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The Urgent Need of Reforming the WTO: Why and How?

Amrita Narlikar, Lisandra Flach, Bernard Hoekman and *Robert Wolfe, Jürgen Matthes, Alicia García-Herrero*

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RESEARCH REPORT

REFORM MODEL

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The World Trade Organization (WTO) has gone through stormy times. There have been a number of serious controversies in recent years. Many of these have been attributed to the disruptive positions that former US President Donald J. Trump has taken on international trade and multilateral institutions. But that is just one of numerous, deep and long-standing problems plaguing the WTO. Most notably, it is struggling with the fact that its "trade liberalization" function has become a blunt sword. Discussions about reforming the WTO have been triggered by increasing competitive tensions among the United States, the EU and China. At the same time, China has become an increasingly powerful force within the global trading system. This edition of the CESifo Forum examines the current challenges facing international trade and global cooperation systems. The authors discuss the future of the WTO and proposals to reform it that will make trade multilateralism meaningful again.

Amrita Narlikar

Rebooting the World Trade Organization: A Rethink on Purpose and Practice

The trials and travails of the World Trade Organization (WTO) in recent years have often been attributed to the unpredictable and disruptive positions that the former President of the United States, Donald J. Trump, took on both international trade and multilateral institutions. But the problems afflicting the WTO are numerous, run deep, and many predate Trump's arrival on the trade scene. In fact, "tough love" may be an apt description of how the US has approached its relationship with the multilateral trade regime in the last two decades.

Different US administrations had developed a familiar pattern of expressing their dissatisfaction with certain aspects of the WTO's functioning while also signaling overall support. Hence, on the one hand, it was commonplace to see various US trade representatives in the past (e.g., Robert Zoellick and Susan Schwab) berating the larger developing countries for their reluctance to open up their markets. On the other hand, they stayed engaged with the organization, both in its daily business and also in offering proposals for reform. The US was moreover not alone in working with but also criticizing the regime. Discontent was rife throughout the (still incomplete) Doha negotiations as countries sparred over the processes and substance of the negotiations and jostled with each other over shifting balances of power and conflicting visions of order (Narlikar 2010a and 2010b).

True, under the Trump administration, the "toughness" came to significantly outweigh any affection or support that the world's largest economy might have had for the WTO. Trump himself denounced the WTO as "the single worst deal ever made," (Trump 2018) while his administration took the unprecedented step of paralyzing the organization's Dispute Settlement Mechanism by blocking the appointment/reappointment of Appellate Body members. Such rhetoric and action to discredit the WTO would have been damaging in its own right but was rendered many times more pernicious as it came from the United States—the world's largest economy, which had played a leading role in creating and sustaining trade multilateralism over the last 75 years. Perhaps it was not surprising that media pundits breathed a sigh of relief when President Biden took office in January 2021. Headlines such as "Biden ends deadlock over first African and first woman to lead WTO," (BBC 2021) greeted the administration's expression of "strong support" for Dr Okonjo-Iweana (USTR 2021). But changes in leadership—and much goodwill besides—will not rescue the organization from its decline into irrelevance.

Amrita Narlikar

is President of the German Institute for Global and Area Studies (GIGA), Professor at Hamburg University, and non-resident Senior Fellow at the Observer Research Foundation.

In this paper, I argue that the WTO needs a reboot to make trade multilateralism meaningful again. For a member-driven organization, this means a fundamental reconsideration—by the members themselves—of the original bargain that brought the multilateral trade regime into existence. In the first section, I explain how new structural conditions make the old model of multilateralism ill-suited to the demands of the present day. Minor level tinkering will no longer suffice: the *purpose* of trade multilateralism needs to be reconsidered. In the second section, I suggest what a reboot of the WTO could entail in practice. The third and concluding section outlines concrete next steps in pursuit of the reform agenda outlined here.

RETHINKING THE PURPOSE OF TRADE MULTILATERALISM UNDER CONDITIONS OF "WEAPONIZED INTERDEPENDENCE"

The post-war multilateral order was premised on the understanding that prosperity and peace were inextricably linked. Speaking at the inaugural session of the Bretton Woods conference in 1944, Henry Morgenthau, US Secretary of the Treasury had declaimed, "economic aggression can have no other offspring than war. It is as dangerous as it is futile" (Morgenthau 1944). The corollary of this argument was that economic integration could serve as a vital pathway to not only prosperity but also security and peace. The system of global economic governance in the post-war era came to be founded on this logic, epitomized in the evolution of the European Steel and Coal Community into the European Union. The idea of a liberal peace based on progressive convergence—even socialization—among a diverse group of nations gained further traction with the end of the Cold War: "the notion that extending interdependence and tightening economic integration among nations is a positive development that advances peace, stability and prosperity" (Wright 2013). And while economic integration—often driven by smoother and increased trade flows, facilitated by the General Agreement on Tariffs and Trade, and subsequently the WTO—had indeed helped lift millions out of poverty for over half a century, this model of globalization is now under serious challenge.

Writing in 2013, Thomas Wright noted that countries had been acting "as if increasing and freewheeling economic interdependence is a force for good in itself. Yet over the past five years, it has become increasingly apparent that interdependence and integration carries strategic risks and challenges with it." While Wright had pointed to the perils of asymmetric interdependence, Henry Farrell and Abraham Newman (2019) have taken the argument further in their pioneering work on "weaponized interdependence" (WI). Farrell and Newman trace the interactions between network structures, state power and global value chains. They demonstrate that production patterns today—at least in certain key areas—are based on closely integrated network structures; these networks are not "flat" but highly asymmetric. Only a few states occupy key network hubs and have the necessary institutional capacity to exploit their positions to coerce others via "panopticon" and "chokepoint" effects. The panopticon effect allows hub states to "extract informational advantages vis-à-vis adversaries," while the chokepoint effect enables them to "cut adversaries off from network flows." Network externalities under WI are usually high, which create significant barriers to entry for new players; natural monopolies emerge around some global supply chains that tend to reinforce and exacerbate existing power hierarchies (Drezner 2021). Farrell and Newman (2019) focus specifically on the US as a hub power, and its ability to exercise control over financial transactions and internet flows as cases that illustrate WI. Others have conducted similar studies on China, for instance in the area of semiconductors (Kim and VerWey 2019) and rare earth minerals (Gavin 2013).

Now the problem with the WTO—and indeed many of the post-war institutions of multilateral cooperation—in a world of WI is the following: the very ties of economic integration, which were supposed to serve as a route to prosperity and peace, can become weaponized. Under the old system, as still espoused by the WTO, well-integrated global supply chains should further promote global interdependence and convergence; under WI, the same global supply chains offer control of key nodes to just a handful of states, thereby exacerbating power asymmetries and the misuse of this control against trading partners. And there is enough scholarly research (Drezner, Farrell and Newman 2021; Farrell and Newman 2019) as well as real-world developments (witness the debate on 5G technology in Germany) to suggest that WI is gathering greater sway, presenting unprecedented challenge to liberal multilateral institutions.

Besides the structural logic of WI, there is a further twist to the way in which this challenge is playing out. Fundamentally different political systems may allow some states a higher capacity to establish control over network hubs, and also exercise panopticon and chokepoint effects than others. Even during the Cold War era, most members of the Eastern bloc were not contracting parties to the GATT; the old multilateralism worked well amid a group of reasonably like-minded countries. The WTO inherited many of the principles of the GATT but has come to include a much more divergent group of countries with competing political systems, within a transformed geoeconomic context of WI. One does not even need to bring in the question of systemic rivalry to recognize that the WTO is ill-equipped to deal with the challenges of the present day.

In recent years, when the WTO found itself caught up between trade wars launched by the US on the one hand, and misuses/bending of WTO rules by China (via forced technology transfers, IPR violations, export controls, subsidies) on the other, a standard defense in Geneva was: the member-driven WTO could only be as good as its members, no more, no less. This defense does not take us very far. The very purpose of multilateralism in its broadest sense, after all, is that members agree to coordinate relations "in accordance with certain principles;" institutionalization of "principled" meanings (along with other mechanisms, including iterated interactions, interests and norms) is meant to serve as a safeguard against rule violations (Ruggie 1993). In any case, though, awareness of WI should now enable the supporters of multilateralism to revise this defensive approach. Instead, they can use the opportunity to update the purpose of trade multilateralism and align it with the altered patterns of production and geopolitical reality.

Such an update requires a recognition that if trade flows can indeed be weaponized, then expanding trade per se cannot be an end in itself. The post-World War II rationale of peace *through* prosperity sits at odds with WI. If economic gains via trade come at the cost of security losses, then the WTO needs to have a system in place that allows countries to find a balance between these (sometimes) competing goals. What could such a rethink mean in practice?

REFORMING THE PRACTICE OF TRADE MULTILATERALISM TO MEET THE CHALLENGES OF WI

Even as the WTO has gotten mired in an ever-deepening crisis, a rich debate on reform has been underway. Several proposals have been advanced to improve the existing rules in order to prevent their misuse/close loopholes (e.g., on subsidies, state-owned enterprises, SDT provisions, export restrictions) and enhance the WTO's crisis-management capabilities (Evenett and Baldwin 2020). Others have explored possible ways in which gratuitous securitization of trade via exceptionalism might be circumvented (Klaussen 2020). On the ground, under the leadership of the EU, a multi-party interim arbitration appeal arrangement has been set up as a temporary dispute settlement measure until the Appellate Body is functioning again. Negotiations are continuing on the important issue of fisheries subsidies. Many efforts are being targeted toward strengthening global supply chains, which are considered especially important to aid post-pandemic economic recovery. While many of these are worthy in their motivation and their attention to detail, these efforts represent reform *within* the system. They do not recognize that if increasing trade comes at the cost of security—if close trade ties risk weaponization by actual or potential rivals—then the direction and extent of trade expansion may need to be reconsidered.

The risks of deep integration were borne out in the early months of the pandemic, when shortages of life-saving medical equipment and drugs affected many countries. Evenett and Baldwin (2020) have argued that these shortages occurred not due to a breakdown in global value chains, but inadequate stockpiles of medical supplies. It is important to note, however, that the WTO's model of globalization has emphasized the efficiencies of trade over stockpiling (recall, for instance, the extent to which the issue of stockpiling in agriculture contributed to the Doha deadlocks, Narlikar and Tussie 2017). Under this model, countries are encouraged *not* to build stockpiles of essential or strategic products. We also know that, faced with shortages, many countries did put export restrictions on key medical supplies[1] and also sometimes used surpluses as bargaining chips (Walker 2020). The pandemic has thus provided some dramatic illustrations of how unreliable and prone to instrumentalization crucial trade flows can be.

Against this background, and in a context of WI, simply advancing the cause of more market opening, now additionally in the name of post-pandemic recovery, will not be useful. Such efforts to return the WTO to a "business-as-usual" approach may, in fact, be counter-productive and push countries to adopt more inward-looking policies. What might work better is a model of variable geometry. Deeper integration could be pursued among like-minded allies, willing to commit to tighter rules; supply chains would have to be restructured accordingly (which in turn would require partner states to adopt several systematic policy measures, including domestically, Gertz 2020).[2] Any such reform would not be easy, not least because it would require a new set of exceptions to the most-favored nation (MFN) status that the WTO grants all its members. Alternatively, membership criteria would have to be revised according to adherence to the (stricter and updated) rules, which would transform the WTO from a universal body to a limited-membership one (Narlikar 2020b).

Even an ambitious reboot of the WTO, such that the organization is better able to deal with WI, would not be a silver bullet in solving all its problems. But if variable geometry were allowed to facilitate shorter and more integrated value chains among like-minded countries, this could also enable a corresponding reform of the organization's clunky consensus-based decision-making processes (which have contributed to recurrent deadlock during the Doha negotiations). Concentric circles of integration, and voice and veto that corresponds to the circle, would further help

[1] As early as April 2020, the WTO reported that "80 countries and separate customs territories have introduced export prohibitions or restrictions as a result of the Covid-19 pandemic, including 46 WTO members (72 if EU member states are counted individually) and eight non-WTO members" (WTO 2020). These developments were enabled partly by the fact that the WTO has weaker language on export restrictions and has traditionally paid greater attention to import controls and quantitative restrictions (Korinek and Bartos 2012). This gap in the rules is an illustration of how the WTO, while well-suited to address older (and often still relevant) problems, has not kept up with the changing instruments and goals of trade diplomacy.

[2] I am suggesting here a concentric circles' model, rather than one based on a plurilateral approach.

reduce the problems that have arisen from large numbers and divergent goals amidst the great diversity of members. Expanding the mandate into pressing issues such as e-commerce and digital economy would take place within the framework of variable geometry.

Importantly, the variable geometry model proposed here would be based not only on economic criteria or development levels; an initiative to build closer value chains with reliable friends and allies would have to take into consideration shared security concerns and shared values. To ensure the viability of deeper integration amid smaller groups of countries, allies from the global south will also have a key role to play (Narlikar 2021). It is worth mentioning that while the global south has acquired significant agency in the WTO (in comparison to the limited influence that developing countries exercised in the GATT), this battle is far from won (Narlikar 2020a). The fact that there is an ongoing debate over a TRIPS waiver to facilitate vaccine access during a global pandemic at all (let alone when the global north too could benefit from expanded production capacity in the global south) shows that there is much room for improvement in how the WTO engages with and integrates the global south. By directing reform efforts to address WI, though, rich countries would have reason to engage seriously with developing countries for reasons of not only ethics but also Realpolitik.

NEXT STEPS

In the last two sections, I have argued that the WTO faces a fundamental challenge. The emergence of WI has turned some of the founding tenets of post-war multilateral cooperation upside down. To play a constructive and meaningful role in the current context, the organization would need to undergo a major reboot, revising prior assumptions of a trade-induced liberal peace.

Below I outline the next steps to facilitate reform with the necessary ambition. First, much of the discussion on WTO reform takes place in a largely technocratic bubble. The hope that technical solutions would be the panacea for all problems may have been a by-product of an "end of history" mindset in the 1990s. But this line of thinking has considerably less resonance today amid problems that are often political in nature. Geopolitical/geoeconomic competition among great powers cannot be resolved simply by technocratic solutions. Trade in some strategically important sectors is no longer "just" a tool for growth, development and welfare; it has emerged in recent years as a powerful instrument of coercion and geopolitics. The sooner trade enthusiasts recognize these political constraints—and opportunities—the greater will be the possibility for WTO reform.[3]

Second, a possible reason why much of the reform debate still involves proposals that suggest low-level tweaking and tinkering is because it takes place mainly in the echo chambers of trade economics and trade law. To some extent, this is understandable, given the traditional mandate of the WTO. But if the WTO is to have even a remote chance of catching up with the altered basic realities of the present day, the organization (and its members) will be well-served by complementing trade-specific expertise with know-how from security studies, foreign policy analysis, international political economy. The sooner economists and trade lawyers start including political scientists in their conversations on WTO reform, the more real-world relevance will such exchanges acquire. This also paves the way for an important—and thus far still unexplored—research agenda. There is much give-and-take to be had between the lively debate on WI in political science, and the rich repertoire of studies in economics and law on governance and markets.

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[3] This does not mean the end of technocracy. Details of any reform plan will have to be worked out in close cooperation with the WTO's Secretariat and officials within relevant national ministries of member states.

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Lisandra Flach

Recent Challenges for Global Cooperation and the Future of WTO

Important events in 2020 have increased uncertainty over the future multilateral trade relations: the crisis at the World Trade Organization (WTO), increasing protectionism, Brexit, uncertainty about the US election outcome and, not least, the Covid-19 crisis. The year 2021 starts with good reason for hope for international trade and global cooperation, with the development of new vaccines in record time, the election of US President Biden and the recent letter of support from the United States Trade Representatives (USTR) for the candidacy of the Nigerian Dr. Ngozi Okonjo-Iweala as the next Director General (DG) of the WTO.

Lisandra Flach

is Director of the Center for International Economics at the ifo Institute and Professor of Economics at the LMU Munich.

In this article, I discuss recent challenges for global cooperation and the future of the WTO. What is the future of the WTO and globalization after the Covid-19 crisis? What does the inauguration of US President Biden and the new WTO DG mean for multilateralism? What are the options for reforming the WTO?

WTO AFTER THE URUGUAY ROUND: THE STANDSTILL OF MULTILATERALISM

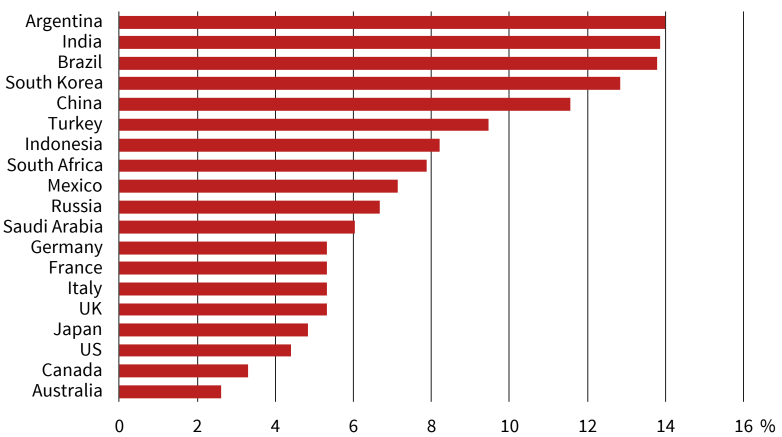
In 1995, 123 countries agreed to establish free trade on a global scale and founded the WTO. This happened at the successful Uruguay Round, during which far-reaching tariff reductions as well as agreements on the protection of intellectual property, for example, were agreed. Further, large economies such as China (in 2001) and Russia (in 2012) became members of the WTO, and as of today, WTO members account for 98 percent of global trade.

However, since the conclusion of the Uruguay Round and the creation of the WTO in 1995, there has been no significant reduction in the bound most-favored nation (MFN) tariffs.[1] The Doha Round failed, in part, because the industrialized countries' tariffs are already very low, whereas tariffs in many developing countries are still high.

As discussed in Goldberg and Pavcnik (2016), import tariffs remained high in many developing countries as they did not actively participate in earlier GATT/WTO negotiation rounds. Large tariff disparities are also present within the group of G20 countries. Different from the bound MFN tariff, the applied MFN tariff has decreased since 1995. However, large differences are also present in applied MFN tariffs, as shown in Figure 1. For instance, the average tariff rate that is deposited with the WTO as the applied MFN tariff is 14 percent in Argentina, 13.9 percent in India and 13.8 percent in Brazil, whereas in developed countries tariffs are much lower: 4.4 percent in the US, 4.8 percent in Japan, 5.3 percent in Italy, France, Germany and the UK (Teti 2020). The large tariff differential makes future tariff reductions much more difficult as, when negotiating tariff reductions with emerging countries, developed countries can hardly offer further tariff reductions.

But policy instruments go far beyond tariffs. For instance, subsidies and export-related measures (including export subsidies) account for 60.4 percent of all protectionist measures imposed worldwide (Global Trade Alert 2021). One example is in the EU agricultural market. In the agricultural sector, there are enormous subsidies for farmers and quantity import restrictions for many products. Given that many developing countries have a comparative advantage in producing agricultural products, such barriers distort competition and worsen market access of developing countries. A reassessment of trade-distorting subsidies in the agricultural sector is in the interest of these countries. On this issue, the EU must find a way to make its agricultural sector compatible with free trade in the long term.

Figure 1
MFN Tariff in the G20 Group



Note: The figure shows the average applied MFN tariff (in %) in the G20 group countries, year 2017.
Source: Teti (2020).
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[1] The maximum tariff rate that may be applied vis-à-vis all WTO members.

STANDSTILL OF MULTILATERALISM AND INCREASING NUMBER OF BILATERAL TRADE AGREEMENTS: THE GAINS FROM TRADE SINCE THE URUGUAY ROUND

Many countries responded to the standstill in multilateralism by increasing the number of bilateral trade talks. In fact, it is quicker to reach consensual solutions in bilateral negotiations as it would be in the case of in multilateral rounds under the umbrella of the WTO. For instance, opening services markets or removing non-tariff trade barriers such as product safety or phytosanitary standards are generally easier to resolve in bilateral negotiations.

During the first ten years of existence of the WTO, the number of regional trade agreements in force more than tripled, from 58 to 188 (Maggi 2014). These trade deals are within the rule of law of the WTO and are much more comprehensive than, for instance, investment agreements.

The EU, for instance, concluded several new trade agreements in recent years (e.g., with Singapore, Canada, Japan, Mexico, Vietnam) that benefit participating countries, as the agreement puts them in a better position in comparison to the most-favored-nation treatment that applies under WTO rules. Modern trade agreements include much more than tariff agreement, they also comprise harmonization of product safety and hygiene standards, approval procedures, recognition of geographical indications, as well as access to local service and procurement markets. For trade in services, deep trade agreements play an instrumental role: Dhingra et al. (2021) show that they have a relatively larger impact on trade in services than on trade goods.

An analysis beyond traditional trade policy instruments is relevant for quantifying the gains from trade following the Uruguay Round. Dhingra et al. (2021) quantify the welfare gains from trade through (i) tariff reductions and (ii) deeper trade policy commitments. Deeper trade agreements include, for instance, investment liberalization, recognition of professional qualifications for service providers, intellectual property protection commitments as well as policy areas such as anti-corruption, visa, and asylum. Using the universe of deep trade agreements, Dhingra et al. (2021) show that the welfare gains from commitments involved in deep agreements have played a crucial role in overall welfare gains since the conclusion of the Uruguay Round. The elimination of tariffs increased welfare by 1.8 percent on average, compared to 1.4 percent for non-tariff measures.

NEW PROTECTIONISM? NUMBER OF NEW PROTECTIONIST MEASURES EXCEEDS THE NUMBER OF NEW LIBERALIZING POLICIES

Whereas the number of trade agreements has increased in recent years, which indicates an effort toward international cooperation, we also observe an increase in the number of protectionist measures worldwide. Data from Global Trade Alert—GTA (Evenett and Fritz 2020) show that since 2009, protectionist policy interventions have outnumbered liberalizing policies, with a sharp increase in 2018. In 2019, newly added protectionist policies exceeded liberalizing ones by a factor of 3.7.

In the year 2020, subsidies and export-related measures (including export subsidies) accounted for 71.6 percent of all protectionist measures imposed worldwide, according to GTA Data. Subsidies create a distortion in competition and account for 50.8 percent of all protectionist measures. Tariffs comprise 9.1 percent of the protectionist measures and are followed by contingent trade-protective measures and further trade barriers such as non-automatic licensing and quotas.

Disputes over subsidies can be long-lasting and lead to tensions in global cooperation. One example is the dispute on Airbus/Boeing subsidies. The EU has recently lost a WTO dispute over illegal subsidies to Airbus. As a result, the US may impose countervailing duties on goods coming from the EU, whose member states refuse to change their subsidy practices to make them WTO-compatible. This dispute puts a strain on negotiations between the EU and the US, at a time when these countries should realign relations and reactivate trade talks for a trade agreement.

