreement.

C. Unleashing Services, New Production Modalities and Digital Trade

Policy has lagged far behind the evolution of services in the global economy. Services comprise some two thirds of global GDP and employment, and a quarter of global trade (nearly half of global trade measured on a value-added basis). Innovation in e-commerce and other services has helped to reshape the trade landscape and spurred the development of GVCs. The policy barriers to services trade remain large, however, and reforms have tremendous potential to promote global trade and growth. The low level of attention to services issues throughout much of the Doha Round has encouraged negotiations outside the MTS, including ongoing work by 52 countries (accounting for 70 percent of world trade) toward a Trade in Services Agreements (TiSA); nonetheless, advances through regional agreements have been uneven.

Governments should set a high-ambition agenda. Elements could include:

- Deepen and expand specific commitments under the WTO General Agreement on Trade in Services (GATS), including by transitioning to a "negative list" approach.

- Address gaps between GATS commitments and actual policy with standstill and "roll back" provisions (as in many regional agreements) to discourage policy reversals.

- Clarify the application of existing GATS commitments to *cross-border data flows*. Develop provisions to discourage local data storage requirements, while recognizing legitimate public interests such as privacy and financial regulation.

- Raise *de minimis* customs levels (below which import duties are waived), facilitating cross-border flows of small packages often supplied by internet-enabled retailers.

- Strengthen cooperation in managing the entry and stay of natural persons for the purpose of supplying a service (Low, 2016).

Some elements may at first be more conducive to "best endeavors" than binding "hard" law.

D. Challenges and Opportunities

The global trading system can also play an important role in promoting other international economic priorities, including development and climate policy.

Lower barriers to trade integration for low income developing countries (LIDCs)

The fragmentation of production internationally offers major new opportunities for *low-income developing countries* (LIDCs). To exploit these opportunities they require stable macroeconomic policies and a strong business environment, including policies that promote access to inputs and trade-related services (e.g., transport) at competitive prices. Other countries can help by promoting a rules-based, open, and equitable MTS and through targeted capacity building to support LIDCs in implementing trade-related reforms that encourage investment and integration into GVCs. Among the actions that can help:

- Bring into effect the Trade Facilitation Agreement and follow through on commitments to assist the poorer countries as they implement its commitments.

- Further open markets for goods and services of particular interest to LIDCs.

- In trade preference schemes for poor countries, promote trade among beneficiary countries by extending the rules of origin "cumulation" provisions, allowing poor countries to use more imported inputs while remaining preference eligible.

- As in the TFA, link LIDC implementation of future WTO agreements to capacity and create mechanisms for other countries to provide related capacity building.

Trade/Climate interface

Policies to address climate change can have significant implications for trade, particularly if not tackled multilaterally. Many observers have highlighted existing ambiguities in WTO rules relevant to climate policies, such as the allocation of emissions trading permits or the use of border tax adjustments as part of a domestic carbon pricing mechanism. This legal uncertainty and operational challenges may discourage legitimate climate policies, and may also leave the system vulnerable to protectionist policies dressed up as climate policy. Addressing these concerns is important both to climate policy and to the trading system. Moreover, trade rules may be able to promote well-designed climate mitigation policy. For example, one suggestion put forward would require the notification to the WTO of fossil fuel subsidies, together with provisions to discipline and to progressively reduce the subsidies (Bacchus, 2016). (This would parallel in some ways the approach taken in the WTO regarding domestic agricultural subsidies.).

A PATH FORWARD: FLEXIBLE NEGOTIATING ARCHITECTURE FOR THE MULTILATERAL SYSTEM

A path forward needs to heed the hard lessons of nearly 15 years of Doha negotiations and to recognize today's increasingly complex trade policy landscape. As trade agreements enter new and more diverse areas, the negotiating field has expanded significantly. Moreover, given that the center of gravity in the global trading system has moved towards RTAs over the last two decades, an important issue for a path forward is how to integrate into the multilateral system key aspects from recent and ongoing RTAs.

Tackling trade policy issues important to the global economy would require flexible approaches to the multilateral negotiations. The WTO's institutional and legal framework and near-global membership carry benefits that cannot be replicated in RTAs. However, the experience of the Doha Round suggests that it may be worthwhile to explore alternatives to large-scale "single undertaking" endeavors. When founded, the WTO was envisaged as facilitating a constant flow of agreements of all kinds (Bacchus, 2011); indeed, recent achievements effectively matched trade issues and negotiation structures (WTO, 2016). Even if some WTO members choose not to participate in certain agreements – as was the case with some agreements reached earlier in the history of the MTS – the non-participants will often be better off with the agreement inside, rather than outside, the WTO.

Negotiating formats can vary in several ways. Aspects include participation (universal or not), whether benefits are extended to non-participating WTO members, and the degree of commitment (e.g., whether legally binding and enforceable through dispute settlement) (Hoekman and Mavroidis, 2015). Agreements under one format may later take on another; for example, while only part of the membership accepted an agreement on customs valuation in the 1970s (during the "Tokyo Round"), that agreement was later accepted by all WTO members upon the conclusion of the Uruguay Round. Within the flexible negotiating architecture, it is important that agreements attract a broad range of

members (such as those at different income levels) even when they cannot necessarily attract each WTO member.

Plurilateral agreements may be the most practical approach to some issues, but face obstacles. Plurilateral agreements (PAs) – reached inside the WTO by a subset of WTO members – are often superior to FTAs done outside the WTO: PAs are more transparent, have legal and institutional links to the WTO, and provide a clear path for expanded membership and possibly evolution to a full multilateral agreement. Depending on the topics addressed in a PA and whether its benefits are limited to participating countries (rather than being available to all WTO members), the initial approval of a PA may require consensus of all WTO members. This consensus requirement can be used to ensure that a proposed PA is beneficial to the overall trading system; however, individual non-participants could also seek to leverage the consensus requirement to gain a negotiating advantage on some other – perhaps unrelated – topic. Hoekman and Mavroidis (2013) argue that outsiders' support may be achieved through clear ex-ante rules for subsequent accession and by ensuring that they protect the interests of small and poor countries. Nonetheless, there is a risk that the consensus requirement is misused in a way that obstructs progress in the WTO, and they see that a change in the consensus rule, or perhaps rules governing its use, may ultimately be necessary. Ongoing negotiations on a Trade in Services Agreement (TiSA) would be a prime opportunity to demonstrate how such negotiations and agreements could be brought into the WTO and to start catalyzing a way forward for the MTS.

A PATH FORWARD: ENSURING COHERENCE IN A COMPLEX TRADE POLICY WORLD

A long period without a path forward for the MTS would risk continued proliferation of RTAs, fragmenting the global trade system and undermining its governance. Bringing past trade deals inside the WTO would help to increase transparency and coherence, and underpin the WTO's role at the center of the global trading system.

Strengthening the global trading system is important to global prosperity. More vigorous trade integration should be a key part of the global policy agenda. Regional agreements can bring substantial benefits and help to expand trade policy frontiers, but are not enough on their own. Governments should avoid a protracted interregnum at the WTO and move quickly to establish a way forward for the multilateral negotiating agenda; that agenda should seek to resolve key longstanding issues while addressing other issues important to the global economy. They will also need to draw on the hard lessons of the Doha Round, including with respect to how issues are packaged and sequenced.

Given the present landscape of trade agreements, the productive coexistence of RTAs and multilateralism requires coherence. The rapid growth of RTAs, amid limited multilateral achievements, has altered their relative importance in the global trading system in ways not anticipated when the WTO was established. Within this increasingly complex system the potential for incoherence is real.

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