

SPECIAL REPORT

No. 228 | MAY 8, 2020

The Fight for Free Trade

Edited by Tori K. Smith and Riley Walters

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THOMAS A. ROE INSTITUTE FOR ECONOMIC POLICY STUDIES

Contributors

Simon Lester is Associate Director of the Herbert A. Stiefel Center for Trade Policy Studies at The Cato Institute

Paul D. Ryan is Senior Vice President, Here for America

Gabriella Beaumont-Smith is Policy Analyst for Macroeconomics in the Center for Data Analysis, of the Institute for Economic Freedom, at The Heritage Foundation

Tori K. Smith is Jay Van Andel Trade Economist in the Thomas A. Roe Institute for Economic Policy Studies, of the Institute for Economic Freedom, at The Heritage Foundation

Dr. Takashi Terada is a Professor in the Faculty of Law Department of Political Science at Doshisha University

Riley Walters is Senior Policy Analyst for Asia Economy and Technology in the Asian Studies Center, of the Kathryn and Shelby Cullom Davis Institute for National Security and Foreign Policy, at The Heritage Foundation

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Introduction

Over the past seven decades, the benefits of free trade have been recognized by growing numbers of individuals, businesses, and countries throughout the world. The creation of the General Agreement on Tariffs and Trade in 1947, establishment of the World Trade Organization in 1995, and negotiation of scores of preferential trade agreements have eased the flow of goods and services between individuals and firms, have added value to local economies, and have contributed enormously to the growth of the global economy.

Today, however, many people are questioning the benefits of trade and calling for protectionist trade policies as the way to address almost any perceived flaw within the global economy. In such an environment, the need to defend the freedom to trade could not be more important or more urgent.

The Economic Case for Free Trade

The trade freedom rankings in the *Index of Economic Freedom* correlate strongly with overall indicators of prosperity and human development.

As shown in Chart 1, countries with greater trade freedom have higher—and often much higher—income per capita. The individuals within these countries enjoy greater food security, healthier environments, increased political stability, and higher levels of social progress.

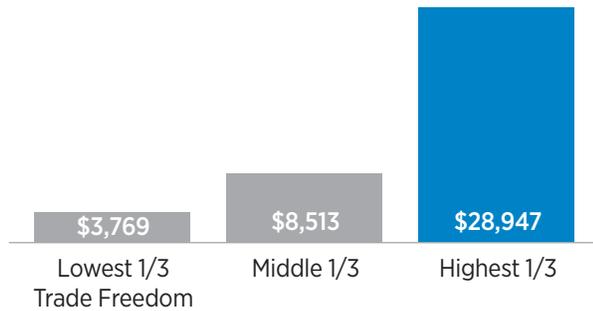
Despite these manifest benefits, governments impose a wide variety of regulations and restrictions on trade that distort or limit opportunities for businesses and consumers. Policies like tariffs and quotas that restrict imports and even policies like subsidies that are meant to support exports all disrupt the natural flow of trade. Such policies arbitrarily increase costs,

CHART 1

Nations With More Trade Freedom Also Have ...

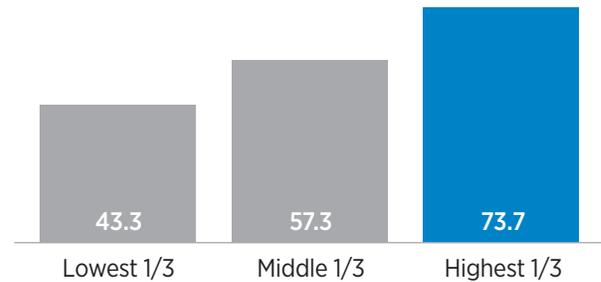
... Higher Average National Income

Average National Income



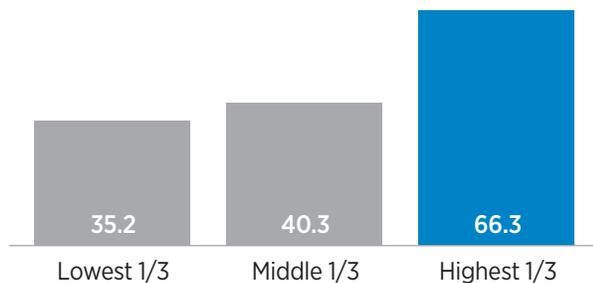
... More Food Security

Higher scores indicate more food security



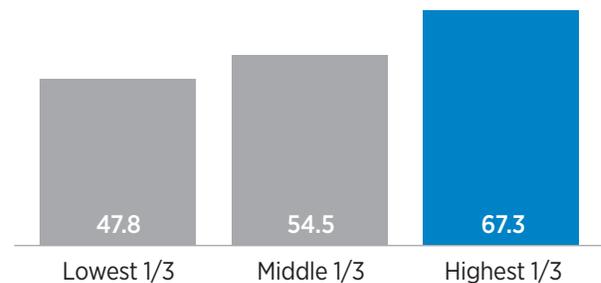
... More Political Stability and Less Violence and Terrorism

Higher scores indicate more political stability and less politically motivated violence and terrorism



... Healthier Environments and Less Polluted Ecosystems

Higher scores indicate better environmental protection



SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2020 Index of Economic Freedom* (Washington: The Heritage Foundation, 2020), <http://www.heritage.org/index>, and:

- World Bank, "GNI per Capita, Atlas Method (Current US\$)," <https://data.worldbank.org/indicator/NY.GNP.PCAP.CD> (accessed May 5, 2020). Figures are based on 179 countries that are in both indexes/datasets.
- The Economist Intelligence Unit, "Global Food Security Index 2018," <http://foodsecurityindex.eiu.com/Resources> (accessed May 5, 2020). Figures are based on 114 countries that are in both indexes.
- World Bank, Worldwide Governance Indicators, "Political Stability and Absence of Violence," 2018, <http://info.worldbank.org/governance/wgi/#reports> (accessed May 5, 2020). Figures are based on 182 countries that are in both data sets.
- Yale University, "2018 Environmental Performance Index," <https://epi.envirocenter.yale.edu/epi-topline> (accessed May 5, 2020). Figures are based on the 176 countries that are in both indexes.

reduce efficiency, and can stifle the research and investment that are essential for growth and development.

Fighting a Return to Protectionism

Unfortunately, protectionist pressures seem to be increasing. The United States, although historically in favor of trade, has imposed tariffs on more than 14 percent of its total imports over the past several years,¹ making trade less free and causing its average applied tariff rate to increase by 73 percent.² Countries like France are now imposing non-tariff trade barriers on e-commerce businesses. And developing countries like India continue to maintain high levels of tariffs on agricultural imports in an attempt to protect domestic industries and farmers.

Recently, however, there have been efforts to protect the efficient global trading system that has developed over the past several decades. At the end of 2018, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which includes seven Asian countries and two in South America as well as Canada and Mexico, entered into force.³ Just a few months later, the European Union and Japan finalized an economic partnership agreement. And in the summer of 2019, the European Union signed a trade agreement with the Mercosur states of Argentina, Brazil, Paraguay, and Uruguay.

Equally notable, some African countries have also been advancing a free trade agenda. Of the 55 African Union states, 54 signed the African Continental Free Trade Agreement (AfCFTA), and 27 countries have ratified the agreement. In addition, a number of other bilateral trade agreements have been formalized that extend the benefits to trade beyond the most favored nation requirements of the World Trade Organization.

The lesson would seem to be clear: While some countries may fall victim to the blandishments of protectionism, the world can continue to trade without them. Moreover, the 25 years' worth of authoritative data compiled and analyzed in the *Index of Economic Freedom* makes it equally clear that freer trade, not protectionism, is the way to prosperity.

Protecting Our Trade Freedoms

The following essays examine the intricacies of the global trading system. The authors provide insights into the threats facing the system, the complexities of its management, and its constantly evolving nature.

- Paul D. Ryan of Here for America discusses the intricacies of global supply chains from the perspective of the North American automotive industry;
- Simon Lester from the Cato Institute discusses one of the most important institutions of the global trading system, the World Trade Organization, the WTO's role in promoting free trade, and the future of the organization;
- Gabriella Beaumont-Smith of The Heritage Foundation discusses the increasing role of digital trade and how it can be enhanced or hindered by government intervention; and
- Dr. Takashi Terada from Doshisha University in Tokyo, Japan, discusses the future of trade agreements and the complexity involved in making new trade deals.

