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Rules-based Global Governance at Risk: Challenges of US Unilateralism and US-China Superpower Competition

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Rules-based global economic governance is at unprecedented risk due to the US's departure from multilateralism and global cooperation, its unilateral use of higher tariffs as threats to gain concessions from its trading partners, and its intensifying competition with China in pursuit of economic and technological supremacy. The US has unilaterally raised tariffs on imports of steel and aluminum and threatens to do the same on imports of automobiles for "national security" reasons. The US has also raised tariffs on imports from China in three steps for reasons of China's "unfair trade practices" such as the infringement of intellectual property rights (IPR). Through these measures the Trump Administration believes that it can correct the behavior of its trade partners, particularly China, the EU, Japan and Mexico, so as to reduce its bilateral trade deficits with them.

While criticizing China's "unfair trade practices," the US also perceives China as challenging the US's global dominance in the economic, technology and military arenas and is determined to deter China's ambition. The US-China bilateral talks that started in December 2018 may well result in some short-run resolution of conflict by China's promise to expand its imports from the US, strengthen IPR protection and address some of its policies deemed as trade-distorting by the US. However, bilateral competition for high-tech supremacy will not be resolved in the short run and will likely be a lingering issue for a long time to come.

The policy brief suggests that to restore global economic governance based on rules and norms, (1) the US must return to multilateralism and global cooperation, (2) China must transform itself into a truly market-oriented economy and society, (3) the two countries must resolve and manage the bilateral conflict, and (4) the internaiotnal community must substantially overhaul the World Trade Organization (WTO) so that it regains its central place as a global overseer of international trade and trade-related rules. It is essential to make the positive outcomes of the US-China bilateral talks (such as China's market-opening measures, IPR reform, and reduction of industrial subsidies) available to third countries by embedding them into the WTO's new disciplines.

Challenge

Global economic governance led by multilateral cooperation is facing a significant risk of collapse due to the US's departure from multilateralism and global cooperation, its unilateral use of higher tariffs as threats to gain concessions from its trading partners, and its intensifying competition with China in pursuit of economic and technological supremacy. This is particularly the case with the WTO, which served well for the growth and stability of the world economy in the post-World War II period, but is now facing the challenge of transformation to remain effective and relevant.

A central feature of the recent global economic landscape is the rapid rise of China and other emerging and developing economies, which has been made possible by the very success of the liberal international economic order led by the US and other G7 countries. In addition to their large populations, economic sizes and financial powers, their political influences and technological capabilities have also grown. In contrast the relative importance of the US and other G7 economies in the world has declined, particularly their manufacturing industries.

With the declining share of manufacturing production and employment in the US and its rising trade deficits vis-à-vis the rest of the world, the Trump Administration has unilaterally raised tariffs on imports of steel and aluminum and threatens to do the same on imports of automobiles for "national security" reasons. The US has also raised tariffs on imports from China in three steps for reasons of China's "unfair trade practices" such as the infringement of intellectual property rights (IPR). Through these measures the Trump Administration believes that it can correct the behavior of its trade partners, particularly China, the EU, Japan and Mexico, so as to reduce its bilateral trade deficits with them.

The rapid growth of China's high-tech industries has begun to threaten the US's global dominance in the economic, technological and military arenas. The Trump Administration identifies China as one of the "revisionist powers" that are challenging US interests, along with Russia, and as the US's "strategic competitor" that is attempting to displace it as the next hegemonic power in Asia and eventually in the world. Washington seems determined to confront China and resist Beijing's ambitions. The administration has imposed higher tariffs on imports from China, thereby inviting China's tariff retaliation and thus a bilateral trade war, limited China's foreign investment in the US, and decided to exclude Huawei Technologies and other major Chinese high-tech firms from its government procurement market.

This policy brief asks several key questions. Is it possible to restore and strengthen a rules-based, liberal international economic order, and if so how? What should the US and China do for this purpose? What reform would be needed on the part of the WTO to regain its central role as the overseer of international trade and trade-related rules?

