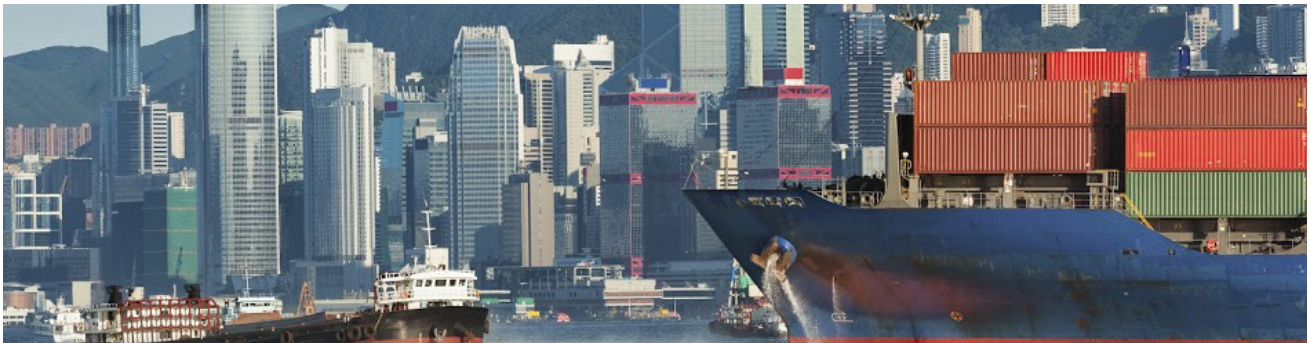




The **E15** Initiative

STRENGTHENING THE GLOBAL TRADE SYSTEM



When the Immovable Object Meets the Unstoppable Force: Multilateralism, Regionalism and Deeper Integration

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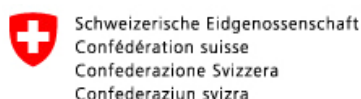
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ABSTRACT

The experience of trade negotiations of the past decade shows that the multilateral system is at an impasse. Not only has it been difficult to get agreement on traditional issues such as meaningful reductions in tariffs and subsidies, but it also has been impossible to obtain agreements that require developing countries as a group to implement rules that constrain their domestic economic and social policies in new areas. Many developed and developing countries are seeking to pursue zero for zero tariff reductions together with deeper integration through regional and mega-regional agreements in precisely the areas that have been roundly rejected by the WTO as a whole.

On the one hand, as large emerging economies become increasingly important, it has become more difficult to either ignore them or to coerce them into signing agreements they deem against their interests. On the other hand, the forces driving deeper integration have also become stronger.

So what happens when (the immovable object of) resistance to the erosion of domestic policy space by emerging economies meets the (unstoppable) force driving deeper regional integration? Thus far the clash has left the WTO at an impasse. But could the regional initiatives be a way in which they could be reconciled?

Regional agreements can be discriminatory and can introduce unwarranted complexity to the trading rules. However, by creating markets that are more easily contested; by implementing standards that others voluntarily adopt; and by setting precedents that make countries more accustomed to signing deeper agreements, RTAs could make deeper agreements at the WTO easier to negotiate.

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LIST OF ABBREVIATIONS

EU	European Union
FTAs	free trade agreements
GDP	gross domestic product
NAFTA	North American Free Trade Agreement
RoO	rules of origin
RTAs	regional trade agreements
TPP	Trans-Pacific Partnership
TTIP	Transatlantic Trade and Investment Partnership
US	United States
WTO	World Trade Organization

INTRODUCTION

The debate about whether or not regional trade agreements (RTAs) are building or stumbling blocks has raged for more than two decades, and it is not surprising that it has now been joined again. It has always been the case, however, that the answer to the question depends not simply on whether RTAs proliferate but rather on what precisely they entail. "The devil," as the saying goes, "lies in the details." In particular, what is crucial is whether these agreements lead to discriminatory treatment and build in constraints on additional liberalization or whether they actually make the markets of the participants more contestable, not only for themselves but also for non-members. There is evidence of both tendencies at work, although officials generally emphasize the latter. By subjecting each agreement to a "multilateral impact statement," an independent assessment body could encourage agreements that are building blocks.