Debates about trade are likely to continue in the years ahead, and those who love freedom will be called upon to defend the openness of our international system and the rights of individuals to engage in commerce wherever and with whomever. The freedom to trade is the foundation of economic advancement, and the expansion of global markets has proven to be a powerful engine for growth and a key factor in the worldwide fight against poverty. Governments that curtail trade freedom in order to insulate their producers from international competition ultimately condemn both those producers and their citizens as a whole to second-class economic status. The goal of the *Index of Economic Freedom*, by contrast, is to identify policies that can allow any country to rise into the top ranks of freedom and prosperity. This special focus section on the freedom to trade is intended to advance that goal.

Supply Chains: The Odyssey of a Honda

Paul D. Ryan

The Honda Odyssey is made in Lincoln, Alabama. Or maybe it would be more accurate to say that in Lincoln, Alabama, parts and components from all over the world meet to become a Honda Odyssey.

The same is true in Georgetown, Kentucky, where the Toyota Camry is built; West Point, Georgia, where they build the Kia Telluride; Chattanooga, Tennessee, and Tuscaloosa, Alabama, where Volkswagens and Mercedes-Benz products, respectively, roll off the lines, as well as Warren, Michigan (Ram trucks); Wayne, Michigan (Ford trucks); and Arlington, Texas (Cadillac Escalades and Chevy Tahoes, among other products).

The story of every modern motor vehicle the world over—and a great many manufactured goods more generally—is the story of complex manufacturing and sales processes that can be as circuitous and often unexpected as the tale laid out in the Honda minivan's namesake. The Odyssey ventures into multiple countries and involves numerous actors. Technology, trade rules, and competitive pressures have combined to enable the creation of a web of supply chains that have bound the global economy together and resulted in higher-quality, more innovative products that give consumers greater choice at lower costs. Not coincidentally, those global supply chains have kept the North American auto industry and North American auto production globally competitive.

What Are Supply Chains?

With globalization blamed for many of the ills of the modern era, it is worth recounting what supply chains are, how they operate, and the benefits of the complex supply chains companies now employ. In short, supply chains are the steps required to get a product to the customer, including developing a product, producing it, transporting it, and selling it.

At points in the past, these functions were performed in one country—even in one location. The most famous example is the River Rouge plant in Michigan that Henry Ford built, where sand and iron ore were poured in at one end and a car popped out at the other end. Today, the mass production system model for which Henry Ford is rightly famous has been both retained and refined: Production functions that once were centralized have been spread out with a view to ensuring that a finished car or truck is cost-competitive, quality-competitive, and delivered to the customer on a timely basis.

Today, the global supply chain is not just about manufacturing. Major automakers whose headquarters may be in Europe or Asia have design and styling, research and development (R&D), and testing facilities across the United States. All of this is part of the effort to satisfy the world's most discerning customers in the world's most open and competitive auto market.

In the automotive sector, product design and development may occur in an automaker's dedicated facility. Parts production takes place at both in-house and outside supplier locations, with final assembly of the finished vehicle conducted at yet another of the automaker's plants. In setting up supply chains, automakers identify their own core and non-core competencies and establish relationships with outside suppliers with expertise in non-core areas.

Technological Developments and Trade Agreements

Complex supply chains have been facilitated by a series of technological, regulatory, and business developments over the past several decades.

For example, advances in information and communications (ICT) technology have provided critical tools necessary for effective supply chain management. Information management software, ever more powerful computers, and communications technologies such as broadband service and smartphones have made it possible to coordinate the process of ordering and delivering the many thousands of parts required to manufacture a car. GPS and radio-frequency identification (RFID) technologies likewise have made it possible to track the movement of supplies to ensure timely deliveries. Specialized businesses have carved out a niche deploying these technologies in the areas of logistics, communication, and business services to partner with multiple companies and industries so that they can further increase the effectiveness of supply chains and reduce their cost.

Another breakthrough technology that facilitated complex supply chains and international trade more generally was the development of standardized shipping containers and intermodal transport systems for those containers. This greatly reduced the cost of shipping goods both domestically and internationally, opening up new doors for drawing on supply sources remote from the final assembly facility, including internationally. At the same time, emerging markets overseas improved their transportation and other infrastructure that enabled them to link into global supply chains.

Along with these technological developments, trade agreements have reduced tariff and nontariff barriers to moving goods across borders and have contributed to greater certainty and stability in the international

business environment. This too has opened the door to broadening supply sources and moving inputs and finished goods internationally at lower cost. In the automotive sector, for example, the North American Free Trade Agreement (NAFTA) facilitated fully integrated North American supply chains in which parts for any given vehicle are typically sourced from all three NAFTA countries. In many cases, the production process for a finished part is itself broken up into multiple locations, with the part traveling across borders several times before completion.

A Typical Production Process: Traveling Across Borders

Two years ago, Bloomberg took a fascinating look at the journey of some parts going into modern vehicles:⁴

- A Grand Rapids, Michigan, company buys capacitors from a company in Colorado, which gets them from a number of suppliers in Asia.
- Those capacitors are shipped to Mexico, where they are integrated into a circuit board.
- The boards are stored in El Paso before being shipped to another plant in Mexico, owned by a Norwegian company, that puts the circuit boards into a seat actuator—basically, the mechanism that allows you to fold the seats in a minivan or an SUV with the simple touch of a button.
- The actuators are then shipped to plants in Texas and in Ontario, Canada, where an American company makes finished seats.
- Once finished, those seats are installed in vehicles built a short distance away.

All told, the parts may cross international borders five or six times before going to the final assembly facilities in the U.S. You could deconstruct (literally) just about any vehicle and find hundreds of similar examples.

Producers look for the greatest freedom in sourcing lower-cost, commodity-type parts, but while cost is one factor in developing a supply chain, it is not the only consideration. “Just-in-time” manufacturing processes like those in the auto sector require that key parts be sourced from locations and suppliers that present a low risk of supply disruption. In addition, quality

and safety requirements also frequently lead to sourcing from locations relatively close to a final assembly facility, both to ensure proper oversight of the supplier's operations and to ensure that problems can be corrected promptly. Parts specific to a vehicle under development may likewise be sourced more locally in order to allow better coordination with design or engineering teams.

Thus, considerations of cost, reliability, and quality all play a part in developing supply chains. The most apparent results for consumers are lower prices for automobiles, but the cost savings that complex supply chains generate also allow automakers to invest more in developing innovative features and to offer these features in vehicles at reasonable prices. All of this boosts vehicle demand to the benefit of both companies and their employees.

The competitive advantages of complex supply chains are such that access to them is a central consideration in company decisions about where to invest and produce. Technology, infrastructure, and the integrated North American market created by NAFTA have made the United States a highly effective supply chain hub and, thus, a very competitive manufacturing platform. As a result, the United States has attracted billions of dollars of investment in manufacturing, design, and R&D facilities.

International automakers alone have invested nearly \$82 billion in the United States, directly employing 133,000 Americans at nearly 500 facilities. Together, these companies create jobs for 1.29 million Americans in design, R&D, manufacturing, sales, finance, and dealership operations as well as other businesses. They produced nearly half of all cars, SUVs, vans, and light trucks made in America last year and accounted for nearly half of vehicle exports in 2016, exporting 17 percent of their production to 140 countries and territories.

Looking to the Future: Electrified and Autonomous Transportation

As the auto industry looks to the future, the role and importance of global production chains are only going to increase, for several reasons. Foremost among these reasons is the major transformation to electrified and autonomous transportation that the worldwide auto industry is currently undergoing. Automakers have made enormous investments and commitments to bring electrified vehicles to market over the next five years. One can properly debate the best policies for achieving the goals of zero-emission or carbon-neutral transportation—sustainable market incentives will

be more successful and enduring than government mandates—but the direction is clear.

The enormous capital investments required to transform the fleet increase the competitive pressures on companies to find the best and lowest-cost components to bring about the transformation. Electrified vehicles have narrowed the cost gap with internal combustion vehicles in recent years, and there is still a distance to go. But if the public policy goal is to reduce emissions from motor vehicles through electrification, it makes no sense to limit the ability of manufacturers to obtain the best low-cost electric motors, batteries, and raw materials that will make a zero-emission future possible.

The same is true for autonomous vehicles. Whether we get to a driverless future or not, many of the technologies that could make autonomous vehicles possible will provide tangible safety and other benefits to the public today. For example, emergency braking systems are already at work to reduce collisions. The sensors that warn you of an impending crash are constantly being refined and improved for future uses. Artificial intelligence capabilities are expanding rapidly. The ability of cars to talk to each other (vehicle connectivity) will provide another layer of protection from crashes.

