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MULTILATERALISM AND BILATERALISM IN TRADE POLICY

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Introduction

Irrefutably, trade does inspire growth. Indeed, import liberalisation has the potential to replace comparatively costly domestic production, reallocate resources more efficiently, and spur capital accumulation, economies of scale as well as long-run dynamic gains such as the transfer of technology and skills. While a country's trade policy shall determine the means by which trade benefits are realised, sound domestic policies constitute a prerequisite to ensure these indeed translate into economic growth.

Participation in the rule-based multilateral trading system, the purpose of which, as defined in the Preamble of the General Agreement on Tariffs and Trade (GATT) 1947, is *'the substantial reduction of tariffs and other barriers to trade and elimination of discriminatory treatment in international commerce'* so raised standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand are attained by all parties to the agreement, emerges as the preferred trade policy choice. Indeed, the European Community has been explicit regarding its commitment to strengthen the current trading system and as such, views the recent suspension of the Doha Development Agenda (DDA) negotiations as a major missed opportunity, with serious systemic implications for multilateral trade that needs to be rectified in due course.

Undeniably, the potential gains from a substantial multilateral liberalisation can be much more pronounced than those attained by alternative trade liberalisation scenarios, namely bilateral or regional arrangements. The OECD estimates gains in terms of increased economic activity and hence prosperity in the region of \$100 billion if full tariff liberalisation for industrial and agricultural goods was to be attained. The figure pertaining to services, the fastest growing sector of the economy is five times as high, estimated at \$500 billion, whereas an additional \$100 billion has been attributed to a Doha agreement on trade facilitation that shall remove procedural barriers.

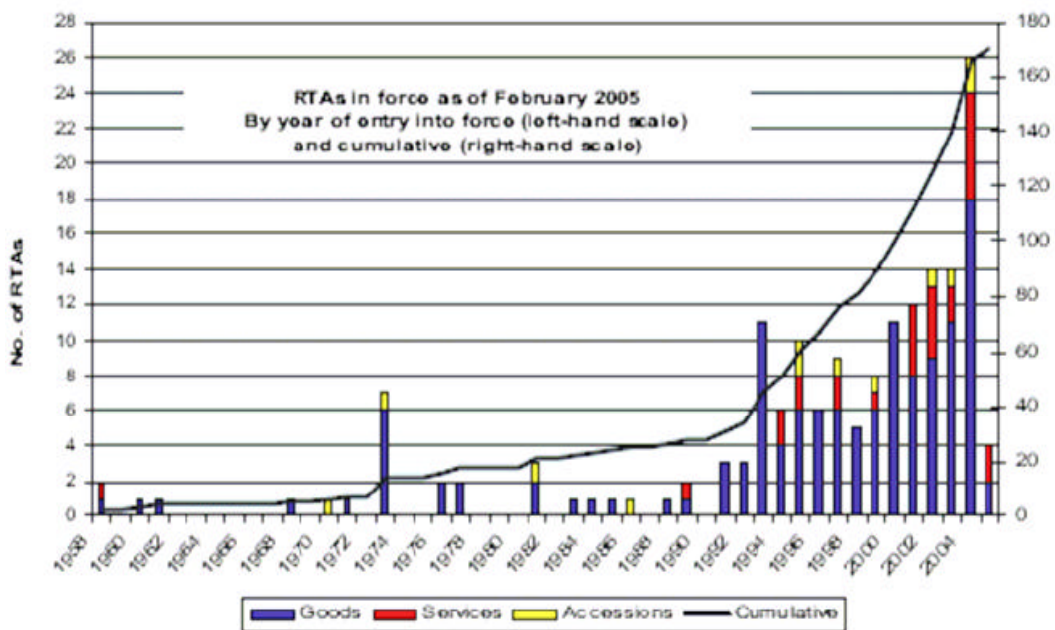
The rationale for Regional Trade Agreements (RTAs)

Nevertheless, the proliferation of bilateral and regional trade arrangements (hereafter referred to as Regional Trade Agreements (RTAs))¹ has been considerable. **(Figure 1)**

¹ Regional Trade Agreements (RTAs) shall mean bilateral, regional and plurilateral agreements

