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## MULTILATERALISM IN THE MIDST OF THE RISING TIDE OF BILATERAL AND REGIONAL TRADE PACTS

*Discussion paper presented by Mr. P. Rübig (European Parliament)*

### **Executive Summary**

The international trade community has long been debating the advantages and disadvantages of multilateralism and bilateralism in the sphere of international trade. It is perhaps time to approach the discussion from a different angle and find practical ways how the two can be made to enhance each other. In the future one could envisage a stronger multilateral system that has a bigger control over bilateral trade agreements, whilst the later could be used to supplement the multilateral trading system by addressing issues that are more specific to countries and regions.

### **Multilateralism and bilateralism**

The discussion about the respective merits of multilateralism and bilateralism in the sphere of international trade and the compatibility, or incongruity, of both approaches has been going on for decades now. A lot has been said about this issue and several scientific, measurable approaches have been put forward in order to determine, with the help of empirical data, the net gain or loss caused by bilateral trade agreements vis-à-vis multilateral ones. However, perhaps the occasion of the IPU Conference 2011 presents us with a unique opportunity to briefly cast aside the empirical search for an axiom that would firmly plant bilaterals in the "bad" or "good" pigeon holes.

The truth is that, whether one likes it or not, bilateral agreements are here to stay. Actually, the truth goes further than that: bilateral agreements have always been around, it is the multilateral system that is new. Despite its undisputable success and the wealth that it has produced over the past half-century, it would be rather naive to expect that any time soon it is going to displace to a large extent, or even completely, bilateral preferential trade agreements. This is not a pessimistic premise. On the contrary, it should be seen as a possibility of shifting the argument away from "*Which approach is best?*" to the more constructive question of "*How can both approaches be made to complement each other?*".

## The need for Preferential Trade Agreements

There are several reasons which lead countries to engage in bilateral trade discussions and some of these go beyond purely economic interests. Therefore, any discussion that only applies rigorous commercial considerations in its evaluation of bilateral Free Trade Agreements (FTAs) can only be partial at best. Governments, for one, often want something tangible to show to their citizens for their hard work. Bilateral FTAs are, indeed, a good way of "taking something back home" because they are easier to conclude, they tend to address local or regional concerns more directly and last but not least they ensure that the credit is attributed to the governments involved and not to an anonymous international organisation such as the World Trade Organisation (WTO). In simpler words, citizens tend to feel more directly concerned by bilateral agreements than by multilateral ones, regardless of the actual financial benefits in real-terms.

As Euro-parliamentarians we are all too often exposed to this tension between individual Member States and supranational bodies. In the European Union, Member State governments tend to relinquish authority only in areas that are too difficult to deal with or where the level of outside competition necessitates a common approach. However, the latter has successfully led EU Member States to pool their resources together and put the Commercial Policy as an EU competence, adding even Foreign Direct Investments to the package. This is a good example of bilateral approaches giving way to more coordinated trade strategies.

The IPU and the European Parliament are fully committed to the WTO and the multilateral approach and hope that Members will increasingly opt for the multilateral option as a first solution. At the moment, this does not always seem to be the case, as bilateral agreements are flourishing. Academic research has shown that countries often engage in bilateral trade agreements not only on the grounds of economic considerations but also for political reasons. It is time to start thinking seriously about a revision of the multilateral system so that it becomes the first solution for trade negotiations. However, countries should be given the possibility to engage in bilateral trade agreements when these address region-specific issues and when it is confirmed that they offer benefits that cannot be achieved otherwise, i.e. multilaterally.

The following considerations will hopefully form the basis of a fresh (Post-Doha) debate on how to achieve this.

### **1. Ensuring that the WTO has more control over bilateral agreements**

Since bilateral Preferential Trade Agreements (PTAs) are here to stay, and are indeed necessary in certain instances, one of the best ways of making sure that they do not undo the efforts at the multilateral level is to ensure that the WTO has a higher degree of control over the implementation, the monitoring and the content of such PTAs.

At the moment, countries or regions that sign a bilateral preferential agreement are supposed to register them with the WTO. As of July 2010, a total of 474 PTAs have been notified to the WTO, 283 of which are currently in force. However, despite the obligation to notify, we cannot, by any means, say that the WTO holds any kind of regulatory control over PTAs. Indeed, in several instances PTAs are notified late and often after their entry into force. The WTO imposes three substantive conditions on PTAs but it is no hidden secret that the effective imposition of these conditions is difficult and that several loop holes exist.