Automated and connected vehicles will save us time, lives, and money. As with electrified vehicles, however, if the benefits of automated and connected vehicles are to be fully realized, manufacturers must be able to use the best technologies available at the lowest cost possible.

It should also be noted that many of the new entrants into the auto industry—companies looking to build electrified and automated transportation—have established U.S. offices *in advance* of beginning full-scale production. Some of them even describe themselves as “virtual auto companies,” knitting together worldwide operations in a manner and scale far different from what we have known.

Critics of global supply chains often overlook the fact that the jobs that add the highest value to a product often stay in locations closest to the customers (in this case, in the United States). For example, the high-value-added design and intellectual property of an iPhone remains in Cupertino, California, even though Foxconn might manufacture the actual phone in Asia. Similarly, some of the most legendary auto products were designed by teams working in California for U.S. and globally based companies. All told, 12 international automakers operate 36 automotive design and R&D operations in California, taking advantage of the state’s reputation as a center of fashion and design.

Conclusion

The basic question is: If not for global supply chains, would auto production in the U.S. be as strong, innovative, and competitive as it is today, particularly in the face of increasing competition from both old and new business ventures? The answers are revealed by the facts: The U.S. auto industry is not just viable. It continues to stand at the leading edge of innovation and competitiveness worldwide.

The Central Role of the WTO in the World Trading System

Simon Lester

In 1947, a trade agreement called the General Agreement on Tariffs and Trade (GATT) was signed by 23 nations. Its lasting impact may not have been clear to its creators at the time. It was supposed to be part of a larger project called the International Trade Organization, but that institution was rejected by the U.S. Congress a couple of years later and never came into force.

The GATT could have been just another trade agreement that was surpassed by subsequent trade agreements. Instead, it became permanent, with new elements added over time, and was expanded to cover many new countries. In 1995, the GATT was transformed into the World Trade Organization (WTO), the overarching framework of rules that governs today's world trading system.

Like most trade agreements, the WTO consists of individual elements that cover a range of trade policy issues: tariffs, agriculture, domestic regulations, services, government procurement, and intellectual property, among others. Just as important, however, it is an institution. Early in the GATT era, a Secretariat was established to oversee the GATT's functioning. That Secretariat has continued under the WTO and is a key element of the WTO's success in a number of areas. The WTO is far from being any kind of "world government," but through its rules and its staff, it offers an international framework for promoting and managing freer trading relationships among most of the world's countries.

Fundamental Importance of the WTO

As bilateral, regional, and plurilateral trade agreements proliferate, it may seem that the WTO's role has diminished over time. However, there are several aspects of the trading system's liberalization that only the WTO has accomplished—or in some cases even could have accomplished—in comparison with preferential trade agreements. What follows are some key areas in which the WTO is vital and that make it unlikely that the system will be either replaced or abandoned.

Tariff Reductions and Trade Liberalization for Everyone. Free trade agreements (FTAs) make a lot of headlines these days. Hundreds of bilateral, regional, and plurilateral trade agreements are now in existence, and it seems as though there is always a new one being negotiated. Despite

TABLE 1

World Trade Organization Agreements

Agreements	Description
General Agreement on Tariffs and Trade (1947)	The legal framework that established the modern World Trade Organization as we know it. It has allowed for the removal of barriers to trade in an effort to build a more fair international trading system between members.
Agreement on Agriculture	Reduces domestic support for agricultural produces like export subsidies and limited market access. Also addresses issues of food security, environment, and concerns of developing countries.
Agreement on the Application of Sanitary and Phytosanitary Measures	Increases transparency for the trade of plants and animals produced with certain additives like pesticide. Prevents governments from restricting imports based on overly restrictive additive rules.
Agreement on Technical Barriers to Trade	Removes non-tariff restrictions on trade like standards, testing, and certifications for products. Eases the regulatory process for trade between members.
Agreement on Trade-Related Investment Measures	Removes barriers to investment between members that could restrict or distort trade. This includes allowing members' equal treatment for investment as well as restrictions on local content requirements.
Agreement on Implementation of Antidumping	Limits members' ability to apply antidumping measures without first going through a sufficient investigation at the World Trade Organization.
Agreement on Implementation of Customs Valuation	Normalizes the customs value of imported goods between members.
Agreement on Preshipment Inspection	Ensures governments cannot excessively use preshipment inspections to restrict the outflow of trade.
Agreement on Rules of Origin	Increases transparency and a long-term standard for the trade of goods originating from certain areas that is not excessively restrictive.
Agreement on Import Licensing Procedures	Increases the information required, and the amount of restrictions applicable, for import licenses.
Agreement on Subsidies and Countervailing Measures	Establishes a more definitive definition and rules for subsidies for industry groups and the level of countervailing duties against imports.
Agreement on Safeguards	Sets limits on members' ability to enact safeguard measures to protect domestic industry from import competition.
General Agreement on Trade in Services	Establishes an equal treatment for services across members.
Agreement on Trade-Related Aspects of Intellectual Property Rights	Establishes rules and disciplines around the protection of intellectual property including a dispute settlement.
Understanding on Rules and Procedures Governing the Settlement of Disputes	Strengthens the existing dispute settlement system to enable members to litigate and resolve issues over other agreements.
Trade Policy Review Mechanism	Establishes a periodic review for members and whether they are upholding the various agreements.
Agreement on Trade in Civil Aircraft	Removes tariff and non-tariff barriers to civil aviation trade.
Agreement on Government Procurement	Increases transparency and non-discrimination for the goods and services purchased by members.

SOURCE: World Trade Organization, "Legal Texts: the WTO Agreements," https://www.wto.org/english/docs_e/legal_e/ursum_e.htm (accessed May 5, 2020).

their number, however, these agreements do not cover all of the trading relationships covered by the WTO.

The GATT started with 23 “contracting parties,” but over the years, the accession process, with the assistance of the Secretariat, added many more. Most trade agreements remain static in their membership; the WTO has grown tremendously. The WTO now has 164 members, and many more accessions are underway. That means the WTO covers the trading relationship between each member and 163 other members.

At its core, the GATT/WTO has always been about trade liberalization. For each WTO member government, there have been commitments to reduce tariffs. “In eight rounds of negotiations between 1947 and 1994,” as a leading WTO textbook explains, “the average level of tariffs imposed by developed countries on industrial products was brought down from over 40 per cent to less than 4 per cent.”⁵ In addition, for each WTO member government, there is a commitment not to use domestic regulations and taxes to discriminate against foreign goods.

The WTO provides an overarching framework of general principles and specific obligations that applies to the trading relationships of almost the entire world, including all of its major economies. FTAs can supplement that, but they cannot replace it.

Most Favored Nation Principle. One specific principle that FTAs cannot offer is most favored nation (MFN) treatment. This principle means that countries agree to treat all other WTO member countries equally in relation to trade. For example, if a government commits to lowering its automobile tariffs to 2.5 percent, it must charge that same rate to all countries rather than discriminate among them with a variety of rates. Along the same lines, where it has domestic regulations (for example, in the area of food safety), it commits to applying those regulations to all of its trading partners in the same way.

In contrast to this, FTAs are fundamentally at odds with the MFN principle. By their very nature, FTAs discriminate in favor of some countries and against others. They offer lower tariffs to the FTA partners than they offer to other countries. They represent preferential trade rather than free trade.

While FTAs violate the MFN principle, WTO rules do allow FTAs, provided they meet certain conditions, as an exception, but the conditions in this exception act as a constraint on the development of sectoral trade alliances through FTAs. Only deep FTAs (or customs unions) that cover substantially all trade are allowed; sector-specific arrangements are prohibited. FTAs also must focus on lowering internal barriers between the partners rather than raising barriers to trade with outsiders. Without such constraints, FTAs could

undermine the whole enterprise of multilateralism, and the trading system could see a downward spiral toward trade alliances and greater conflict.

