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## **REGIONALISM AND MULTILATERALISM IN TRADE POLICY**

*Discussion paper presented by Senator Donald H. Oliver (Canada)*

The global trading system has become increasingly uncertain and quite complex. The World Trade Organization's (WTO) Doha Round of multilateral negotiations has stalled, with the prospects for a restart of these trade talks in the near future dim. Meanwhile, there continues to be a flurry of activity on the bilateral and regional trade-deal front, with only a handful of countries now not having some sort of preferential trading arrangement as part of their overall trade structure. As the Canadian government's Senior Trade Policy Advisor observed, "No corner of the world is without some regional or bilateral trade dynamic as various countries seek to be their own hubs rather than someone else's spokes – implicitly therefore securing their place at the expense of others in what seems to be an increasingly uncertain global trading environment."<sup>(1)</sup>

There is no question that the game today in international trade is occurring at the bilateral and regional levels. There has been an enormous proliferation of regional trade-related agreements after the completion of the Uruguay Round of the General Agreement on Tariffs and Trade in the early 1990s.

Given the slow pace of WTO negotiations on a new Round of negotiations, the United States has been very active in finalizing bilateral trade agreements with countries from all over the world. Some fifteen of these agreements have been finalized. In East Asia, new interest in regional arrangements followed the onset of the Asian Financial Crisis, which demonstrated that markets considered East Asia a region. Europe, which has long been the standard bearer for regionalism, has been active in both deepening and widening the European Union's (EU) common market. Moreover, to the EU's efforts to integrate regionally must be added the extensive web of bilateral and plurilateral agreements that the Europeans have entered into with Eastern European and non-European partners. For Canada's part, this country has only entered into one bilateral trade agreement in the past five years, a relatively poor performance compared to that of other trading nations.

This paper presents the arguments in favour of both bilateralism and regionalism (hereafter called regionalism since most of these trade arrangements are occurring at the regional level), and multilateralism in trade policy. It ends with a brief discussion of Canada's interests in the world trade system.

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(1) This paper draws extensively from John M. Curtis, "The Importance of Being Multilateral (especially in a regionalizing world)," in John M. Curtis and Dan Ciuriak, eds., Trade Policy Research 2003, Department of Foreign Affairs and International Trade, 2003, [http://www.dfait-maeci.gc.ca/eet/research/TPR\\_2003/TPR\\_2003-en.asp](http://www.dfait-maeci.gc.ca/eet/research/TPR_2003/TPR_2003-en.asp).

### The case for regionalism

What are the arguments for regional trade agreements (RTA)? Are these arrangements, in the terms that many trade specialists use, “building blocks” or “stumbling blocks” to global liberalization?

The first argument in favour of RTAs is that they result in net trade creation as opposed to trade diversion. RTAs do enable members to enjoy gains from trade. Members of such agreements will increase imports of goods and services which their partners can produce more efficiently, and increase their own exports which they themselves can produce more efficiently than their partners. This increase in trade is known as the “trade creation” effect of a free trade area.

Unfortunately, the gains from trade creation in a preferential trade arrangement can be partly or wholly negated by an effect referred to as “trade diversion,” which does not arise in the case of non-discriminatory liberalization. Trade diversion occurs when the preferences created under the arrangement in question cause imports to be switched from non-partner to partner countries, even though they are available from the non-partner countries at a lower cost. This can happen because the higher-cost goods from the partner country enter free of duty or other restrictions under the free trade agreement. There is some evidence of reasonably significant trade diversion, especially where there are high external tariffs applied to goods from third parties. Trade experts have advocated concepts such as “open regionalism” that would try to ensure that the implementation of RTAs would not unduly harm the trading prospects of non-participating countries.

The question then is whether the economic growth that is generated from this increased trade exceeds any trade diversion and associated inefficiencies in the allocation of resources arising from the preferential trade arrangement. “The evidence suggests that, while trade diversion has probably occurred as a result of RTAs, trade creation on balance has dominated leading to welfare gains.”<sup>(2)</sup>

Second, the main motivation for reciprocal trading arrangements appears to be simply to generate a more sure access to foreign markets, not to build “fortresses” around geographical areas as was initially feared when these RTAs first materialized. One could even imagine that this panoply of non-multilateral agreements is causing a race to the bottom in protectionism as more and more liberalized market access occurs.