One of the reasons why PTAs are tempting is the exemption from the most favoured nation (MFN) clause. Article XXIV GATT, under which several PTAs are authorised, explicitly forbids increases in MFN protection. But there are ways and means how this can be circumvented. It can thus be argued that it should be possible to consider changing the rules so that a PTA would only benefit from a temporary exemption from the MFN clause. Accordingly, if a bilateral preferential trade agreement is exempted from the MFN clause for, let's say, five or ten years the following impacts could be foreseen:

- Countries will weigh more carefully whether the effort of negotiating a PTA is worthwhile.
- The erosion of the exclusive preferences in the PTA will be much faster, thus offering reprieve for affected parties.
- This might actually filter between PTAs that are a real economic necessity, and therefore would be signed anyway, and those PTAs which are being signed simply as part of a power-struggle amongst individual regions and countries.

Another form of regulatory control would be the calculation of the negative impact in terms of trade that a bilateral PTA would have on non-signatories. Subsequently, a form of efficient compensation, on the same lines as the dispute settlement, may be considered. Once again, this will have countries think twice before going into PTAs and will only do so when they are sure of the advantages.

## **2. Tackling Non-Tariff Barriers and Behind the Border Barriers more effectively**

The multilateral system has been so successful that nowadays tariffs hardly remain the biggest stumbling block to international trade. Indeed, as of 2010, the average uniform tariff equivalent of goods trade policies of OECD countries is less than 4%. Non-Tariff Barriers (NTBs) and Behind the Border Barriers, however, have become more apparent and are fast becoming the "battle turf" of negotiations. They are, however, proving to be a more insidious barrier to eliminate. It is more difficult both to calculate the effects of NTBs as well as to find a water-tight legal way to eliminate them.

As long as the multilateral system continues to be ineffective in dealing with this new "currency" of international trade, regions and countries will continue to prefer bilateral tools to deal with this issue.

We should thus seriously think how to adapt the multilateral system to better calculate the effect of NTBs and Behind the Border Barriers and how to better ensure conformity.

## **3. The WTO should encompass areas that are currently covered by bilateral agreements**

The multilateral approach is still relatively narrow in terms of coverage. Those areas that are either not covered at all, or not covered sufficiently, are a big incentive for countries to engage in PTAs.

The global environment of international trade has moved away from the traditional goods market to encompass areas such as intellectual property rights, public procurement, investments and services. The multilateral approach, on the other hand, with the notable exception of the GATS, has kept to the more traditional business sectors, such as goods and agricultural products. The areas mentioned above are, at best, covered by a plurilateral agreement. Some progress has been achieved in the area of trade facilitation, but as long as the "Singapore issues" remain indeed "issues", PTAs will remain one of the only tools available for countries and regions to fill the gap.

Therefore we should ensure that a reform of the WTO becomes a reality so that the multilateral system is widened in scope. Perhaps the issues of finalising DOHA and a possible reform of the WTO should, in fact, be decoupled.

One partial solution to this problem is to encourage trade heavyweights, such as China, to put more effort in joining the Plurilateral Agreement on Public Procurement. Any agreement that does not reflect a balanced geopolitical and commercial picture is bound to leave great gaps that can only be filled by PTAs.

#### **4. We should work harder to enable non-member trade partners to adhere to the WTO**

As long as important players stay out of the WTO, countries will always be forced to resort to bilateral agreements to establish deals with partners that they cannot afford to ignore. When these countries join, however, they would not only be committed to the same rules and principles as everyone else but would also have the possibility of using the multilateral setup to their advantage. Countries, like China, can now influence the trade negotiations in their favour through the multilateral system rather than through a number of individual FTAs that, more often than not, contribute to a disparate set of complicated rules such as Rules of Origin. Russia, one of the last remaining key trade partners not a member of the WTO, will hopefully join the organisation over the next year.

Ironically, the appetite of developing countries for PTAs does not seem to have waned with their accession to the WTO. This is largely due to the above-mentioned lacunae that exists in the multilateral system, the fact that DOHA is taking a long time to conclude and the emergence of what unfortunately appears to be a political "rat-race" amongst developing countries to conclude as many PTAs as possible - which is seen as an affirmation of their commercial power as they become regional trade agreement hubs.

We have, thus, to work not only to convince countries that they need to accede to the WTO but also to instil, as much as possible, amongst existing members that the multilateral approach can enable countries to exploit their full trade potential and consolidate their commercial presence.

#### **5. Opening the access to the Dispute Settlement Mechanism**

One of the biggest successes of the WTO has undoubtedly been the Dispute Settlement Mechanism. This mechanism has offered a stable and relatively quick manner of resolving disputes without resorting to detrimental trade wars. Moreover, it has given small countries the possibility to find a way of capturing the attention of larger trade partners and have their complaints addressed.