Dispute Settlement Understanding. The WTO's dispute settlement system is currently under attack. Nonetheless, for the past several decades, it has been the international trade dispute mechanism of choice for resolving trade conflict. As of this writing, in the years since the establishment of the WTO in 1995, under the Dispute Settlement Understanding (DSU), 586 complaints have been filed, in addition to which there have been 242 panel rulings, 141 appellate rulings, and 51 arbitration rulings. By contrast, the hundreds of FTAs in existence have led to only a handful of complaints. The most active non-WTO dispute mechanism has been the NAFTA's, but in 2000, the United States blocked the appointment of a panel, and no panels have been set up since then.⁶ When countries have complaints about trade barriers, they generally go to the WTO for resolution.

One of the key reasons for the WTO dispute settlement system's continued success is the existence of an independent Secretariat to manage the process. Two divisions of the WTO Secretariat provide primary assistance to the panels, and a separate Secretariat assists the Appellate Body, the standing group of seven appellate "judges" who hear appeals of panel reports. The role of the WTO staff is crucial in making sure panels are appointed when needed, as well as providing administrative and legal support in handling complex litigation. For FTA disputes, parties have to figure out the process from scratch each time. At the WTO, by contrast, an efficient and effective system is already in place for every dispute that might arise.

The DSU has been successful in part because it strikes a good balance between enforcement and flexibility. It strongly encourages compliance with panel and Appellate Body rulings, but it does not force governments to take actions that are politically infeasible. If a government is found to have violated WTO obligations, it can choose not to change its policies and instead accept retaliation from the complainant. In this way, the balance of commitments is maintained.

Disguised Protectionism Jurisprudence. The DSU has dealt with a wide range of issues, but there is one in particular where clarifications by panels and the Appellate Body have been helpful: the rules on disguised protectionism, such as those in GATT Article III, paragraphs 2 and 4, or the agreements on Technical Barriers to Trade and on Sanitary and Phytosanitary Measures. These provisions explain in broad terms that domestic regulations and taxes are not to be used to protect domestic producers of goods from foreign competition. How to apply these rules to specific government measures, however, is not always straightforward.

Over the years, WTO panels and the Appellate Body have applied these obligations in specific cases in a way that has provided a great deal more certainty about the boundaries. In cases where the tax or regulation explicitly treats foreign goods worse than similar domestic ones, the protectionism is obvious, but sometimes the discrimination is implicit. For example, a Chilean law that taxed liquor products on the basis of alcohol content looked neutral on its face. However, the panel and the Appellate Body were able to figure out that most foreign goods had a high alcohol content, most domestic goods had a low alcohol content, and the true purpose of the law was thus to protect domestic producers.⁷

In theory, cases of disguised protectionism could be handled in an FTA if one applies between two countries, but because of the well-developed jurisprudence under the DSU, the WTO has become the natural place to hear these cases.

Obligations on Trade Remedies and Subsidies. While there is a great deal of overlap in the coverage of the WTO and FTAs, there are certain policy areas for which the WTO has extensive disciplines but that FTAs do not cover and are unlikely ever to cover. Two of particular significance are trade remedies and subsidies.

“Trade remedies” refers to certain tariffs and other measures that can be used in response to both “unfair” and “fair” trade that causes or threatens economic injury to domestic producers. These measures include anti-dumping and countervailing duties and safeguards. Such remedies may be politically necessary in order to get trade deals completed, but they are potentially subject to abuse by domestic industries seeking protection from foreign competitors. What the WTO rules in this area do is offer a set of procedural and substantive rules that help to prevent this protectionist abuse.

Over the years, trade remedies have been one of the main subjects of WTO dispute settlement. Of the 586 complaints that have been initiated under the DSU, 196 have been related to trade remedies. In such cases, without the WTO disciplines, it would be much more difficult to keep the often disguised protectionism of trade remedies in check.

As for subsidies, the WTO provides general constraints on the use of subsidies for goods. It specifically prohibits export subsidies and domestic content subsidies, and it also has obligations related to any subsidies that cause “adverse effects” (loosely speaking, economic harm to foreign competitors). In addition, through the WTO’s Agreement on Agriculture, governments have made commitments not to provide subsidies to designated products beyond a certain amount, and these amounts are subject to reduction commitments over time.

Unlike tariffs, which can be applied on a country-by-country basis, subsidies have a broad effect on all trading partners. As a result, they are not likely to be disciplined through FTAs.

Transparency. Many of the WTO's benefits, like those described above, are well known, but others are more subtle and receive less attention. One that gets less acclaim than it should is the transparency on laws, regulations and other trade measures that the WTO provides. It does this in a number of ways.

First, through several specific obligations, the WTO requires governments to publicize and notify all of their measures that might affect trade so that other governments will be aware of them. In this regard, Article X, paragraph 1 of the GATT requires the publication of a wide range of measures:

Laws, regulations, judicial decisions and administrative rulings of general application...pertaining to the classification or the valuation of products for customs purposes, or to rates of duty, taxes or other charges, or to requirements, restrictions or prohibitions on imports or exports or on the transfer of payments therefor, or affecting their sale, distribution, transportation, insurance, warehousing inspection, exhibition, processing, mixing or other use, shall be published promptly in such a manner as to enable governments and traders to become acquainted with them.⁸

In addition, each of the individual WTO agreements on particular subjects requires that the covered measures be notified to the WTO.

However, publication and notification are not the end of the story. The WTO has a number of committees where governments meet to discuss measures that have been notified and raise concerns about their trade effects. In this way, many trade conflicts can be resolved without reaching the formal dispute stage.

Finally, the WTO periodically conducts country-specific "trade policy reviews" of each member. During these reviews, governments provide detailed information on their trade policy actions and respond to questions from other governments. With assistance from the Secretariat, this is a very useful exercise that allows governments to enhance their understanding of each other's trade policies and raise issues outside of the more contentious litigation process.

Current Crises at the WTO

Despite all of these benefits, it is clear that not all is well with the WTO. After the immense success of the Uruguay Round, which led to the

establishment of the WTO, expectations were high for the future. However, protests at the 1999 Seattle Ministerial Conference and the failure of the Doha Round talks launched in 2001 have caused a great deal of angst about the future of the WTO as a negotiating forum. There have been some successes, such as the Trade Facilitation Agreement, but broader liberalization has remained elusive.

One source of problems is the broader membership that exists today and the growing power of certain middle-income countries, which makes agreement harder to reach. In the past, agreement among the United States, the European Union, Japan, and Canada might have been enough to bring the rest of the membership along and serve as the basis for a deal. Now, though, China, Brazil, India, and others have to be on board as well. Some have suggested that perhaps the WTO negotiations should focus on plurilateral agreements by which countries willing to move forward can do so on their own without having to seek others' consent. E-commerce and services are two areas where attempts are being made, but the success of this approach has not yet been demonstrated.

In addition, the Trump Administration has put forward several serious criticisms of the existing system, and it is not clear at this point how these issues should be resolved.

- **Role of the Appellate Body.** In the view of the United States, the Appellate Body—the WTO's appeals “court”—has been engaged in “judicial activism” (exceeding its mandate in various ways) and has deviated from the agreed upon rules. The Bush and Obama Administrations voiced some criticisms of the Appellate Body on this basis and blocked the reappointment of certain appellate “judges,” substituting new judges in their place. The Trump Administration has ratcheted up the criticism and tactics and has refused to appoint any new judges until its concerns are addressed. As a result, by the end of 2019, there may not be enough judges to hear new appeals.
- **Notifications.** The United States has expressed concern that some countries (China in particular, but many other developing countries as well) are not properly notifying their laws, regulations, and other measures and has proposed harsh penalties for governments that fail to notify properly.
- **Development Status.** The United States believes that some countries are claiming developing country status without a proper basis, thus

allowing them to avoid taking on their fair share of commitments.

The United States would like to apply objective criteria to determine whether a country should be classified as developing rather than letting it be purely a matter of self-selection as it is now.

These issues have put the future functioning of the WTO in a state of uncertainty. With regard to the Appellate Body crisis, which is the most serious and pressing issue, other WTO members have responded with various reform proposals, but none of these has satisfied the Trump Administration. The Administration has insisted that the system should reflect the rules as written in 1995 but has not put forward its own ideas about how to achieve that. In all likelihood, there will be workarounds that members can adopt, such as agreements not to appeal a case or the use of *ad hoc* arbitrations for appeals, but the potential disappearance of the Appellate Body poses a real threat to the dispute settlement system.

Conclusion

The WTO is a fundamental and foundational part of the world trading system. U.S. Trade Representative Robert Lighthizer, although a long-time critic of the WTO, has emphasized its importance: “The WTO is a valuable institution, and offers many opportunities for the United States to advance our interests on trade. As I have said before, if we did not have the WTO, we would need to invent it.”⁹ Bilateral and regional FTAs can supplement the WTO, but they cannot replace it.

