

**Essential Security Interests and the Future of the World Trade Order
- Including Japan's Potential Role**

Text for remarks of

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The horror of war has produced 'a blessed interval' during which the world's great nations could 'take their forward steps to world organization.' ... The common thread running through all these agreements was the American unwillingness to support or uphold any of them, which given the realities of power, meant they wouldn't be enforced.

Robert Kagan¹
(quoting Winston Churchill)

Overview

The Global Trade Order (GTO) has changed dramatically since 2016 as President Obama was ending his second term as American president. Essential security interests now dominate US international economic policy. They are at the heart of a self-centered US trade policy. The new policy is very much shaped by challenges posed by China and by a retrenchment in US international economic policy in reaction to a more globalized world.

Japan's international economic policy interests require consequent adjustments in its policies. It should take an even more proactive role in maintaining and improving the Global Trade Order. Japan has a positive record in collaborating with other countries to maintain and improve trading relations. As the Trump Administration withdrew from TPP as it came into office, Japan took the initiative to save the Trans Pacific Partnership (TPP) (slightly restructured as the Comprehensive and Progressive Trans Pacific Partnership - CPTPP). Under Prime Minister Abe's leadership, it championed e-commerce in international trade arrangements. Japan is one of three co-convenors of the WTO e-commerce plurilateral (a Joint Statement Initiative (JSI)). For its part, the US shows no sign of being interested in rejoining TPP and has backtracked from its support for an open digital world economy.

Japan straddles the geo-economic divide: joining RCEP, a trilateral investment agreement (Korea, Japan, China) as well as concluding an initial agreement to support the US-Japan trade relationship, in 2020 concluding the US-Japan Trade Agreement (USJTA). It has entered into a critical minerals agreement with the US and joins the US in sanctions and export controls.

Japan is an important actor in improving the world trading system, working with others to preserve an open and rules-based World Trade Order.

¹ Kagan and Churchill here are describing events of a century ago, the 1920s when the United States decided, after World War I, that a foreign policy was unnecessary, and that it could absent itself from world affairs (when that meant European affairs). This is from his book *The Ghost at the Feast: America and the Collapse of World Order, 1900-1941*, Atlantic Books (2023). Kagan is referring to the Locarno Treaties.

Global economic mismanagement - trade

There is a current leadership vacuum in the world trading system (WTO). The US has signed out and China has not yet signed in for a leadership role. The gap that has been created remains unfilled by collective leadership from mid-level countries not from other nations. Japan is needed to play a more assertive part.

Essential security interests are crowding out cooperation among the US, China, and the EU, as well as deeper US economic engagement among allies. The WTO's disabilities are evident -- members remain unable to deliberate and reach agreements on major issues; the WTO rules are no longer fully enforceable. Although dispute settlement has not been fully extinguished, it is not binding for countries not agreeing that decisions are final. No WTO executive branch exists, charged with providing management of the system, to drive progress.

Stark change occurred in the Global Trade Order (GTO) – from 2016 to 2024

It is common to divide the modern years of the continuum of the world economy by the financial crisis in 2008, with a substantial difference in willingness to commit to greater openness in international economic relations before and after that time. But there was also a later shift in the world's political economy, during the last few years of the second decade of the 21st century. It is that change that is addressed here.

What was the world trade order like as recently as 2016?

The multilateral trading system. All WTO members continued to profess adherence to the multilateral trading system. The system had seemingly weathered the 2008 Financial Crisis. While the WTO's record was not stellar, it had substantial accomplishments – the Trade Facilitation Agreement (agreed in 2013), the Information Technology Agreement (and the ITA expansion agreed in 2015), and a ban on agricultural export subsidies (agreed in 2015). It struggled to make further progress, however.

Regional trading arrangements. The Transpacific Partnership Agreement (TPP) had been signed, although ratification by the US had been delayed. (Termination of US participation in TPP had been pledged by candidate Trump but was not yet an accomplished fact.) The EU was negotiating a Comprehensive Agreement for Investment (CAI) with China. China was negotiating the Regional Comprehensive Economic Partnership (RCEP).

The geopolitical setting. The major powers were at peace. Russia's seizure of Crimea in 2014 was a fading memory in the West. Europe was heavily reliant on imports of Russian energy, but was untroubled, assuming close trade relations would cement good relations with Russia more generally. China had not yet been named a "strategic competitor" in the US National Security Strategy (this was to occur in Dec. 2017) foreshadowing a change in US policy. The Paris Agreement had entered into force, climate change as an existential threat was moving steadily into the forefront of the consciousness of policymakers.

