

Canada and Japan can play a role in rebuilding a rules-based trade order

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Abstract

The rules-based trade order confronts a crisis as both rule-making and enforcement have stalled in the World Trade Organization (WTO). Locked in great power rivalry, the United States and China are undermining the rules, making it necessary for middle powers like Canada and Japan to lead a coalition to reform the WTO. Working together they should advocate for greater transparency over subsidy policies and guidelines for how to balance security goals with economic cooperation.

Keywords

WTO, trade war, economic interdependence, Ottawa Group, CPTPP

As they rely on the rules that support open markets, middle powers must step forward to avert the collapse of the World Trade Organization (WTO). Dependent on trade with the US but unwilling to break ties with China, countries like Canada and Japan must create a new trade consensus. As victims of economic coercion by China and vulnerable to unilateralism by the US, middle powers seek to enhance supply-chain security and market access. But acting alone will be inadequate. Only skillful diplomacy as a coalition can rebuild the rules-based trade order and protect national interests. The Ottawa Group's¹ negotiations to support the WTO needs buy-in from top leaders and their publics to accelerate their work.

1. This group is composed of Australia, Brazil, Canada, Chile, European Union, Japan, Kenya, South Korea, Mexico, New Zealand, Norway, Singapore, Switzerland, and the UK.

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The multilateral trading system confronts deadlock over both rule-making and rule enforcement. The WTO has expanded to 164 members, but this more diverse group cannot agree on new rules. After fourteen years, the Doha round failed, and the rules subsequently have not kept pace with economic change. This places more pressure on the judicial side of the trade order, which has issued decisions on critical policies about subsidies and national security that touch closely upon sovereignty. In a destructive reaction, the US continues to block the appointment of appellate body judges, creating a vacuum at the top of the system. The combined failure of rule-making and enforcement undermines the system's legitimacy. Dismissive comments about the WTO's utility have become all too common in diplomatic and academic circles.

The weakened WTO faces the threat of escalating sanctions and subsidies amidst a broad trend toward securitization of economic policy. Governments today are four times as likely to impose sanctions as they were in the 1990s, and much more likely to resort to industrial policy.² The US takes the lead in securitization as it imposes tariffs on steel and aluminum, spends \$52 billion on semiconductor research and development, and restricts economic exchange with China. Other governments are quickly following. The result is widening risk and volatility for international commerce and fears that the global economy will divide into blocs.

The tension between the US and China undercuts the prospect that either government will provide leadership to save the WTO. The overlap of commercial and security rivalries creates a volatile mix. Each step that China and the US adopt to protect an industry or support technology development appears threatening to the other. The beliefs and interests of the leading economies have moved away from mutual gains of interdependence toward zero-sum competition, and both sides are actively undermining the rules-based order.

The absence of leadership from the major powers creates demand for action from middle powers. Trade-dependent states like Canada need to support the rules-based trade system. While the largest share of Canada's trade is with the US, access to world markets, including China, is vital. Japan faces similar challenges with nearly half of its GDP from trade and leading industries embedded in global supply chains. Both governments have turned to WTO dispute settlement to address trade friction and urged support for the WTO from other members of the G7 and G20, whose endorsement of free trade is weakening.

There is precedent for Canada to broker institutional solutions for multilateral trade. As Douglas Irwin writes, a 1945 Canadian proposal helped generate momentum for the General Agreements on Tariffs and Trade.³ As talks floundered over the creation of an expansive International Trade Organization, a breakthrough came after Canada suggested pursuing a more moderate tariff agreement among fewer countries. This pragmatic approach—building a coalition of the willing to conclude a deal that has room

2. "The great regression," *The Economist*, 11 May 2024, <https://www.economist.com/weekleydition/2024-05-11> (accessed 26 July 2024).

3. Douglas Irwin, *The Genesis of the GATT* (Cambridge University Press, 2008).

to evolve—may be necessary again. Canada also played midwife to the birth of the WTO.⁴ A creative layering of new institutional processes, which resulted in part from the efforts of Canadian trade negotiators, improved governance while not infringing on the member-driven mantra of the organization. Time and again, Canada has been the “US whisperer” to elicit compromises that serve the larger goal of multilateralism.

Encouragingly, Japan has transformed from laggard to leader on free trade. Once the last to lower trade barriers in reaction to US complaints, Japanese prime ministers now counsel their American counterparts not to go too far in bashing China, even as they share frustration with unfair economic policies and fear the growing security threat of their hostile neighbour. The Japanese public is more negative toward China than either the Canadian or American public. In a hedging strategy, the government concluded a bilateral free trade agreement with the US and joined the Regional Comprehensive Economic Partnership among East Asian economies including China. Since neither of these agreements offer strong dispute settlement, however, Japan must rely on the WTO to counter protectionist threats from both the US and China. This brings Japan to strongly support the goals of the Ottawa group.

