

Realist and Internationalist Perspectives of WTO Reform Challenges From the US-China Trade War and Broader Questioning of the International Trade System

Shuo Tan^{1†} and Yanchen Wu^{2}**

¹*Boston College, 140 Commonwealth Avenue, Chestnut Hill, MA 02467*

²*Jackson School of International Studies, University of Washington, Seattle 98195, United States*

**Corresponding author. Email: Yanchw2@uw.edu*

†These authors contributed equally to this work

Abstract: During its twenty years, WTO's longstanding commitment to forming the multilateral international trade freedom shaped the rule and system among its hundreds of members. The trading world has been a seamless façade, covering the increasingly revolutionary change of a new, emerging order. The conundrum of WTO reform has been a consequence of global economic imbalance and political conflicts. Two representatives of the world's extreme ideologies once again compete against each other for decades without effective resolution. WTO needs self-reform, not only for its own international jurisdiction and jurisprudence, but more of the collaboration from a settled international economic and free trade community. We will discuss the relevant elements from two different perspectives from institutionalism and realism.

Keywords: US-China trade war, WTO reform, international trade order, institutionalism, realism

1. Introduction

As the products of victory from WWI and WWII, General Agreement on Tariff and Trades (GATT) and World Trade Organization (WTO) have proved reliable, effective, and overall successful in projecting the missions and visions of the winning country members to reshape and adjust to the global trade regime in different times. Since the creation of the multilateral trading system in 1947, the world has witnessed the unprecedented success of WTO's effectiveness in settling the economic and trade disputes among its members and functioning as the leading force in the international economic order shaping.

Over the fifty years of the GATT regime, from whom WTO inherited its substantive trade rules and the most favored nation clause, all signatories would benefit from the low tariffs and other rules concluded at successive rounds of negotiations. WTO continued its jurisdictional effectiveness in maintaining substantive trade equality and the establishment of dispute settlements for its 164 members, including the world's largest traders like China, the US, and the European Union. The WTO has three widely acknowledged functions: policy implementation and supervision, international trade negotiation forum, and dispute settlement panels. Notably, the dispute settlement system is referred to as the "crown

jewel" of the WTO because rule-based arbitration fundamentally consolidates member states' confidence in preserving equal trade relations.

However, in recent years, the WTO regime has become increasingly unstable as some powerful member states continuously express discontent with WTO, including its Appellate Body. Individually, the jurisdiction system of WTO has been challenged as early as 2016 when the Office of United States Trade Representative (USTR) blocked the reappointment of South Korean member Seung Wha Chang under the Obama Administration [1]. Since 2018, the Appellate Body has operated with its minimum quorum of three representative members. In the following years, despite the efforts from WTO General Council initiatives to reform the organization's consensus, the United States has rejected various reform proposals, same as many other countries [1].

Moreover, while the People's Republic of China has been advancing its economic surplus in international trade, this emerging power adopts a more active role in international organizations. A crucial way China imposes challenges to the WTO has to do with Chinese state-owned enterprises (SOEs). While China employs a magnificent pool of SOEs, they become increasingly competitive in the global market thanks to the expanding state power. However, the growing influence of Chinese SOEs raises a considerable problem that these enterprises have blurred the lines between the actions of state and private entities, which, in turn, significantly challenges the existing WTO trade regime [2].

Based on the evolution from GATT to WTO and the power change of the international order expedited by the technological advancement over the past decade, the sabotage of the WTO jurisdiction system in reflection of the ongoing China-US trade war, and the growing inquiry of an effective international trade dispute settlement body, WTO and its experts have been demanded a thorough self-analysis from its previous records of triumph to revolutionize a path for its new future. In the next pages, the authors will first present a set of causes of WTO contemporary changes. Then, this paper will offer two different perspectives of WTO reform pathways based on the realist and internationalist views. It should be noted that the two authors do not engage in a debate. Rather, they welcome the other's view since both arguments make sense based on different assumptions. Yet, no one has a decisive answer of which assumption will triumph, just as no one is capable of defining the future. In short, this paper serves as an inspiration for two possible ways of the WTO in the following decades.