Nevertheless, no organization or set of rules is ever perfect. The current crises at the WTO represent an opportunity to address some weaknesses and concerns about its functioning. A good-faith effort on all sides should lead to a strengthening of the WTO in order to preserve its place at the center of the world trading system.

Digital Trade: Propelling Trade into the Future

Gabriella Beaumont-Smith

In the 1990s, the World Wide Web changed everything. Until 1991, the National Science Foundation had restricted commercial use of the Internet.¹⁰ Once such restrictions were lifted, the Internet increased the freedom of people all over the world by making it easier for them to share information and expand marketplaces. This was the beginning of e-commerce and, more broadly, digital trade. The capabilities of the Internet increased the freedom to trade—a key component of economic freedom.

The Internet gives people access to almost anything at the touch of their fingertips, pushing businesses to be more competitive and to advance innovative solutions. However, such freedom has sometimes faced roadblocks in the name of security, privacy, or law enforcement. More often than not, these issues are masks for protectionism. Digital trade is making traditional trade more efficient, enhancing the benefits that the freedom to trade has already brought to millions of people. Policymakers should refrain from erecting barriers that would reduce economic freedom and discourage innovation.

Defining Digital Trade

Before the 1990s, e-commerce and digital trade did not exist. The closest concept was teleshopping, popularized in the 1970s.¹¹ Then advances in computers made steps toward widespread digitalization possible. In the 1980s, personal computers became increasingly accessible, but early versions could be used only for video games, word processing, and programming; the Internet was not available for the public until 1991.¹² Thus, e-commerce and digital trade were not possible until the Internet became widely available.

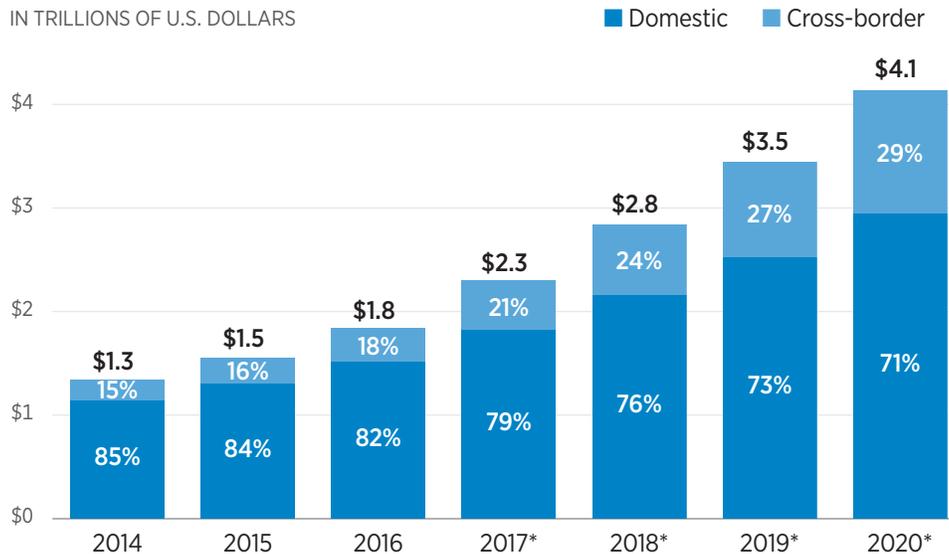
In 1995, Amazon.com was launched. Beginning as an online bookstore, it is now the world's largest online retailer. One of the most effective tactics that Amazon uses is reviews, a tactic now commonplace in online retail but groundbreaking in its infancy.¹³ Amazon is only one example of what was to come, and it is more accurately an example of e-commerce than of digital trade.

E-commerce is simply the buying of goods and services over the Internet; digital trade is broader. There is no standard definition of digital trade, but there is a consensus that it captures the sale of goods and services, data flows that facilitate global supply chains, services that power smart manufacturing, and other digital platforms and applications.¹⁴ Digital trade

CHART 2

Global Business-to-Consumer E-Commerce

IN TRILLIONS OF U.S. DOLLARS



* Projected

SOURCE: Sebastian Rovira, "The Growing Role of Data and Cross-Border E-commerce in the World Economy and Latin America and the Caribbean, Intergovernmental Group of Experts on E-Commerce (IGE) and the Digital Economy," ECLAC, p. 5, April 3, 2019, https://unctad.org/meetings/en/Presentation/tdb_ed3_2019_p04_SRovira_en.pdf (accessed May 5, 2020).

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encompasses transactions that are digitally processed and digitally or physically delivered. It is increasingly important for the competitiveness of businesses.

Digitalization Transforming Supply Chains

Digital trade can, of course, involve transactions that occur within a single country, but the term is more generally understood to involve transactions that involve cross-border data flows.¹⁵ Such flows are the foundation of trade in services and increasingly support trade in goods. By 2020, global e-commerce directly from business to consumer (B2C) is projected to reach \$4.1 trillion, 30 percent of which will be cross-border—double the amount seen in 2014. (See Chart 2.)

These projections illustrate how important data flows are to trade freedom. Data is an informational tool for businesses that supports production

and makes supply chains more efficient. However, data itself can also be traded. Trading data makes the production process more efficient because it organizes the important information upon which businesses rely in making investment decisions. Customer responses to products, for example, can be used to determine trends in purchasing and whether investment is needed to improve or discontinue a product or production should be increased. Collecting such data allows firms to meet their customers' needs more effectively.

Almost all businesses are partially digitally enabled,¹⁶ and digitalization has become a crucial feature of competitiveness on the international market. Digitalization can support scale and scope by increasing the speed of trade, not only in the final sale transaction stage, but also in facilitating payments, enabling collaboration, finding alternative funding mechanisms such as crowdfunding, and avoiding investment in fixed assets by using cloud-based services.¹⁷ These options are made possible by the Internet of Things (IoT), which consist of devices that are connected to the Internet. The IoT connects over 5 billion objects, including (among others) cars, refrigerators, locomotives, airplanes, and buildings. It is estimated that by 2024, 27 billion devices will be generating and transferring data across rooms and borders.¹⁸ This access to data will help small businesses to break into markets and help businesses to run more efficiently.

The manufacturing sector has seen enormous gains because of digital trade. The sector creates more data, at every stage of the supply chain, than any other sector in the U.S. economy. Businesses rely on the data from research and development, factory operations, and services to evaluate productivity and cost efficiency. Metal companies such as steelmakers use data and the IoT to analyze the physical properties of raw materials and constraints of production plants to help them find ways to improve efficiency and reduce energy consumption.¹⁹

Technological innovation and evolving business models are blurring the lines between businesses that produce goods and businesses that produce services, creating companies that produce and supply a combination of both. For example, if a business in the United States wants a product printed by a 3D printing company in the United Kingdom, a cross-border service is taking place because of the design aspect of 3D printing. Once the printed product is shipped to the U.S., it is now a good being traded.

Digitalization can allow a company to provide both a good and a service in the same transaction. Smart refrigerators, for example, are a good embedded within a service. A company that produces smart refrigerators may produce both the physical appliance and the embedded software, or it may contract with a software company to embed the service into the product.

Barriers to Digital Trade Freedom

Data Localization and Restrictions on Cross-Border Data Flows.

Some governments are using digitalization as a protectionist tool. Examples include implementing data localization requirements or restricting cross-border data flows.

- Data localization is a type of regulation that requires a business operating in a territory to store the data it collects in a computing facility in that territory.
- Restrictions on cross-border data flows involve a range of regulations that restrict or prohibit what is considered to be routine cross-border transfers of information.

All of these regulations negatively affect cloud computing and cloud-based services, the purpose of which is to provide information from anywhere.

Cloud computing is a network of remote servers hosted on the Internet so that data can be stored, managed, and processed more efficiently than is possible on a local server or personal computer. Cloud-based services can be used on the Internet on demand from a cloud computing–provider’s servers. These different servers can be anywhere because of the Internet and create a network infrastructure that underpins the digitalization of other services. Businesses and global supply chains rely on cloud computing and services because they increase the access to and delivery speed of information that is necessary for production and supply.