The Rise of China and Global Economic Governance

The rise of China and other emerging and developing economies is rapidly reshaping the structure of the world economy and political landscape. The management of the global economy—to sustain stable growth—has become increasingly difficult without their active participation and cooperation.

The economic size of China and other emerging and developing economies has been expanding faster than that of the advanced economies, particularly since the mid-2000s. China has been the most dynamically growing country in the world. These economies, particularly China, made surprisingly important contributions to the global recovery from the financial crisis of 2007-09. Based on GDP at market exchange rates, the economic size of emerging and developing economies is expected to exceed that of major advanced (or G7) economies in the early 2020s, while China is projected to exceed the US in economic size in the latter half of the 2020s. Based on GDP at PPP in international dollars, the Chinese economy is already larger than the US economy.

Thus it was natural that the G20 summit process was launched in the aftermath of the Lehman shock as the "premier forum" for international economic and financial policy cooperation. The G20 economies include not only the G7 countries but also major emerging and developing economies which have become the primary driver of global growth since the global financial crisis, and China has been the leader among these economies. They have legitimately acquired a greater voice in the management of the global economy.

The WTO is a major institution in global economic governance established in 1995, which evolved from the former General Agreement on Tariffs and Trade (GATT). The WTO has three primary functions: advancing global trade liberalization and setting trade-related rules; monitoring the multilateral trade system; and managing a system for settling trade disputes. The first function has not been effectively performed as indicated by the failure of the Doha Development Round. This was due to the inability of major developed and developing countries to come up with mutually satisfactory agreements. The second function still works, although some developing countries have been criticized for not notifying the WTO of their policy measures (such as government subsidies and regulations) affecting trade and thus for lack of transparency. The third function now faces a significant challenge as the dispute settlement system will likely cease to have a binding Appellate Body by the end of 2019. The usual number of judges is seven and three is the minimum required for it to function. Currently there remain only three judges and two of them will end their terms by December this year.

The Trump Administration has argued that the WTO's existing rules are inadequate to respond to practices of non-market economies, most notably China. Such practices include: infringement of intellectual property right (IPR); subsidies for high-tech industrial development; market distortions created by state-owned enterprises (SOEs); and the practice to "self-declare" developing country status and enjoy "special and differential treatment," thereby avoiding the WTO's strict disciplines. Washington has also expressed concerns over the Appellate Body's excessively interpretative decisions and overreach, which led to the blockage of new appointments of judges to the body.

President Trump's Unilateral "America-first" Trade Policy

The Trump Administration has adopted a unilateral, "America first" approach and opposed multilateral negotiations in favor of bilateral negotiations to maximize US leverage. Its immediate objective seems to be to reduce its bilateral trade deficits. The US runs its largest trade deficit against China, followed by the EU (particularly Germany), Mexico and Japan. Naturally, the Trump administration has targeted these countries.

His administration has made several moves. First, it imposed higher tariffs on steel and aluminum imports for "national security" reasons based on Section 232 of the Trade Expansion Act of 1962. For the same reason, Mr. Trump threatens to raise tariffs on automobile imports, which would be a major blow to large auto exporters such as Japan, the EU, Canada and Mexico.

Second, it renegotiated the US-Korea FTA and signed final texts in September 2018, with the Republic of Korea (ROK) agreeing on a quantitative limit to its exports of steel and aluminum to the US. It is reported that the US was able to come up with a "currency clause" in an MOU related to the agreement, aiming to prevent competitive devaluation and exchange rate manipulation to promote a level-playing field for trade and investment.

Third, it successfully renegotiated the North American Free Trade Agreement (NAFTA) with Mexico and Canada separately and signed the US-Mexico-Canada Agreement (USMCA) in November 2018. The agreement included higher rules of origin (ROO) value-added requirements for automobile trade, a wage clause, a quantitative limit on US imports of automobiles, a currency clause, and a nonmarket economy clause.