2. Causes of WTO Change

2.1. Frontal Role of the US in the Crisis

The United States in crisis [3] has been in the frontal role of causing WTO to reform its dispute settlement and relevant judicial system accordingly, including mechanism and solutions on how to decrease the negative impact of "judicial activism" of WTO's role in dispute settlement as the supposed adjudicator, how to utilize and interpret the appeals tribunal's decisions and advice under the scope of WTO agreement(s) in maximization of each member's economic benefits rather than severing unnecessary political conflicts, how to weigh between Appellate Body (AB)'s persuasive values and other Dispute Settlement System (DSS)'s binding values consistently effectively [1].

2.2. Concerns about Judicial Activism by the Appellate Body

WTO does not belong or is not managed by any specific country. Its governance and especially jurisdiction system are functioning based on negotiations and common understandings among its member countries. In another word, the juridical power of achieving its binding rules, agreements, and principles

is the exemplification of all member countries' ratification based on volunteerism and positivism, traditionally and passively.

However, according to the USTR's 2019 Trade Policy Agenda and 2018 Annual Report, the US has cited several concerns with the Appellate Body to justify the withholding of approval of judges. Among those concerns, the appeals tribunal exceeded its mandate while interpreting the WTO agreements. Therefore, "adding to or diminishing rights or obligations under the WTO Agreement(s)" took place without the WTO members' consent, especially on topics about subsidies, trade remedies, and technical product standards [1].

On the other hand, the USTR held the opinion that the "judicial activism" constrains US's ability to protect itself against unfair commerce. Also, the USTR referred to Article 3.2 of the DSU, arguing that "recommendations or rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements." However, the DSU objected to this opinion that the dispute settlement mechanism may clarify provisions of those agreements in line with customary rules of interpreting public international law. When adjudicators bring more complexity to agreement and rules, the US worried that the Appellate Body de facto created novel obligations out of the formal interpretation or amendment processes in the WTO agreements [1].

2.3. Chinese SOE-Related Challenges

By definition, a certain state possesses ownership in its State-owned enterprises (SOEs). Though this claim seems to be a tautology, what "ownership" consists in is still under heavy debate. The struggle in conceptualizing SOE contributed to Chinese SOE-related challenges in the WTO, and this paper will address this later. Now, SOEs have many advantages in the global economy, including but not limited to the ease of receiving access to favorable government support and greater access to a large and stable customer base [4]. In particular, Chinese SOEs are controlled by the central party-g

overnment through the State-Owned Assets Supervision and Administration Commission (SASAC). While China employs a magnificent pool of SOEs, they become increasingly competitive in the global market thanks to the expanding state power. However, the growing influence of Chinese SOEs raises the considerable problem that these enterprises have blurred the lines between the actions of state and private entities, which, in turn, significantly challenges the existing WTO trade regime [2].

Despite the definition of the SOEs, the determination of SOEs (whether it constitutes a "public body" or a private one) proves controversial in current WTO rules, leaving "unsatisfactory" litigation outcomes remarkably likely. For instance, the WTO adopts strict censorship on "government or public body's" subsidies to exporting firms. In other words, once a firm purchases intermediate products or raw materials from an SOE, the firm will be qualified as accepting government subsidy and thus be subject to WTO censorship [5]. The most challenging situation occurred in the 2008-2012 case between the US and the PRC (DS379). On the one hand, the US Commerce Department argued that a set of Chinese SOEs constituted "public bodies" because of the Chinese government owned a share in these SOEs. Thus, in the US's view, it violated the WTO rules when providing a subsidiary package to exports. On the other hand, interestingly, the Appellate Body made decisions more favorable to China compared to the US. The Appellate Body interpreted that "government owning a share" cannot solely determine an entity to be a "public body." Rather, to be a "public body," the entity must exercise "governmental authority" (and indeed, Chinese SOEs in question did not) [5].

Worse, by further interpreting the rules of "public body," the Appellate Body, in fact, complicated the situation and sowed the seed for later dispute around the SOEs. For instance, it admitted that if the

government implemented "meaningful control" over the SOEs, the SOEs in question would be, to some degree, exercising governmental authority. Yet, the words and phrases like "meaningful control" and "to some degree" are substantially controversial and vague [5]. Though the US Department of Commerce expressed discontent about the result afterward, the influence of such vague interpretation went on. Notably, since the SOE-related study in this paper means to encounter Chinese SOE's issues in the WTO system, problems regarding SOEs in other countries are beyond the scope of this paper.