COVID-19 CRISIS AND DISRUPTIONS IN INTERNATIONAL COOPERATION

The Covid-19 crisis increased the skepticism over global supply chains and the international division of labor. Not only has the virus led to disruptions in global value chains, but the responses of many governments in terms of export restrictions have also aggravated global supply shortages.

Dhar (2020) compiles all trade measures adopted by WTO members since the outbreak of the Covid-19 crisis. As of 21 September 2020, WTO members had submitted a total of 244 notifications related to Covid-19, most of which were technical barriers to trade (89), sanitary and phytosanitary standards (59) and quantitative restrictions (41) (Dhar 2020). While some of these trade measures were import liberalizing or export-promoting measures, the clear majority were trade-restrictive measures.

Most importantly, Dhar (2020) shows that notifications issued during Covid-19 fall short of transparency. Members have not complied with transparency obligations, with long delays for notifying standards, and most notifications have not been in conformity with international standards. A WTO reform should increase transparency of technical regulations. In a period of crisis, such restrictions have the potential to disrupt trade and supply chains.

Especially for essential goods and medical equipment, trade disruptions aggravated global supply shortages and had negative consequences for the containment of the virus. As discussed by Bown (2020), in the first months of the crisis, not only the EU and US imposed export restrictions on personal protective equipment, but also G20 members including India, Brazil, Argentina, South Korea, Turkey, Indonesia, UK and Russia imposed similar restrictions. One recent example of a protectionist measure related to the Covid-19 crisis is the temporary export control on Covid-19 vaccines imposed by the EU on 30 January 2021. It is questionable whether further countries will impose similar control regimes, which could trigger a vicious cycle that would have a devastating effect on the health and economic fronts.

The Covid-19 crisis might deepen some prior tensions and lead to an increase in the number of protectionist measures, especially for critical goods such as medical equipment or human medicines. However, the fear that the crisis would lead to a jump in the number of export restrictions across all sectors of the economy did not become reality. A possible explanation is that countries realized the importance of global cooperation in dealing with the crisis, as international trade may alleviate the negative effects of the crisis, rather than being the source of the problem.

Because lockdown measures took place at different times around the world, shortages due to production shutdown in a country could be in part replaced by imports. Hence, international trade can act as an insurance against production shortfalls and alleviate the effect of negative shocks. International trade and a diversified supply chain allow countries to reduce the risk of negative shocks and to reduce dependencies on one single source. Finally, recent research has shown that an increase in trade barriers would be the wrong response to the current crisis, as it leads to large decreases in welfare worldwide and does not make the economy more resilient to shocks. Moreover, as shown in Steininger and Sforza (2020), the impact of such a crisis would be only marginally smaller in a less globalized world. The results emphasize the welfare-promoting effects of international trade.

The global economy is frequently confronted with negative shocks: prior to Covid-19, other pandemics, financial crises, natural disasters or extreme weather events led to supply-chain disruptions worldwide. Given the magnitude of the current crisis and the likelihood of further negative shocks in the future, the Covid-19 crisis might offer an opportunity for multilateral organizations such as the WTO to show the importance of increasing the level of global trust by setting common ground for cooperation.

THE ABILITY OF THE MULTILATERAL TRADING SYSTEM TO FUNCTION IS CURRENTLY LIMITED

In the case of trade disputes, a member state can appeal to the WTO Appellate Body (AB), which consists of seven members. Three members are required for a quorum. Because of the US blockade to fill vacant judgeships, the AB stopped its activities at the end of 2019. The US argues that the AB has exceeded its mandate and should perform the role originally assigned to it in 1995 in the agreement negotiated in the Uruguay Round. Hoekman and Mavroidis (2019) evaluate the negotiating history and discuss conditions under which it should not be difficult to ensure operation of the AP under the 1995 mandate. In the absence of its activities, it is no longer possible to ensure compliance with global trade rules. On the one hand, WTO members should take US concerns seriously, as there is room for improvement in the AB from an institutional perspective. On the other hand, reestablishing the AB is in the interest of the US. In fact, the recent letter of support from the USTR for Ms. Okonjo-Iweala as new WTO DG might give hope for reforms and a revival of the AB.

A REVIVAL OF MULTILATERALISM UNDER NEW US PRESIDENT JOE BIDEN?

The election of Joe Biden provides room for hope for multilateral organizations and potentially a WTO reform. First, US trade policy becomes more predictable in comparison to the prior administration. Second, the democratic party does not want to pursue a unilateral tariff war with China and gives an opportunity to revive the transatlantic partnership and negotiate common standards in trade, technology and investment. Third, various sentences in the Democrats' party platform suggest that they seek cooperation within the framework of international institutions such as the WTO. The recent letter of support from USTR for the candidacy of Dr. Okonjo-Iweala as DG of the WTO confirms the willingness to cooperate with multilateral organizations. Overall, his views on multilateralism are crucial to secure the future of WTO as well as to reduce global uncertainty and trade tensions.

However, trade relations with the US will not necessarily become easier under the new president, given his highly protectionist agenda. For instance, the Democratic Party Platform (2020) stresses on page 85 that the US "will not negotiate any new trade deals before first investing in American competitiveness at home." They also threaten penalties if China or another country engages in "unfair" trade practices: "Democrats will protect the American worker from unfair trade practices [backed] by the Chinese government [...]. We will rally friends and allies across the world to push back against China or any other country's attempts to undermine international norms" (Democratic Party Platform 2020, 88).

President Biden's nomination for the USTR also indicate the willingness to level the playing field and to address long-term challenges with China. In her first speech after being nominated by President Biden for the USTR, Katherine Tai emphasized that the new administration's policy priorities include confronting

China over its trade practices and helping American workers by ensuring trade agreements protect and enhance US jobs.

Joe Biden voting history, his nominations and current agenda indicate that he seeks multilateral cooperation without abstaining from a protectionist agenda. A closer look at the voting history of Joe Biden as member of the United States Senate reveals that he voted in several circumstances against pro-trade liberalizing issues. For instance, in 2003, he voted against approving free trade area between United States and Singapore and against approving free trade area between United States and Chile.[2]

Finally, and perhaps most importantly, there are the domestic market policies that will be competing with trade policy. There is no doubt that the new administration offers an opportunity to realign multilateral relations and to reactivate trade talks. But domestic market policies will have priority in the new administration. For example, the Buy America campaign, which existed earlier under former US President Barack Obama, could lead to trade conflicts with the EU. But something must be done in terms of international relations: the US should take the opportunity to realign international relations.

REVITALIZING WTO UNDER THE NEW DIRECTOR GENERAL

In the view of the current tensions and the fact that the appointment of the new DG must be unanimous, it is a great success to achieve an appointment. This is a unique opportunity to revisit the grounds for multilateral trade cooperation.

To carry out reforms, the DG must have the support from all members. Hence, the WTO should look for common causes for all members. Even if further trade liberalization is not expected soon, the WTO offers grounds for negotiations and for addressing global trade concerns. WTO standards reduce uncertainty and are a good fallback option in case of bilateral conflicts. The WTO should increase transparency to build a collaborative environment and trust, both of which are urgently needed among WTO members. Ms. Okonjo-Iweala's development and financial expertise will be an asset for the WTO. But also, her ability and experience as a world leader are key: given tensions between WTO members, being a leader and a peacekeeper are important characteristics of a new WTO DG.

The Covid-19 crisis imposes additional challenges for multilateral cooperation. As shown by Dhal (2020), hundreds of new Covid-19-related trade-restrictive measures have been adopted by countries. WTO members should adopt a commitment not to impose restrictions beyond the necessary and increase transparency of trade-restrictive measures. In a period of crisis, such restrictions can exacerbate disruptions in global supply chains. Finally, it is important to strengthen the advantage of global cooperation in a global crisis. In this aspect, having a WTO DG with experience in key challenges such as global coordination of vaccines such as Ms. Okonjo-Iweala is a key asset for future reforms in this area.

The new WTO Director General undoubtedly faces many challenges: reforming the dispute settlement and reducing global trade tensions, updating trade laws with a focus on digital services trade and CO_2 border taxation, as well as regaining trust and credibility for the organization.

An optimistic view of the current challenges is the fact that none of the WTO members left the organization, which is not the case of other multilateral organizations, and 23 other nations are seeking to join the WTO, as discussed in Baldwin and Evenett (2020). Members agree that WTO reforms are needed, but these reforms must be aligned with the interests of its members, implying that to start reforms in accordance with the purpose of the organization, the WTO needs common causes all members agree on. The post Covid-19 crisis and the WTO DG election offer an opportunity to realign relations and to reanimate trade talks toward a more cooperative and stable multilateral system.

[2] Vote summaries are available at US Senate's webpage, see https://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=108&session=1&vote=00318 and https://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=108&session=1&vote=00319.

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Bernard Hoekman and *Robert Wolfe*

WTO Reform As a Triangular Problem among China, the EU and the US

Although structural weaknesses and gaps in its rules were evident right from the start,[1] the impetus for current talk of reform of the World Trade Organization (WTO) largely stems from the tension among the three major trade powers—the EU, the United States and China. The three-way dynamic can be seen clearly in the commentary on the EU-China Comprehensive Agreement on Investment announced at the end of 2020. Is it a political win for China alongside the Regional Comprehensive Economic Partnership (RCEP)? Does the deal complicate US efforts to negotiate with China? Will it undermine US efforts to work with the EU and other allies to address level playing field concerns?

When people identify the aspects of the WTO that need reform—no progress on negotiation of important new issues, the Appellate Body in crisis, inadequate notifications of applied trade policies, working practices no longer fit for purpose—a concern with the impact of China on the trading system is often in the background. The US especially has raised a series of complaints before the WTO, mostly dealing with the role of the state in the workings of the economy. Lurking behind the US push for reform of the WTO is its frustration, shared by others, that integration into the trading system has not changed China into a liberal market economy. Frustration with China's state capitalism model was behind the initiation of Trilateral meetings of the trade ministers of the US, Japan and the EU, who have met four times since May 2018, when they "reiterated their concern with the non-market-oriented policies of third countries and discussed actions being taken and possible measures that could be undertaken in the near future." After many inconclusive discussions in the General Council, the US submitted a draft resolution on its own proposing that the Council express its serious concerns with non-market-oriented policies and practices "that have resulted in damage to the world trading system and lead to severe overcapacity, create unfair competitive conditions for workers and businesses, hinder the development and use of innovative technologies, and undermine the proper functioning of international trade" (WTO 2020a).

China's attitude to WTO reform is essentially conservative and reactive. China claims to support WTO reform as long as it preserves such core values of the multilateral trading system as non-discrimination and openness, safeguards the development interests of developing members, and follows the practice of decision-making by consensus (WTO 2019). Meanwhile, China is adapting its economic strategy, reflected in the "dual circulation" concept enunciated by President Xi Jinping in 2020 (Sandbu 2020). Insofar as the domestic market is thought to be big enough to sustain further growth, China may be less concerned about the policies of its trading partners that limit access to global markets. That puts China on the same footing as the US, for whom giving or restricting access to its vast internal market helped it shape the postwar trading system, and the EU, which leverages the single market to influence the increasingly important domains of product, sustainability and data privacy standards (Rühlig 2020).

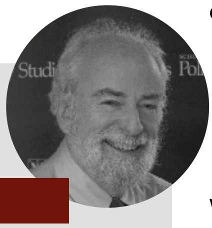
All three trade powers need the WTO. All three have a big stake in reinforcing a multilateral system of rules to manage the inevitable frictions among interdependent economies organized on different principles. This applies as much to transatlantic regulatory cooperation as to challenges across the Pacific. In this paper, we draw on the findings of a recent research project on WTO reform[2] to discuss elements of the WTO reform agenda through the lens of the triangular tensions among the three major powers. Reforming the WTO will not solve China-US conflict nor will it settle outstanding transatlantic disputes, but it can enhance the salience of the organization as a forum for the large economies to agree on rules of the road on matters that have been causing trade conflicts,

[1] For a compelling case for institutional reform by one of the architects of the WTO, see Ostry (1999).

[2] For all of our papers on WTO reform in a project supported by the Bertelsmann Stiftung, see https://globalgovernanceprogramme.eui.eu/research-project/revitalizing-multilateral-governance-at-the-wto-2-0/.

Bernard Hoekman

is Professor and Director, Global Economics, at the Robert Schuman Centre for Advanced Studies, European University Institute. His research focuses on trade in services, international regulatory cooperation and the WTO.



Robert Wolfe

is professor emeritus at the School of Policy Studies, Queen's University, KIngston. He has published extensively on WTO reform including of transparency mechanisms and deliberative functions.

in the process helping to resolve the problems of the WTO. All three major trade powers, but particularly China, have to accept that progress on some issues will require leaving some obstructionist members behind—i.e., to negotiate on a plurilateral basis.

The plan of the paper is as follows: in the first section, we consider the problems created by the WTO consensus working practice and the approach towards recognizing economic development differences—"special and differential treatment" for developing nations; the second section moves from negotiations to problems with WTO transparency, which are especially marked in the domain of industrial subsidies; we then consider reforms to WTO working practices in the third section before coming in the fourth section to the Appellate Body crisis; the final section concludes with implications of our analysis for the design of trade cooperation between the three major powers.

WORKING PRACTICES: CONSENSUS AND SPECIAL AND DIFFERENTIAL TREATMENT

A key reason for the difficulties experienced in using the WTO as a negotiation platform was the backward-looking Doha Round agenda, notably the decision by WTO members to prioritize tariffs on manufactured products and agricultural support policies as opposed to twenty-first century policy priorities such as trade in services, regulation of the digital economy, investment, and using trade policy to combat climate change. The consensus working practice impeded the ability of members to adjust the agenda. After almost 10 years of deadlock, in 2017 many countries decided to shift gears and launch talks on a plurilateral basis.

The associated "joint statement initiatives (JSI)" span e-commerce, domestic regulation of services, investment facilitation, and measures to enhance the ability of micro and small and medium enterprises (MSMEs) to utilize the opportunities offered by the rules-based trading system. Most address coordination failures and/or entail joint efforts to identify good regulatory practices. The EU participates in all four groups, as does China, but the US only participates in one JSI.

The EU objective in the e-commerce negotiations is to negotiate a set of provisions that will become a reference paper that participants could include in their GATT and GATS schedules, which would ensure that these commitments apply on an MFN basis. As this plurilateral includes the EU, China and the US, the outcome could be de facto critical mass, whether or not all Members choose to participate. Plurilateral approaches are not a panacea, but they offer a mechanism for large trade powers to cooperate without engaging in negotiations on trade agreements that liberalize substantially all trade (Hoekman and Sabel 2021). But the results will not be worth having if large traders claim that they need special and differential treatment. Here too the focus of US concern is China.

Special treatment for developing countries is now part of WTO theology, to the point that it was baked in to the 2001 Doha Development Agenda. In the negotiations on non-agricultural market access, it did not matter if small developing countries wanted less than full reciprocity in reduction commitments (paragraph 16 of the Doha declaration), but unwillingness on the part of larger developing countries to make real commitments did matter. Whether existing special and differential treatment provisions make sense is one thing but asking for it in new negotiations is problematic if it vitiates the point of the exercise.

In May and November 2019, the US submitted a proposal for a decision on "Procedures to Strengthen the Negotiating Function of the WTO" with criteria for assessing which countries will not avail themselves of special and differential treatment in WTO negotiations (WT/GC/W/764/Rev.1). The US asked for this item to be placed on the agenda of one General Council meeting after another in 2019 and 2020, with some support from other members but met with unrelenting opposition from China and most developing countries. For example, at the July 2020 meeting of the General Council (WT/GC/M/186), the representative of China said that it is better to respect the current practice of self-designation of developing country status and at the same time to encourage those in a position to do so to make a greater contribution to the best of their capabilities. China was willing to do so, he said.

Whether China will contribute by being part of the critical mass on any JSI remains to be seen. The signs are not good if we consider an "old" issue still on the table, the negotiation on fisheries subsidies. Launched in 2001, these talks have repeatedly missed deadlines, in part because of special and differential treatment. China supports disciplines that prohibit fisheries subsidies that contribute to overcapacity and overfishing as long as "appropriate and effective special and differential treatment for developing country Members and least developed country Members [is] an integral part of the negotiations (TN/RL/GEN/199)." The EU and US might accept such differentiation for some developing countries, but not for China. Low et al. (2019) argue flexibilities be made available to those Members who actually need them to fully benefit from their membership in the organization. Whether such a principle will be included in new plurilateral agreements and accepted by China will do much to determine whether this approach can revitalize negotiation in the WTO.

IMPROVING TRANSPARENCY

Transparency of actor behavior and expectations within regimes requires high-quality information (Wolfe 2018). The WTO agreements have dozens and dozens of formal notification obligations. Inadequate notification of trade policies is an old issue, but its inclusion on the "WTO reform" agenda only began when the US tabled a detailed proposal that reviewed the unsatisfactory compliance with notification obligations under the Trade in Goods agreements. The US proposal included punishment for Members who are behind in their notifications (WTO 2017). A much-revised version of that proposal (WTO 2020b) remains before the General Council, now with co-sponsors, including the EU. An important question that has not been adequately confronted is why compliance with notification requirements varies by WTO Agreement and by Member. If the problem is a lack of capacity, then technical assistance may be needed, although a failure to notify by the countries most likely to need technical assistance is a problem for them not the system. If the real difficulty is outdated and overly complex notification requirements, a thorough review is warranted. Only if the reason for a poor notification record is bad faith would penalties as suggested in the US proposal be appropriate.

The US could do more itself to contribute to WTO information. One of the most contentious areas in trade policy are the negative international spillovers of industrial subsidies. Subsidies can help to address market failures and therefore might have a good economic rationale, but cooperation is needed to minimize negative spillovers of such measures on trading partners. As discussed at greater length in Hoekman and Nelson (2020), this is not simply a "China issue." Subsidies of one type or another constitute the great majority of trade interventions imposed since 2009. Here too the problem is inadequate information. The periodic monitoring reports prepared by the Secretariat to aid in understanding Members' trade policy do not cover the full extent of the "general economic support" provided by governments. Information on subsidies, including general economic support, is requested periodically in questionnaires issued by the WTO Director-General (DG). The overall response is dismal. For the most recent report, 67 WTO Members and one Observer volunteered information on 638 Covid-19-related general economic support measures. The EU did so; the US and China did not. The US is less cooperative than China or the EU with the trade-monitoring exercise (WTO 2020c, Appendix 1).

The EU, Japan and the US have pursued discussions on a trilateral basis with a view to identifying gaps in WTO subsidy rules and suggest new disciplines. A revamped subsidy regime requires participation of China. A necessary condition for China to do so is that the effort not be perceived as an attempt to isolate or "reform" China. At the same time, China should accept that it has a leading role to play in the regime. In the short term, agreement on binding rules is unlikely to be possible. Work on developing more informal discipline on subsidies based on information, dialogue and peer review may be more feasible. As noted by Hoekman and Nelson (2020), calling for a work program on subsidies may be criticized as kicking the can down the road. It is not. WTO members simply do not have enough information to develop a common understanding of where new rules are needed and the form they should take. One of the ways to get there is to make better use of WTO bodies.

WTO DELIBERATIVE BODIES CAN BE BETTER USED

WTO committees and councils are first and foremost deliberative bodies for discussing emerging issues and addressing trade concerns without recourse to the dispute settlement system. Or at least they should be (Wolfe 2020). Most WTO bodies address so-called "specific trade concerns (STCs)" to some extent. Doing more to encourage committees and other WTO bodies to discuss STCs pertaining to policies under their purview is one way to improve conflict management and to increase the relevance of the organization for its stakeholders.

One suggestion to this effect is to establish guidelines for all WTO bodies. Tabled by the EU and supported by 19 other Members, including China, this proposal, WTO document WT/GC/W/777/Rev.5, or 777 in what follows, aims to make better use of the possibility offered by WTO Council and committee meetings to discuss and resolve concerns with trade-related measures by equipping them with horizontal procedural guidelines. The 777 proposal begins with clarifying timelines for convening documents and other meeting arrangements, which are important for making efficient use of committee time. China shared that objective in its own reform paper (WTO 2019). The 777 proposal encourages submission of written questions and answers, which would enhance transparency for other Members, or firms, having the same concern. The US has made a similar proposal in the SCM Committee for ensuring timely written responses to questions posed by Members on the subsidy programs of other Members (G/SCM/W/557/Rev.4). China has resisted every time the item comes up, arguing that the ASCM does not require members to submit responses to such questions in writing, nor to provide them within a specific time period, and that setting deadlines as proposed by the US would impose substantial new notification obligations on WTO members and cause difficulties for developing countries in particular.

THE APPELLATE BODY CRISIS

A central dimension of the "value proposition" offered by the WTO is independent, third-party adjudication of trade disputes reflected in the principle of de-politicized conflict resolution (Hoekman and Mavroidis 2020). An effective dispute settlement mechanism is critical for existing WTO agreements to remain meaningful, and for the negotiation of new agreements.

The US has been critical of the system, alleging that the Appellate Body has too frequently overstepped its mandate. US concerns are long-standing, and the US is not alone in at least some of its concerns. Although China lost many of the cases brought against it, Appellate Body rulings on key matters such as what constitutes a public body under the ASCM fueled US frustration (Ahn 2021). The Appellate Body ceased operations in December 2019 because of US refusal to agree to appoint new adjudicators or re-appoint incumbents. Resolution of the crisis requires reform of how the system works.

By the end of 2020, sixteen appeals were pending before the now dormant Appellate Body and only 5 new cases had been filed, the lowest for any of the WTO's 25 years. If appeal "into the void" remains possible, issued panel reports will have no legal value, unless the disputing parties forego their right to appeal, and accept the panel report as the final word in their dispute. For the 24 participants in the Multi-Party Interim Appeal Arbitration Arrangement (MPIA), including the EU and China, but very much not the US, that route may provide a short-term alternative. However, the US would see no point in any kind of WTO reform that did not address this problem. And equally, the US would see no point in any new agreements aimed at Chinese practices if dispute settlement remains slow and ineffective. All three trade powers have an incentive to make dispute settlement operational again.

INCREASING THE PROSPECTS FOR COOPERATION

The WTO agenda is large. Prominent items include ensuring a consistent response to global public health crises, resolution of conflicts regarding the use of industrial-cum-tax-subsidy policies, taxation of digital services, regulation of data privacy and cross-border data flows, and the appropriate role of trade policy in reducing the carbon intensity of economic activity. Revisiting the terms of engagement with China is a necessary condition for revitalizing the WTO as a forum to address these matters and to sustain an open world economy, but equally important will be reinvigorating cooperation between the US and the EU.