Third, RTAs are considerably quicker to negotiate. Given the smaller number of players involved in the negotiating process, it is easier to overcome negotiating hurdles. One can add to this negotiating speed the slow and intermittent pace of multilateral trade liberalization.

Fourth, RTAs can be of particular use to developing countries in that they typically lock in domestic economic reforms. In other words, these free trade arrangements prevent bad previous economic policies from reappearing. The RTAs can also serve as a learning experience to help these poorer countries prepare for multilateral negotiations.

Fifth, bilateral and regional trade agreements, properly constructed with due respect to WTO obligations, can complement and assist the WTO. Indeed, many of the provisions found in RTAs (e.g., NAFTA) have either made their way into multilateral agreements or are serving as models for future deals. Examples include rules on investment protection, intellectual property, services, and trade-related investment.

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(2) *Ibid.*, p. 4.

Finally, the creation of RTAs can help advance negotiations on multilateral agreements. For example, it has been argued that the signing of the NAFTA spurred on a quicker completion of the above-mentioned WTO Uruguay Round.

### **The case for multilateralism**

What is the case for multilateralism in a world trading system that is increasingly being characterized by a spaghetti bowl of intertwined RTAs? Several factors in support of multilateralism can be mentioned.

The first is the inability of RTAs to deal with complicated agricultural trade issues. The divisive agricultural trade issues between the major industrialized economies of the world (i.e., the United States, the European Union, Japan) will only be resolved in a multilateral setting.

Second, complex trade and development issues in poor countries are best handled in Geneva for they often require a multilateral approach. For example, the current discussion surrounding the richer countries of the world providing "aid for trade" (i.e., technical assistance to help developing countries trade more effectively) to poorer ones is occurring at the multilateral level. It also bears mentioning that for most of the developing countries of the world, the bulk of the benefits from a successful completion of the Doha Round will come from agricultural trade liberalization.

Third, trade disputes are best resolved through the use of an effective dispute settlement mechanism at the multilateral level. The WTO remains the best framework yet devised to mediate the disputes that arise from global economic activity.

Fourth, as was alluded above, non-participants in RTAs can suffer if trade is diverted to within the borders of the trading bloc.

Fifth, the plethora of sometimes overlapping trade agreements adds considerable administrative cost and confusion to the trade system. There are costs involved in both negotiating the agreements, and in administering and policing the various trade provisions that they contain.

A final point to make is that the diversion of scarce negotiating resources towards regional and bilateral trade pacts that is occurring in many countries may be draining away the resources required to successfully complete the WTO Doha Round. Emphasis on building bilateral and regional alliances could be diluting the momentum that is required for the multilateral trade talks.

### **Where do Canada's trade interests lie?**

The WTO continues to be the cornerstone of Canadian trade policy and provides a forum to advance our relations with both established and potential trading partners around the world. These would include the emerging markets as well as other developing countries.

Canada is one of the most open economies of the industrialized world. Trade is the lifeblood of the Canadian economy and our continued well-being rests on having excellent access to global markets for our goods and services. It is also extremely vital that Canada continue to benefit from the importation of inputs, technology and expertise to improve the productivity and competitiveness of Canadian firms in both domestic and global markets.

However, given Canada's small size relative to the United States and the European Union, a rules-based system of international trade is critical to ensure that larger economic powers do not take advantage of their superior economic clout in the event of a dispute. This provides security for Canadian businesses trading and investing abroad.

Only a multilateral rules-based system can provide the predictability and security that Canadian businesses need in order to flourish both at home and in the global economy.

Given the obvious benefits of the WTO to Canada, it is surprising that we have allowed our credibility at this international trade organization to be significantly reduced, largely as a result of our protectionist stance on certain defensive interests that we continue to hold (e.g., supply-managed agricultural products, certain services).

Despite the importance of the multilateral trading system, the slow pace of WTO negotiations has caused the federal government to try to join the trend in evidence elsewhere and explore potential bilateral and regional trade agreements. It is working to deepen cooperation under the NAFTA and it is attempting to complete negotiations on several bilateral trade and investment agreements.

However, as was previously mentioned, its recent performance in this area has not been strong. Historically, Canada has benefited greatly from bilateral free trade agreements with the United States and Mexico. Both the Canada-U.S. Free Trade Agreement and the NAFTA have shown how trade liberalization can stimulate economic growth and create employment. There is no reason why this country could not benefit from liberalization at all levels, and therefore it should use all possible levers to drive progress: bilateral, regional and global.