The WTO needs a course correction to remain relevant. Amidst a trade war between the leading powers and skepticism about globalization, it is unrealistic to call for a rigid legal order or deepening liberalization. The more moderate goal should be to enhance stability and predictability. Under the auspices of the Ottawa group on WTO reform, negotiations address institutional changes that could improve the deliberation processes at the WTO and resolve the deadlock over the rules of dispute settlement. The group brings to the table the diverse perspectives of developing and developed economies that could develop proposals to kick-start wider negotiations at the WTO.

Critical areas for updating the rules involve subsidy and competition policies, which are the most difficult issues for designing new rules. In the 1970s the Tokyo Round spurred new attention to non-tariff barriers at a time when Japan’s surging trade caused concern. By cutting its tariffs and supporting a new subsidy agreement in a multilateral negotiation, Japan abated some of the friction arising over its export success. Now, however, subsidy reform and competition policies must tackle the China challenge. State ownership and industrial policy converge to block the liberalization force of WTO agreements.⁵ Transparency and notification are the first step. Restraint for categories of subsidies and proportionate reductions will allow governments to avoid a subsidy arms race. Such changes may occur in a large multilateral trade round—a Beijing round, perhaps—if China comes to see its own interest served by making concessions for systemic stability that could end its trade war with the US. More likely, a smaller group of like-minded states will forge rules that must evolve to include more states, as we saw with the first GATT rules. This could

4. Alan Wolff, *Revitalizing the World Trading System* (Cambridge University Press, 2023).

5. Yeling Tan and Christina Davis, “The limits of liberalization: WTO entry and Chinese state-owned firms,” *International Studies Quarterly* 67, no. 3 (2023), <https://doi.org/10.1093/isq/sqad056>.

be based on proposals from the Ottawa group, or the expanding number of preferential trade agreements (PTA) may offer templates for updating trade rules.

The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) offers one such PTA model. In addition to lowering tariffs, the agreement forges new rules on free flows of data and protection of biodiversity along with clarity on subsidies and competition policies. The agreement enhances fair trade within a pluralistic view that accommodates multiple economic models and shows that a trade order can grow without the US. After the US withdrew from the CPTPP in 2017, Canada worked with Japan and other members to complete an agreement. It has already attracted the UK as its latest new member, while facing the dilemma of having applications from both China and Taiwan. In the first three years after the CPTPP entered into force, Canada has seen its merchandise trade increase with partner countries by 10 percent, which is faster than its trade with other members of trading system.⁶ Chairing the 2024 CPTPP Commission gives Canada an opportunity to demonstrate that trade agreements can still work.

New rules won't work, however, if national security concerns undermine their credibility. Governments will always want some discretion to restrict dual-use exports, impose sanctions, and support strategic industries. Multilateral institutions lack the legitimacy to challenge core sovereignty with rulings on these issues. Yet the expanding scope of national security damages commerce as firms face more uncertainty and higher costs. Governments need to agree on reasonable restraints. When the US raises tariffs on Canadian and Japanese steel in the name of national security, discretion has gone too far.

Decision-making rules must respect sovereignty and power but enhance transparency and restraint. One way to moderate government intervention lies in the approach taken for health and safety standards, whereby member states commit to using the least trade-distorting means to achieve their stated regulatory goal. A second approach taken for agricultural subsidies uses various signals to qualify levels of intervention in different contexts. Similar approaches could guide rules governing trade restrictions based on national security. Governments can raise tariffs and subsidize industries in the name of national security but, in a multilateral trade system based on reciprocity, such actions should occur in a process that every state could follow without causing the system to break down.

As it did with the negotiation of the trade order in 1945 and its renewal in 1994, Canada could play a significant diplomatic role in rebuilding the multilateral trade order. This requires joining partners with a stake in the system to push forward reasonable compromise in support of a rules-based trade order. Japan as another US treaty ally and partner in the Ottawa Group and CPTPP stands uniquely positioned to join forces with Canada. If the US-China rivalry worsens into a complete decoupling with China and unraveling of multilateral rules, both Canada and Japan would stand

6. "An overview of Canada's trade performance under the CPTPP after three years," Global Affairs Canada, June 2023, <https://www.international.gc.ca/trade-commerce/economist-economiste/analysis-analyse/cptpp-three-years-ptpgp-trois-ans.aspx?lang=eng> (accessed 26 July 2024).

to lose. Their asymmetric dependence on the US would increase just as US policy-making becomes more unpredictable and unilateral. Since middle powers have little recourse in a power-based trade order, now is the time for concerted leadership to save the WTO.

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