In fact, a combination of geopolitical developments most of which date back to the late 1980s or early 1990s is often believed to have instigated the move towards regionalism. These would include the uncertainty concerning the fate of the Uruguay Round (1986-1994), the fragmentation of the former Soviet Union, the policy of 'additive regionalism' pursued by countries such as Chile, Mexico and Singapore, the more favourable stance towards preferential agreements of countries such as the United States, and the expansion of the European RTA network to incorporate new acceding countries from Central and Eastern Europe, the Balkans and the Mediterranean. Indeed, 21 RTAs coming into force within a period of 1990-1994 demonstrate a fivefold increase when compared to only 4 within the preceding 4 years. **(Table 1)** The number of notified agreements currently in force surpasses 190, while approximately a further 70 are being negotiated or indeed considered.

Figure 1 The proliferation of Regional Trade Agreements (RTAs)



Source: WTO

Table 1 Notified RTAs in goods by the date of entry into force and type of partner

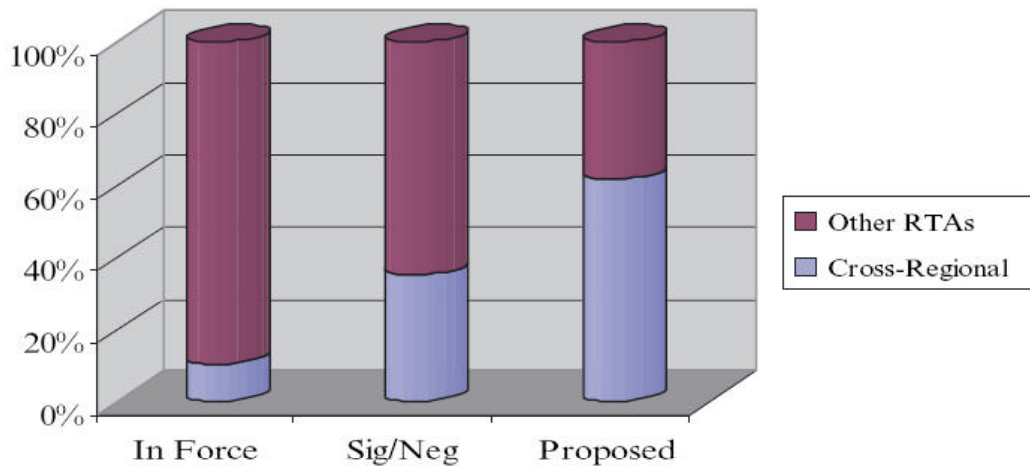
	Developed-Developed	Developed-Developing	Developed-Transition	Developing-Developing	Developing-Transition	Transition-Transition	Total
1958-1964	2	0	0	1	0	0	3
1965-1969	0	0	0	1	0	0	1
1970-1974	5	1	0	2	0	0	8
1975-1979	0	3	0	1	0	0	4
1980-1984	2	1	0	2	0	0	5
1985-1989	1	1	0	2	0	0	4
1990-1994	3	3	4	5	1	5	21
1995-1999	3	7	0	4	2	16	32
2000-2002	0	11	4	8	2	5	30
2003-2005	2	9	0	4	2	16	33
Total	18	36	8	30	7	42	141

Note: developed economies include Canada, the United States, EU, EFTA, Japan, Australia and New Zealand, transition economies include the former Soviet Union, Eastern and Central Europe, the Baltic States and the Balkans; the remaining countries are classified as developing

Source: WTO (February 2005)

Traditionally, RTA formation occurred between geographically contiguous countries with already well established trading patterns. Australia and New Zealand, the NAFTA countries, the EC, EFTA, and CEFTA would serve as good examples of such arrangements. Irrefutably, most countries sign their initial RTAs with one or several neighbouring or regional partners and this has indeed been the case with South East Asian countries and ASEAN, sub-Saharan African groupings such as CEMAC or SACU, or the Western Hemisphere grouping of CARICOM, the CACM and MERCOSUR. Concurrently however, once strictly regional prospects are exhausted, a country may begin to seek preferential partners beyond the boundaries of its geographical proximity. This trend is most evident in countries of the Western Hemisphere, Europe and increasingly Asia-Pacific. **(Figure 2)**

Figure 2 Cross-Regional RTAs as a percentage of total RTAs



Source: WTO (February 2005)

With such a substantial number of RTAs it is not uncommon for a country to be a signatory of several such agreements. Though this may be viewed as primarily advantageous, differing rules of origin, tariff schedules and period of implementation complicate customs administration and thus may result in an increased cost of trade.