The basic premise of the mostly misguided approach of the Trump Administration—relying on unilateral trade actions that were not sanctioned by the WTO—did little to address core differences between the two countries (Economist 2020). The EU has been more balanced, seeing China as a negotiating partner for cooperation, an economic competitor, and a systemic rival (European Commission 2020a). This is beginning to be reflected in EU policy initiatives, including the White Paper on industrial subsidies (European Commission 2020b). The Biden Administration may well use Trump's China tariffs for negotiation leverage. Similar thinking animates the EU ratcheting up its ability to act against subsidies, restricting the ability of Chinese firms to bid on public procurement, and screening inward investment. Whether such pressure will increase China's willingness to engage in the WTO is an open question.

The revealed preference of many WTO members has been to pursue regional trade agreements. Most such agreements lack strong disciplines on policy areas that are central to trade tensions with China—notably subsidies. Many also do little to assure transparency, especially for non-signatories. WTO mechanisms therefore remain critical, which is why reforms to bolster transparency are so important. Everybody would benefit from knowing more about each other's trade policies and from more analysis of issues coming onto the agenda. A collaborative rather than punitive solution is possible, especially if the three major powers work with like-minded Members, such as the Ottawa Group.

The Doha Round deadlock means plurilateral initiatives and agreements are the (short term?) future for negotiations on adding to the WTO rule book for domestic economic and regulatory policies that have repercussions for international competition. A feature of plurilateral initiatives is that countries that want to insist on special and differential treatment do not have to participate, which allows Members like the African Group to stand aside. At the same time, when it comes to policy areas such as subsidies and state-owned enterprises, to address the sources of underlying trade tensions China must participate. Thus, a revamped subsidy regime requires participation of the US, the EU and China.

Chinese officials in Geneva profess support for WTO reform, but demand respect and non-discrimination, which leads to an insistence on maintaining China's status as a "developing country." China does not want to be treated differently from other developing countries. But China is both a very large economy and is more prosperous than many other developing countries. It cannot and should not expect to be treated differently to other signatories of any new agreements, and it should accept that it can no longer hide behind the obstruction of supposed developing country leaders such as India and South Africa. China will need some political cover to allow it to maintain support for the principle while accepting a pragmatic approach in new plurilateral negotiations.

China, the EU and the US have substantially different views on the relative importance of many areas of international trade policy and potential cooperation. The three do not agree with each other and no two of them can provide the public good of an open liberal multilateral trading system on their own, which is why it is a triangular problem. How the three could conclude a package of reforms given the potential for obstruction by some other WTO Members should be a major focus of the policy officials and advisors tasked with the design of trade strategy in the three major trade powers. And they should be willing to proceed on a critical mass basis on issues where waiting for the full membership is not necessary.

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Jürgen Matthes

How to Unlock the WTO Blockage and Why China Holds the Key

The WTO has been getting into an ever-deeper crisis in recent years, even though it had been a success story at its outset in 1995 and for several years afterward (Kolev and Matthes 2020). And still in 2001, despite the upcoming anti-globalization criticism, the start of the Doha Round in 2001—shortly after the 9/11 terror attacks—it was understood as a strong signal for multilateral cooperation toward further trade liberalization. At the end of 2001, admitting China to the WTO was considered an important milestone as well.

However, for several reasons, the Doha Round got stuck (Matthes 2006)—among them many countries' fear of rising competition from fast-growing China. In consequence, the trade liberalization function of the WTO proved to have lost its power. In broad terms, the WTO's function of monitoring new trade barriers functions well despite some room for improvement, as was the case in and after the global financial crisis in 2008/9 and during the coronavirus crisis. However, the WTO's liberalization function, probably its most important objective, has also been dealt a serious blow. The Appellate Body (AB), the second stage of its dispute settlement system, has been out of order since December 2019 because the US has continually blocked the nomination of new trade experts as members of the AB.

There are very fundamental disagreements behind the WTO crisis, including globalization skepticism, rising state influence and protectionist industrial policies. Moreover, there is a deep divide and distrust between emerging and developing countries on the one hand and industrialized countries on the other about opening up markets for agricultural goods (desired by the first group and resented by the second) and opening up markets for industrial goods and services (desired by the second group and resented by the first). However, the elephant in the room is China with its state capitalism. The Chinese economic model is based on a domestically relatively successful industrial policy that, however, increasingly leads to competitive distortions in world markets to the benefit of Chinese firms and to the detriment of others (Matthes 2020a). These spillovers of China's state capitalism could eventually put the WTO in jeopardy. Therefore, China is a key player in saving the WTO and in ending its crisis. This claim will be elaborated on and discussed in this article with a focus on a possible solution to the AB crisis.

Jürgen Matthes

heads the Research Unit International Economics and Economic Outlook at the German Economic Institute in Cologne.

WHY TRUMP'S WTO BLOCKAGE DID NOT COME OUT OF THE BLUE

Seeing China (also and mainly) in charge of saving the WTO stands in stark contrast to the commonly held view that only the Trump administration can end the WTO crisis because it is commonly regarded as the main culprit for causing the blockage. At first glance, the evidence seems to support the latter standpoint: indeed, it was Donald Trump who blocked the nominations of new AB members until the WTO's demise, and he is also the one who recently vetoed the nomination of a new Director General (DG) to head the WTO, although a majority of WTO members supported Ngozi Okonjo-Iweala, the candidate from Nigeria. Moreover, blocking the AB was likely also motivated by the intention of the Trump administration to avoid a final and binding AB verdict regarding the tariff measures of the US on China and on steel/aluminum that are based on alleged national security reasons. Moreover, there was a deep resentment of multilateralism throughout Trump's trade team and the WTO for interfering in domestic affairs.

However, there are also deeper reasons behind the US actions, many of which have to do with China and its state capitalism. In fact, blocking the AB nominations had already begun under the Obama administration, and US discontent regarding the AB goes back much further than that (EP 2019). The longstanding concerns include various issues that were summarized, for example, in a Report by the United States Trade Representative (USTR 2020; Willems 2020; Fukunaga 2020). The US' main criticism is that the AB overstepped its mandate and indirectly created de facto new trade rules that diminished various US rights and created new obligations. In general, the USTR (2020, 2) criticizes that the AB's "errors have favored non-market economies at the expense of market economies." This relates especially to the use of trade defense instruments (TDIs) also and particularly against competitive distortions originating in China. TDI use was restricted in several respects according to USTR (2020). An important example is the AB's narrow interpretation of WTO law relating to the term "public body," which severely limits the scope for using WTO rules to tackle the pervasive competitive distortions by China's SOEs.

From this viewpoint, the AB acted as a normal court in interpreting rules and established a new meaning pertaining to WTO law. However, the US holds the opinion that the AB is not a usual court but should stick very closely to WTO law. The US also criticizes other issues: it holds the opinion that the AB overstepped its mandate by creating binding precedent, interpreting domestic law, reviewing the panel's fact finding, and by issuing advisory opinions on issues not raised by WTO members in the relevant case. On top of this, there are several more technical issues the US had continuously criticized: appeal proceedings often took much longer than the foreseen 90 days provided for in WTO rules, and the terms of outgoing AB members working on ongoing appeals were sometimes extended for longer periods without clear consent of WTO member states. Many of the aspects criticized by the US are reasonable and are thus shared by the EU and other WTO members (European Commission 2018; Stewart 2019).

Put in a broader and more general context, after the foundation of the WTO the AB acted in the liberal sense of the time when trade openness was still the prevalent mantra. However, China challenges this view with its state capitalism and its immense export market gains that operate partly at the expense of others. In fact, the combination of China's technological catch-up (fostered by unlawful forced technology transfer), the competitive distortions of its industrial policies, and China's enormous and growing size pose the danger of welfare losses for industrialized countries (Matthes 2020b).

TDIs are limited tools for countering this trend. However, the AB restricted their use, even though the US has always seen TDIs as tools that are mainly within the national realm of WTO members. Therefore, there is some reason for the US believing its faith was betrayed when it agreed at the time the WTO was founded to TDI rules that still allowed for a wide scope for national determination and at the same time to a binding dispute settlement system. The same is true in relation to the agreement of the US to China's accession to the WTO, which was related to the expectation that over time, China would gradually become a market-based economy with a democratic system like Japan's and South Korea's. Viewed from this perspective, the AB has changed the rules of the game and this has become ever more relevant due to the increasing spillovers of China's state capitalism.

HOW TO SOLVE THE APPELLATE BODY CRISIS WITH THE BIDEN ADMINISTRATION

The Trump administration blocked reform efforts in the WTO to resolve the AB crisis (Stewart 2019). Now, there is nascent hope of moving forward with the Biden administration. But this will be no panacea, because the Democratic Party is no staunch supporter of the WTO and also criticizes many of the above-mentioned shortcomings of the AB. Moreover, existing US tariffs on steel and on China could still be a hindrance. However, President Biden's generally positive attitude toward multilateralism could open the door toward a more constructive cooperation with the US on AB reform.

An additional incentive for the US to engage in this respect lies in the temporary dispute settlement solution that some countries have set up as an interim alternative to the AB—the MPIA (Multiparty Interim Appeal Arbitration Arrangement). The MPIA was initiated by the EU and Canada and went into force at the end of April 2020 (WTO 2020). It is an open agreement among all WTO members. In the meantime, around 20 countries have joined, among them China, Brazil, Mexico, Australia, and Switzerland—but not the US. However, the EU and other countries have "catered for the event" that in a bilateral trade dispute the US could appeal into the legal void after a panel finding against its interests. In such a case, the EU will now be able to apply counteractions on US exports based on the panel finding, i.e., the first stage of the dispute settlement mechanism. This had not been possible before. Thus, the EU had to reintroduce this enforcement mechanism, which it did only recently. It allows for counteractions in the form of higher goods tariffs, limited access to European public procurement as well as the withdrawal of service liberalizations or of intellectual property rights. This step allows the EU greater discretion compared to the WTO rules based on an AB finding so that potential countermeasures against the US could be more severe. The Biden administration might use this argument in the domestic public debate to justify an engagement on AB reform. This would also be in the interest of the EU, as the MPIA is very clearly intended to be merely an interim solution until a reformed AB is installed.

There are good starting points for a new cooperation with the Biden administration on reforming the AB: as early as 2018, the EU presented a concept paper on WTO reform which, among other issues, also deals with the US' concerns with the AB (European Commission 2018). Also on this basis, there were broad discussions within the WTO and a serious attempt to resolve the critical issues (the "Walker Process"). David Walker, New Zealand's ambassador to the WTO, informally consulted members in search of issues of convergence and eventually produced a draft General Council decision on the functioning of the AB (WTO 2019). The draft decision tackles many of the issues raised by the US. It stipulates that the Appellate body "cannot add to or diminish the rights and obligations provided in the covered agreements," and that "precedent is not created through WTO dispute settlement proceedings" (WTO 2019, 6). Moreover, domestic law (in the sense of municipal law) is to be "treated as a matter of fact" and the AB must not engage in new fact finding. Related to the more technical issues, it is reiterated that the AB is to issue its report within 90 days except for special circumstances. Concerning outgoing members, it is stated that only WTO members can decide upon AB members and that outgoing members would only be allowed to continue an appeal process with this clear consent, which would be given more than 60 days before a term ends.

However, the Trump administration criticized that the reformed wording did not go far enough to ensure a sufficient change in the AB's behavior by stating their distrust toward other WTO members who did not share the view of the AB's shortcomings (Stewart 2019). While the Biden administration might be more constructive and build upon the "Walker process," some further work on the draft General Council decision might be needed. Many experts have made suggestions to this aim (Willems 2020; Stewart 2020). One important problem that may also have to be dealt with is correcting past AB findings that restricted the use of TDIs.

In addition to the above-mentioned efforts to "ensure the use of existing TDIs" as foreseen in WTO law, it is indispensable to "expand the remit of TDIs." Particularly regarding the WTO's Agreement on Subsidies and Countervailing Measures (ASCM), there are large regulatory gaps that prevent leveling the playing field with regard to various forms of trade-distorting subsidies (Matthes 2020a). Also in this respect, there is a foundation to build upon. In fact, a Trilateral Meeting of the EU, the US and Japan has proposed reforms to broaden the definition of prohibited and actionable industrial subsidies, including stricter disciplines on SOEs (Joint Statement 2020). For example, the following subsidies should be unconditionally prohibited in the future: unlimited guarantees, certain direct forgiveness of debt and subsidies to an insolvent or ailing enterprise in the absence of a credible restructuring plan. These proposals should be officially tabled in the WTO and the three countries should seek broad support for their initiative among like-minded WTO members.

Moreover, apart from the AB, there is also room for fruitful cooperation between WTO members with the US on other important issues regarding the WTO (Matthes 2020c). Some of these issues shall be briefly mentioned:

- There is hope that the Biden administration will consent to Mrs. Okonjo-Iweala and enable the WTO to get a new Director General.
- Constructive cooperation on smaller liberalization initiatives could help rebuild trust among the US the other WTO members (Evenett and Baldwin 2020). In fact, the lack of trust is a fundamental problem at the root of the WTO crisis. Issues that lend themselves for smaller, but still highly relevant initiatives include facilitating trade in medical goods in view of the Covid-19 crisis, concluding far-advanced negotiations on fisheries and concrete attempts to find common rules for open markets in digital trade.
- The burning issue of the relation between trade and climate protection needs to be discussed more intensively in the WTO in order to avoid future disputes. Such conflicts could easily arise, for example, if the EU introduced a carbon border adjustment mechanism to avoid carbon leakage due to its ambitious Green Deal, without first intensively consulting with its trading partners.

WHY CHINA HOLDS THE KEY TO SAVING THE WTO AND HOW BEIJING CAN BE INDUCED TO USE IT

Returning to WTO reforms of the AB and of the ASCM, both the US and China play an important role in saving the WTO from its crisis. In fact, many of the problems that make these reforms necessary boil down to China's state capitalism and the increasing spillovers from its subsidy system. It has been pointed out that a key reason for the US blocking the AB is due to the restrictions that the AB imposed on using TDIs to better level the playing field in view of dumped or subsidized Chinese products.

In this respect, the best solution for global trade would be for China to change its domestic policies and to limit competitive distortions at the root. However, as state capitalism has proved rather successful for China, this appears highly unlikely. A second option would entail Beijing acknowledging that the spillovers of its economic system undermine competitive conditions in the world market, and that its trading partners need to have instruments to neutralize these distortions in order to ensure a level playing field. The above-mentioned ASCM reform would be a key part of such a move.

However, despite numerous attempts to strengthen the disciplines on subsidies in the WTO and despite increasing pressure from the Trilateral Meeting, China continues to refuse to negotiate about an ASCM reform. Due to the WTO's consensus principle, the China's resistance (as well as that of some other nations) renders a meaningful reform elusive. A plurilateral subsidies agreement in the WTO framework might be seen as an alternative, but without China it would not be worthwhile. Bilateral approaches could be an additional alternative approach. However, the US, in its phase 1 agreement with China, and the EU with its investment agreement, succeeded only to a limited extent in increasing the disciplines on China's subsidy strategies. Moreover, it is clearly preferable to create better multilateral rules for anti-subsidy measures.

If China's state capitalism spillovers increase further, as might be expected, the danger arises that more countries follow the US approach and use TDIs and other tariffs against Chinese imports in a fashion that goes beyond WTO limits. In this case, it is foreseeable that WTO disputes would increase significantly and that such defensive trade measures would be viewed as breaking WTO rules. However, it might get to the point that the countries using these measures will not comply with WTO dispute settlement findings, because this would lead to considerable domestic job loss. Such a constellation would lead to trade wars and further serious erosion of the WTO. This is why China's state capitalism might eventually put the WTO at stake. In other words, the following danger appears imminent in the near future: since an unchanged state capitalism system in a country as large as China does not fit into a largely market-based multilateral trading system, either China changes, the system changes, or the whole system could break down. Thus, more pressure on China to agree to WTO reforms is required.

Based on these considerations, Kolev and Matthes (2021) have put forward an ultima-ratio-proposal for cooperation between the EU and the US to increase the pressure on China. It boils down to opening the option to put the WTO at stake in order to save it—and with it the multilateral trading system as we know it. This strategy assumes—not implausibly—that only when the WTO benefits can no longer be taken for granted might Beijing move sufficiently on WTO reform.

The Kolev and Matthes proposal (2021) suggests a multi-regional plurilateral trade agreement of market-based economies spearheaded by the EU and the US that would also comprise Japan, the UK, Canada, Australia, Chile, Mexico and many other industrialized and emerging economies. The enormous size of the agreement would act as a gravitational force that would encourage further accessions. The agreement would build on and extend WTO rules so that new trade liberalization among like-minded countries becomes feasible. In particular, strong level-playing-field rules for SOEs and industrial subsidies would have to be defined and established. These rules would have to allow for a certain level of government financial support as is common in most countries. However, they would forbid excessive subsidization as is common in China (Think!Desk 2015 and 2019) and as the OECD has found in China in case studies on such differing sectors such as aluminum and semiconductors (OECD 2019a and 2019b).

Depending on China's preparedness to comply with subsidy-related reforms, the plurilateral agreement could be developed in different directions. First, China could be offered the option of acceding to the agreement, if it complies with its rules. Second, the rules of the agreement could be used as a blueprint for WTO reform to which China agrees. Third, if China were not prepared for one or both of these steps, however, the agreement could be developed into an alternative plurilateral arrangement with the WTO that could eventually substitute for the existing multilateral trading system. If concrete steps in this direction were effected, China should be given further chances to move on the required reforms.

Kolev and Matthes (2021) are aware of the grave implications of such a step, particularly for the EU as a staunch supporter of multilateralism and rules-based trade. However, they see the danger that the WTO could break down anyway, if China does not agree to WTO reform. Even if this outcome does not appear highly probable, preparing for such a scenario is essential. Since spillovers from China's state capitalism are increasing and since setting up such a plurilateral agreement would take time, it should be agreed upon sooner rather than later. One option could be to enlarge and adapt the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the pros and cons of which are discussed by Matthes and Kolev (2020).

Such a plurilateral agreement is no panacea. For example, the US and the EU follow different approaches on many kinds of rules and standards in their bilateral free trade agreements, so that potentially difficult compromises would have to be found. However, the geostrategic value of increasing the pressure on China and of having an alternative ready if the WTO broke down should be a more important consideration. In addition, a plurilateral agreement would reduce the transactions costs of the multitude of intersecting bilateral trade agreements globally and clean up the so-called "spaghetti bowl."

It is to be hoped that the last-resort strategy of putting the WTO at risk is not needed because either the spillovers of China's state capitalism remain sufficiently limited or because China soon recognizes the necessity of a WTO reform along the lines laid out here.

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Alicia García-Herrero

The Elephant in the Room of WTO Reform: China*

Alicia García-Herrero

is Senior Research Fellow at Bruegel, Brussels and non-resident Research Fellow at Real Instituto Elcano, Madrid. She also serves as adjunct professor at Hong Kong University of Science and Technology.

As the World Trade Organization finally changes its leadership after a long impasse to install a female candidate from the emerging world, Ms. Okonjo-Iweala, it seems like a good time to review the experience of one of the WTO's most transformative moments, namely the accession of the most populous country in the world, China. China was not only the paradigm of an emerging economy trying to participate in the global economy, but was still an economy governed by central planning and socialist principles. It is important to note, however, that China started its accession process before the collapse of the Soviet Union, so it is much more driven by its own reform zeal than as a way out of a failing economic model. In fact, a number of countries that were either part of the Soviet Union or in its sphere went through WTO accession before China. More specifically, five former members of the Soviet Union, namely Kyrgyz, Latvia, Estonia, Georgia and Lithuania, together with others in Soviet Union's sphere, such as Albania and Bulgaria, succeeded in becoming WTO members by end of November 2000.

China's accession, though, was very different from that of those countries as it started well before and was much lengthier and tumultuous. Interestingly, however, China also experienced a much faster transformation than any of these countries, at least when measured in terms of economic growth. This article will explore the reasons behind China's transformation and what it means for the WTO and the ongoing discussion for China's reform.

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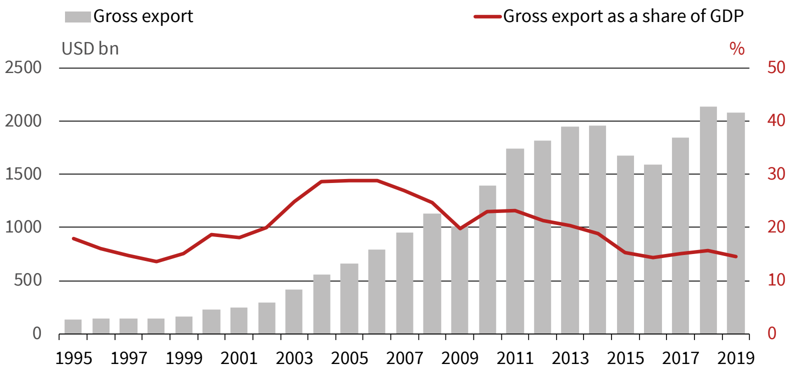
Figure 1

China Export



Source: UNCTAD.

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CHINA'S ACCESSION INTO WTO AND ITS ECONOMIC SUCCESS

China's economic success in the last few decades is clearly linked to its accession to the WTO but not only in terms of market entrance. Tan (2021) contends that China's accession to the WTO brought about major change and tied a rising China more tightly to global economic networks and institutions. The key to success was the reforms that China introduced, which enabled it to fulfill its commitments to the WTO. China's emergence as an economic superpower since 2001 has been meteoric: gross exports expanded fourfold—from 243 billion USD in 2001 to over 1 trillion USD in 2009, taking it from the world's the sixth largest exporter of goods to the world's largest exporter (Figure 1). Within five years, the share of export in GDP rose by 10 percent points, from 18 percent in 2001 to nearly 29 percent in 2005. Thanks to the export-led growth model, China's rapid export growth has been accompanied by rapid growth in income. GDP per capita more than doubled from 1,053 USD to 2,099 USD from 2001 to 2006 and multiplied by almost ten times to 10,261 USD in 2019 (Figure 2). Be that as it may, the growth story of China is still unfolding.