An observer of the trading system could reasonably draw two contrasting implications from the experience of trade negotiations of the past decade. The first is that the multilateral system is at an impasse. The combination of decision-making by consensus and a highly diverse and heterogeneous membership with powerful and large emerging economies makes it very difficult to include all members in a single undertaking. Not only has it been difficult to get agreement on traditional issues such as meaningful reductions in tariffs and subsidies, but it also has been impossible to obtain agreements that require developing countries as a group to implement rules that constrain their domestic economic and social policies in new areas. At Cancun, for example, it proved impossible to obtain the required consensus to launch negotiations on three of the Singapore issues—competition policy, investment, and transparency in government procurement. The World Trade Organization (WTO) has also repeatedly passed resolutions rejecting the expansion of its remit to include commitments on labour and environmental standards.

Yet, another powerful force is in motion. Many developed and developing countries are seeking to pursue zero for zero tariff reductions together with deeper integration through regional and mega-regional agreements in precisely the areas that have been roundly rejected by the WTO as a whole. The European Union (EU) and Japan have been actively negotiating deeper agreements with each other and with numerous other partners. Despite a lack of enthusiasm for trade agreements for much of its first term, the Obama administration has now embraced free trade agreements (FTAs) with considerable energy. The comprehensive United States (US) FTAs with Colombia, Panama, and South Korea were passed in 2012, and President Barack Obama has agreed to launch negotiations for the Transatlantic Trade and Investment Partnership (TTIP). Japan has now joined Canada and Mexico as recent additions to the 11 nations that are

negotiating the Trans-Pacific Partnership (TPP). The scope and depth sought in the TPP and the TTIP are considerable and far beyond anything contemplated at the WTO. Their agendas call for agreements that not simply eliminate tariffs, but accomplish extensive liberalization in investment and services, place new rules and disciplines on subsidies and state-owned enterprises, and aim to achieve greater regulatory convergence and coherence.

The forces propelling both these trends are strong. On the one hand, as large emerging economies become increasingly important, it has become more difficult to either ignore them or to coerce them into signing agreements they deem against their interests. Prior to the Uruguay Round it was relatively easy for the developed countries to simply exempt developing countries from obligations when these countries were unwilling to sign. In the Uruguay Round, by buying off some countries with concessions (such as the elimination of the Multi-Fibre Arrangement quotas that protected textiles) and putting pressure on others to go along, it was possible to induce developing countries to sign an agreement that contained intellectual property rules to which many were opposed. But that time has now passed, and since Cancun it has become clear that the emerging economies not only can say no, but when they do, achieving agreement with a single undertaking becomes impossible because they are too important to exclude.

On the other hand, the forces driving deeper integration have also become stronger. The combination of liberalization, improvements in technology, logistics, and telecommunications has increased the possibilities of reaping additional economic gains from economic integration through establishing and improving the operation of global value chains. Multinational corporations are thus leading the way to help take full advantage of these opportunities by agreeing to new rules and more effective governance, and many countries seeking the growth and employment these companies can provide are willing to oblige. In addition, in many advanced countries, representatives of the major political forces (labour, environmentalists, and enterprises) all seek "a level playing field" in which their foreign competitors are subject to similar rules. Hence the pressures for agreements to include rules for labour, environment, and competition policies.

So what happens when (the immovable object of) resistance to the erosion of domestic policy space by emerging economies meets the (unstoppable) force driving deeper regional integration? Thus far the clash has left the WTO at an impasse. But could the regional initiatives be a way in which they could be reconciled?

A TEMPLATE?

Probably the least likely outcome is the claim, commonly offered by official proponents of regional negotiations that, once concluded, the new RTAs can be rubber-stamped in broader agreements at the mega-regional and multilateral levels. The TPP in particular is seen as “the most promising platform for development of an eventual Free Trade Area of the Asia-Pacific,” and as the basis for agreements on 21st century issues in order “to raise the overall bar for the multilateral trading system.”¹ While such claims may provide officials with some cover from accusations that they are undermining the multilateral system, they are not very convincing.

Given the problems with ending the Doha Round with its emphasis on conventional issues such as agricultural subsidies and market access for industrial products, and the positions taken on issues of deeper integration described above, it is not immediately apparent that the central problem of the multilateral system will be solved by “raising the bar” through deeper RTAs that emphasize regulatory convergence, investment liberalization, and generally higher standards. Indeed, these are precisely the kinds of issues the multilateral system has the greatest problems dealing with. On the basis of the experiences of the ill-fated Multilateral Agreement on Investment in the 1990s and the debacle at the Cancun Ministerial, it is especially hard to understand why the excluded developing countries should be expected at the Asia-Pacific Economic Cooperation (APEC) or the WTO to embrace an agreement they were not even party to negotiating.