Data localization is defended by policymakers for a variety of reasons. The most common involve cybersecurity and privacy. However, physical location is not likely to protect data. Data localization increases costs by preventing firms from transferring data that is needed for day-to-day activities. Firms may pay for duplicative services or increase expenditures “on compliance activities, such as hiring a data-protection officer, or putting in place software and systems to get individuals’ or the government’s approval to transfer data.”²⁰ Requiring businesses to store data in a specific territory burdens them with additional costs, both because they need the necessary infrastructure in that territory and because they need to be sure that they are in compliance with the law. These additional costs reduce trade freedom and undermine a firm’s competitiveness.

A growing number of jurisdictions are introducing or strengthening data localization requirements. For example:

- China has prohibited foreign companies from providing cloud computing services directly to customers in China. In addition, if foreign suppliers of services wish to enter the market, they must work with a Chinese company and share all technology, intellectual property, and brands.²¹
- In October 2018, India implemented a measure that required suppliers of payment services to store all information related to electronic payments made by Indian citizens within India. India has been a hub for information communication technology (ICT) and business services companies for decades because of its cheap skilled labor. However, the government has stated that it needs to exert more control over its citizens' data for national security and commercial reasons. If businesses do not store data in India, government officials will have to submit requests to foreign technology firms, creating bureaucratic burdens. It seems that India's data localization policies are driven by digital protectionism as it tries to encourage the development of Indian technology companies.²²
- In Indonesia, categories of data that are subject to data localization rules have been expanded, and any provider of a "public service" must establish local data centers and disaster recovery centers.²³
- South Korea restricts the cross-border use of cloud computing for financial services, which is a serious impediment to market access for foreign companies.²⁴
- Nigerian laws force businesses to store any data in Nigeria that concern Nigerian citizens and require businesses to host any governmental data locally unless exemptions are granted.²⁵
- Electronically collected data on Russian citizens must be processed and stored in Russia. Numerous Internet protocol (IP) addresses that are associated with U.S. cloud services have been blocked, and because of this, U.S. firms must consider whether the Russian market is worth the legal uncertainty.²⁶
- Saudi Arabia has a framework for cloud computing that requires cloud and other ICT companies to install government filtering software and localize certain data.²⁷

- Turkey limits the transfer of personal data abroad, requires suppliers of electronic payment services to maintain information systems in Turkey, and requires any publicly traded company to keep its primary and secondary information systems and data in Turkey.²⁸
- Vietnam passed a cybersecurity law that forces online service suppliers to store data in Vietnam.²⁹

A recent study found that imports of services would rise on average by 5 percent across all countries if restrictions on cross-border flows of data were lifted.³⁰ Cross-border data flows are important for services such as advertising: “For instance, advertising on search engines such as Google and Bing bring[s] together overseas buyers and sellers and is often how consumers learn of the goods and services available in other countries.”³¹ This increases consumer choice. Cross-border data flows are also important for financial transfers and communications, which are key to increasing trade freedom.

However, many countries are restricting cross-border data flows. China has implemented a policy to restrict data flows that include a broad range of information falling into the undefined category of being “important.”³² South Korea restricts the export of geo-location data. This is disadvantageous for foreign companies that incorporate services like traffic updates and navigation into their products.³³

Data localization policies and restrictions on cross-border data flows are protectionist in nature and reduce the freedom to share information across borders. Requiring businesses to use local data centers fractures their ability to compete. The Internet has given businesses of all sizes an easier and more efficient way to break into the international market, and data localization and restrictions on cross-border data flows threaten this progress. They raise costs and, in response, disrupt services. As a result, some firms may exit the market, thereby reducing competition and artificially ceding dominance to domestic firms. Reducing trade freedom in the digital sector will stunt growth and harm consumers who benefit from the varieties of goods and services that a competitive industry can provide.

Digital Taxation. Taxation has typically been based on physical location. However, as physical location is ambiguous when it comes to the Internet, policymakers have claimed that physical location is no longer an appropriate standard. Physical location matters for tax purposes because local governments are better equipped with cultural knowledge to estimate the impact of a tax on an industry. Destination-based taxes give distant

politicians the ability to involve themselves in local affairs, threatening individual liberties and thereby reducing economic freedom.³⁴

Digital taxes have been floated in the European Union (EU)³⁵ and Indonesia. The European Commission proposed a directive to member states about levying a tax on the revenues of large companies from digital services, including online advertising, online marketplaces, and data services, even if they did not have a physical presence in the EU.³⁶ As the tax would be revenue-based, it is economically inefficient because it could be imposed on a firm that has no net income in the jurisdiction yet is still required to pay the tax.³⁷

Digital services benefit Europeans because they allow companies to tailor products to their customers. The digital tax would likely cause companies to increase prices so that the cost falls on their customers. This adds risk and administrative burden to doing business in a foreign market, as well as expense, thus reducing trade freedom and competition in the digital sector.

Indonesia implemented a new regulation that establishes tariff lines for digital products that are electronically transmitted, including software, apps, videos, and music. The tariffs are currently set at zero, but duties could be imposed in the future. Indonesia's regulation may violate a World Trade Organization commitment (the Declaration on Global Electronic Commerce) not to impose duties on electronic transmissions.³⁸

Digital protectionist measures such as these are limited only by the imagination of potential beneficiary companies and national authorities. There is no doubt that finding and enforcing measures to ensure data openness and freedom will play an increasingly important role in trade negotiations and disputes in the future.

Blockchain and International Trade

Blockchain could be one solution to the tradeoff between the free flow of data and privacy. Blockchain is a virtual distributed ledger that records transactions held by multiple distinct parties. It is connected by nodes, which are devices such as a smartphone or computer. These distributed nodes securely add and store transaction data, creating a full blockchain transaction history that is recorded across the numerous participating nodes.³⁹

New information must be added by consensus.⁴⁰ Consensus removes the need for a centralized third-party authenticator. Any new transaction is considered new information, and "a majority of nodes must confirm the history over which the new information will be built." Following this confirmation, "the blockchain log is then updated across all nodes."⁴¹

This process is important because it illustrates the key attribute of blockchain: encryption. Encryption makes it extremely difficult to tamper with new and stored data because only authorized parties can access the information. As there is no centralized third party recording transactions, it becomes very difficult to hack or steal information. The combination of encryption and the distributed ledger results in trustworthy and efficient cross-border data flows. Users can freely transfer information knowing that it is protected by incorruptible code and validated by numerous other users.⁴²

Blockchain may also play a role in easing cross-border processing and increasing the speed of delivery. Improved efficiencies from digitalization need to be met with evolving procedures at the border, primarily in the area of providing customs forms and payment options online.

Blockchain could be widely applicable in this area. The distributed ledger is a communication tool and could help inspectors to verify that a shipment has been inspected and is compliant with regulations,⁴³ helping customs and law enforcement to detect illicit trade and mitigating risks.⁴⁴ It could also be used by a carrier to verify receipt of cargo, log temperature, and track GPS data while a shipment is in transit.⁴⁵ In short, using blockchain could reduce the bureaucratic burden for traders and make procedures more efficient, allowing customs officials to increase the speed and accuracy of accepted shipments.

Finally, as policymakers aim to increase economic freedom through trade liberalization, more businesses are attracted to the international market. This can exacerbate the traditional and often difficult problem of determining the provenance of traded goods. Through the distributed ledger, blockchain could help supply chains to manage information about the origin and movement of goods in real time.⁴⁶

Conclusion

The Internet has been integral to increasing the trade freedom of individuals and businesses worldwide. Digital trade may be expanding beyond the Internet, but it also would not be possible without it. Digitalization is facilitating the speed at which the global economy is integrating, providing businesses with better resources and consumers with better products.

However, the borderlessness of the digital economy has brought new waves of policy issues. Admittedly, important matters such as security, privacy, and law enforcement must be considered in international trade; however, digital protectionism is not the solution.

Several recent trade agreements have addressed digital trade, including provisions that ban data localization, restrictions on cross-border data flows, and the forced transfer of source code. Trade liberalization and digitalization enhance the benefits of trade. The freedom to trade has increased living standards around the world and pulled millions out of poverty. Embracing digital trade will propel this effort, increase transparency, and help countries to hold each other accountable for illegitimate trade actions.

The Evolving Frameworks for International Trade Negotiations

Takashi Terada

Globalization has fundamentally shifted the nature of international economic relations. Countries increasingly rely on international institutions and agreements in managing their trading relations with other economies. Given that the world economy has become more globalized, countries face greater difficulty in pursuing isolationist economic policies. The modalities of international trade negotiations have evolved significantly over time, but it seems clear that cooperation through multilateral efforts will become increasingly important, and perhaps more complex or difficult, as trade becomes less reliant on the physical concept of borders and as automation changes the nature of employment.