Third, it agreed with the EU and Japan to negotiate respective trade agreements, which is expected to take place in the spring of 2019. The US and the EU are expected to focus on both tariff and non-tariff barriers to achieve fairer, more balanced trade. It is unclear at this point if the negotiation will result in a very comprehensive package a la US-EU Transatlantic Investment and Trade Partnership. The US and Japan are expected to focus on Japan's agricultural market opening and bilateral trade in automobiles. It is again unclear if the negotiation will result in an comprehensive package a la Transpacific Partnership (TPP) agreement. The problem for the EU and Japan is that such negotiations will have to be held under the US's threat of higher tariffs on automobile imports.

US-China Trade War

The Trump Administration has raised tariffs on imports from China on the grounds of China's "unfair trade practices" based on Section 301 of the US Trade Act of 1974. As a result of a series of tariff measures, the US now applies higher tariffs on US$250 billion worth of imports from China, which is about a half of total US imports from China. China has retaliated and imposed higher tariffs on US$110 billion worth of imports from the US, which is more than 80% of total imports from the US. President Trump threatened to further increase tariffs if China would not concede. Thus, the US approach to China has been much more aggressive than its approach to its allies and friends, such as Canada, Mexico, Japan and the EU.

In early December 2018, President Donald Trump and President Xi Jinping agreed on a tariff truce in Buenos Aires for sixty days and started negotiation talks on how to reduce bilateral imbalances and China's "unfair trade practices." President Trump puts pressure on the Chinese side by saying that if no agreement is reached during this period, he would raise tariffs on imports from China.

The US has taken a tough stance towards China because of several concerns. The first is the very large bilateral trade deficits against China. By applying pressure, it wants China to increase imports (LNG, soybeans and others) from the US. The second is China's "unfair trade practices," including IPR infringement, subsidies for high-tech industries under "Made in China 2025" programs, and market distortions due to SOEs. Finally, China is rapidly catching up with the US in the economic, technology and military arenas, threatening US supremacy and attempting to displace it as the next hegemonic power in Asia, and the US is determined to deter the ambition of China, its "strategic competitor."

From this perspective, the Trump Administration tightened its regulation on inward foreign investment and technology transfers abroad by strengthening the function of the Committee on Foreign Investment in the United States (CFIUS). The administration has also decided to ban equipment and services of five Chinese high-tech fimrs such as Huawei Technologies and ZTE from US government contracts and systems.

This means that firms seeking government contracts should not be using these Chinese equipment and services.

The US seems headed to contain and confront China, thereby decoupling the Chinese economy from the US economy and global supply chains and limiting China's further economic development. However, this approach would be too costly for firms in the US and other countries in the supply chains given the highly interdependent nature of the US and Chinese economies. As the Chinese economy would continue to grow relatively fast given the large and growing size of its domestic market, the failure to exploit economic opportunities created by China's rise would reduce the growth potential of the US economy and its Asian allies.

Japan's Approach

The Japanese government led by Prime Minister Shinzo Abe is expected to demonstrate its leadership as an active promoter of globalization and multilateralism in its attempt to restore rules-based global economic governance during its G20 presidency in 2019. For this purpose, the Asian country intends to focus on trade and investment (including WTO reforms), the digitalization of economic activity, "quality" infrastructure development, global imbalances, and issues related to the aging population among others.

Even though Japan is one of the closest allies of the US in terms of security, the country has been critical of the US's departurue from multilateralism and globalism and its unilateral approach using higher tariffs as threats in bilateral trade deals. After the Trump Administration withdrew from TPP, Japan took the lead in negotiating, concluding and implementing the TPP11 without the US. In addition, Japan has implemented the Japan-EU Economic Partnership Agreement (EPA). Japan has been insisting that the US should return to TPP. At the same time, Japan has been balancing risks and opportunities posed by the economic rise of China by engaging China in several economic cooperation processes. In addition, PM Abe has been supporting WTO reform to restore a rules-based international economic order.

Japan has been actively negotiating on the Regional Comprehensive Economic Partnership (RCEP), an FTA among 16 Asia-Oceanic countries (i.e., the ten ASEAN member states, Australia, China, India, Japan, the ROK, and New Zealand). Although RCEP is not a high-quality FTA like TPP (or TPP11), it is still expected to induce greater market opening and domestic regulatory improvement in member countries, particularly China. Japan can also help China, once it is ready, in making preparations to join TPP11 (or TPP if the US returns) in the medium term.