It seems important to go back to the history of China's accession as well as the commitments to better understand where we stand today. China's entry into the WTO was clearly not smooth. In fact, China was one of the 23 original signatories of the General Agreement on Tariffs and Trade (GATT), the predecessor of the WTO. But after China's revolution in 1949, the situation between Taiwan and the mainland was all but easy. There are many interpretations of what happened then, but it ultimately boils down to China withdrawing from the GATT system. In 1982, the Chinese government was granted observer status of GATT and in 1986, China formally applied to accede to the GATT in the form of a "resumption of its status as a contracting party." For 15 years after its initial application, China engaged intermittently in bilateral negotiations with Japan, the US, the EU and other WTO members, as well as the multilateral negotiations in the WTO Working Party on Accession. The first developed country to reach a bilateral agreement with China was Japan, which gave new momentum to other bilateral negotiations. The bilateral negotiations between the US and China, which held the key to accession, were stalled by suspensions that were imposed after the Tian'anmen Square incident

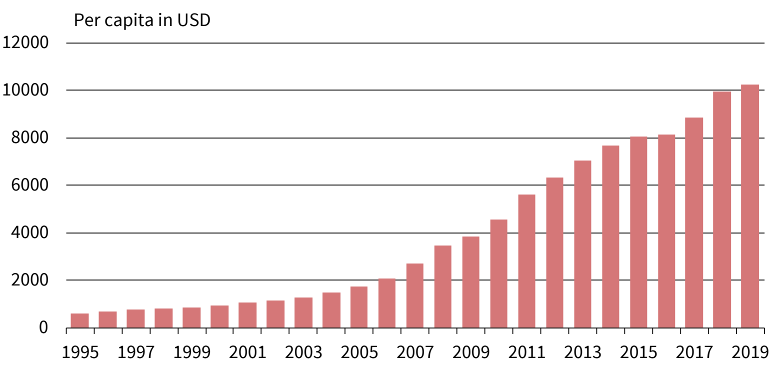
(June 1989) and the accidental bombing of the Chinese Embassy in Belgrade (May 1999), but a US-China agreement was reached in Beijing in November 1999. The EU reached a substantial agreement with China as well in May 2000. Consequently, the bilateral negotiations with the major developed countries were virtually completed. As of February 2001, China had roughly completed negotiations with all 37 of the WTO members requesting the bilateral negotiations, with the exception of Mexico. This was the last country to give up its implicit veto, opening the door for China's accession to the WTO on 11 December 2001.

In short, China's accession to the WTO was preceded by a lengthy process of negotiations that required significant reforms to transform its economy into one which is more market based. The results of bilateral negotiations on market access were extended to all members under the most-favored-nation principle. Regarding market access for goods, China agreed to reduce import tariffs and to eliminate quantitative restrictions on imports by 2005. China also committed to unifying all laws, regulations and standards, applying discriminatory standards to imports by the time of accession to the WTO, and to ensure transparency of the system as well as equal treatment between imports and domestic products. China's concessions on market access for services was more limited but it did agree to a phase-out of restrictions to entry to foreign investors that vary widely across sectors.

It is also important to look into the safeguard, or emergency measures, that the WTO allows (Shaffer and Gao 2018). Such safeguard measures ordinarily take the form of tariff hikes or quantitative restrictions. Subsidies are an exception to the principle of national treatment and the WTO agreement does allow subsidies to be provided only to domestic industries. Government procurement is also an exception to the principle of national treatment. Governments are allowed to preferentially purchase domestic goods when sourcing goods as the final consumer. The WTO agreement sets forth rules on these measures so that they are not abused to create barriers to trade. As a general principle, China was required to adhere to these rules when joining the WTO, but conditions differ according to the specific agreement.

The very important issue of adherence to commitments to subsidies has so far been watered down as China has kept is status of developing economy. Regarding procurement, China decided not to join the plurilateral agreement binding members for international procurement rules and the situation has not changed. In any event, as part of the accession process, China did agree to guarantee non-discrimination against foreign and foreign-capital companies in applying conditions to the procurement of inputs and goods and services. It is also committed to eliminating the discriminatory two-tiered pricing system for foreign companies purchasing transportation, energy and telecommunications services charges. In terms of

Figure 2
Gross Domestic Product



Source: The World Bank. © ifo Institute

protecting intellectual property, China amended legislation to bring it in line with obligations of the TRIPS. Among several actions, China amended its criminal law, adding penalties for intellectual property rights infringement, it has provided a legal framework for protecting intellectual property rights by the customs authorities, the State Administration for Industry and Commerce (SAIC) was given power to prosecute infringements, and a specific section was set up at the Supreme People's Court to handle this. Still infringement is rampant. In the case of technology transfer, legislation in China remained, which was inconsistent with the TRIPS agreement, such as the "Technology Importation Contract Control Ordinance" and concomitant enforcement rules, which impose restrictions on international technology importation contracts (i.e., licensing contracts).

Regarding standards and certification, the WTO, under the GATT non-discrimination principles, contains rules on technical standards and certification so that arbitrary standards and technical requirements at the national level do not constitute technical barriers to trade. China was very far from WTO commitments on this front at the time of accession. Different authorities or institutions were in charge of product inspections depending on whether the product was domestic or imported. Also, the standards by which products were inspected lacked transparency. Various steps have been taken since then, including the creation of China compulsory certification, but problems leading to discrimination toward foreign products remain.

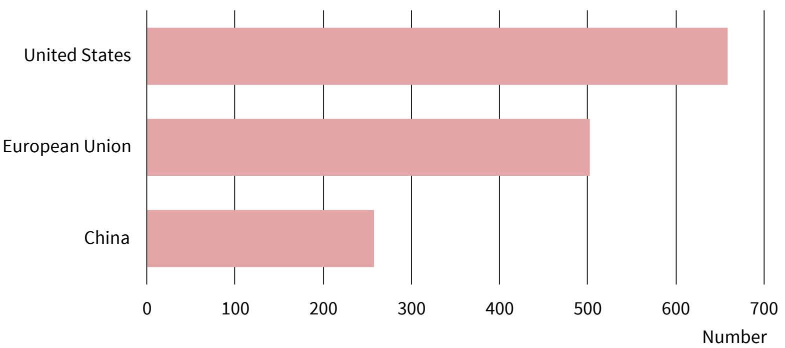
Regarding anti-dumping and countervailing duties, China formulated its own legislation in 1997 and began investigations at the end of that year into newsprint from Canada, Japan, Republic of Korea, and the US but its legislation was not in line with that of the WTO. Regarding the use of anti-dumping and countervailing duties against China by WTO members, it is important to note that the scope and approach change substantially depends on whether China is considered a market economy. The US-China bilateral agreement for accession in November 1999 treats China as a "non-market economy" for the first 15 years after accession and allows the use of third-country domestic prices and production costs in the calculation of normal values.

EVOLUTION AFTER CHINA'S ENTRY INTO THE WTO

The Chinese economy has gone through several reforms and "opening-ups," which have obviously helped fulfil the requirements set in China's WTO accession, but China has clearly fallen short of becoming a market economy. In fact, China does not define itself as such, but rather as a socialist economy with Chinese characteristics. Overall, one could argue that China remains a mixture of a planned and a market economy.

The key question remains as to how compatible this model is with that of other WTO members. A good reflection of the lack of compatibility is the use of WTO safeguarding measures, especially anti-dumping ones, against China. Even though China clearly stands out as a target for anti-dumping initiation, it is not the worst performer. Up to the end of 2018, China has been charged with 258 cases of anti-dumping since its entry into WTO (Figure 3), and this number is much smaller than that of the United States (659 cases) and that of the EU (502 cases). In terms of the source country, the US stands out as having initiated 48 cases of anti-dumping against China, which makes up more than one-fourth of the total anti-dumping initiations against China (Figure 4).

Figure 3
Anti-dumping Initiations through WTO



Source: Natixis; WTO.
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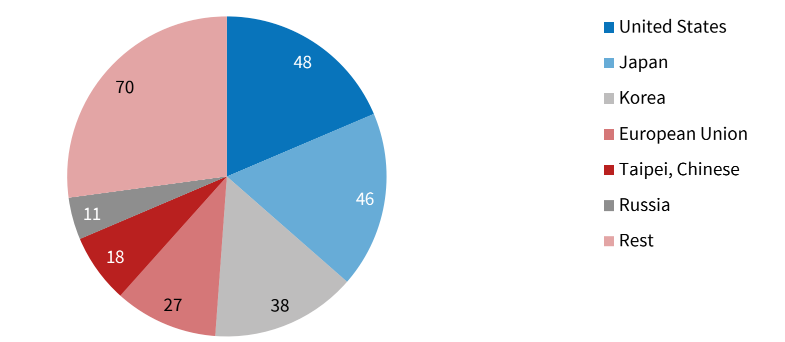
Figure 4
Anti-dumping Initiations against China Breakdown by Country



Source: Natixis; WTO.
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Neighboring economies such as Japan and Korea have also been a major initiator of anti-dumping cases against China. The number of anti-dumping cases against China might, however, been biased downward, especially more recently, due to China's reaction through retaliation. This is inherent in China's economic model and the dominance of state-owned enterprises (SOEs) in many sectors, which receive government support when dealing with pressure from overseas. In fact, the sectoral distribution of anti-dumping cases against China already points to this hypothesis as China's chemical products have been under the greatest amount of attack, with 140 cases of anti-dumping or more than half of the total anti-dumping initiations against China. This sector is indeed dominated by large SOEs (Figure 5).

WHY WE STILL NEED A REFORM

While China was not the first or even the last non-market economy to enter the WTO (Vietnam followed China, for example), there are a number of reasons why China is a much more important case for the future of the WTO and the need for reform. The most obvious reason is China's sheer size. China today is the second-largest economy in the world, or even the first when measured in terms of purchasing power parity (PPP). In addition, its companies have continued to grow, and now top the rankings of the largest companies in the world. In fact, China now has more Fortune 500 companies than the US (Figure 6), which means that any distortions in an economy of the size of China, which also has such a large number of huge companies, have global implications. Vietnam cannot really compare with China, size or influence-wise. The other important reason why China makes a case for WTO reform is related to the large role the state plays in the Chinese economy.

The role of the state in the Chinese economy has long been debated both in the economic literature and in political circles, and the dispute has by no means been settled. To this end, we show the share of corporate assets still in state hands, particularly among listed companies. In fact, as of the first half of 2020, 58.9 percent of assets were in the hands of SOEs, regardless of whether they were central or local SOEs. This percentage is even higher in the telecom, infrastructure, airlines, energy and utilities sectors (Table 1). While the pervasiveness of state control in the production of goods and services already points to potential distortions in the Chinese economy, pushing it away from market functioning, one could argue that ownership does not necessarily determine how a company may behave. In fact, the concept of "competitive neutrality" is designed to measure how close the behavior of a state-dominated entity may be to that of a private company in the production of goods and services. In a recent paper by García-Herrero and Ng (2021), the authors measure sector by sector how far Chinese SOEs are from competitive neutrality in the domestic market. They find that SOEs are generally advantaged compared to their private counterparts except for the real estate sector.

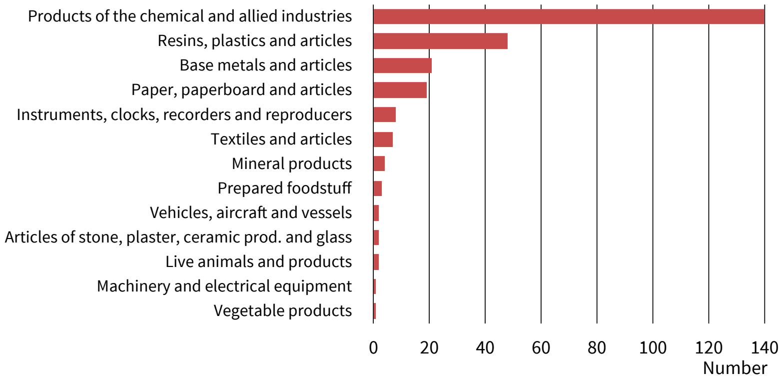
Another important role of the state in the economy is that the Chinese Communist Party (CCP) is intrinsically involved in the functioning of companies in China. In particular, the CCP appoints and controls key company executives through the CCP Organization Department. In addition, both state-owned enterprises and private Chinese companies have internal Party committees that are capable of performing government and Party functions. In recent years, moreover, the Party has taken steps to increase the strength and presence of Party committees within all companies. For example, state-owned enterprises and private Chinese companies are being pressured to amend their articles of association to ensure Party representation on their boards of directors, usually as the Chairman of the Board and to ensure that important company decisions are made in consultation with Party cells. Further reinforcing the Party's influence over enterprises in China is the Social Credit System, which monitors and rates individuals and companies in China, including foreign ones.

More generally, the strategic planning stemming from China's latest Five-Year Plans and beyond makes it very clear that China wants to remain a socialist economy with Chinese characteristics and that the overarching role of the state is not going to wane. Both China's growth size and its economic model have a huge impact on the function of the WTO, making a reform even more necessary, in addition to other reasons.

China is obviously not the only country with a state-led economic model, which means that a reform is bound to affect many other economies. The most serious issue is related to SOEs that dominate many economies, especially in Gulf countries and Vietnam. There are basically no specific obligations regarding SOEs within the WTO agreement. The Agreement on Subsidies and Countervailing Measures (SCM) does not even mention SOEs. The second key issue is technology transfer. The US and others have also voiced concerns about China's use of informal non-state channels and informal norms not openly articulated by a government official. The issue is only partly addressed within the existing WTO rulebook, which fails to specify what constitutes a "forced" technology transfer. The GATT and other multilateral agreements do not cover investment for goods, nor do they therefore address transfer of technology.

Figure 5

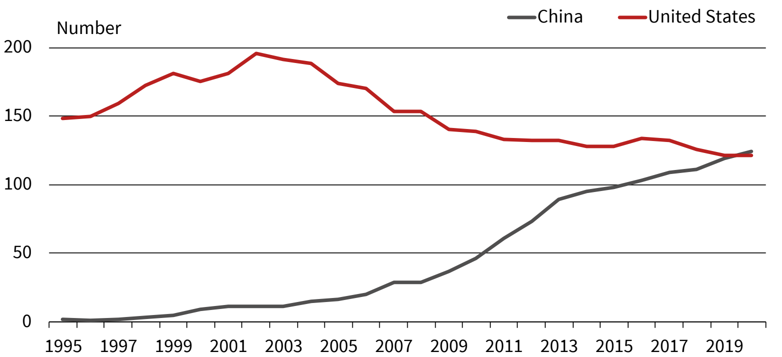
Anti-dumping Initiations against China, Sectoral Distribution



Source: Natixis; WTO. © ifo Institute

Figure 6

Companies in the Fortune 500



Source: Fortune; Natixis. © ifo Institute

On the other hand, the GATS (General Agreement on Trade in Services) is the only multilateral agreement that covers investment. In addition, the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs Agreement) has something to say about this as well.

The other important issue is the developing-country status. The WTO treaties provide certain exceptions and more permissible rules for developing countries, which, under the special and differential treatment (S&D), are entitled to longer time periods for implementing agreed commitments, measures to increase trading opportunities and twice the number of agricultural subsidies available to developed countries. However, there are no set rules for what constitutes a "developing country"—meaning that this is an issue of self-declaration. Most of the WTO's members claim to be developing, including China. Hence, the system allows China to enjoy preferential rules in some areas, despite the fact that it is a larger trading power than many advanced economies and that it has the largest number of Fortune 500 companies, and that it is the first-/second-largest economy in the world. It seems clear that WTO rules were not crafted with the unique structure of China's political economy in mind and that reform is clearly needed.

Table 1

Ownership by Sector Measured by Asset Size (%) for 3,000 Largest Listed Corporates in China, First Half of 2020

Sector	Central SOE	Local SOE	Private-owned enterprises (POE)
Telecom	98.6	0.0	1.4
Infrastructure	79.1	14.6	6.3
Airlines	78.1	15.4	6.5
Energy	81.3	11.9	6.8
Utilities	65.9	27.0	7.0
Industrial	41.9	31.6	26.5
Automobiles	20.3	43.0	36.7
Materials	23.3	37.2	39.5
Total	**39.1**	**19.8**	**41.1**
Health care	24.5	15.5	60.0
ICT	22.7	13.5	63.7
Real estate	21.1	12.4	66.5
Consumer	4.1	23.7	72.1
Semiconductors	7.3	16.3	76.3
Renewables	13.4	6.8	79.8

Source: Natixis.

HOW TO REFORM THE WTO WHILE ACCOMMODATING CHINA

When it comes to how to reform the WTO regarding China, there are opposing views on what to do. Some argue in favor of a "regime change," especially within US policy circles. China's own reform proposal basically calls for the WTO to accept China's economic size and importance. Other views are more nuanced, proposing a third way. In this section, we summarize a few proposals by different bodies, which could potentially address the key complaints about China within the WTO system.

US Views

In the 2017, United States Trade Representative (USTR)'s Report to Congress on China's WTO Compliance, the US Administration announced that it would pursue a new, more aggressive approach towards China, as far as trade and investment relations are concerned (USTR 2018). As part of these efforts, the US would take all appropriate actions to ensure that the costs of China's non-market economic system are borne by China and not by the US. How this translates into proposals for WTO reform widely varies across the spectrum of US experts, even more so given the recent change in administration.

Still, there seems to be a commonality between old and new US administrations, namely that adhering narrowly to the letter of the law under WTO existing rules is not enough to address the problems stemming from China's non-market practices. The US-China Phase 1 trade deal reached in January 2020 was considered by the US administration itself a first step in that direction but with many important issues left for a second phase and/or a reform of the multilateral system. This includes critical issues such as subsidies, excess capacity, state-owned enterprises, state-sponsored cyber-enabled theft of intellectual property, standards, cybersecurity, data localization requirements, restrictions on cross-border data transfers, competition policy and regulatory transparency as well as intellectual property, technology transfer and services market access.

The first thing to note is that, based on the 2017 USTR Report to Congress on China's WTO Compliance, the Trump administration clearly did not believe that reforming the WTO would solve the problems involving China's state-led economic model as China became part of the global economy. It is still too early to know whether this view will be held by the current Biden administration, but there are some preliminary signs that this might be the case. In other words, WTO reform might be on Biden's agenda but not as his main tool for dealing with it.

This is indeed the position of Mark Wu, recently appointed by the University of Pennsylvania to work on a project involving the future of US-China relations, who states in his recent paper on US-China, how he believes the trade challenge should be handled (Wu 2020). Wu underscores the difficulties of a WTO-centric strategy for any joint alliance-based approach for tackling the China trade challenge in the short term (more specifically, he refers to the 2021-24 period). Wu believes that the reasons for these difficulties are that the urgency to formulate a response contrasts with the very slow speed at which such large multilateral institutions operate. Still, he advocates US involvement in the WTO and its reforms, and that there should be a clear focus on resolving differences with US allies as to the direction reform should take, and that more timely ways of dealing with China need to be developed as far as trade and investment are concerned. This multi-pronged approach for dealing with China seems like the most likely action that the Biden administration will take.

Regarding the WTO, one important aspect of the reform expected by the US administration regarding China relates to increasing the speed for introducing new rules. One way to speed up this reform is to foster the consensus process that WTO ministers use and to implement Annex IV Plurilateral Agreements, to which only a select group of countries currently agree, but which is an agreement that other countries are also free to agree to. There are a number of problems with this, such as potential free riding, as well as a minimum threshold of membership that must be covered.

It is also important that the most obvious shortcomings of the current WTO rules are covered, such as subsidies, e-commerce, and services. Two problems emerge in this context. First, only industry-related subsidies are partially covered under the WTO. Service-related subsidies are excluded. Second, it is not clear whether other bilateral arrangements can be used as a formula for WTO reform. The recent investment deal reached between the EU and China offers a new formula for service subsidies, at least in terms of additional transparency but does not introduce any changes to industrial subsidies, which means that there is no new guidance as to how to address this issue within WTO reform. Regarding e-commerce, formal negotiations have started at the WTO on a new plurilateral rule, but US and China positions are really far apart.

The EU's Proposal

The European Union has been one of the key supporters of multilateralism and the WTO, but has urged reform during the past few years, because the US government (and the Trump administration in particular) turned its back on the WTO. In 2018, the EU published a concept paper with a detailed proposal for WTO reform, focusing on a range of issues, such as overcoming the deadlock of the dispute settlement system, among others (European Commission 2018). More recently, on February 18 this year, the EU published a review of its trade policy, which also included WTO reform of as one of its key issues (European Commission 2021). While the approach to WTO reform in the EU's 2018 document does address some of the key issues related to China, its 2021 document states digitalization and climate change as the EU's key views. Multilateral means (WTO) and bilateral trade deals seem to come closer together in terms of priorities, and assertiveness appears as an important new concept. Finally, in its latest trade policy review, the EU is increasingly pushing the idea of using multi-country deals when consensus cannot be reached at the WTO level.

A number of issues should be highlighted regarding the EU proposals for WTO reform that directly relate to China. First, market distortions from non-market economies should be one of the key objectives addressed, which is very similar to the US position. The EU, though, seems to link market distortions to state involvement in the production of goods and services (namely SOEs), whereas the US position is more nuanced, based on the increasingly pervasive influence of the CCP in private companies. With regard to subsidies, the EU and the US recognize that the Agreement on Subsidies and Countervailing Measures (SCM Agreement) is not as effective as would be necessary. Therefore, one of the key aspects of the EU's proposal is to improve transparency regarding subsidies, since the lack of information makes it close to impossible to pursue cases at the WTO. Regarding SOEs, there is the additional problem that they can be classified as "public body" and thus escape the responsibilities imposed by the SCM Agreement. For the EU, WTO reform would need to clarify the commercial nature of SOEs so that they are fully covered by existing WTO commitments on subsidies and other non-market practices. It should be noted that the EU-China investment deal does include a clause clarifying the nature of SOEs, which could serve as a basis for reforming the WTO on this specific topic.

The EU proposal does recognize that, even with better transparency on subsidies and better coverage of SOEs in existing mechanisms such as SCM, other-market distorting measures from non-market economies need to be addressed with a WTO reform. To start with, some types of subsidies are still permissible within SCM, which means that the list of prohibited subsidies would clearly need to be expanded. These include unlimited guarantees and subsidies given to an insolvent or ailing enterprise with no credible restructuring plan or dual pricing.

Beyond subsidies and SOEs, the EU proposal also includes new rules to address barriers to services and investment, including forced technology transfer, market access barriers and discriminatory treatment of foreign investors. Starting with forced technology transfer, the scope of application of existing provisions in the WTO rule is limited and therefore insufficient for addressing some of the most important sources of problems, such as requirements prohibiting or limiting foreign ownership (e.g., joint venture requirements or foreign equity limitations). The recently signed EU-China investment deal improves on the existing rule book on forced technology transfer, which follows the example of the US-China Phase 1 deal. This improvement could be a first step toward reforming the WTO on this specific topic but it is clearly not sufficient. In fact, the EU position paper calls for new rules to improve overall market access conditions for FDI.

The final point that the EU position paper focuses on is the developing versus developed status when it comes to WTO policies (European Commission 2021). In fact, the idea that such difference should be made stems from the assumption that developing countries benefit less from trade. China is probably the best example of the opposite and there are many others, such as Vietnam. The EU holds the view that the lack of nuance and its consequences with regard to the special and differential treatment question has been a major source of tensions in the WTO and an obstacle to the progress of negotiations. The demand for blanket flexibilities for two-thirds of the WTO membership dilutes the call from a much more targeted group of countries that do have development assistance needs. The EU proposal does not offer a specific solution to this problem, but the direction is clear: reduce the number of countries considered developing and, implicitly, move away from each WTO member deciding on their own status independently.