2.4. Problems with Precedents

The Appellate Body's treating the previous report as precedent came to recent years. The US observed and found it problematic following or obeying some precedents created from Appellate Body's dispute settlement. Because, on many levels, AB's persuasive value is not as consistently effective as other Dispute Settlement System (DSS) "binding" values. Unlike other sort of disputes in international law, previous reports by the Appellate Body cannot stand as binding precedents on subsequent cases. For these reports, once the Appellate Body thinks that the reasoning in them is persuasive in a present case, the AB will add it to the DSS. This approach aimed at advancing the predictability and security of the multilateral trading system under Article 3.2 of the DSU. Moreover, in *US-Stainless Steel (Mexico)*, the AB said that the reports were only binding on the parties between whom the particular dispute was to be resolved. Nevertheless, this decision did not translate to legal interpretations under the DSB. Analysis was only relevant for similar cases. Consequently, the entire process failed to establish any legal obligation for the DSS to cite that interpretation [3].

As the aforementioned litigation outcome in DS379 came across several subsequent cases, which drew prior case law into conflict, the Trump administration of the United States announced condemnation against the WTO Appellate Body [6]. Moreover, the US's discontent with the dispute settlement mechanism has led it to block the appointment of new members to the Appellate Body, bringing dispute resolution to a halt [2]. Among six grievances issued by the Trump administration that covered a range of US concerns, "the treatment of Appellate Body reports as precedent" proves to be a look-back on the DS379. Simply put, the US's perception that WTO agreements were inadequate has led the country to take unilateral measures in addressing perceived competitive distortions [7]. In retrospect, the challenges facing the WTO are not merely in a set of controversial cases but, more importantly, in the foundation of WTO's "crown jewel:" the dispute settlement system.

Existing reform efforts are targeting the US's concern, but the effect is foreseeably palliative. The EU's role was critical in pushing forward the strengthening and safeguarding of WTO's dispute settlement function and 11 other WTO members, including Canada and China. In the EU's proposal related to the Appellate Body, the passage "The Appellate Body should address only the issues necessary for the resolution of each specific dispute" was drafted in direct response to the US's concern [8]. Linking back to the previous Chinese SOE case, this passage aims to prevent the Appellate Body from interpreting the rule beyond the need for deciding the specific case, leaving less possibility for controversial or vague precedents as aforementioned. However, such efforts are only limited to resolving upfront problems technically. That said, a permanent solution to the crisis facing the WTO dispute settlement system will require a balancing between substantive multilateral concerns.

In respect to the tradition and consistency of the jurisdiction, rules and decisions from the previous judges would automatically become a guideline, though not binding on the legislature, that can pass laws to overrule unpopular court decisions involving similar disputes [9]. The increasingly fast economic and technological growth and changing speed of any global rising power can easily outgrow the limits and

regulations from an existing economic order if there is no updated triage accordingly, needless to mention the order is as vulnerable and interchangeable as it has never been. A more effective dispute settlement mechanism is summoned by the member countries' goodwill, common interests, and, most importantly, a new rising global order.

3. Hypothesis and Impacts of WTO Reform - Realism and Internationalist Perspectives

After the US intended to cripple and retract from the dispute settlement system of WTO, the trilateral working group, established in late 2017, aimed to lead WTO reform and initiate non-market-oriented policies and practices of third countries in accordance with the spirit of the July 2018 Rose Garden Deal. However, even several positive meetings were held in the past two years, the working group has been in a stagnant situation [10].

Neither has the paralyzed AB or the China-US trade war nor even COVID has stopped the global trade among countries. Each member country has its political and economic allies and confidants to initiate new regional cooperation and association, but none of the experiential attempts have achieved meaningful results.

EU, United States, China, and Japan are the four largest trading members in [11], who are entitled to contribute to forming an effective, reformed WTO dispute settlement system and maintaining a stable economic order if they'd like to remain to benefit from the complicated, challenging international trade order.

In a summary by Anvar Rahmetov of Prof. Manfred Elsig's speech at the 3 April Trade Lecture Sessions at the WTO, organized by the Embassy of Israel in Switzerland, three grand schools of political science theories have served as the foundation for the future of WTO reformation guidelines and plausible principles, realism, liberalism, and social constructionism [12]. This research tends to present the two main approaches from the perspectives of realism and a "revised version" of liberal internationalism to hypothesize the reform of WTO and its DSS.