The new normal for world trade – 2024

Geopolitical. There is a surfeit of uncertainty. The US – China rivalry shapes both US and Chinese policy. There is potential for armed conflict in the East China Sea. The Russian cut-off of gas exports to the EU highlights supply chain vulnerability, as did COVID, and the Russian invasion of Ukraine has re-shaped trading relations for much of the developed world.

The world is now divided into three camps over the war in Ukraine. Current major global trade concerns are that the war in Europe can potentially spread to the Baltics, that the war in the Middle East expands to other participants, and that the US adds further national security restrictions, enlarging the use of sanctions.

New International Economic Policies

The United States

Current US policy is shaped primarily by a series of negative factors: the political and economic harms of domestic income inequality, a retreat from globalization, and a wish to reduce the role of multinational corporations. These forces arrive in the context of seeking support for sanctions against Russia for its aggression in Ukraine, and China's economic statism. China's expanding influence and the threat of potential conflict with China overhang US policy. This is more than the friction that is said to exist between a rising power and an incumbent. The rivalry goes to the kind of world trading arrangements that are to be maintained.

At present, US economic policy is not shaped by identifying positive possibilities through international cooperation, although parallel actions in support of agreed policies are possible (e.g., with respect to the Paris Agreement and decarbonization).

The new normal of US economic policy includes promotional tax provisions, industrial subsidies, high tariffs on Chinese goods, selective export controls and Russia sanctions. Essential security considerations drive the new policy. Near-shoring appears sometimes to be seen by the US government to be much the same as off-shoring, that is, it is spoken of in positive terms but is not much implemented.

US policy is unlikely to return soon to what it was, seeing openness to the world as virtue and a rewarding policy. US policy will continue to be highly self-centered. The US is no longer the guarantor of the multilateral trading system, the rule of law in international trade relations and the WTO.

On-shoring has been made operational. The turn inward began with the Trump administration and the imposition of import restrictions on steel and aluminum in the name of national security and the application of blanket broad tariffs on US imports from China, together with national security export controls. For President Biden, the chief impetus remains to

strengthen the US manufacturing economy and the workers who serve it. The current US industrial policy began with the Infrastructure Act, with its Buy America procurement. It continued with subsidies for semiconductors, then EVs and batteries contained in two new laws, the Chips Act and the Inflation Reduction Act. Casting about for some form of engagement with the Asia Pacific region, it created the Indo-Pacific Economic Framework (IPEF) – a set of jointly expressed aspirations among fifteen countries, with little if anything that rises to the level of binding obligations as doing so would require Congressional approval which has been shunned by the administration.

In theory, national security controls are to be limited, consisting of “a small yard, high wall”, but the definition of what is needed for national purposes tends to expand. TikTok was banned, not surprisingly as a US concern, but unprecedented in the way in which it was put into place by act of Congress. US trade policy is conducted otherwise largely by the Executive Branch without Congressional participation, in a manner unanticipated by the US constitution. Delegations of trade authority have been interpreted to grant broader powers than anything intended, such as the Trump-era China tariffs retained by Biden, and the narrower, more focused tariffs put into place by Biden -- 100% tariffs on Chinese EVs. The US purpose is not to seek to change China’s behavior. It is to limit the success of its industrial policies. The Biden Administration lectures others to follow the US lead, to curb harms from foreign over-capacity as well as to aim for supply resilience. Should there be a second Trump administration, Trump has threatened 60% tariffs on Chinese goods, repeal of normal trade relations with China (implying returning the applicable tariffs to 1930 rates, import bans), a 200% duty on Chinese EVs, and 10% tariffs on the products of all others.

Departures from global trade rules have become commonplace.

The European Union

The US is not alone in adopting new international trade policies. The EU has been deploying an arsenal of defensive international economic measures in recent times. It declared the American steel and aluminum measures (said by the US to be a national security measure) to be in reality a safeguard, giving it, it said, a right of retaliation, which it proceeded to apply (prior to a truce being worked out).

It participates actively in Russia sanctions stemming from the invasion of Ukraine. It adopted a law to allow retaliation against trade coercion in response to a Chinese embargo of Lithuanian goods. It has adopted a Foreign Subsidies Regulation (FSR) implemented with dawn raids against a Chinese company under the EU’s International Procurement Instrument that may have used subsidies to sell its security screening equipment to Member States. It has adopted investment screening similar to the US Committee on Inward Foreign Investment (CIFIUS) regulation. It has adopted a carbon border adjustment mechanism (CBAM) unilaterally, as well as applying a policy against deforestation - part of its package of green policies.