Frequently, the apparent preference in a country's trade policy for RTAs as opposed to multilateral liberalisation may be due to the following reasons:

- **Market access.** Countries often seek an improved market access when compared with that of WTO MFN treatment. As such, the prospect of obtaining a first-mover advantage by signing bilateral trade agreements with major trading partners before others can do so may often constitute an incentive for pursuing regionalism. However, though such gains could have indeed been plausible at the onset of the move towards regional agreements, the proliferation of RTAs around the world has surely reduced if not eliminated them. Nonetheless, this strategy tends to trigger a chain reaction of bilateral arrangements, as other nations in order to ensure a more level playing field opt for comparable solutions.
- **Broader economic and political goals.** RTAs may often be driven by geopolitical considerations. In fact, regional trade arrangements encompassing a number of parties within a geographic region or regional groupings (region to region agreements) though primarily concerned with integrating markets, may also aim to increase regional

political stability, enhance relations between the parties and bring together countries at different levels of development and with divergent institutional structures and capabilities.

- **Development goals.** Certain trade arrangements, such as the North-South agreements often aspire to accomplish development objectives. Industrialised countries by opening their large markets where consumers retain a high purchasing power, and allowing for an asymmetric reduction of trade barriers with transitional periods for the benefit of the disadvantaged countries may indeed assist them to attain the intended development goals.
- **"WTO-plus" liberalisation.** RTAs may additionally have the flexibility to pursue trade-expanding policies not addressed well in multilateral trading rules. As such, they may go beyond the reduction of tariffs to include measures that mitigate trade impediments associated with standards, customs and border crossings, services regulations and broader rules that can improve the overall investment climate. Moreover, these agreements may serve as a leverage to facilitate domestic reforms, particularly with respect to nations undergoing acute transformation of their economies, as has indeed been the case with the countries of Central and Eastern Europe and the Europe Agreements.
- **Pace and political gain.** Irrefutably, reaching a consensus among the members of the WTO can be a lengthy process and as such governments might be prompted to turn to regionalism as a means to achieve their trade objectives more swiftly. However, while this may have indeed been formerly viable, with bilateral negotiations becoming increasingly complex this incentive is likely to cease.

The WTO compatibility of RTAs

Article XXIV of GATT 1947 defines the modalities under which WTO members are allowed to derogate from the principle of Most-Favoured-Nation treatment (Article I), a foundation of the multilateral trading system. As such, providing certain conditions are met, the formation of Free Trade Areas (FTAs) and Customs Unions (CU) has indeed been allowed for. Accordingly, parties to the agreement that endeavour to form an RTA are required to eliminate duties and other restrictive regulations of commerce within a 'reasonable length of time' on 'substantially all the trade between the constituent territories'. Though a 10 year period has been generally accepted as the reasonable time for such arrangements to take full effect, admittedly the phraseology, employed to prevent sector and product-specific favouritism and to limit trade diversion effects, does not constitute a precise definition and as such its interpretation left to individual WTO members may vary considerably between agreements. The European Commission interprets 'the substantially all trade' provision as a liberalisation of around 90% on average of the total value of trade between the parties and thus allows for a certain degree of asymmetry. Nonetheless, given the complexity and specific nature of problems in various regions, particularly those pertaining to development and environment that RTAs attempt to address, the rules governing their formation shall be undeniably more flexible. As such, article XXIV of GATT may indeed need to be amended to allow for the protection of vulnerable sectors, particularly among unequal trading partners.

In fact, trade between developing countries represents a significant exception to the somewhat stringent rules of Article XXIV. In accordance with the Enabling Clause (Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing

Countries 1979) the disadvantaged countries may accord differential and more favourable treatment to each other and this indeed may be product specific.

Similarly to Article XXIV of GATT, Article V of GATS, governing the conclusion of RTAs in the area of trade in services, requires a substantial sectoral coverage from both developed and developing nations although still does not provide a precise definition of the term.