China's Proposal

Against the backdrop of rising unilateralism and protectionism, China is also in support of making necessary reform to the WTO. To this end, China has submitted two formal documents on the topic of WTO reform, these being the Position Paper on WTO Reform of November 2018 and the Proposal of China on WTO Reform of May 2019 (WTO 2019). In general, China's primary focus is how to bring the Appellate Body to work again but also, fisheries subsidies, e-commerce and investment facilitation. As for the more controversial topics such as trade distortions and subsidies, China still defends its interest and stresses the uniqueness of its economic structure. Key complains such as forced technology transfer are not mentioned in these proposals even though China did respond by introducing a new investment law in 2019 which states a prohibition on forced technology transfer.

Regarding the behavior of SOEs, China maintained a tough position and reasoned that SOEs are equal players in the market whose only difference is ownership. In that regard, China would like to avoid discrimination against SOEs in foreign investment security reviews by WTO members. In other words, China' s position is that it would accept discriminatory disciplines on SOEs in the name of WTO reform and that foreign investment security reviews should be conducted in an impartial manner.

As for subsidies, China does admit the potential misuse and abusive application of trade remedies, in particular discriminatory practices based on country-of-origin and types of enterprises. However, it attributes the problem to the ambiguities in existing multilateral trade remedy rules. As such, it proposes to further clarify and improve relevant WTO rules on subsidies, countervailing measures and anti-dumping measures. That said, it still stresses the need to give consideration to the special situations of developing members and gives no signal that it was to move away from such status.

Beyond the US, the EU and China positions on this issue, the economic literature also proposes a few ways to reform WTO as concerns China, especially around the key complaints such as the unfair trade advantages of SOEs and the use of forced technology transfer on foreign companies. A very important case in point is the recent book on China and the WTO by Mavroidis and Sapir (2021). The authors try to offer a middle ground and conclude that, for the WTO to function smoothly and accommodate China's unique geopolitical position, the WTO needs to translate some of its implicit principles into explicit treaty language. More specifically, the authors propose that the WTO translate its implicit legal understanding into explicit treaty language. China will then have the choice regarding whether it wants to comply, which they believe will be the way to accommodate China. Another important recommendation from the authors is to limit the role of the state in the economy to unleash the potential for liberalization.

CONCLUSIONS

China's accession to the WTO has been a landmark event both for China and the rest of the world. In fact, it has been instrumental in embarking an economy of the size and population of China in competing in the global economy and the result has been a great success. To achieve that goal, China has no doubt reformed and opened up its economy but not to the extent of becoming a full market economy. That duality—striving to operate as a market economy in some areas while keeping the key characteristics of a state-led planned economy—makes it very difficult for China to comply with the principles of what the WTO, as an institution, was designed for. Therefore, a reform is not only necessary but also long overdue. The key problem, though, is that China—and probably other emerging economies with a largely state-led economy or with big industrial policy plans—may feel more comfortable with the kind of WTO rules we have today than with the proposals for reform coming from the US, the EU or Western academics in general. At the other end of the spectrum, the US administration (certainly under Trump but possibly also under Biden, given his team choice) does not seem ready to wait for a multilateral solution in terms of China's trade and investment issues, and certainly not for a reform of the WTO. This means that an increasing number of autonomous measures for dealing with China's economic threat are to be expected. A very good example of it is the executive order that the Biden administration has announced to protect value chains from Chinese components in certain key sectors. Beyond autonomous measures, the Biden administration is prepared to work with like-minded countries on WTO reform, but acknowledges that reform will not come in time to address China-related problems. This is why the US administration seems ready to choose a faster route to improve its trade and investment relations with China. One potential outcome will be for the US to push a bilateral negotiation beyond the Phase 1 deal covering the most contentious issues, such as subsidies, SOEs and forced technology transfer. At the same time, a US-EU-led WTO reform (with other like-minded countries) will probably focus on all the above, with some help from the EU-China investment deal that will also clarify when countries can claim developing-country status. It goes without saying that the EU-China investment deal only offers a partial solution to some of the issues, such as transparency for subsidies on services, as well as transparency on SOEs activities, especially those involving their commercial goals. Many other issues will still need to be resolved. Within that context and based on China's own position on WTO reform, the lack of consensus is blatantly clear. This is particularly true for treating SOEs.

Both the need for urgency in dealing with market distortions stemming from China's economic model and China's increasing size and influence on the rest of the world might not necessarily be channeled toward the WTO. The reasons for this are several. First and foremost, China seems unwilling to give up its status as a developing country and the benefits that come with it, and WTO procedures are simply too slow for such a change to occur at an acceptable speed. This means that either bilateral solutions (such as the EU-China investment deal) or a potential follow-up of the Phase 1 deal may be used as a bridge to WTO reform. In parallel and especially on the front of dispute settlement, multi-country arrangements might be the preferred option while a slow, but hopefully feasible, WTO reform is achieved.

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Giulio Cornelli, Jon Frost, Leonardo Gambacorta, Raghavendra Rau, Robert Wardrop and *Tania Ziegler*

Fintech and Big Tech Credit: What Explains the Rise of Digital Lending?

ABSTRACT

Credit markets around the world are undergoing a deep transformation. Fintech and big tech firms are providing more lending to households and small businesses. A new database estimates that fintech credit flows reached USD 223 billion in 2019, while big tech credit reached USD 572 billion. What explains their growth? Both fintech and big tech credit are larger with higher GDP per capita (at a declining rate), higher banking sector mark-ups and less stringent banking regulation. Both are higher where economic and institutional factors favor the supply of such lending. The Covid-19 pandemic represents an important test for these new forms of credit.

In the last decade, two new types of credit intermediation have emerged and grown rapidly. Both use new digital technologies to compete with banks in their core lending function (Stulz 2020). The first innovation is fintech credit, i.e., credit activity facilitated by electronic (online) platforms that are not operated by commercial banks (Claessens et al. 2018). This is also called "debt-based alternative finance" (Wardrop et al. 2015). It includes peer-to-peer or marketplace lending by platforms like Zopa and Funding Circle in the UK, LendingClub and SoFi in the US, Yiren Digital and others in China, and Harmoney in Australia and New Zealand. It also includes invoice trading, mini-bonds and other forms of financing for consumers and small businesses based on online platforms. Data on this type of activity is compiled in the Cambridge Centre for Alternative Finance (CCAF) and the Global Alternative Finance database (Ziegler et al. 2020). These data, discussed in Rau (2021) and available from CCAF, are based on an annual online questionnaire of alternative finance volumes and characteristics available for 2013-2018.

A second innovation is the expansion of big tech firms into credit markets. Big tech refers to large companies whose primary activity is digital services, rather than financial services (de la Mano and Padilla 2018; Frost et al. 2019). These firms often have large established networks from non-financial business lines, such as electronic commerce ("e-commerce"), social media or internet search, and these networks and activities give them access to valuable data on individuals and firms (BIS 2019). In recent years, many such firms have begun to lend to their users, either directly—e.g., through a financial services subsidiary—or in partnership with traditional financial institutions. Examples include the lending activities of Alibaba's Ant Group and Tencent's WeBank in China, of Amazon in the US, UK and other countries, of Google in India, of M-Pesa and other mobile money operators in Africa or Grab and Go-Jek in Southeast Asia and of Mercado Libre and others in Latin America.

Because these forms of credit intermediation are new, they are often not yet included in official credit statistics. This is a problem, as central banks and regulators are responsible for monitoring credit markets. Like good pilots, authorities should not be "flying blind."

Giulio Cornelli

is Senior Financial Market Analyst at the Monetary and Economic Department of the Bank for International Settlements.

Jon Frost

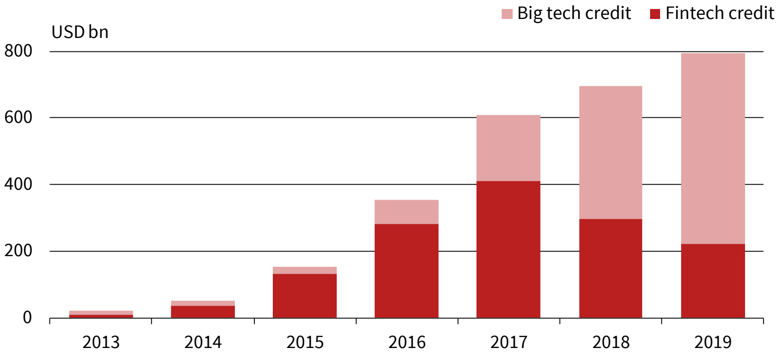
is Senior Economist at the Monetary and Economic Department of the Bank for International Settlements and a research affiliate of the Cambridge Centre for Alternative Finance at the University of Cambridge.

Leonardo Gambacorta

is Head of the Innovation and the Digital Economy Unit at the Monetary and Economic Department of the Bank for International Settlements.

Figure 1

Big Tech Credit Is Overtaking Fintech Credit



Note: 2019 fintech lending volume figures are estimated on AU, CN, EU, GB, NZ and US.
Source: Cornelli et al. (2020).

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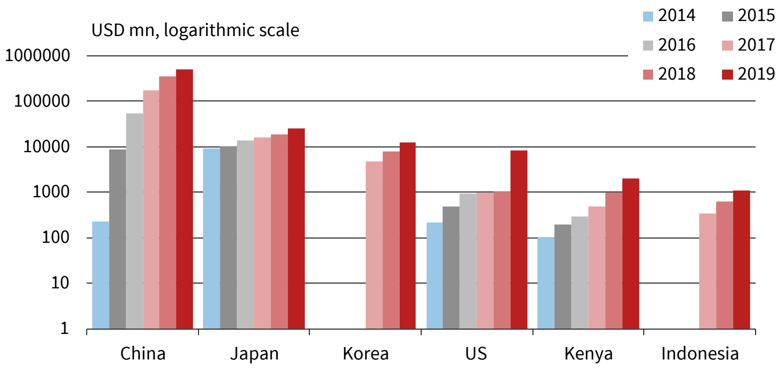
Figure 2

Big Tech Credit Is Booming in Asia, the United States and Africa



Note: Figures include estimates.
Source: Cornelli et al. (2020).

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A new paper and database (Cornelli et al. 2020) aims to fill this gap. It combines data from the CCAF Global Alternative Finance database with hand-collected data on big tech credit from various public sources such as firms' annual reports, as well as information from contacts at big tech companies and central banks. In some cases, it has been necessary to estimate lending flows based on end-year stocks of credit, and to estimate 2019 numbers based on figures in past years and growth in user numbers or revenues. Where big tech firms lend in multiple jurisdictions, it has sometimes been necessary to make assumptions about how such lending is distributed across different markets.

The data show that globally, big tech credit is booming, overtaking fintech credit (Figure 1). Big tech lending volumes reached USD 572 billion in 2019—a growth of 44 percent over 2018. Fintech credit volumes actually declined by 25 percent to USD 223 billion in 2019. This decline is driven entirely by China, where regulatory reforms and a series of platform exits have led to a contraction in both the stock and flow of fintech lending. In other countries, fintech credit continues to grow rapidly. Both fintech and big tech platforms have in some cases moved toward partnership models, where the fintech or big tech firm distributes financial products, but a financial institution retains such lending on its balance sheet.

The largest markets for big tech credit in absolute terms are China, Japan, Korea and the US. In each of these markets, lending by big techs, either directly or in partnership with financial institutions, has risen rapidly (Figure 2). In Japan, e-commerce firm Rakuten and social media company LINE are notable lenders. In Korea, the two virtual banks Kakao Bank and KBank have ramped up their lending since their launch in 2017.

In some markets, the two new forms of credit intermediation are becoming economically relevant. In particular, the sum of fintech and big tech credit flows were equivalent to 2.0 percent of the stock of total private credit in China in 2019 (Figure 3). Meanwhile, they reached 5.8 percent of the stock of total credit in Kenya and 1.1 percent in Indonesia. In advanced economies, volumes are smaller relative to overall markets, but market shares can be large in specific market segments. In the UK, for example, Ziegler et al. (2020) estimate that fintech credit platforms accounted for up to 27.7 percent of equivalent bank credit to small and medium enterprises with annual turnover below GBP 2 million in 2018. Buchak et al. (2018) and Fuster et al. (2018) show that fintech lenders are becoming important players in US mortgage markets.

There are some key differences between fintech and big tech lenders. Most notably, the core busi-

Raghavendra Rau

is the Sir Evelyn de Rothschild Professor of Finance at Cambridge Judge Business School, University of Cambridge. He is Director of the Cambridge Centre for Alternative Finance and a member of the Cambridge Corporate Governance Network.

Robert Wardrop

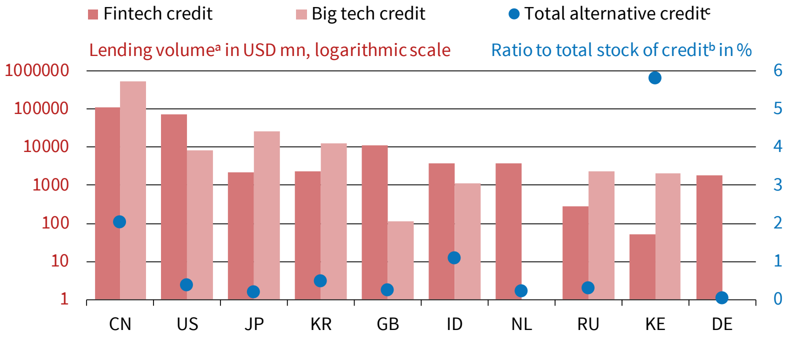
is Professor in Management Practice at the University of Cambridge Judge Business School and Director of the Cambridge Centre of Alternative Finance.

Tania Ziegler

is a senior research associate at the Cambridge Centre for Alternative Finance, Cambridge Judge Business School and manages the Centre's alternative finance benchmarking program.

Figure 3

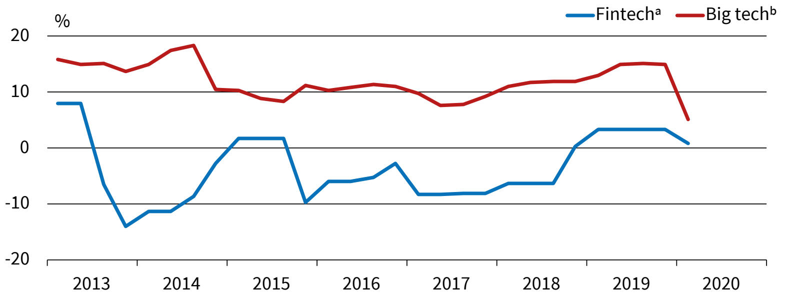
Fintech and Big Tech Credit Are Sizeable in Some Economies



Note: [a] Data for 2019. [b] Domestic credit provided by the financial sector. Data for 2018.
[c] Total alternative credit is defined as the sum of fintech and big tech credit. Data for 2019.
Source: Cornelli et al. (2020).

Figure 4

Big Tech Firms Are More Profitable Than Fintech Platforms



Note: [a] Simple average of Black Knight Financial Services, Elevate, Enova International, Fellow Finance, Funding Circle, LendingClub, Lendingtree, Nelnet, OnDeck and Synchrony. [b] Simple average of Alibaba, Amazon, Apple, Baidu/Du Xiaoman, Facebook, Google, JD.com, Kakao, LINE, Microsoft, MTS bank, Orange, Rakuten, Samsung, Tencent, Uber, Vodacom, Vodafone and Yandex.
Source: Cornelli et al. (2020); Brismo.com; Refinitiv Eikon; WDZJ.com.

ness of fintech credit platforms is financial services, whereas big tech firms often have a range of (non-financial) business lines in addition to their lending activities. This gives big techs access to user data and distribution networks, as well as high profit margins, which in turn provide big techs' financial resources to grow. These margins are particularly high when compared with those of fintech credit platforms, which have often struggled to achieve profitability (Figure 4) and have relied on new investor funding for expansion.

DRIVERS OF FINTECH AND BIG TECH CREDIT

To understand the drivers of fintech and big tech credit, we perform panel regressions of log credit per capita for 79 countries over 2013–2018.[1] We consider fintech and big tech credit separately and the sum of the two (total alternative credit). We also consider differences between fintech and big tech credit. Table 1 shows our regression results.

We confirm that fintech and big tech credit can be explained by a mix of supply and demand factors. On the demand side, we show the following:

– More developed economies (with higher GDP per capita) have a higher demand for credit from firms and households, and thus higher fintech and big tech credit. This relationship decreases for very high levels of development (in line with Claessens et al. 2018; Barbash and Beaton 2020). It is relative stronger to fintech than for big tech credit; the difference between the estimated coefficient for fintech and big tech credit for GDP per capita is statistically significant.
– When banking services are more expensive (higher banking sector mark-ups), for instance because of less competition, this may mean more demand for cheaper credit from fintech and big tech lenders. Bank mark-ups explain around 5 percent of the variability of total alternative credit per capita. Again, fintech credit is especially higher in these cases.
– Where there is a larger un(der)met demand for financial services, as proxied by fewer bank branches per capita, we find higher fintech credit volumes—but not more big tech credit. This is consistent with the view that fintech credit serves clients in underbanked areas and that it is therefore complementary to traditional bank credit. Big tech credit, while also relying on digital distribution channels rather than physical branches, does not appear to be correlated with the number of bank branches relative to the adult population, all else being equal.

On the supply side, we find that:

– More stringent banking regulation (a proxy for the overall stance of financial regulation—see Barba Navaretti et al. 2017) is associated with higher fintech and big tech credit. These rules may create barriers to the entry for fintech and big tech firms. Banking regulation explains around 10 percent of the variability of total alternative credit per capita in the baseline model. Conversely, we find in a separate set of results that dedicated regulatory frameworks for fintech credit (typically designed when the market reaches a certain scale) allow these markets to further grow and develop. This is in line with Rau (2021).
– Institutional characteristics, such as the ease of doing business, investor protection and disclosure and the judicial system (also reported in the paper), are associated with higher alternative credit volumes, likely because they allow fintech and big tech firms to enter credit markets and to grow.
– Characteristics of the incumbent banking system and of financial markets shape innovation. Alternative credit volumes are higher where banks are better capitalized, the bank credit-to-deposit ratio is lower, and where bond and equity markets are more developed. There is also a strong

[1] We exclude 2019 volumes given the lack of availability of many independent variables.

Table 1

Drivers of Fintech and Big Tech Credit Volumes
(All variables are expressed in current USD, except where indicated)

	Ln (total alternative credit per capita)	Ln (big tech credit per capita[5])	Ln (fintech credit per capita[6])	Difference |b-a|
		(a)	(b)	H_0: |b-a|<0
GDP per capita[1]	0.123***	0.069***	0.171***	0.102***
	(0.022)	(0.020)	(0.038)	(0.043)
GDP per capita^2	– 0.002***	– 0.001***	– 0.002***	0.001
	(0.000)	(0.000)	(0.001)	(0.001)
Lerner index[2]	1.438***	0.867**	2.436***	1.569**
	(0.401)	(0.365)	(0.732)	(0.818)
Bank branches per 100,000	– 0.017***	0.005	– 0.028***	0.033***
adult population	(0.005)	(0.005)	(0.009)	(0.010)
Normalized regulation index[3]	– 4.665***	– 1.735***	– 8.427***	6.692***
	(0.560)	(0.544)	(1.068)	(1.199)
Other controls[4]	Yes	Yes	Yes	
Geographic area fixed effects[7]	Yes	Yes	Yes	
No. of observations	453	453	453	
Estimation method	OLS	OLS	OLS	
R^2	0.469	0.112	0.516	

Notes: Estimation period: 2013–18. Robust standard errors in parentheses. ***/**/* denotes results significant at the 1/5/10% level. Ln = natural logarithm. The dependent variables have been winsorized at the 1% and 99% level. [1] GDP per capita (in USD thousands). [2] Lerner index of banking sector mark-ups in economy i, reflecting market power by incumbent banks. [3] The index is normalized between 0 (no regulation) and 1 (max regulation). [4] Other controls include: GDP growth; a crisis dummy that takes the value of 1 if the country was hit by the GFC and 0 elsewhere; total banking credit growth to the private non–financial sector; mobile phones per 100 persons; a dummy that takes the value of 1 for advanced economies and 0 elsewhere; and country-specific real interest rates. [5] Big tech credit is zero in 47 countries. To allow the computation of the log of the ratio (not defined for zero), big tech credit has been rescaled summing an arbitrary constant (the minimum value). [6] Fintech credit is defined as credit activity facilitated by electronic platforms that are not operated by commercial banks or big tech firms. [7] The sample has been divided into five geographical areas: Africa, Asia Pacific, Europe, Latin America, Middle East, and North America.

Source: Cornelli et al. (2020).

positive association with venture capital, private equity and merger and acquisition activity. Overall, this implies that fintech and big tech credit can complement bank credit and market-based finance, rather than substitute for it.

LOOKING AHEAD: WHAT IMPLICATIONS FOR POLICY?

Fintech and big tech credit are growing rapidly in countries around the world. However, data on their size and growth have until now been scarce. The CCAF database and the data in our new paper aim to fill this gap. Our full database of fintech and big tech volumes by country is made publicly available as a resource for policymakers, researchers and practitioners.[2] Nonetheless, improving the data availability will remain an important policy priority. As such, efforts to include fintech and big tech credit providers in regulatory reporting should continue apace.

As with other forms of credit, there is the potential for these new forms of lending to enhance economic growth—but also to engender risks to the macroeconomy and financial system. In particular, as credit grows rapidly, there is the potential for individual borrowers to become overindebted, and—as in past periods of rapid credit growth—even for risks to financial stability. Whether this growth represents the natural diffusion of a promising new type of intermediation or a credit bubble remains an open question; it may only be possible to assess this after a downturn.

In this light, the Covid-19 pandemic represents an important test to these new business models. Information on lending flows and credit losses over 2020 is not yet available. However, the recent "Global COVID-19 Fintech Market Rapid Assessment Study" (CCAF et al. 2020) suggests that digital lending transaction values contracted globally as a result of Covid-19. It will be important to assess how new credit models function during the Covid-19 induced recession. After the initial shock and credit losses, it can be expected that the greater demand for online services may actually further support fintech and big tech credit. For instance, big techs have seen a surge in demand for e-commerce services, particularly in countries with more stringent lockdown measures (Alfonso et al. 2021). Both fintech and big tech providers have seen a surge in demand for digital payment services, which generate further transaction data for use in lending decisions (BIS 2020). In some markets, fintech and big tech firms have even helped to channel emergency lending to small businesses during the Covid-19 pandemic.

[2] The database can be found at https://www.bis.org/publ/work887.htm.