Eager to promote liberalization for economic growth in the age of globalization, countries have adopted a variety of trade policy strategies. These strategies include efforts and negotiations at the multilateral, regional, and bilateral levels, and often some mix of all three. Countries have attempted to maximize opportunities for flows of trade, investment, and services, meanwhile harmonizing or otherwise reconciling different domestic rules and regulations. This multilayered trade strategy has required government officials to engage in complex negotiations through multiple legal frameworks in support of widely diverse constituencies that include domestic producers, multinational corporations and international service providers, and consumers.

Each of the three trade policy “layers” (global, regional, and bilateral) has distinctive features in terms of negotiations and rules. The global layer includes the World Trade Organization (WTO), which replaced the General Agreement on Tariffs and Trade (GATT) in 1995. The WTO is a consensus-based institution that is used for negotiations that involve competing interests within a broader shared vision aimed at greater economic welfare. The GATT/WTO system is today the embodiment of a U.S.-led international liberal order built through a series of multilateral negotiating rounds over the past six decades. The key guiding principle of this order is nondiscrimination, as stipulated in the GATT Article 1, with its egalitarian most favored nation treatment among members. This is meant to avoid trade discrimination among WTO members by granting equal treatment to all.

Many nations have come to view the long-serving GATT/WTO system as essential to maximizing the benefits from a more interconnected global economy, but the WTO has become increasingly ineffectual in trade

liberalization negotiations. This became evident in the 1999 Ministerial Meeting in Seattle with the growing influence of developing countries and non-governmental organizations. These newly empowered members and increasingly prominent outside groups were strong enough to hamper further global liberalization in the WTO, which still operated under a consensus-based decision-making approach among its then nearly 150 members. The motives for the resistance varied from old-fashioned protectionism to fears of neocolonialism to radical environmental and anti-capitalist stances. Although the WTO managed to launch the Doha Development Round two years later, negotiations continued to be bogged down.

The breakdown in global trade negotiations pushed a great number of members to pursue alternative bilateral and regional trading agreements for which there was no set model. Countries thus faced a whole new set of questions and options, and the result was increasing diversity in the specific agendas and norms for trade negotiations. An examination of the power relationships between countries provides an interesting perspective on how and why specific agendas were chosen for certain free trade agreements (FTAs) and not others.

The Role of Powerful Economies in Bilateral FTA Proliferation

Countries' agendas are the basis for any kind of international negotiation or policy coordination. Countries have to identify interests that will be commonly pursued, or problems to be jointly solved, in international arrangements such as trade agreements. Norms that underpin these agendas also serve as important elements in international cooperation. An examination of a variety of FTAs over the years shows that powerful economies have had an important role not just in influencing the agenda of trade agreements, but also in establishing broad acceptance of the norms underpinning them. In other words, the creation and maintenance of FTAs are generally contingent upon the powerful party's ability to impose its values on others, and its interests will largely determine the agenda and rules of the trading agreement.

While multilateral efforts at trade liberalization through the WTO have stalled to a large extent since the start of the millennium, FTAs have continued to proliferate at a rapid pace. This is because "FTAs provide participating countries with flexibility in view of both picking their partner countries and the content of these agreements."⁴⁷ But they also allow

countries to cover a wider range of issues, a fact that can be attributed in large part to powerful states with huge markets attempting to impose their own regulatory and legal standards on their trading partners.

For instance, both the European Union (EU) and the United States have instruments in place to provide assistance to workers and industries that are hit by trade liberalization.⁴⁸ Both usually require potential trading partners to comply with core International Labour Organization (ILO) standards, such as the “Fundamental Principles and Rights at Work,”⁴⁹ which stop “countries—for example, Colombia, Peru and South Korea—from amending or failing to enforce domestic labour standards to gain a competitive advantage in trade or investment.”⁵⁰

The EU has targeted Asian countries as potential FTA partners and in the process is attempting to propagate globally its agendas and norms such as deregulation in government procurement. In 2006, the European Commission published its Global Europe Communication, which announced a marked shift in the EU’s trade strategy from a “multilateralism first” approach to a more strategic approach based on bilateralism with a focus on major Asian trading partners.⁵¹ This strategy has manifested itself in the conclusion of the following FTAs with key Asian trading nations:

- Vietnam (signed June 30, 2019, and yet to enter into force);
 - Japan (entered into force February 1, 2019);
 - Singapore (signed October 19, 2018, and yet to enter into force); and
 - South Korea (entered into force July 1, 2016).⁵²
- The EU negotiating agenda also targeted some key developing nations in Asia:
- India (negotiations started in 2007, although rounds halted in 2013);
 - Indonesia (negotiations started in 2016);
 - Malaysia (negotiations started in 2010);
 - Myanmar (negotiations started in 2015);
 - Philippines (negotiations started in 2015); and

- Thailand (negotiations started in 2013, although none have taken place since 2014).⁵³

The EU's pursuit of these bilateral FTAs with Asian developing states has contributed to the changing nature of the international trade environment, including the multitude of FTAs proliferating across the Asia–Pacific region. There currently are as many as 158 FTAs in Asia (signed and entered into effect).⁵⁴

In addition, the EU has viewed trade negotiations as a way to capitalize on and improve human rights, labor standards, and environmental protection while pursuing economic benefits. For example, the EU–Vietnam Trade and Investment Agreements include “sanitary and phytosanitary measures” designed to “protect human, animal or plant life or health in the territory of each Party while facilitating trade between the Parties and to ensure that SPS [Sanitary and Phytosanitary] measures adopted by each Party do not create unnecessary obstacles to trade.”⁵⁵

While powerful states can set the agenda for bilateral FTA negotiations, they can also affect negotiations in a negative way by hampering the launch of more liberalized FTAs. For instance, Japan has concluded an FTA with the Association of Southeast Asian Nations (ASEAN) and separate bilateral FTAs with seven ASEAN member countries. In most cases, Japan concluded these FTAs without even broaching the subject of eliminating tariffs on its agricultural produce. Instead, in order to conclude negotiations, Japan offered to provide economic cooperation such as human resource development, further delaying the liberalization of its domestic agricultural sector.

This is a unique feature of Japan's FTA negotiations. Although Japanese trade negotiators request that the tariffs levied on most goods in ASEAN countries be eliminated, with the exception of textiles, tariffs on nearly all of Japan's industrial products have already been eliminated or their tariff rates have been reduced, so Japan cannot provide that “prime cut” known as preferred market access to FTA counterparties. For example, of the 940 items for which tariffs were *not* eliminated in FTAs that Japan concluded before the existence of the Trans-Pacific Partnership (TPP) agreement, 850 were agricultural, forestry, or marine fisheries products, including rice and grain.

As long as there remain domestic political difficulties in eliminating tariffs on agricultural produce in Japan, the country will be forced to rely on offering other benefits to conclude FTAs. Such benefits have included the promotion of direct investment, economic and technical cooperation,

or the movement of people. A recent example is the intake of nurses and caregivers from the Philippines and Indonesia.

Article 24 of the GATT recognizes any FTA or tariff union as a legitimate exemption to most favored nation tariff treatment. This exemption allows for the abolishing of tariffs on “essentially all trade” between countries party to the agreement. This “essentially all” means, for practical purposes, 90 percent of all trade of each country party to the agreement, making it possible for Japan to exempt items such as rice and sugar. Therefore, FTAs concluded between Japan and Southeast Asian nations are examples of liberalization without political pain.

Sticking to this approach, Japan has concluded only FTAs that have avoided, to every extent possible, promises to liberalize its agricultural industry. That changed in 2013 when Japan became a negotiating member of the TPP, now succeeded by the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), following the withdrawal of the U.S., where Japan made concessions on pork and beef tariffs in response to U.S. demands for greater market access. The U.S. proved to be powerful enough to secure these Japanese agricultural liberalizations in the negotiations and has apparently resecured them in more recent talks with Japan on a bilateral FTA in 2019.

Generally, however, when it comes to regional FTAs, or multilateral negotiations where three or more countries seek to enhance their trading relations, the “powerful party” dynamic you might see in bilateral FTAs is much less significant. This is true even if the negotiations include less-developed economies. Once a powerful party enters into negotiations in a multiparty framework, it has strong incentives to want those negotiations to succeed and will often relent from even core policy interests rather than run the risk of the FTA’s collapsing under its demands.