The EU states that it will be selective in de-risking trade with China, seeking a middle way, trading actively with China without adopting the panoply of US tariff measures, but exercising a degree of care to avoid dependence on the trade and other harms.

Current Chinese policies

Self-sufficiency remains a major objective, but it nevertheless entered into the Regional Comprehensive Economic Partnership (RCEP) which is now in its third year. It has not retreated from its commitment to state intervention (party control) in production and commerce. It had rankled trading partners with a more aggressive “wolf-warrior approach” in relations with others but has since softened this rambunctious assertiveness. Likewise, it has de-emphasized its industrial policy objectives in public statements, as compared with the introduction of Manufacturing 2025. A de-escalation in tensions with the US has been sought from the period immediately after the balloon incident (the “weather” balloon that crossed the United States and was shot down). Trade retaliation and coercion measures presumably remain on-tap. China has not been shy in emphasizing that its partnership with Russia is deep and committed. It has greatly increased its trade with Russia.

The potential impact on Japanese international economic policy

It will be increasingly difficult to navigate a middle path between the US and China. The national security policies of the US and Japan are, of necessity, aligned. The US will expect of Japan an increasing degree of policy alignment.

Japan has the opportunity with the US to:

- Build on their mutual economic interests.
- Foster deeper integration of the two economies through investment and trade.
- Improve and add additional agreements to IPEF, for example, negotiating a US-Japan essential goods & services supply chain agreement.
- Identify mutually beneficial science and technology interests for collaboration.
- Support joint industrial efforts, e.g., in cutting edge products, EVs, batteries.
- Find ways to take advantage of complementary demographics.

Japan on the world economic stage

Japan can and should take a leading role in fostering multilateral (open plurilateral) cooperation to create global public goods in the fields of food security, climate adaptation and decarbonization, pandemic preparedness and response, dealing with economic insecurity, fostering economic development, and improving the functioning of the world trading system in particular through reforms to the World Trade Organization (WTO). Japan also has the scope to be active in other regional and bilateral arrangements (including CPTPP, DEPA, J-EU, ASEAN. This will require additional efforts by Japan as part of its fostering of a positive Global Trade Order.

More will required from others that have allied interests.

The EU has to punch at its economic weight, leading in improving the Global Trade Order. The forward-leaning countries must be more active as well. This includes, for example, Canada, Australia, New Zealand, Chile, Costa Rica, Singapore, and Norway and Switzerland. An example of this is the initiative in which Australia, Singapore and Japan combined to press for a WTO e commerce agreement. Now this effort needs to yield a formal agreement, which must be accepted formally within the WTO if that organization is to enhance its relevance.

The state of the world trade order

The world is still in the afterglow of the height of the liberal international order. Most of world trade continues to be strong in a world American dominance made possible. World exports of goods stand at ~ \$23 trillion/year, following dips in 2008 and 2020. World services trade is at ~ \$7.8 trillion, with strong growth annually. Digital commerce grows inexorably, amounting to 54% of total global services exports. AI applications multiply, its growth becomes exponential.

Nevertheless, trade flows are being rearranged through diversification in the name of increasing resilience. In some cases, this is manifested in a China +1 strategy. It is not unlikely that the two geopolitical protagonists are pursuing a degree of decoupling but in slow motion.

Among the risks: will increasing trade restrictions slow global growth?

Is there a high road via global cooperation?

Can the US and China, others, find common ground? There is reason to believe that they can. Trade remains essential for effective global responses to –

- Food insecurity
- Climate change
- Future pandemics
- Economic insecurity

Throughout, there is a need for fostering economic development through increased integration of developing countries into the world economy.

“Global essential trade” can provide a basis for cooperation.

- Bringing food from areas of plenty to areas of want. (Self-sufficiency at acceptable cost is unattainable. This is a lesson yet to be learned.)
- Providing environmental goods and services to combat and adapt to extreme climate events and trends.
- Providing personal protective equipment, medicines and vaccines in times of pandemic.
- 100% onshoring is not practical, it cannot assure supply resilience, and cannot satisfy national or economic security objectives.
- Diversification through trade is the only means to provide broad essential security.

Global solutions require at a minimum selective US-China cooperation. Can the US and China compartmentalize to reach consensus in some crucial areas of cooperation – a *modus operandi* as part of striking a new equilibrium? It is a given that there will be serious strains in US-China relations. This should not paralyze all attempts at international cooperation where cooperation is possible. The two antagonists need to find areas to work together for the common good. To succeed in meeting these challenges, Japan, the EU and mid-sized countries need to play a stronger role. They can initiate deliberations towards solving global challenges.

To underwrite international cooperation, trade must function through agreed and honored rules.