Policymakers should continue to monitor these new markets, and to develop a better understanding of their risks and potential. They may need to accelerate the pace of regulatory intervention to better regulate and supervise an increasingly digitalized financial sector (CCAF et al. 2020). Some authorities have already taken measures to better regulate fintech credit platforms, for instance with dedicated rules or frameworks. There is an ongoing debate on how best to regulate big tech firms, both in financial services and beyond, as evidenced by recent regulatory initiatives in China, the EU and the US. Ensuring financial stability and market integrity, efficiency and competition, and consumer and data protection will pose new trade-offs and challenges (Feyen et al. 2021).

Equally, during the Covid-19 pandemic, fintech firms have reported a need for regulatory interventions that relate to core regulatory activities, such as customer on-boarding and stream-lined authorization processes (CCAF et al. 2020). Despite calls from the industry for greater regulatory assistance, fintech firms have by and large been unable to enjoy enhanced support from their key regulator or supervisory relationship.

In all of this, authorities can learn a great deal from one another, and from research conducted around the world.

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Antonia Díaz

The EU Budget and the Role of Public Goods

ABSTRACT

This paper argues that investing in public institutions and goods are the best tool for shielding the economy against events similar to Covid-19 because private agents cannot foresee extremely unlikely events and there are markets where informational problems are pervasive. This is even more true in a confederation such as the European Union, where the right mix of public transfers and public goods is critical in minimizing incentive problems related to consolidating the single market and European integration. The Multiannual Financial Framework 2021-27 and the Fund Next Generation are steps in this direction.

Covid-19 has wrought an economic crisis of unknown dimensions since WWII. This crisis amplifies the already high degree of uncertainty that we are facing due to rapid climate change. It is clear to all of us that our patterns of economic growth, based mostly on using energy of fossil origin, are not sustainable over time. Tackling the necessary industrial transformation to fight climate change is not easy for any country and it is a challenging task for a confederation such as the EU because the costs and benefits of altering the status quo are not equally distributed across generations, regions and over time. In addition, our economies, which are currently undergoing an enormous digital transformation, will be in a weaker state after the Covid-19 pandemic is over. For these reasons, the policies that we should implement to fight the effects of the pandemic should focus not only on stabilizing the economy but on creating conditions that ensure that the economy is set on a sustainable and robust growth path.

LESSONS FROM THE EURO CRISIS: THE IMPORTANCE OF COMMON FISCAL CAPACITY

One of the main achievements of the EU has been the single Market with its four legs: free movement of goods, services, people and capital. The economic integration fostered by the single market brings gains for all. Just to mention a figure, Campos et al. (2019) estimate that the average gains during the first 10 years of EU membership amount to 10 percent of GDP. The appreciation of these gains, however, has been overshadowed by the significant costs of the financial imbalances experienced within the EU. Economic integration gives incentives to sectoral specialization which, in its turn, makes business cycles fluctuations and financial positions across Union members more asymmetric – see, for instance, Imbs (2004); Corsetti et al. (2008); Atalay (2017); or Mongelli et al. (2020). This asymmetry should not significantly impact welfare and private consumption of households when the appropriate risk sharing mechanisms are in place. This is where the EU, especially, the EMU, has failed. There are two private channels for risk sharing: banking integration and capital market integration. By now it is clear to all of us that both channels cannot work in the absence of a common safe asset denominated in euros. The reason is that, in absence of such asset, banks can only rely on their respective country's debt and use the repo market and the interbank market for precautionary motives. This led to the "deadly embrace," as Farhi and Tirole (2018) argued, between bank debt and sovereign debt. Moreover, in absence of the common safe asset, capital markets cannot deepen and grow beyond a country frontier, which is a necessary condition for households of different countries to share risks (Bathia et al. 2019). The result was that sharing the same currency without making further progress in capital market unification and transnational integration of the banking system left countries more financially fragile and exposed to asymmetric shocks (Jaccard and Smets 2020). The ensuing crisis threatened the very existence of the common currency, as Bunnermeier and Reis (2019) explain.

The first lesson that we have learned from the euro crisis is that private risk-sharing mechanisms cannot work properly, if the underlying institution is not well designed. The faulty institution was the Monetary Union itself, since, until now, we did not have a common safe asset denominated in euros. The European Commission and the Council have both learned this lesson and for the first time in EU history, a European institution is issuing debt to finance a common expenditure, the Recovery Fund. The amount issued, 750 billion euros, however, is tiny compared to the volume that the Commission itself deems necessary to foster banking and capital market integration and, therefore, ensure financial stability (around 13 to 30 percent of the GDP of the Eurozone – see European Commission 2020).

Antonia Díaz

is a professor at the Universidad Carlos III de Madrid, and her main research areas are housing and inequality, growth and productivity, and energy and climate change.

The emergence of true European debt gives rise to the issue of common fiscal capacity. The reason is that, as argued in Díaz (2020b), a risk-free asset is only perceived as such when it is backed by fiscal capacity. Otherwise, it becomes a bubble. Thus, the second lesson is that the fiscal capacity of the European Commission will have to be strengthened beyond the current design of the EU budget, not to finance particular expenditure programs, such as the Common Agricultural Policy (CAP), with which we may or may not agree, but to support private risk-sharing mechanisms. Otherwise, economic integration cannot progress, and the single market will be crippled. The debate is already open and, as suggested in Díaz (2020b), that common fiscal capacity should come from harmonizing corporate taxation across EU members.

LESSONS FROM THE COVID-19 CRISIS: THE ROLE OF PUBLIC GOODS AND PUBLIC TRANSFERS

The Covid-19 pandemic is a very stark example of a negative externality, such as pollution, but they have important differences. We call it pollution because of the fact that agents use clean air as an input in their economic activities for free. Thus, to restore efficiency (i.e., to cut the externality) we have to figure out the price that agents have to pay to pollute. That price should strike a balance between a clean environment and economic activity, given the constraints imposed by sustainability (this constraint has been forgotten until very recently).

Covid-19, however, is a far more complex type of externality than pollution although, hopefully, shorter lived if vaccines become widely available soon. We could think of the Covid-19 as the fact that agents use their co-workers' and/or customers' health with a positive probability, which is not known with certainty. Both polluting and infecting others may be not observable, so the regulator has to act in both cases, but the key difference is that setting a price is far more complicated in the case of the Covid-19, because health markets are plagued with severe private information problems so that learning the true marginal social cost of infecting people is very difficult. Setting a price for the externality is almost impossible in a country with a public health system, because the allocation of health care is not carried out by a price system but by queues and patient characteristics. Setting a price in a country with a private health system would amplify the already large inefficiencies of the market. This is the reason why governments do not even attempt to create a market for the coronavirus externality and resort to regulating and coordinating actions of private agents. This is why we have lockdowns and the short-run negative trade-off between health and the economy. It follows that a combination of health system capacity (particularly ICU beds) and a wide system of testing and tracing is the only feasible way of cutting the transmissions (i.e., the externality). The larger the capacity of the health system and the ability to test and trace, the smaller the short-run negative trade-off between health and the economy. Thus, the first lesson from Covid-19 is that public goods are the best way to restore efficiency when we cannot set markets for those externalities.

The other feature that has made Covid-19 so disruptive is that it is a contingency that could not be contracted ex-ante. It is a very good example of what is called "rational inattention" (Sims 2003). Writing ex-ante contracts that cover every possible contingency is extremely costly, especially when probabilities of occurrence are not well known. It could be argued, though, that by now we have more information about the pandemic and its infection probabilities so that agents could write contracts to share risks. This is almost impossible because moral hazard problems are pervasive because Covid-19 symptoms develop much later than infection occurrence. This is particularly unfortunate because the economic effects of Covid-19 are not uniformly distributed across sectors and across regions and, therefore, there is space for risk sharing (Prades Illanes and Tello Casas 2020; Díaz 2020a, 2020b and 2020c). This is why governments intervene: implementing transfers between agents to mimic in the best possible way a risk sharing mechanism. Governments are doing this in two ways: financial guarantees and tax deferrals. In both cases, however, governments are committing their fiscal capacity if firms become insolvent. Therefore, the second lesson of Covid-19 is that fiscal capacity is key to implementing the needed transfers when private risk-sharing mechanisms fails.

The third lesson of Covid-19 is that the uncoordinated national responses to fight the pandemic disrupt the single market. Coordination is key to fighting externalities. For instance, as Motta and Peitz (2020) argue, financial guarantees and tax deferral are a sort of industrial policy. Thus, differences in fiscal capacity across countries distort the level playing field in which European firms operate. This is why we need to unify programs to help solvent firms remain afloat. One such program was the Solvency Support Instrument included in the first draft of the Fund Next Generation, which however disappeared in the Council's conclusions. It could have helped recapitalize healthy companies regardless of the fiscal capacity of their governments. The programs InvestEU (public guarantees) and React-EU (public transfers) included in the Multiannual Financial Framework will fulfill that role, although not soon enough to deal with the worst consequences of the pandemic. The incoordination of actions is particularly harmful when it pertains to public action in the fight against the Covid-19. The EU4Health Program is very welcome, although its final funding is significantly lower than the Commission's initial proposal.

COMMON FISCAL CAPACITY, PUBLIC TRANSFERS, PUBLIC GOODS AND INCENTIVES

The issuance of Eurobonds and the common tax instruments needed to finance them (whether digital rate, plastics taxes or others), as well as the implementation of public transfers programs, create a moral hazard problem: some governments may feel tempted to relax their fiscal discipline, as was pointed during the European Council meeting on 27 July. This is a very reasonable fear in a confederation of countries. Persson and Tabellini (1996) studied the political-economic equilibrium of a confederation of countries that have to determine the volume of public transfers (at the confederation level) and public goods (provided at the local level) among members. The key assumption in their analysis is that public goods improve economic resilience and reduce the impact of negative shocks. Examples of such goods are infrastructures, public education, retraining and R&D.

These authors show that in the non-cooperative political-economic equilibrium of a confederation (i.e., what we would have if all decisions were made at the European Council without the check of the European Commission and Parliament) the volume of transfers is inefficiently high, whereas the number of public goods is inefficiently low because agents do not internalize the benefits they derive from public investment in other countries. The interesting thing is that the under-provision of public goods raises the political support for higher transfers, what amplifies the problem of moral hazard. The authors study two alternative institutional arrangements. In the first one, voters choose the volume of public transfers before choosing the volume of public goods at the local level. With this type of timing, agents choose a mix involving fewer transfers and more public goods, which improves welfare with respect to the non-cooperative equilibrium. This result provides a theoretic basis for the fact that the Multiannual Financial Framework is planned on a seven-year time horizon, much longer than the typical country's government budget. The third institutional arrangement studied, which results in higher welfare than in the two previous set-ups, would be to transfer to the European Commission, i.e., the common institution, the policies to facilitate transfers between citizens of different countries. In other words, to avoid moral hazard problems, policies that, until now, are in the hands of country governments should be transferred to the supranational body. The first candidate is to create a true European unemployment insurance program (Dolls et al. 2018). The SURE facility should be considered as an embryo of such a program.

The same logic that applies to public transfers should apply to public goods, particularly those that have significant increasing returns to scale and spillovers across countries; for instance, public infrastructures and investment in R&D activities. The latest developments in the Covid-19 pandemic show that that is also the case for health expenditures. Investment in these public goods should be decided at the supranational level. The European Commission is designed to be the social planner of the European Union and should be given the power to act as such.

It should be stressed that delegating these policies to the European Commission follows from the moral hazard problem created by giving it fiscal capacity. That is, fiscal capacity and "policy capacity" must work hand in hand. The corollary of this is that we need to revise and, very possibly, to reduce the scope of the principle of subsidiarity as it is a source of incentive problems in the functioning of the European Union.

THE FUND NEXT GENERATION AND THE MFF 2021–2027

The European Union faces enormous challenges in the short- and medium-term: it has to fight against the effects of Covid-19, preserve the single market, avoid a new financial and sovereign debt crisis and, on the top of that, fight climate change by promoting an inclusive green and digital transition. As I have already pointed out, Covid-19 and climate change are negative externalities that call for collective action. I think that we need to analyze the Fund Next Generation and the Multiannual Financial Framework 2021–2027 within this context.

The new organization of the budget shows the change in priorities in the Commission, which is correctly committed to investing in public goods, and promoting digital and ecological transition. This remains the case in the budget that the European Council finally approved. The size of the MMF 2021–2027 is slightly smaller than the previous one, but it is still around 1 percent of EU GDP. The question that remains is whether this is the optimal budget size given the urgency of tackling climate change and the digital transformation of the economy. In addition, the bulk of the 2021–2027 EU budget (MFF + NGEU) is allocated to "Cohesion, Resilience and Values," which accounts for 60 percent of total spending, followed by the expenditure item "Natural Resources and Environment" which comprises 20.5 percent of the total. The main programs of these two categories are transfers, as opposed to "Single Market, Innovation and Digital," which is devoted to public goods and R&D investment, amounting to around 7.9 percent of the total budget (Fuest 2021). These numbers make us wonder whether the mix transfers-public goods is "too tilted to transfer" in the Persson and Tabellini (1996) terminology. "Horizon Europe" receives less absolute funding than its predecessor Horizon 2020, which is very short sighted. Finally, we have to wait to evaluate the full development of the expected reform in the CAP in order to assess its role in the European

Green Deal and the necessary transformation of our agricultural sector.

In my view, as my theory suggests, the EU budget should give precedence to the construction of European public goods. Fuest and Pisany-Ferri (2019), in this respect, remind us that one of the first objectives of the European Community was, exactly, the construction of public goods and argue that investing in them must take precedence over the other possible objectives of the European Union. In this respect, we should see this MFF 2021-27 as a first attempt to fix faulty institutions and building common fiscal capacity.

As explained above, creating public goods and the solid design of institutions is a precondition for risk sharing and economic integration. That is, timing is key. The timing outlined in this article dictates that the first step should be building fiscal capacity so that the common institution has enough muscle to invest in common public goods. The second step is transferring to the common institution (the European Commission) those policies that need to be coordinated at the European level. In my view, this points to a European unemployment subsidy and all industrial policies. The Commission is heading perhaps too cautiously in this direction.

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Clara Albrecht, Maria Hofbauer Pérez and *Tanja Stitteneder*[1]

The Integration Challenges of Female Refugees and Migrants: Where Do We Stand?

ABSTRACT

The challenge of integrating migrants and refugees is a widely known and discussed topic among policymakers within the EU, though a comprehensive gender-specific approach is still lacking. Migrant women and especially refugees deserve special attention, since nearly every second migrant and every third asylum seeker is female. However, many of these women are poorly educated, lack work experience and labor market participation. In this article, we examine gender-specific challenges of female migrants and refugees and look at strategies and existing initiatives suitable for overcoming obstacles and promoting their integration into host country labor markets and societies.

Female migrants and refugees face similar but probably greater integration challenges than their male counterparts. It is not only language, culture, access to work and western school systems that present obstacles. Women are traditionally also confronted with additional household and childcare duties. Their challenges are thus twofold.

Why is it important to strengthen the participation of female migrants, and especially refugees in education, the labor market and society? The answer is evident: first, women are first responders and transfer their experiences directly to their children. It is thus essential to improve options for women today in order to strengthen female labor market and education outcomes of younger generations in the future. Second, almost half of all migrants and one-third of all refugees in the EU are women—thus comprising a significant share of the population (European Commission 2018), and it is a matter of equal opportunity for all.

In light of the intuitive need for gender-specific options, it seems somewhat odd that they have been given relatively little consideration in integration policy in the past. Although this shortcoming has of course been noticed in recent years, and appropriate actions to improve it have been initiated, there remains a lack of equal opportunities in the political and economic arena for women in general, and female refugees in particular. This article looks at the integration challenges female migrants and refugees face in terms of education, work and society, while also considering those same challenges their male counterparts and native-born women face. Furthermore, this article identifies some existing initiatives and concludes that there is a lack of guidance at the international level.

FEMALE MIGRANTS, REFUGEES AND NATIVE-BORN WOMEN IN THE EU

Women make up about half of the world population, at 51%, which is also the case in the EU28. The share of women among migrants has remained fairly stable at 45% over the last decade. Among refugees,[2] this number has traditionally been lower. However, the percentage share of refugee females has recently increased. Now more than one in three refugees is female (see Figure 1).

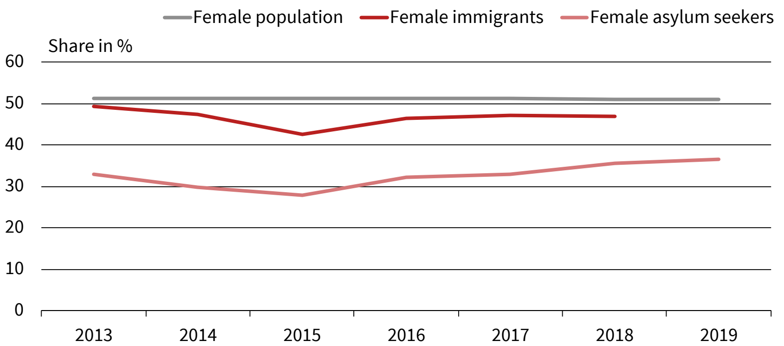
Female refugees in particular are a group of the population that deserves more attention. Eurostat data shows that while the absolute number of female refugees has decreased by around 130,000 since 2016, the share of women has increased by almost 14% in the EU28. In contrast, both the absolute number of women and the percentage share of women among immigrants have increased. Among native-born women, these figures have remained almost unchanged.

Figure 2 shows the share of women among migrants and refugees in selected countries—all coun-

Figure 1

Women's Share in the EU28 over Time

General female population, migrants and refugees born outside the EU28



Source: Eurostat (2020).

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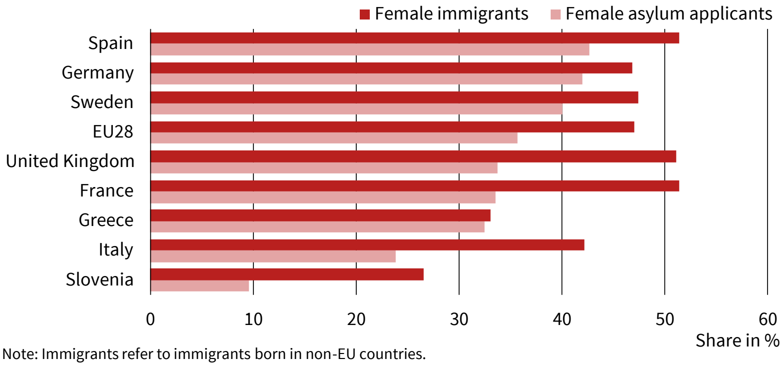
[1] All ifo Institute. The authors thank Leon Prag for his excellent support in preparing this article.

[2] In this article, no distinction is made between refugees and asylum seekers/applicants.

Figure 2

Share of Females among Asylum Seekers and Migrants

Selected countries, 2018

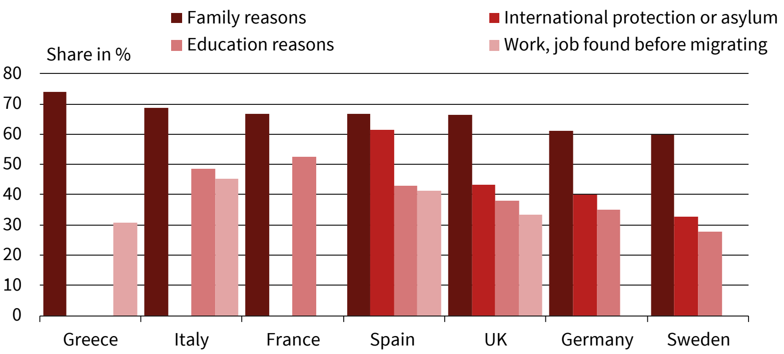


Note: Immigrants refer to immigrants born in non-EU countries.
Source: Eurostat (2020). © ifo Institute

Figure 3

Migration Reasons of Female Migrants

Non-EU citizens, 2014



Source: Eurostat LFS 2014 ad hoc module (2020). © ifo Institute

tries presented had a greater percentage of females among migrants than among refugees. In Spain, France and the UK, more than 50% of migrants were female in 2018. In Slovenia, it was less than one third. The percentage share of women among refugees was highest in Spain, Sweden and Germany, all of them at 40% or more. All 3 of these countries were also above the EU28 average. Again, the smallest share of female asylum seekers was found in Slovenia at roughly 10%.

When it comes to the question why women migrate in the first place, a clear pattern emerges. Figure 3 shows four reasons for migration and per reason how many women are among first-generation immigrants. Across all countries presented, at least 60% of the migrants who moved for family reasons are women, with the highest percentages occurring in Greece and Italy. On the other hand, men more often tend to migrate for work and educational reasons. However, family reunification is among the top reasons for migration for both men and women and is an important aspect of the decision to migrate—for women in particular.[3]

[3] It has to be noted that the questionnaire covers all non-EU citizens currently living in the respective reporting country and is thus not limited to refugees. The figure also does not show migrants seeking international protection in Greece, Italy and France. This is probably due to the fact that the survey took place in 2014 and an update is planned for 2021. More recent results are likely to paint a different picture and a comparison of the 2014 and 2021 results will be highly interesting.

But what does their life look like when they come to Europe and what are the most pressing challenges they face? To answer this question, we first resort to general challenges for women in education and employment before turning to the more specific challenges of migrant and refugee women.

CHALLENGES FOR WOMEN: THE GENDER EMPLOYMENT GAP AND THE UNEQUAL DIVISION OF LABOR

Men and women in the EU do not equally participate in the labor market, even though overall female labor market participation has risen over the last several decades. According to the World Economic Forum's Global Gender Gap Report 2020, a global gender gap of 31.4% on average remains. In the area of "Economic Participation and Opportunity," the gender disparity is even larger with a gap of 57.8%. Considering the slow speed of narrowing the gap between 2006 and 2020, it will take 257 years to fully close this gap at the current rate of participation (World Economic Forum 2020). One of the main drivers for the persistent disparity is the unequal participation in the labor market of women and men. While globally, 78% of men actively participate in the labor force, the same is true for only 55% of women. Within the EU, the gender employment gap is less pronounced, but still as high as 12%.

A major factor influencing this disparity is the unequal division of unpaid care work in households. There is no country in the world where men spend an equal amount of time on unpaid work as women do. Also, women in the EU conduct most of the unpaid care and housework, regardless of their employment status. The gap in paid and unpaid work further increases with parenthood—while 88% of mothers with children under 18 engage in unpaid care work on a daily basis, only 64% of fathers do (compared to 81% for women and 48% for men in general). In countries where unpaid work is shared more equally, employment rates for women tend to be higher and gender gaps in earning lower (European Institute for Gender Equality 2020). When combining unpaid and paid work, women in OECD countries on average spend 25 minutes more working (OECD Report 2020a). As a consequence, employed mothers are far more likely to work part-time in comparison to fathers. While 36.5% of women with children under the age of six in the EU27 are employed part-time, the same is true for only 5.3% of fathers (Eurostat 2020b). The gender imbalance in the context of parenthood and employment also becomes obvious when looking at who reduces working hours to facilitate childcare responsibilities. In this aspect as well, women clearly take the lead as the female percentage amounts to 82% (Eurostat 2020c).