3.1. A Realist View - WTO Reform Needs Leading Powers

WTO Reform needs leading powers. Realism puts power and power relations at the center of its analytical narratives. The main characters from the US-China trade war over the past decade have proved that the new global order has been challenged by the rising powers like China, and the western-central economic and political orders cannot keep maintaining their current model. WTO released that the US contributes almost CHF 12.6 million to Doha Development Agenda Global Trust Fund ("DDAGTF"). The US has had an annual contribution of over 11% to the WTO Secretariat budget for the past five years at least, while China contributes over 9%, followed by EU countries and Japan [13].

Financial sustainability is an important survival element for an organization. With the donations and contributions coming from different ends of the negotiation table, the power represented by each country or entity would practically influence the result and success of negotiations. Meanwhile, global power is not only composed of financial or monetary quantity but also mixed with grand political connections and social complexities in the global community. A new, rising power like China disrupts the historic order with its unexpectedly developmental speed and its substantively physical volume, which has become an unavoidable part of WTO reform if they would both like to benefit from each other's existence and if WTO and its reformation would like to gain from its primary components' supports.

WTO reform and its sustainability need large members like the US, China, UK, EU, and other important member contributors to find a new, common ground rule to set aside and channel with each

other on their disputes and disagreements after the increased tariff and conflicts reach to its summit. New legal and judicial elements and its functional system will find the opportunities from which to resume and reshape following the reconstructed international order.

3.2. An Internationalist View - China and a Negotiated WTO Reform

The WTO reform will have to address a balance between the concerns of China, the US, and other member states. In essence, throughout the disagreement regarding the dispute settlement panels and Appellate Body, the interpretation of "public body" in the WTO tackles a more fundamental question of whether the WTO system can handle the state capitalism of China [14]. Thus, simply focusing on getting the Appellate Body functioning again misses the point of reforming the dispute settlement system. Instead, the center of the crisis is a breakdown in the negotiation or rule-making function of the WTO [8]. Only speaking of it is simple. In practice, critical proposed changes might add incoherence to existing WTO rules and make the organization institutionally unstable [15].

Notably, though Chinese SOEs are challenging the WTO's fundamental rules, the struggle over international trade is not about fundamental principles. As Ikenberry argues, China and other emerging great powers do not want to contest the basic principles of the liberal international order but rather wish to gain more authority and leadership within it. China's significant trade surplus and booming economy are inextricably linked to the market size and effectiveness provided by the WTO rules-based system in international trade. In a liberal internationalist view, the effort of the rule-based trading system is to construct an open world economy and reconcile it with social welfare and employment stability, which necessarily requires the nation's stability and economic security [16]. And this provides an answer for the SOE-related dilemmas. For China, the SOEs stand as pillars in its state capitalist economy, on which China's national economic security and stability are built. However, the dispute proves extremely troublesome when the SOEs pursue prosperity in the international market but also bring about rivalry with other powerful states' interests. In this situation, China cannot forgo either national economic security or openness to international trade to solve the other side of the problem. Therefore, letting China fully conform with the existing rules and China's ceasing from the rule-based system are both unlikely.

Still, it remains an open question whether China, among other states, will address more fundamental concerns in the WTO and reform it accordingly or chose to have a less but still functioning cooperative order. Nevertheless, it is almost certain that both China and the US have incentives to preserve cooperation and be open to new opportunities since the rule-based system can still bring significant potential benefits. Although how exactly the cooperation should proceed is beyond this paper's scope, it acknowledges that the WTO's crisis is far from an end of liberal internationalist trade relations.

4. Conclusion

This paper introduced a set of issues facing the modern WTO trade system: frontal role of the US in the crisis, concerns about judicial activism by the Appellate Body, Chinese SOE-related challenges, and problems with precedents. All these factors contributed to the fact that the WTO regime has become increasingly unstable and needs to change. The authors have presented two main approaches from the perspectives of realism and a "revised version" of liberal internationalism to hypothesize the reform of WTO and its DSS.

In a realist view, WTO reform and its sustainability need prominent members like the US, China, UK, EU, and other essential member contributors to find a new, common ground rule to set aside and channel with each other on their disputes and disagreements after the increased tariff and conflicts reach to its

summit. New legal and judicial elements and its functional system will find opportunities to resume and reshape following a reconstructed international order.