Necessary repairs to the global trading system are needed -- now.

The legitimacy of negotiated results among coalitions of the willing (open plurilateral agreements) must be accepted. This is appropriate where there is critical mass, and agreements are consistent with WTO objectives. Non-participants can no longer be allowed to have a veto over progress that other members seek to make.

Binding dispute settlement must remain a cornerstone of the multilateral trade order (GTO). Rules are to be lived up to (*pacta sunt servanda*) as a matter of national honor and commitment. The rules must be enforceable through effective dispute settlement.

Any organization requires an effective executive function. This is particularly true of international economic organizations. The executive, the Secretariat, must assure transparency, provide analysis, leadership (suggesting ways forward in negotiations) and strategic foresight.

WTO reform is a realistic objective.

For concluding open plurilateral agreements, either consensus will be “responsible”, or it should no longer be required within the body of WTO agreements.

Binding dispute settlement including the participation of the United States might be achieved provided that –

- an unaccountable court structure is not revived,
- the balance between trade liberalization and the use of trade remedies to deal with economic harms is respected.
- actions in furtherance of essential security interests are permitted provided the balance of concessions is respected, and
- the system does not seek to dictate management of the US-China rivalry.

In addition, importantly, an effective executive role should be delegated to the Director-General and Secretariat.

The default option: obstacles are not overcome.

The hegemon remains signed out. The rising power does not sign in. No group of countries is able to fill the leadership gap. *Sauve qui peut* is the rule. Each country acts on major issues in line with its currently perceived interests without much room to working for the common good. The scope of what is considered essential security grows in size and importance. The US - China rivalry creates damage that cannot be contained; the two cannot cooperate even selectively. The GATT-WTO rulebook remains without new energy. It is an imbedded memory, a habit.

This cannot be allowed to be the future of the World Trade Order.

Conclusion

For the benefit of the world economy, nations serving their perceived individual national economic security interests must seek to preserve, to the extent possible, an open, rules-based trading system.

Economic efficiency will ultimately be reasserted by countries participating in the world trade order as a key objective – avoiding unnecessary trade distortions. Necessity will not be the sole objective. It will be equally important to lessen economic harms from openness, assigning a higher priority to human health and the environment. Consideration of welfare and sustainability will be assigned their rightful place in the new international economic order.²

²For a detailed proposals for WTO reform, see Wolff, *Revitalizing the World Trading System*, Cambridge University Press, 2023.

Appendix: Essential Security

GATT Article XXI – Essential security (ES)

It was understandable to allow an ES exception from obligations during times of war and other emergency in international relations. The ES exception remained logical and defensible as long as it was almost never invoked, and then almost never applied. Its respectability eroded when the US chose to use it to justify import restrictions on allies' shipments of steel and aluminum and did not accept a dispute settlement panel's ruling.

Its respectability evaporated when Russia invaded Ukraine and its claim of proper use of Art. XXI was upheld because it was at war, which condition it created.

What is the cure?

It would be satisfying for legal scholars and political scientists if expert panels could detect inappropriate use of claims of national security and essential security and condemn them. But not all governments will accept an external review of what each deems to be in its essential security interest. The available penalty for inappropriate ES use, a remedy that should be accepted, is to require the rebalancing of concessions either through trade compensation or retaliation. Wolff and Maruyama suggest that the only practical option to resolve the impasse over the use of the essential security exception is to forego litigation entirely and move to a rebalancing of concessions as provided for in GATT Art. XXVIII.

www.piiie.com/sites/default/files/2023-05/wp23-2.pdf.

A price must be paid for claiming essential security as an escape from WTO obligations.

Today's essential security concerns

The essential security exception is very much a product of its times. Were the essential security exception to be redrafted at present, it would deal with a different set of circumstances than those which pertained when the GATT was being drafted.

Essential security, in the view of those who invoke it, is not always at present related to a declared war or the spread of nuclear weapons. National security export restrictions apply to semiconductors, semiconductor production equipment, popular social media, and AI applications and capabilities. Similarly, national security import protection is being applied to trade in semiconductors, telecommunications' equipment, and to social media.

Essential security will grow to cover protection and discrimination designed to provide supply chain resilience for essential goods. It can be applied by countries to justify export

restrictions in times of food scarcity, or to preserve for domestic use supplies of medicine, essential goods, and vaccines during pandemics. Drafters today would imagine trade measures deemed necessary to deal with other international emergencies. This can easily result in overuse. A caveat is in order: The negotiation of terms of a new GATT essential security exception can cause more harm to the trading system than leaving the conditions for its use unspecified.