CHALLENGES FOR FEMALE MIGRANTS AND REFUGEES: INTEGRATION INTO THE LABOR MARKET AND SOCIETY

Many migrant and refugee women face very similar challenges as native-born women do and often find themselves confronted with additional obstacles.

Challenge 1: Gaps in Education and (Documented) Work Experience

Education is one influencing factor of labor market integration, as it facilitates integration, especially through diploma or qualifications and work experience. In addition, the training itself can provide skills that contribute to rapid integration into the labor market.

In general, refugees tend to have lower skill levels than the native population, with refugee women being particularly poorly educated. These low levels of education greatly influence a refugee woman's employment prospects and hence constitute a principal obstacle to the integration of female refugees (OECD 2019). In order to examine the educational differences between refugee women and native-born women within the EU28,[4] Figure 4 compares the shares of native- and foreign-born females between 30 and 34 years old at three different levels of education (low, medium and high) following the International Standard Classification of Education.[5] Low education refers to less than primary (ISCED level 0), primary (ISCED level 1), and lower secondary (ISCED level 1) education. Medium education includes upper secondary (ISCED level 3) and post-secondary non-tertiary education (ISCED level 4), whereas the high education levels refer to tertiary education (ISCED level 5-8). These educational gaps point to disadvantages female refugees face in terms of education. In 2019, the tertiary education gap between women who lived in the EU28 and who were also born in the EU28, and women who lived in the EU28 but were born outside the EU28 was – 7.4 percentage points. This indicates that the percentage of women with tertiary education is 7.4 percentage points lower among women who were not born in an EU country than among women who were. This gap amounted to – 10.7 percentage points for the upper secondary and post-secondary, non-tertiary educational levels. But most importantly, the gap for low educational levels was, in contrast, 18.2 percentage points, suggesting that the percentage of females with low educational levels at 18.2 percentage points is larger for females born in non-EU28 countries than for females born in EU28 countries.

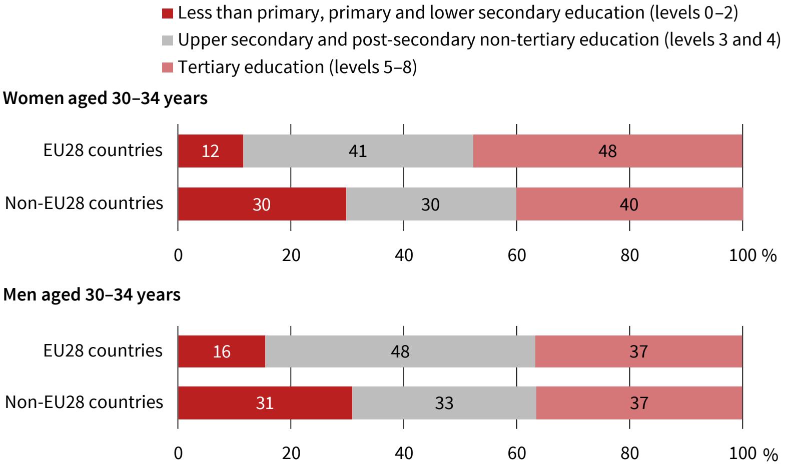
For men, the gap in levels 0–2 is 15.4 percentage points and thus comparable to the one for women.

[4] The EU28 countries include the UK.

[5] We approximate the educational level of refugees comparing non-native females living in EU28 and native-born females in EU28 as recent data referring explicitly to refugees are to the best of our knowledge not available at the EU level.

Figure 4

Educational Level and Country of Birth, 2019



Source: Eurostat (2020). © ifo Institute

For levels 3–4, the gap is 15.2 percentage points and larger than for females, while it is only 0.2 percentage points in tertiary education.

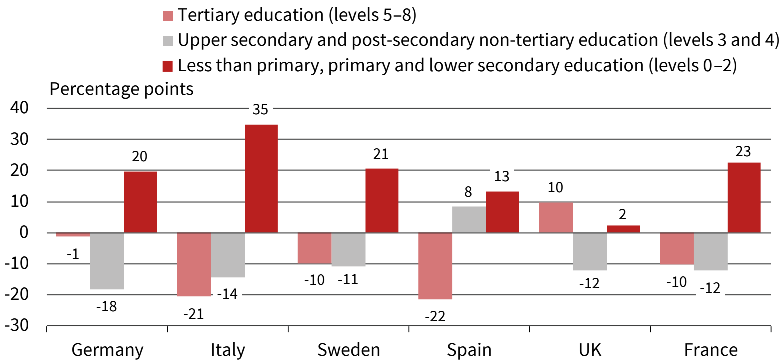
For the main European destination countries except UK, the gaps show on average a similar pattern (Figure 5). While the share of native (here: EU28-born) females in tertiary education and upper secondary/post-secondary education is larger than the share of females born in countries outside EU28,[6] a significantly larger share of them reports levels of less than primary, primary or lower secondary education. In Italy, the difference in the percentage of poorly educated foreign-born women in comparison to native-born women is 34.9 percentage points and is particularly high. The lowest difference in this context is reported by Spain with 13.3 percentage points. Overall, this points to the educational challenge that refugee women are facing due to on average low levels of education. Therefore, educational disadvantages especially for very low skilled female refugees must

[6] It must be noted that the share also includes immigrants from third countries who are not refugees. Therefore, the numbers refer also to females who live in the respective European countries for other reasons than asylum.

Figure 5

Female Educational Gaps by Country and Country of Birth: Non-EU28 vs. Reporting Country

2019, share of females aged 30–34

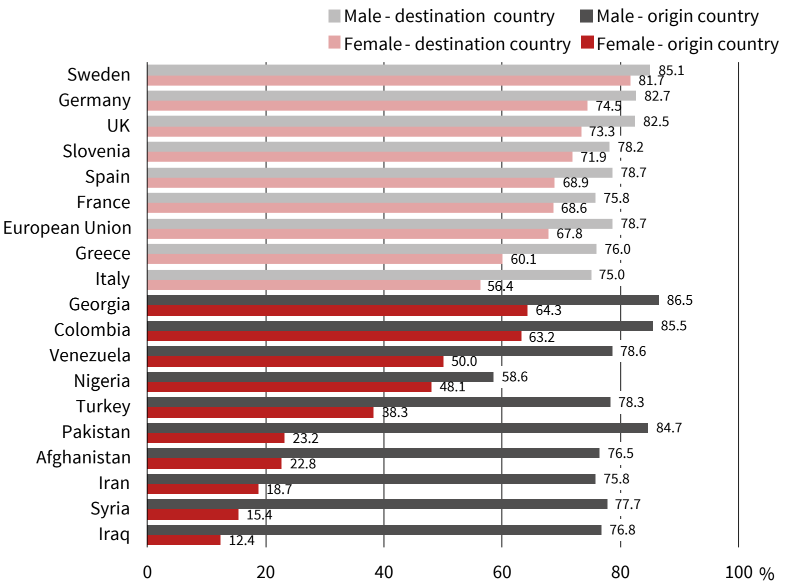


Source: Eurostat (2020). © ifo Institute

Figure 6

Female and Male Labor Force Participation Rate

% of female/male population aged 15–64; modeled ILO estimates, 2019



Source: World Bank (2020). © ifo Institute

Figure 7

Employment and Unemployment Rates, 2019

Source: OECD (2020). © ifo Institute

be addressed by integration programs aiming at integrating them into the labor market.

Given low levels of qualification, female refugees are additionally confronted with obstacles in the labor market if they have little or no work experience, especially in the labor market of the destination country (Degler et al. 2017). However, the work experience attained in the countries of origin also influences and benefits the labor market integration prospects of female refugees to a high extent as any labor market experiences can be advantageous in an employment search.[7] Consequently, the female labor participation rate in countries of origin can be considered a good predictor of female refugee labor market integration (Knize Estrada 2018; Frank and Hou 2015).

Figure 6 displays the female and male labor force participation rate in selected European destination countries (pink and grey bars) and the ten most common asylum seekers' countries of origin (red and black bars) in 2019 (Eurostat 2020).[8] In most countries of origin, the female employment rate is lower than in the European destination countries. While the average rate in the origin countries amounts to 35.6%, the European countries report an average female labor participation rate of 69.4% (the EU average is 67.8%). The countries of origin with the lowest female participation in the labor market are Iraq (12.4%), Syria (15.4%) and Iran (18.7%), while the rates in Georgia (64.3%), Colombia (63.2 %) and Venezuela (50.0%) are comparable to the rates of European destination countries such as Italy (56.4%) and Greece (60.1%). In contrast, European countries such as Sweden (81.7%), Germany (74.5%), the UK (73.3%) and Slovenia (71.9%) report substantially higher female labor participation rates.

The grey and black bars document the male labor force participation rate. While in European destination countries the differences for females and males are on average moderate, the discrepancies between the participation rate in the countries of origin are substantial, which indicates that female refugees have special needs due to the lack of work experience gained in the countries of origin compared to male refugees—an important factor that should be considered in integration programs.

Figure 7 zooms in on the labor force participation and shows the employment and unemployment rates of men and women in selected European countries. In all countries, the employment rates of native-born women are higher than those of foreign-born women (see the upper graph).[9] This is not necessarily true for men: in Greece, Italy, Slovenia, Spain and the UK, the employment percentage is higher among foreign-born men than those of native-born men.

In contrast, the lower graph shows the unemployment rates for the same groups. Again, the unemployment rates of foreign-born women by far exceed the rates of native-born women. Especially in Greece, unemployment is high among women of both backgrounds. The unemployment rates of men

[7] Work experience in the country of origin is clearly connected to persistent social norms and cultural backgrounds (see also challenge 2 below).
[8] The UK is included as it was part of the European Union until December 2020.
[9] Foreign-born is not limited to any countries of origin and thus may include immigrants from all over the world and who have migrated for multiple reasons.

follow similar patterns across countries but are less pronounced in all of them. Thus, women are not only disadvantaged in their home labor markets but also in the European ones.

Related to work experience and educational level, another challenge is that female refugees tend to work in informal employment capacities such as domestic work. Therefore, female refugees are likely to work in jobs with low pay that are poorly appreciated (Kabir and Klugman 2019).

We have shown that female refugees are confronted with dual discrimination in the labor market of being female and having an asylum status that impedes permanent integration into the labor market and prevents female refugees from having a job that matches their skills and knowledge. As the European Commission stated in 2018, the double discrimination of refugee women has not yet sufficiently been the focus of policymakers.

Challenge 2: Gender Norms

Deriving from the field of social psychology, economists have developed a gender identity model that explains different labor market behavior of men and women (Akerlof and Kranton 2000). Following this model, prevailing social norms about what is appropriate for each gender to do have implications for the labor market behavior of men and women and contribute to the gender gap in labor market outcomes (Bertrand 2011).

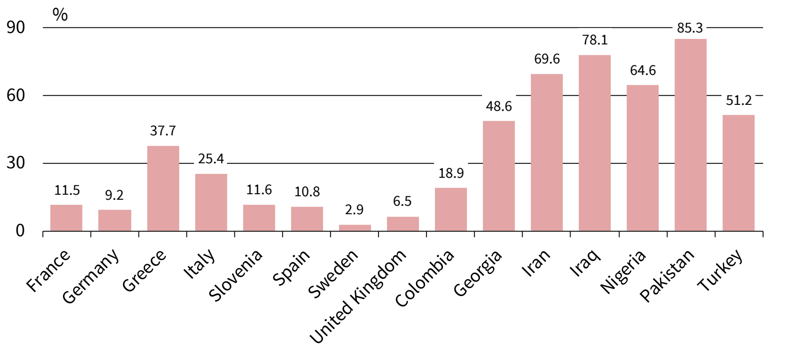
Fortin (2015) investigates the impact of gender role attitudes on women's labor market outcomes across OECD countries and finds that traditional gender role values (captured by the agreement or disagreement with the statement, "*When jobs are scarce, men should have more right to a job than women, Q33,*" World Values Survey) are strongly and negatively associated with female employment rates. Given the fact that beliefs and attitudes are established early in life and are transmitted inter-generationally, the culture of female migrants consequently plays a crucial role for their labor market behavior in the host countries.[10]

To what extent culture matters for female labor market outcomes is the research question of an influential paper by Fernández and Fogli (2009). The authors examine second-generation immigrant women's behavior on the labor market, using female labor force participation in the country of ancestry as a quantitative proxy for culture, as the decision to become active in the labor market depends on the distribution of preferences and beliefs. Their findings suggest that culture is a significant determinant of women's work outcomes, depending not only each woman's preferences, but also on her husband's preferences if she is married.

Figure 8

Gender Role Attitudes in Selected Migrant Countries of Origin and Host Countries

When Jobs Are Scarce, Men Should Have More Right to a Job Than Women



Source: World Values Survey Wave 7: 2017–2020, Q33. © ifo Institute

When looking at female labor market participation in the main countries of origin of asylum seekers in Europe (Figure 6) in combination with prevailing gender role values (Figure 8) and the scorings in the Global Gender Gap Index (World Economic Forum 2019),11 a strong correlation between the three indicators is noticeable—countries with very low female employment rates and/or a large gender employment gap generally show extremely poor outcomes in terms of gender equality and highly traditional gender role attitudes, whereas those with female labor force participation rates similar to the European Union ones (e.g., Colombia and Venezuela) show better outcomes in terms of gender equality and have fewer traditional gender norms. Extreme examples are Iraq and Pakistan, which occupy the second last and third last rank in the Gender Gap Index (out of 153 included countries), which at the same time show gender employment gaps of over 60 percentage points and range among the countries with most traditional gender role attitudes.

As a result, the successful labor market integration of migrant and refugee women is also highly dependent on their (and their husband's) gender norms in their countries of origin. Policies aiming at increasing female labor market participation should also take persisting gender role attitudes into account in case the target group's country of origin is one with a big gender equality gap. Moreover, as men's attitudes toward working women also play a crucial role for female labor market participation, initiatives that address men and their traditional gender norms should not be neglected.

Challenge 3: Lack of Language Skills and Information about Initiatives

In addition to disadvantages in education, at work and due to cultural backgrounds, the lack of language

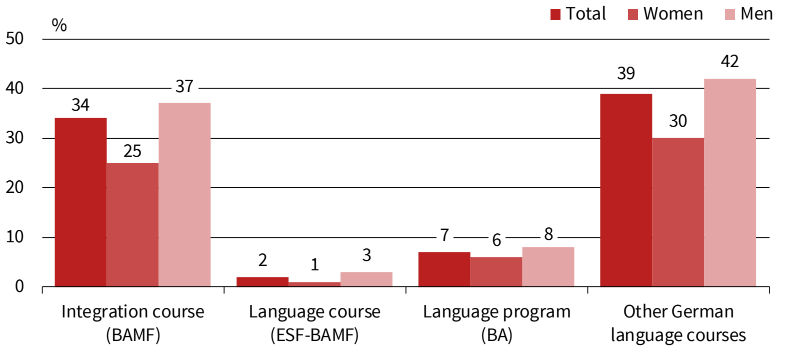
[10] Guiso et al. (2006) define culture as the customary belief and values that ethnic, religious and social groups transmit fairly unchanged from generation to generation.

[11] The Global Gender Gap Index comprises and measures gender gaps in four fields: "Economic Participation and Opportunity," "Educational Attainment," "Health and Survival," and "Political Empowerment."

Figure 9

Integration and Language Course Participation

Refugees in Germany, 2016



Source: DIW (2017) based on IAB-BAMF-SOEP Survey 2016, weighted. © ifo Institute

skills and knowledge about what is on offer in the host country also play a role. Without doubt, mastering the host country's language is beneficial to the social and economic integration of migrants and refugees (Chiswick and Miller 2001; Ager and Strang 2008). This is especially true if language skills are promoted early after arrival. Language and integration courses are designed to provide foreign-born individuals residing in the EU with at least basic language skills and knowledge about the host country's cultural norms. The European Labor Force Survey (LFS) from 2014[12] interviewed first-generation immigrants about their language skills in the host country's language. Especially in Spain and the UK, relatively high percentages (around 50%) reported "mother tongue" or a "proficient" level. Whereas in Greece, Germany and Slovenia, the percentages were much lower.[13] Due to the scarcity of cross-country data on refugees, we resort to national data from Germany to gain deeper insight into female participation in language courses and potential gender differences.

Figure 9 shows the percentage of refugees who have participated in different language and integration courses in Germany in 2016. This figure demonstrates that men and women do not participate equally often. Only 25% of female refugees participated in an integration course offered by the Federal Office for Migration and Refugees (BAMF) compared to 37% of male refugees. The difference in participation is similar to other language training and mentoring programs. Mentoring programs in particular present another good policy tool for fostering the integration of refugees and improving their language skills (DIW 2020). Resnjanski et al. (2021) show that mentoring can significantly increase the labor market opportunities of school-attending adolescents from disadvantaged families which often include refugees. The authors find positive effects on first-generation migrants' math performance, patience and social skills as well as on their labor-market orientation. A rough cost-benefit-analysis thereby suggests that the benefits of the program outweigh the costs by almost 31 to 1.

In recent years, there has been a growing call for more specific job-related language courses (Extramiana 2012) to prepare migrants as much as possible for the world of work. However, such courses would predominantly target migrants with a job or good labor market prospects, but do not necessarily provide a solution for women who have migrated for their partners or families (as seen in Figure 4) and are likely to have poorer labor market prospects. In an effort to even out gender differences, Germany has implemented courses that specifically target women.[14] The program includes language and orientation lessons for migrant mothers so that they can learn and network with other migrant mothers, who have not been able to attend regular language or integration courses in the past due to childcare or household responsibilities. Such initiatives address gender-specific challenges and aim to help female refugees acquire the necessary skills to manage their daily lives in Germany. Ultimately, these courses are a first step toward integration into society.

Challenge 4: Experiences of Trauma and Physical Abuse Before and During Refugee Flight

Another potential challenge, especially for refugee women, is coping with trauma and/or physical abuse. NGOs and the media frequently report on the scandalous conditions in refugee camps and the dangerous journey to Europe (UNHCR and MMC 2020). While this alone is an enormous challenge for refugees in general, women in particular are too often victims of (sexual) violence (OECD 2019). The UN Office for the Coordination of Humanitarian Affairs states that one in three women experience physical or sexual violence in their lifetime, which is associated with higher rates of HIV, depression and pregnancy-related problems (UN OCHA 2018).

Access to medical and psychological care is thus crucial in overcoming such traumatic experiences. While in theory, health care is available to all migrants and refugees in the EU, in practice many barriers remain. Lebano et al. (2020) review the existing literature on the provision and access to health care and conclude that there are large differences across member states. The authors note that in particular mental health care, preventive care and long-term care for older people need to be improved. Kohlenberger et al. (2019) examine survey data on refugees' access to health care in Austria and find that refugees' self-assessed health is lower than that of the native population, even though basic health care is available

[12] More current data regarding language course participation and effects are unfortunately not available on a European level, making it difficult to analyze and evaluate the potential costs and benefits of such programs.

[13] See Eurostat's data set on "Skills in host country language by migration status and citizenship [LFSO_14BLANG]" from 2014.

[14] For more information, see BAMF (2020).

to both segments of the population. The barriers to health care are related to language, (hidden) costs and socio-cultural factors. The authors conclude that the specific health needs of refugees are poorly understood and rarely adequately addressed, leading to health inequalities that hinder integration. This is particularly the case for women and Afghan refugees.

HOW TO ADDRESS THESE CHALLENGES APPROPRIATELY AND EFFECTIVELY?

Apart from the difficulties arising from migrating or refugee flight itself, foreign-born women face additional gender-specific challenges. Female refugees in particular typically arrive in Europe poorly educated with little work experience, and have often been victims of abuse and physical (sexual) violence.

Initiatives addressing female refugee and migrant acquisition of skills needed for specific jobs is important, but it should be kept in mind that women often migrate in a family context. Specifically designed and tailored courses can help mitigate existing gender differences and promote social integration of migrant and especially refugee women. Some countries, e.g., Germany, already offer such programs. Also, Spain tackles this issue with the SARA program at the Institute for Women in the Spanish governmental department for equality. This program aims at motivating and supporting migrant women with social and labor integration (Instituto de la Mujer 2018 and 2020). Furthermore, it helps female refugees develop confidence and improve social and communication skills on the one hand, and become aware of their professional objectives and integrate more strongly into society on the other hand. The program includes motivational and occupational training, support in job searches and entrepreneurship, and an internship (Instituto de la Mujer 2018). Between 2018 and 2019, 578 women participated in the program and approximately 20.2% of them were employed six months after having finished the program (Instituto de la Mujer 2020). In Vienna, the Austrian capital, the program "Mama lernt Deutsch" (Mom is learning German) is intended for women with no or little knowledge of German who have not attended school for more than eight years. The course aims at teaching German as a second language as well as some basic skills in reading and writing. As a special feature, childcare is offered to women with kindergarten- or school-age children (Station Wien 2021).

Such programs are a great first step. In recent years, more initiatives and programs for women and girls have become available, yet gaps still remain. Additionally, in countries of origin, gender-nuanced approaches are lacking (UN Women and UNFPA 2020). The OECD (2020b) reports that only 4% of development aid was funded to programs dedicated to gender equality and women's empowerment in 2016 and 2017. In contrast, 64% of aid was gender blind. Also in the EU, differences continue to exist across the member states, where gender equality still tends to be underfunded. More data and research are needed to better understand the drivers of female integration and to support evidence-based policy advice in the area of gender equality and equal opportunities between migrant and native (female) populations.

Integrating refugees and especially refugee women is of global importance, so initiatives should be available on an international level and for different subgroups and specializations. The potential benefits of closing the funding gap would far exceed the investment costs needed to implement programs for women and girls. Estimates for the potential benefits of gender-sensitive programs range from USD 1.7 to USD 150 for every US dollar spent (UN Women and UNFPA 2020). Integrating female migrants and refugees therefore deserves to be a core topic on the European political agenda.

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*Chang Woon Nam**

World Economic Outlook for 2021 and 2022

ABSTRACT

The Covid-19 pandemic caused a severe economic downturn worldwide in 2020. This article briefly presents the IMF's first growth forecasts for 2021 and 2022, and highlights the necessity of continued economic and health policy supports for a rapid recovery from the pandemic recession.