The TPP, again, is a useful example. It included chapters on health, the environment, and labour rights,⁵⁶ all high priorities for the U.S. under President Barack Obama. In addition, the U.S. had emphasized the importance of promoting competition policy and dealing with state-owned enterprises (SOEs). However, when the U.S. sought to ensure a level playing field or competitive neutrality between SOEs and private companies, Malaysia, Vietnam, and Singapore, all of which possess their own SOEs, expressed their vigorous opposition to the U.S. proposal. Eventually, the U.S. made exceptions for local SOEs and sovereign wealth funds for the TPP. The U.S. decision not to impose its own will on the other members was therefore important for the successful conclusion of the original TPP in 2015.

Influences of Supply-Chain Production Networks

The use of bilateral or regional FTAs to promote trade liberalization has received an important boost from the growing political influence of multinational corporations (MNCs) with large supply-chain networks. These companies have identified FTAs as an effective way to lower the cost of producing and selling abroad. They see FTAs as promoting stability and efficiency, especially when it comes to previously fragmented supply-chain networks where parts or components are produced in different countries and products frequently cross borders before getting to the final consumption stage. This global production pattern encourages MNCs to “lobby for liberalization with countries from which they source.”⁵⁷

The emergence of “global value chains” has boosted the share of intermediate goods in trade as more firms and countries join these diffuse production networks. As firms focus more on specialized tasks and less on the complete production process, new opportunities arise for firms in developing countries, including in the least developed countries, to become part of these regional and global networks.⁵⁸

In this context, the “Rise of the South”⁵⁹ has precipitated a change in the nature of global trading relations. As of 2015, 47 percent of global manufacturing exports (in value terms) originated in the Global South or developing countries generally,⁶⁰ and the direction of global trade flows, including flows of intermediate goods, has switched from an overwhelmingly South–North orientation to one that includes large elements of South–South trade.

In terms of a percentage of world trade, South–South trade “rose slowly from 11.4 per cent in 1995 to 12.8 per cent in 2000, then expanded dramatically to 25.3 per cent in 2015.”⁶¹ Asia is particularly important in this regard, “account[ing] for approximately 75 per cent of the trade between developing countries over the 1995–2015 period.”⁶² These developing states, with much lower labor costs, are already attractive destinations for investments by MNCs. FTAs add further value to these countries’ investment attractiveness.

Yet the different product coverage and time framework for liberalization through a number of FTAs could make it difficult for MNCs as they attempt to identify which FTAs would be most effective in cost-saving for their businesses. In these instances, MNCs end up facing a “spaghetti bowl” of regulations when they must deal with various rules of origin with specific standards and involving specific procedures. From a business prospective, there is thus now a strong incentive to support mega-FTAs in order to simplify compliance costs to the greatest possible extent. Even these, however, risk fragmenting the world trading system into competing blocs.

Conclusion

The effective collapse of the Doha Round in 2015 and the emergence of mega-regional FTAs such as the TPP point to a great weakening of the centrality of the WTO in global trade. Speaking globally, however, mega-regionals are “not a good substitute for multilateralization inside the WTO” because those mega-FTAs would make the world trading system fragmented (as they are not harmonized among themselves) and exclusive (as China and India are not generally included now and may never be).⁶³

Uncertainties in the global rule-based and open trading system highlight the WTO’s importance in providing “a common language for problem solving, dispute resolution, regulation and administration.”⁶⁴ But as long as there continue to be inefficiencies in this system, countries will continue to use a variety of bilateral, multilateral, and regional trade agreements to implement their selected agendas and pursue trade liberalization in a more discriminatory way.

TABLE 2

Trade Freedom Scores in the *Index of Economic Freedom*

Country	Score	Country	Score	Country	Score	Country	Score
Afghanistan	66.0	Dominica	68.4	Lesotho	82.2	Senegal	65.4
Albania	88.4	Dominican Republic	76.6	Liberia	60.6	Serbia	78.0
Algeria	66.2	Ecuador	66.0	Lithuania	86.4	Seychelles	82.6
Angola	66.2	Egypt	70.2	Luxembourg	86.4	Sierra Leone	69.4
Argentina	69.2	El Salvador	80.8	Macau	90.0	Singapore	94.8
Armenia	80.6	Equatorial Guinea	48.8	Madagascar	73.6	Slovakia	86.4
Australia	88.2	Eritrea	69.2	Malawi	75.4	Slovenia	86.4
Austria	86.4	Estonia	86.4	Malaysia	82.0	Solomon Islands	48.0
Azerbaijan	74.6	Eswatini	88.6	Maldives	61.0	South Africa	75.8
Bahamas	47.8	Ethiopia	60.8	Mali	65.0	Spain	86.4
Bahrain	79.4	Fiji	52.8	Malta	86.4	Sri Lanka	67.6
Bangladesh	63.6	Finland	86.4	Mauritania	62.6	Sudan	52.0
Barbados	56.6	France	81.4	Mauritius	88.2	Suriname	69.8
Belarus	82.0	Gabon	51.2	Mexico	87.6	Sweden	86.4
Belgium	86.4	Gambia	64.6	Micronesia	70.8	Switzerland	86.6
Belize	64.2	Georgia	88.6	Moldova	78.0	Syria	51.6
Benin	49.4	Germany	86.4	Mongolia	74.0	Taiwan	86.0
Bhutan	79.4	Ghana	63.8	Montenegro	83.8	Tajikistan	75.0
Bolivia	67.8	Greece	81.4	Morocco	78.6	Tanzania	67.8
Bosnia and Herzegovina	80.0	Guatemala	82.2	Mozambique	78.0	Thailand	83.0
Botswana	82.8	Guinea	60.4	Namibia	83.2	Timor-Leste	75.0
Brazil	67.8	Guinea-Bissau	49.0	Nepal	60.4	Togo	63.2
Brunei Darussalam	85.0	Guyana	66.8	Netherlands	86.4	Tonga	74.0
Bulgaria	86.4	Haiti	67.0	New Zealand	92.2	Trinidad and Tobago	67.8
Burkina Faso	61.8	Honduras	79.4	Nicaragua	75.4	Tunisia	66.4
Burma	70.8	Hong Kong	95.0	Niger	61.2	Turkey	78.0
Burundi	68.2	Hungary	86.4	Nigeria	62.4	Turkmenistan	74.2
Cabo Verde	68.2	Iceland	86.8	North Macedonia	86.2	Uganda	75.4
Cambodia	65.4	India	73.4	Norway	83.8	Ukraine	81.2
Cameroon	59.6	Indonesia	80.8	Oman	81.6	United Arab Emirates	80.4
Canada	87.0	Iran	54.6	Pakistan	64.8	United Kingdom	86.4
Central African Republic	47.2	Ireland	86.4	Panama	79.2	United States	79.8
Chad	47.2	Israel	86.2	Papua New Guinea	79.8	Uruguay	77.4
Chile	89.0	Italy	86.4	Paraguay	75.4	Uzbekistan	67.6
China	72.4	Jamaica	68.4	Peru	88.4	Vanuatu	63.4
Colombia	81.2	Japan	80.0	Philippines	81.6	Venezuela	58.0
Comoros	59.2	Jordan	81.2	Poland	86.4	Vietnam	79.6
Dem. Rep. Congo	64.6	Kazakhstan	80.2	Portugal	86.4	Yemen	70.0
Rep. Congo	56.8	Kenya	60.4	Qatar	81.6	Zambia	72.6
Costa Rica	81.4	Kiribati	23.8	Romania	86.4	Zimbabwe	70.0
Côte d'Ivoire	69.4	Korea, North	0.0	Russia	77.8		
Croatia	86.4	Korea, South	80.0	Rwanda	70.4		
Cuba	65.6	Kosovo	76.2	Saint Lucia	73.2		
Cyprus	86.4	Kuwait	76.4	Saint Vincent and the Grenadines	67.2		
Czech Republic	86.4	Kyrgyz Republic	79.2	Samoa	64.6		
Denmark	86.4	Laos	82.0	São Tomé and Príncipe	64.2		
Djibouti	49.8	Latvia	86.4	Saudi Arabia	75.4		
		Lebanon	77.4				

SOURCE: Terry Miller, Anthony B. Kim, and James M. Roberts, *2020 Index of Economic Freedom* (Washington: The Heritage Foundation, 2020), <http://www.heritage.org/index>.

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