Will the centripetal attraction of the specific rules that are crafted really be so great that once the TPP and/or the TTIP are signed, China, Brazil, India, and other major emerging economies will have no choice but to follow the lead of those that have signed? If Vietnam agrees in the TPP, for example, to accept restrictive rules for the operation of its state-owned enterprises, will China then sign meekly on the dotted line? If the participants in the TPP and/or the TTIP agree to the inclusion of labour standards (or the preservation of intellectual property protection that inhibits the introduction of generic pharmaceuticals), will India feel it has no choice but to go along? It is very unlikely that in their precise negotiated form these agreements will soon become blueprints for the WTO.

If they were crafted in a manner that really allowed them to command universal acceptance—simply and without reservations—their wider adoption, while still unlikely, might be easier. But in reality these agreements are the outcomes that result from a host of politically driven pressures that depend critically on the power and specific needs of those who are at the table. And this is likely to create obstacles for their broader application, especially as complete packages. The

inclusion of environmental and labour standards in these trade agreements, for example, may make it easier to obtain political support for the TTIP and the TPP in the US Congress, but at the same time could make it impossible to broaden the agreement to include other major partners if these are a precondition for joining.

The TPP is indeed ambitious, but there are numerous inconsistencies between the rhetoric on the one hand, and the concessions to political realities on the other. High standards, like beauty, are in the eyes of the beholder. On pharmaceuticals, the US position is that the stronger the intellectual property protection for pharmaceuticals the better. With respect to state owned enterprises, hard budget constraints are to be the order of the day. And when it comes to regulatory practices, high standards are likely to involve US-like procedures such as transparency, and judicial and public review. But when it comes to sector exclusions, rules of origin (RoO), and the phasing in of benefits, streamlining is expected to take a back seat. One might have hoped, for example, that in a 21st century agreement, the central vision would be akin to that in the EU92 initiative with the exception of the free movement of labour, that is, the aim would be to achieve, as soon as possible, a single integrated internal market with the free movement of goods, services, and investment capital. In this case, all 11 participants in the TPP would be governed by a single set of rules. But the US and some others have insisted on negotiating with participants bilaterally in what is really a hybrid mega-regional in which the concessions that were made in their bilateral agreements will remain in effect. Thus, since sugar was excluded from the US-Australia agreement, for example, it will not be included in US TPP concessions to Australia. Similarly, a 21st century agreement might have been expected to allow the diagonal cumulation of content across all members to meet RoO. Thus fabric from Malaysia could be combined with sewing in Vietnam in order to sell in the US or Japan. But this is unlikely to happen.

These problems in creating the TPP are a microcosm and a test case for the problems of welding RTAs into a more comprehensive arrangement at the multilateral level. Generally what is being sought is a politically realistic compromise between achieving greater integration, and preserving the political benefits that were achieved when the earlier agreements were negotiated. This does not make progress impossible, but it does make it difficult. And it certainly suggests that the rhetoric, which talks about high 21st century standards, deserves to be taken with a grain of salt. The key question that only time will resolve will be whether the RTAs will indeed serve as a foundation upon which more comprehensive agreements can be built, or whether they will actually make these far more difficult to achieve.

1 “The TPP has been central to this rebalancing toward Asia and it’s, as you know, a high-standard agreement. It’s an agreement that seeks to set high standards for 21st century issues as a way of raising the overall bar for the multilateral trading system” (transcript of on-the-record conference call by then Deputy National Security Advisor for International Economic Affairs, Michael Froman), [http:// www.ustr.gov/about-us/press-office/speeches/transcripts/2013/april/dep-nsa-froman-amb-marantis-cc-tpp](http://www.ustr.gov/about-us/press-office/speeches/transcripts/2013/april/dep-nsa-froman-amb-marantis-cc-tpp).

UNEASY COEXISTENCE

An outcome, that is more likely than the wholesale adoption of the TPP or TTIP templates, therefore, is that the current uneasy coexistence of the WTO and RTAs will continue. The WTO will hopefully remain effective in enforcing its existing rules and acting as a forum for discussion and review of trade policies. It might also achieve progress in areas such as trade facilitation, preferences for least developed countries, and the enlargement of product coverage and additional membership in sector agreements and new plurilaterals. But the prospects for a new, mega multi-issue agreement, especially one based on a single undertaking, will be dim. Increasingly, therefore, the attention of many members will be concentrated on their bilateral and mega-regional initiatives. And, with varying degrees of success, these agreements will make some progress.