Japan has begun to cooperate with China on infrastructure investment and connectivity by reaching an agreement that firms in both countries will undertake joint projects in third countries. Japan has been arguing that four principles be observed for such joint projects, i.e., economic feasibility, openness, transparency, and debt sustainability of borrowing countries. As a result of this agreement, Japanese firms are expected to actively participate in some of the BRI projects. Such Japanese engagement is expected to improve the "quality" of BRI projects and reduce the concern that the BRI is an instrument for expanding China's geopolitical and military influence through "debt diplomacy."

Proposal

The US must return to multilateralism and global cooperation

To restore rules-based global economic governance, the US must return to multilateralism and global cooperation. The current unilateral "America-first" approach adopted by the Trump Administration is likely against the WTO rules and highly counteractive in promoting healthy trade and investment. If the US wishes to reduce its trade deficits, the US needs to alter its income-speding (or savings-investment) relations. The US government may wish to adopt policies to promote domestic innovations and technology development, rather than demanding China not to develop its own high-tech industry.

The US is also encouraged to prevent social fragmentation through stronger social sector protection (greater investment in education and health), the retraining and re-tooling of displaced workers, and region-based development programs to mitigate the negative effects of industrial transformation (such as the emergence of the Rust Belt). These will help the US in returning to assuming its traditional role of supporting a more liberal global economic order.

China must transform itself into a truly market-oriented economy

China is advised to dispel the perception that it is challenging the existing international order and the US's global dominance in the economic, technological and military arenas and seeking hegemony, by demonstraiting that it is pursuing harmonious foreign diplomacy and domestic structural reforms. In the area of foreign diplomacy, this entails a much more conciliatory approach to the South China Sea issue, such as the early conclusion of the Code of Conduct in the South China Sea with ASEAN states, the dismantling of military facilities on artificial islands and the re-designing of the BRI as a genuinely international public good.

In the area of domestic structural reforms, China needs to transform itself into a private-sector-driven market economy by returning to "reform and opening" and ending its "state capitalism"-led development model. This includes the redefinition of the role of government in a way consistent with a market economy, substantial market opening for goods and services and for foreign investment, much greater IPR protection, the elimination of state subsidies for high-tech industries, particularly "Made in China 2025" programs, and the privatization of SOEs and state-owned commercial banks supported by appropriate competition policy to reduce their monopolistic and oligopolistic behavior.

The US and China must resolve and manage their bilateral conflict

The resolution and management of US-China conflict is essential to restoring global economic governance based on rules and norms. For this, both the US and China must change in a fundamental way as noted above.

The US will have to avoid the decoupling of the Chinese economy from the US economy and global supply chains, while encouraging China to undertake deep structural reforms through a bilateral "economic structure consultation" process. This consultation process will have to be both ways in the sense that the US will press China to go through domestic structural reforms to transform itself into a true market economy while China can also demand structural changes on the part of the US so that the US will improve the savingsinvestment relations and strengthen social safety nets. In this way the two sides can manage conflict and hopefully become better partners.

The World Trade Organization (WTO) must be substantially overhauled to regain its central role as a global overseer of international trade and traderelated rules

WTO members, including the US, China, the EU, Japan and others need to pursue significant WTO reform in a way compatible with 21st-century trade practices, which will likely restore a rules-based international order. Such WTO reform would include: the restoration of a fully operational Appellate Body to preserve a functioning dispute settlement system; stricter compliance with notification obligations for transparency (on government subsidies and regulations affecting trade); greater protection of IPR; and setting a graduation policy for developing countries. Even though China is a developing country, it is advised to act as a "developed country" without seeking special and differential treatment in most areas and comply with most of the WTO disciplines.

It is essential to make the positive outcomes of the US-China bilateral talks (such as China's market-opening measures, IPR reform, and reduction of industrial subsidies) available to third countries by embedding them into the WTO's new disciplines.

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