Consequences for the Multilateral Trading System

By drawing on or replicating underlying WTO approaches or indeed other existing international agreements, fostering cooperation and technical assistance among regional partners and, in some instances, by helping to forge model approaches for possible subsequent adoption in a WTO setting, RTAs may assume a harmonising role and complement the multilateral trading system. Furthermore, with the import-substitution industry gradually becoming accustomed to higher competitive pressures, liberalisation with respect to the rest of the world could subsequently be more readily enforceable politically, while given the reduced number of participants as a direct result of the establishment of trading blocks, a consensus regarding the extent of such process more attainable.

Conversely, RTAs being discriminatory by nature depart from the basic principle of the multilateral system, namely the MFN treatment. Moreover, though designed to the advantage of the signatory countries, their expected benefits may be undercut if distortions in resource allocation as well as trade and investment diversion are not minimised, or indeed eliminated. In fact, as opposed to amplified trade flows, increased transaction costs for businesses, most evident in the area of rules of origin, are often an unavoidable consequence of RTAs for countries with multiple memberships. Furthermore, such agreements may strain the institutional capacity of governments when those are involved in parallel negotiations at multilateral, regional and bilateral levels and diminish the political pressure for more extensive liberalisations, as interests in new markets by the export industry might already be partially satisfied.

RTAs - their design to maximise benefits

A regional agreement to complement a non-discriminatory multilateral trading system would need to strive towards 'open regionalism', namely low external barriers to trade, non-restrictive rules of origin, liberalised service markets and an acute focus at reducing transaction costs at borders. Low external tariffs and wide coverage shall minimise the risk of trade diversion, while non-restrictive rules of origin shall allow for an increase in trade flows.

In fact, provided prerequisites such as political stability and sound domestic policies are in place, RTAs most likely to have a positive effect on the signatories may be those designed with:

- Low external MFN tariff
- Few sectoral and product exemptions
- Non-restrictive rules of origin that build towards a framework common to many agreements
- Measures to facilitate trade
- Large regional markets
- Measures to promote new cross-border competition, particularly in services

- Rules governing investment and intellectual property that are appropriate to the development context
- Appropriate sequencing of liberalisation and an efficient monitoring mechanism to oversee implementation

The European Union and its approach towards RTAs

Undeniably, regionalism has been a means of harmonising the domestic and external policies of Europe's complementary economies, and the trade aspect of regional integration has been an essential component of this political and economic union. Consequently, in its regional and bilateral trade agreements the EU considers the inclusion of deep integration elements, non-trade issues and social concerns such as labour standards, environmental concerns and human rights as particularly important. Furthermore, the Community fully supports the philosophy that regionalism and multilateralism may indeed be mutually supportive and recognises that regional agreements can provide the basis for identifying specific, regional, political and economic interests that could boost deep integration efforts, especially in areas that go beyond the elimination of tariffs and include regulatory initiatives and non-tariff barriers.

Consequently, by opting for bi-regional accords and those with high coverage in terms of tariff lines, trade volumes and sectors, the EU believes the excessive fragmentation of the international trading system can be avoided while trade diversion minimised. Moreover, driven by the development needs of the disadvantaged countries, the Community promotes a 'North-South-South' model (Economic Partnership Agreements with the ACP countries) which combines the benefits of development aspects such as asymmetric market opening and transition periods with those of a successful regional integration model, notably larger markets and stabilisation of the economic and political landscape.

The EU's commitment to the open and liberal multilateral trading system

As previously noted at the Sixth WTO Ministerial Conference in Hong Kong (December 2005), RTAs that are WTO compliant can indeed '*foster trade liberalisation and promote development*'. Concurrently, they should never be viewed as a substitute for coherent multilateral rules and progressive multilateral liberalisation.

In fact, the multilateral rule-based system under the WTO is the most effective and legitimate means of managing and expanding trade and as such the EU has been explicit about its commitment to strengthen it by *inter alia* increasing its transparency and oversight of inherently discriminatory RTAs. Concurrently, the Community recognises that to ensure such agreements do indeed assist the disadvantaged countries in their development efforts and encourage participation in the multilateral system, the "substantially all the trade" requirement as well as that pertaining to transition periods (Article XXIV of GATT and Article V of GATS) will have to be revised.

The EU deeply regrets that despite significant flexibility on its part, the DDA negotiations have been suspended. Undeniably, the costs of this breakdown are high and have the potential to ascend if it becomes permanent. Doha will certainly remain a central priority of the European trade policy and the Community efforts will irrefutably be directed at bringing it back to life and success.