To date, however, only governments can launch a WTO Dispute. This means that individual companies and lobby groups have to convince their local governments or, as in the case of the EU, their supranational representatives to launch a case. Perhaps it is high time that this changes. As long as the business community continues to feel that the multilateral system is closed for it, it will continue lobbying and financing efforts for bilateral PTAs. A company is much more likely to protect its interests through a bilateral agreement than a multilateral one, if nothing because it has a more direct access to the government of the country where it operates. This is not an argument in favour of the WTO becoming a capitalist-run institution. Still, we have to recognize that transnational companies are becoming bigger and more numerous and are evermore present in international trade flows. Including them in the

multilateral system as much as possible would ensure that they play by the rules and that the WTO becomes more significant for them. Governments should also ensure that SMEs have access to the WTO Dispute Settlement Mechanism perhaps by helping them overcome the stumbling blocks that would otherwise inhibit their possibility to influence trade policy or seek redress, such as providing legal and administrative aid or by increasing the access of SMEs to policy makers.

The WTO should also be in a position to listen to the complaints of the business community about the way the system of retaliation affects them. Businesses find it hard to understand why enterprises, employees and consumers have to "foot the bill" for commitment withdrawals in other sectors or for duty imposition as retaliation of a country's lack of conformity in sectors that are not even remotely connected to their sphere of business. We should strive to find a fairer way whereby, in case of retaliation authorised by the WTO, additional duties are not paid by sectors which have nothing to do with the original contravention. The same should apply to compensation agreed over commitment withdrawals. States and governments should assume responsibility for their own policies and should thus be held fully accountable to the WTO and their trading partners, for example through their national budgets.

## **6. Bringing the WTO closer to the people**

Nowadays, when communicating and selling ideas to the general public plays a pivotal role, we should also consider the possibility that the WTO speaks more directly to its citizens. After all, decisions and deals struck in Geneva have a rather direct influence on the daily lives of people. Making that link more evident will help to increase public awareness.

The recent financial and economic crisis has shown, once again, that nationalistic rhetoric always grows louder in periods of dire economy. Luckily, most governments did not follow-up on their rhetoric and the application of trade defence measures remained limited. Surely, much of the credit here goes to the success of the WTO and the willingness of governments and parliaments to commit to the multilateral system. However, let us not forget that, to some extent, this mitigation in trade defence measures has also been the result of globalisation. Multinational companies are less likely to be bossed around by individual governments when it comes to decisions of where a product should be produced, assembled or sold. The reality is that a single product is nowadays made of components produced in several different countries - the iphone often being quoted as the classic example.

As governments are elected by people, it is rather difficult for politicians to convince their electorate that the right approach is not to implement trade defence measures in times of crisis. Thus, explaining the benefits of the multilateral system to citizens will make the work of governments easier and will in turn put less domestic pressure on governments to adopt defensive trade policies. Here, parliamentarians have a major role to play.

## **7. Upholding the Single Undertaking practice and the Consensus decision-making**

The inevitable downside to multilateral negotiations is that they will always be more drawn out and complex when compared to plurilateral, regional and bilateral trade negotiations. This should not, however, be solved by undermining the practice of Single Undertaking and Consensus. Doing so will simply take the WTO several years back to the *à la carte* practice of the GATT times and undo what has arguably been one of the major achievements ushered by the Uruguay Round. The truth is that even region to region negotiations, as the experience of the EU has shown, sometimes prove too difficult to carry out and end up fraying into smaller agreements, or indeed, bilateral ones.

The WTO can seek to offset this disadvantage by setting an agenda that is more explicit and attainable. This, however, will require a serious, concerted effort at reforming the institutional aspects of the WTO in a way that they become more conducive to efficient, relevant and attainable work. This is an issue that has to be studied in depth and I hope that in the near future, maybe in the course of a Post-Doha-Discussion, we can witness the launch of this much-needed process.

### **Conclusion**

As a conclusion, it is suggested that we change our approach to the issue of bilateral as opposed to multilateral trade agreements from one that seeks to identify the merits of one over the other, to one that actively seeks to create a synergy between the two. As stated before, bilateral and regional agreements are here to stay, and they are in fact a necessary part of the world trade scenario. The challenge is not to make them disappear, but to integrate them and to "multilateralise" what is happening at the regional and bilateral level. This will, indeed, even complement the PTAs by filling the gaps that they leave out and by providing a stronger multilateral structure within which PTAs can be integrated without harming the overall balance.

Achieving this would admittedly be difficult without some kind of reform in the WTO. In 2009 Pascal Lamy stated on the occasion of his re-election as head of the WTO, "no major surgery is required in the WTO... but rather a long to do list." Indeed, it is hoped that the points mentioned here become part of this list.

Parliamentarians have a role in this task, a role which will hopefully be fully reflected in a WTO review. Our presence will surely make the process more democratic and enable it, to quote Mr. Lamy once again, to be more "popular" as opposed to "notorious".