On the other hand, the internationalist view remains an open question whether China, among other states, will address more fundamental concerns in the WTO and reform it accordingly, or choose to have a less but still functioning cooperative order. Nevertheless, it is almost certain that China and the US have incentives to preserve cooperation and be open to new opportunities since the rule-based system can still bring significant potential benefits.

Although exactly how the cooperation should proceed is a question reserved for history, it's acknowledged that the WTO's crisis is far from ending liberal internationalist trade relations. Instead of being restricted within the singularity of directions of national development, the two authors welcome and are open to the opposite stances when it comes to the discussion of a new international, multilateral development strategy including all possibilities. In short, this paper serves as an inspiration for two possible implications of the WTO in the upcoming decades. It should be a more promising time for an open roadmap that delegates the multilateral routes for each member's economic future, forcefully and collaboratively.

References

- [1] Murrill, B. J., (2019). *The WTO's Appellate Body Loses Its Quorum: Is This the Beginning of the End for the "Rules-Based Trading System"?* <https://crsreports.congress.gov/product/pdf/LSB/LSB10385>.
- [2] Teslik, A., (2021). *Is the WTO the Worst of Both Worlds for U.S.-China Tech Competition?* www.lawfareblog.com/wto-worst-both-worlds-us-china-tech-competition.
- [3] Rathore, A., and Bajpai, A., (2020). *The WTO Appellate Body Crisis: How We Got Here and What Lies Ahead?* <https://www.jurist.org/commentary/2020/04/rathore-bajpai-wto-appellate-body-crisis/>.
- [4] Pimentel, F., (2020). *Advantages and Disadvantages of Selling to Chinese State-Owned....* kahnlitwin.com/blogs/tax-blog/advantages-and-disadvantages-of-selling-to-chinese-state-owned-enterprises.
- [5] Xu, C, and Gu, B., (2016). *A Review of State-Owned Enterprises from WTO Law Perspective*. *Journal of Shanghai University of International Business and Economics*, 2016,23(03): 5-22.
- [6] Mavroidis, P. C., and Sapir, A., (2021) *China and the WTO: An Uneasy Relationship*. voxeu.org/article/china-and-wto-uneasy-relationship.
- [7] Hoekman, B, and Mavroidis, P. C., (2021) *WTO Reform: Back to the Past to Build for the Future*. *Global Policy*, vol. 12, no. S3, p. 10.
- [8] Schneider-Petsinger, M., (2020) *Reforming the World Trade Organization*. www.chathamhouse.org/2020/09/reforming-world-trade-organization/04-dispute-settlement-crisis.
- [9] Richards, E., (2009) *The Importance of Precedent*. <https://biotech.law.lsu.edu/map/TheImportanceofPrecedent.html>
- [10] Kasperek, M., (2020) *What happened to transatlantic cooperation on WTO reform?* <https://www.atlanticcouncil.org/blogs/new-atlanticist/what-happened-to-transatlantic-cooperation-on-wto-reform/>.
- [11] Wolff, A. WM., (2020) *WTO reform is both necessary and feasible*. https://www.wto.org/english/news_e/news20_e/ddgaw_24nov20_e.htm.
- [12] Rahmetov, A., (2019) *Is WTO reform feasible? Lessons from political science research*. <https://www.wti.org/institute/news/589/is-wto-reform-feasible-lessons-from-political-science-research/>.
- [13] WTO., (2021) *WTO Secretariat budget for 2021*. https://www.wto.org/english/thewto_e/secret_e/budget_e.htm.
- [14] Ahn, D., (2021) *Why Reform Is Needed: WTO 'Public Body' Jurisprudence*. *Global Policy*, vol. 12, no. S3, 2021, p. 61.
- [15] Howse, R., (2020) *Making the WTO (Not So) Great Again: The Case Against Responding to the Trump Trade Agenda Through Reform of WTO Rules on Subsidies and State Enterprises*. *Journal of International Economic Law*, vol. 23, no. 2, 2020, p. 371.
- [16] Ikenberry, J., (2011) *The Future of the Liberal World Order: Internationalism After America*. www.foreignaffairs.com/articles/2011-05-01/future-liberal-world-order.