Although the start of vaccinations worldwide has raised some hopes for a gradual control and turnaround of the pandemic this year, the persistent dangers associated with renewed waves and new variants of the coronavirus still pose serious concerns for the global economic outlook. Amid this extraordinary uncertainty, the IMF's latest forecast projects that the global economy will grow 5.5% in 2021 and 4.2% in 2022.[1] The projected pickup in growth this year follows a severe slump in 2020 caused by the ongoing Covid-19 crisis, the magnitude of which is estimated to be a global growth contraction of – 3.5% for the same year.[2]

The speed and strength of recovery appears to vary considerably across countries, depending mainly on access to medical interventions, the effectiveness of policy support, openness and exposure to cross-country spillovers, and structural characteristics at the onset of the crisis (Table 1). Growth in the group of advanced economies is anticipated to be 4.3% in 2021. Most economies in this group are expected to recover this year, including the United States (5.1%), Japan (3.1%), the UK (4.5%), Germany (3.5%), France (5.5%), Italy (3.0%), and Spain (5.9%). Overall, the group of emerging and developing countries is expected to expand faster, by 6.3% in 2021 (see, in particular, the growth projection for India of 11.5%, followed by China at 8.5% for the same year). Other sub-regions in this group appear to experience a somewhat moderate expansion in economic activity in 2021: Latin America (4.1%), emerging and developing Europe (4.0%), the Middle East and Central Asia (3.0%), and Sub-Saharan Africa (3.2%).

In the IMF's view, policy actions should continuously provide effective economic support combined with strategies aimed at further reducing infection and protecting lives until the recovery from the pandemic recession is firmly underway. In this context, more intact multilateral cooperation is needed to bring the pandemic under control on all continents. These efforts include, among others, increasing funding for the COVAX facility to accelerate access to vaccines for all countries. In addition, the global community should work together to ensure adequate access to international liquidity for low-income developing countries, which entered the crisis with high levels of debt that will rise further during the pandemic.

* ifo Institute.

[1] IMF World Economic Outlook Update January 2021, https://www.imf.org/en/Publications/WEO/Issues/2021/01/26/2021-world-economic-outlook-update.

[2] This negative global growth rate is much worse than during the 2008/09 financial crisis. In 2009, for example, the growth rate of world output amounted to – 0.7% (see https://www.imf.org/external/pubs/ft/weo/2011/02/weodata/index.aspx).

Table 1
Overview of World Economic Outlook Projections (%)

	2019	2020[a]	2021[b]	2022[b]
World output	2.8	– 3.5	5.5	4.2
Advanced economies	1.6	– 4.9	4.3	3.1
US	2.2	– 3.4	5.1	2.5
Euro area	1.3	– 7.2	4.2	3.6
Germany	0.6	– 5.4	3.5	3.1
France	1.5	– 9.0	5.5	4.1
Italy	0.3	– 9.2	3.0	3.6
Spain	2.0	– 11.1	5.9	4.7
Japan	0.3	– 5.1	3.1	2.4
UK	1.4	– 10.0	4.5	5.0
Canada	1.9	– 5.5	3.6	4.1
Other advanced economies	1.8	– 2.5	3.6	3.1
Emerging market and developing economies	3.6	– 2.4	6.3	5.0
Emerging and developing Asia	5.4	– 1.1	8.3	5.9
China	6.0	2.3	8.1	5.6
India	4.2	– 8.0	11.5	6.8
ASEAN5[c]	4.9	– 3.7	5.2	6.0
Emerging and developing Europe	2.2	– 2.8	4.0	3.9
Russia	1.3	– 3.6	3.0	3.9
Latin America and the Caribbean	0.2	– 7.4	4.1	2.9
Brazil	1.4	– 4.5	3.6	2.6
Mexico	– 0.1	– 8.5	4.3	2.5
Middle East and Central Asia	1.4	– 3.2	3.0	4.2
Saudi Arabia	0.3	– 3.9	2.6	4.0
Sub-Saharan Africa	3.2	– 2.6	3.2	3.9
Nigeria	2.2	– 3.2	1.5	2.5
South Africa	0.2	– 7.5	2.8	1.4

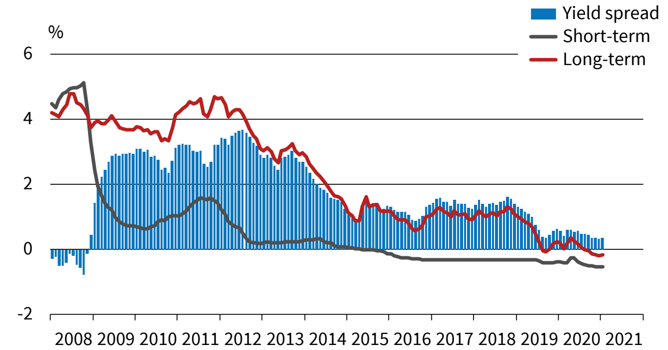
Note: [a] Estimate; [b] Projections; [c] Indonesia, Malaysia, Philippines, Thailand, and Vietnam.

Source: IMF.

Statistics Update

Financial Conditions in the Euro Area

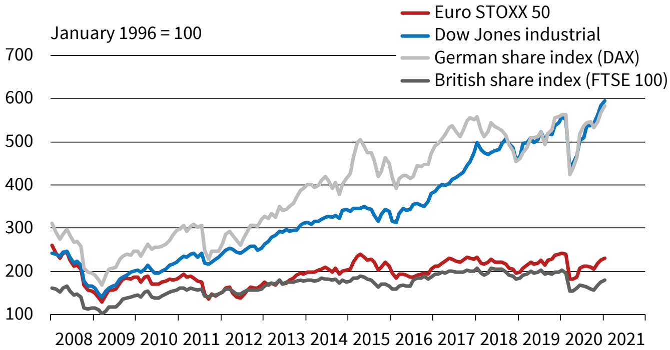
Nominal Interest Rates[a]



[a] Weighted average (GDP weights).
Source: European Central Bank; calculations by the ifo Institute. © ifo Institute

In the three-month period from November 2020 to January 2021 short-term interest rates decreased: the three-month EURIBOR rate amounted to – 0.55 in January 2021, compared to – 0.52 in November 2020. The ten-year bond yields remained stable (– 0.18% in November 2020 and also in January 2021), while the yield spread grew from 0.34% to 0.37% between November 2020 and January 2021.

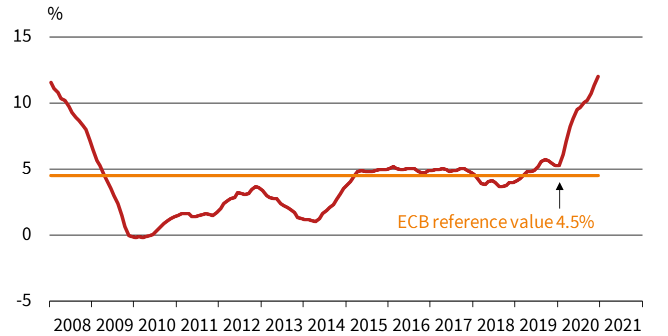
Stock Market Indices



Source: Deutsche Börse; Dow Jones; FTSE; STOXX. © ifo Institute

The global fears about the spread of the Coronavirus, oil price drops caused by an oil price war between Russia and the OPEC countries, and the possibility of a recession led to the stock market crash in March 2020, and global stocks saw a severe downturn in this month. Yet the German stock index DAX continued to grow in January 2021, averaging 13,818 points compared to 13,453 points in December 2020, while the UK FTSE-100 also increased from 6,519 to 6,699 in the same period of time. The Euro STOXX amounted to 3,590 in January 2021, up from 3,531 in December 2020. Furthermore, the Dow Jones Industrial continued to increase, averaging 30,811 points in January 2021, compared to 30,151 points in December 2020.

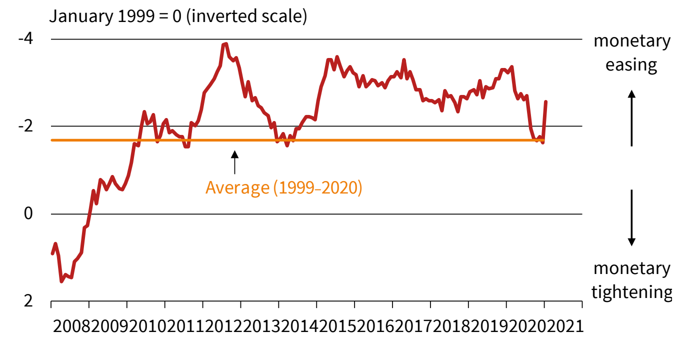
Change in M3[a]



[a] Annual percentage change (3-month moving average).
Source: European Central Bank. © ifo Institute

The annual growth rate of M3 slightly increased to 12.5% in January 2021, from 12.4% in December 2020. The three-month average of the annual growth rate of M3 over the period from November 2020 to January 2021 reached 12.0%.

Monetary Conditions Index

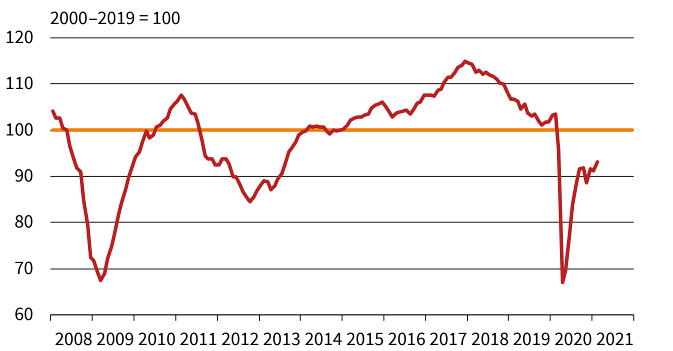


Source: European Commission. © ifo Institute

Between April 2010 and July 2011, the monetary conditions index had remained stable. Its rapid upward trend since August 2011 had led to the first peak in July 2012, signaling greater monetary easing. In particular, this was the result of decreasing real short-term interest rates. In May 2017 the index had reached one of the highest levels in the investigated period since 2007 and its slow downward trend was observed thereafter. A steady upward trend that had prevailed since October 2018 was abruptly halted in March 2020 with the onset of the Covid-19 crisis, and the index continued to decline in 2020. In January 2021, the index started to grow again.

EU Survey Results

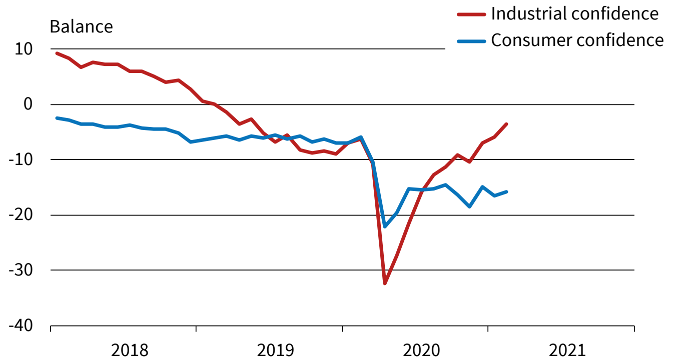
EU27 Economic Sentiment Indicator
Seasonally adjusted



Source: European Commission. © ifo Institute

In February 2021 the Economic Sentiment Indicator (ESI) picked up in both the EU27 (+ 1.9 points to 93.1) and the euro area (+ 1.9 points to 93.4), compared to January 2021. In the EU27, the ESI's increase in February 2021 was driven by improving confidence in industry, services and among consumers, while confidence declined slightly in retail trade and remained broadly unchanged in construction.

EU27 Industrial and Consumer Confidence Indicators
Percentage balance, seasonally adjusted

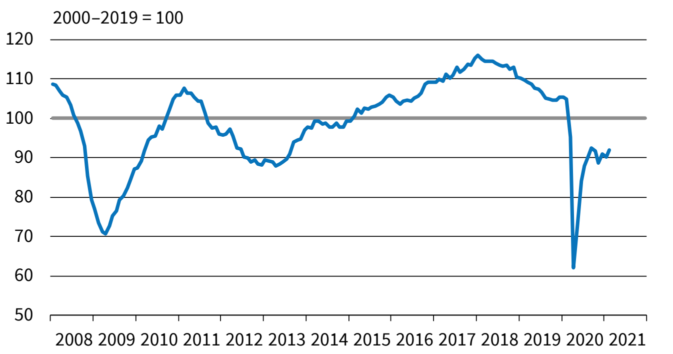


Source: European Commision. © ifo Institute

* The industrial confidence indicator is an average of responses (balances) to the questions on production expectations, order-books and stocks (the latter with inverted sign).
** New consumer confidence indicators, calculated as an arithmetic average of the following questions: financial and general economic situation (over the next 12 months), unemployment expectations (over the next 12 months) and savings (over the next 12 months). Seasonally adjusted data.

In February 2021, the *industrial confidence indicator* increased by 2.4 in the EU27 and by 2.8 in the euro area (EA19). The *consumer confidence indicator* also increased by 0.8 in the EU27 and by 0.7 in the EA19 in February 2021.

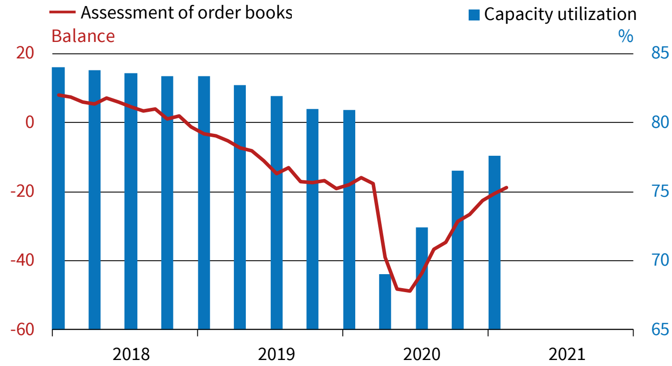
EU27 Employment Expectations Indicator
Seasonally adjusted



Source: European Commission. © ifo Institute

In February 2021 the Employment Expectations Indicator (EEI) increased by + 1.7 points to 91.9 in the EU27 and by + 1.8 points to 90.9 in the euro area.

EU27 Capacity Utilisation and Order Books in the Manufacturing Industry
Seasonally adjusted

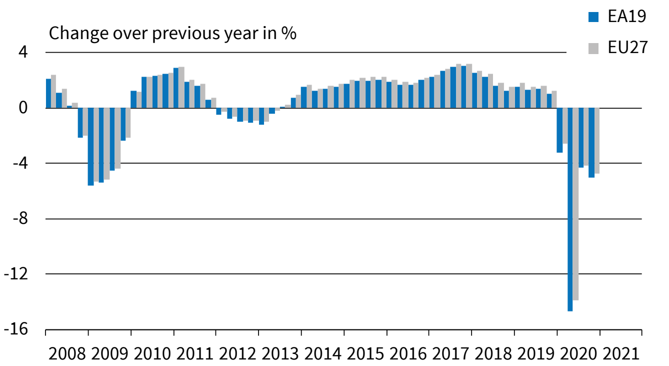


Source: European Commission. © ifo Institute

Managers' assessment of *order books* reached – 18.9 in February 2021, compared to – 20.4 in January 2021. In December 2020 the indicator had amounted to – 22.5. Capacity utilization stood at 77.6 in the first quarter of 2021, up from 76.5 in the fourth quarter of 2020, showing the gradual improvement from the Covid-19 shock.

Euro Area Indicators

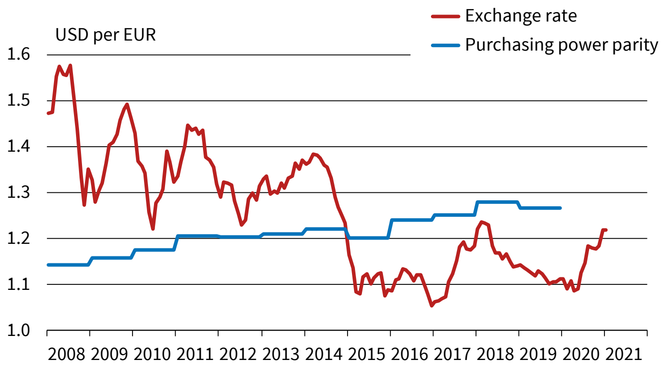
Gross Domestic Product in Constant 2015 Prices



Source: Eurostat. © ifo Institute

According to the Eurostat estimates, GDP decreased by 0.6% in the euro area (EA19), and by 0.4% in the EU27 during the fourth quarter of 2020, compared to the previous quarter. These declines follow a strong rebound in the third quarter of 2020 (+ 12.4% in the EA19 and + 11.5% in the EU27) and the sharp decreases in the second quarter of 2020 (– 11.7% in the EA19 and – 11.4% in the EU27). Compared to the fourth quarter of 2019, i.e., year over year, seasonally adjusted GDP decreased by 5.0% in the EA19 and by 4.8% in the EU27 in the fourth quarter of 2020.

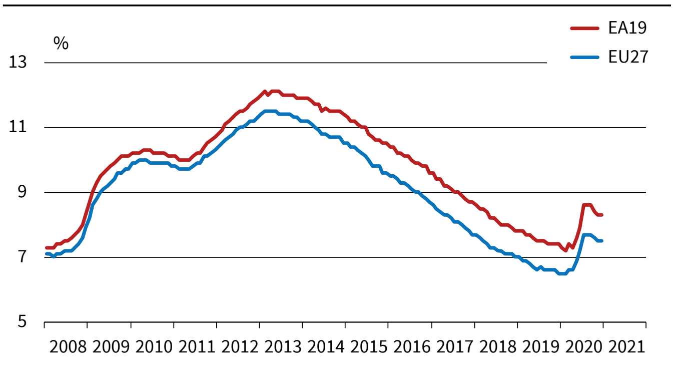
Exchange Rate of the Euro and Purchasing Power Parity



Source: European Central Bank; OECD; calculations by the ifo Institute. © ifo Institute

The exchange rate of the euro against the US dollar averaged approximately 1.21 $/€ between November 2020 and January 2021. (In October 2020 the rate had amounted to around 1.18 $/€.)

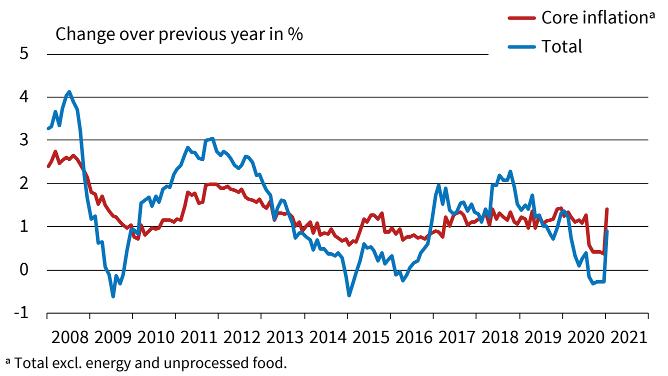
Unemployment Rate



Source: Eurostat. © ifo Institute

Euro area unemployment (seasonally adjusted) amounted to 8.3% in December 2020, stable compared to November 2020. EU27 unemployment rate was 7.5% in December 2020, also stable compared to November 2020. In December 2020 the lowest unemployment rate was recorded in Czechia (3.1%), Poland (3.3%) and the Netherlands (3.9%), while the rate was highest in Greece (16.7%) and Spain (16.2%).

Euro Area Inflation Rate (HICP)



[a] Total excl. energy and unprocessed food.
Source: Eurostat. © ifo Institute

Euro area annual inflation (HICP) amounted to 0.9% in January 2021, up from – 0.3 in December 2020. Year-on-year EA19 core inflation (excluding energy and unprocessed foods) amounted to 1.4% in January 2021, again up from 0.4 in December 2020.

EEAG

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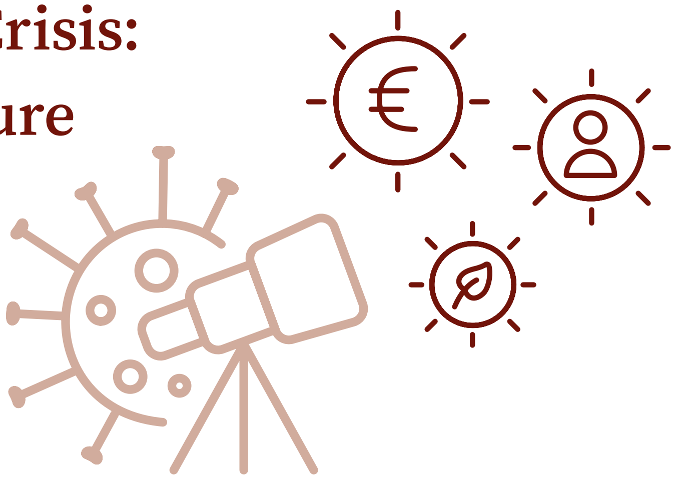
Report on the European Economy

Beyond the Coronavirus Crisis: Investing for a Viable Future



Chapter 1:

MACROECONOMIC CONDITIONS AND OUTLOOK

During the first wave of the coronavirus crisis, countries imposed strict lockdowns to reduce Covid-19 infections. This led to the sharpest reduction in GDP (almost 10 percent) since the Second World War, but the economy recovered quickly during the summer months. When the second wave hit in autumn, harsh lockdown measures were postponed in order to prevent another sharp downturn in value added. However, Covid-19 death rates reached higher levels than during the first wave. Yet, overall economic production remained 2 percent under the pre-crisis level in the third quarter. The situation is expected to improve slowly until spring and economic forecasts are therefore associated with great uncertainty.

Chapter 2:

DISTRIBUTIONAL CONFLICTS AND SOCIAL CAPITAL

The ongoing coronavirus crisis and the resulting containment measures have different consequences for different groups of society and across countries and thus affect social capital and cohesion. Costs and benefits of lockdown restrictions and economic policy interventions are not equally shared and consequently might lead to the erosion of social capital within the European Union. In this chapter, we present policy actions suitable to counteract intergenerational conflicts and to promote a more equal burden sharing, including reforms of tax and pension systems as well as the formation of more resilient institutions.

Online available here:
www.cesifo.org/en/eeag-report

Chapter 3:

LIFECYCLES AND EDUCATION: THE CORONAVIRUS CRISIS ACROSS GENERATIONS

Education is a key investment in the future since it strongly contributes to securing intergenerational and social equity. In the wake of the coronavirus crisis, schools have been closed, which will consequently lead to future income losses for those affected, especially already underprivileged students. Thus, school closures bear the risk of further exacerbating education inequalities. To counteract this effect, rethinking the provision of education is crucial. Hence, new ways of teaching and learning should be adopte.

Chapter 4:

BUSINESS INVESTMENT

Business investment is key for long-term economic growth and productivity. In this chapter, we discuss possible threats to a successful economic recovery. Due to limited access to financing and limited reserves, small- and medium-sized companies may struggle to survive after the crisis. Public support to companies bears the risk of keeping "zombie firms" alive that would otherwise not be viable. European coordination of investment programs is needed since not all EU member states have the financial resources to support desirable private investment and harmful subsidy races of individual national champions need to be circumvented.