While clearly not the best of all worlds, this coexistence scenario has both costs and benefits. The costs could be largest if the mega-regionals that are crafted serve to fragment the world economy into haves and have-nots, that is, into a world divided between those countries that are willing to accept a US and/or EU template for trade agreements and those that are not. These costs could also be felt through lost opportunities for non-discriminatory multilateral liberalization by some of the most dynamic and significant emerging economies. The BRIC countries, for example, are unlikely to sign up to regional or multilateral trade agreement templates that do not reflect their priorities. Yet they are also too large to be ignored, and are more likely to concentrate on concluding their own regional initiatives based on different principles and rules. Some countries may find it possible to coexist in both camps, but others may be excluded, and all of this would come at the expense of achieving a more integrated global trading system under the effective aegis of the WTO.

“The devil,” as they say, “lies in the details.” Depending on how they are crafted, there could, however, be benefits from RTAs, even in this “uneasy coexistence” scenario. Some of the deeper aspects of these agreements could automatically provide benefits to outsiders even if they do not participate directly in the agreement or adopt its rules, by making these markets more contestable. For example:

- More effective measures to control subsidies in a US-EU agreement would not only assist non-subsidized US and European firms and farmers who compete with each other, but also help all foreigners to compete in the US and the EU.
- The achievement of regulatory transparency and reforms would similarly reduce transactions costs not only for insiders but also for all who sell in these markets.

- Measures that facilitate trade, by making customs and regulatory practices more efficient, will likewise benefit all firms, including outsiders that are involved in trade.
- Higher labor and environmental standards might help create an internal level playing field among participants in a regional agreement; but if they raise costs, they could also improve the competitiveness of outsiders.
- Proponents of establishing a single US-European standard sometimes present it as something that will enhance these economies to compete with outsiders. And indeed having a single standard would create efficiencies and lower internal costs. But having to meet only one standard in the US and Europe would also reduce the costs of those who wish to export to it. If the US-EU agreement achieves enhanced approvals of genetically modified products, for example, the benefits would similarly accrue to all producers of these products. Similarly, if mutual recognition of standards were to be agreed between the US and the EU, and outsiders required to meet either the US or the European standard in order to sell in the whole transatlantic market, outsiders would gain.

NETWORK EXTERNALITIES

The multilateral system and other RTAs are likely to be influenced by these agreements, not because other countries formally sign up to its provisions, but rather because they are more likely to voluntarily adhere to their standards and rules because it reduces transactions costs. Conventional wisdom has it that higher standards will lead to a race to the bottom, but there are mechanisms by which standards can lead to a race to conform. Exporters may have no choice but to configure their products to meet the particular standards of one very large market, but once they do, they are more likely to retain the same configuration in other markets. (This point was made, for example, by those who pointed out that the North American Free Trade Agreement [NAFTA] could improve environmental outcomes by inducing Mexican auto firms to produce cars that meet US standards.)

The influence of these large mega-regional agreements will thus be felt indirectly through the power of what are known as network externalities, that is, the benefits that accrue to existing participants when more members join a network. If no one already had learnt how to type using QWERTY typewriter keyboards, perhaps a better arrangement would work on today's electronic keyboards. But today keyboard manufacturers have no choice but to use it, since that is the arrangement most people expect. Similarly, Esperanto may be a fairer option for the global language, but once a critical mass of people started using English as their first or

second language, the rest had to learn and use it in order to be understood. By this logic, if the economies that sign the TPP and the TTIP—which together make up more than half of world trade and gross domestic product (GDP)—agree on a standard, the rest of the world will have incentives to follow. This again suggests a mixed verdict. From a global standpoint, these may not be the best possible standards, but the power of network externalities will tend to induce adherence anyway. On the other hand, common standards could reduce transactions costs and facilitate competition.

A second major indirect influence will occur through setting precedents that will enable additional liberalization. If the participants in a deep regional agreement are prepared to grant one another concessions, they are more likely to be willing to grant other countries similar benefits, both in RTAs and multilaterally. If Vietnam, for example, agrees in the TPP to allow multinational firms from the US, Japan, and other TPP nations the freedom to invest, or the ability to be subject to investor-state dispute settlement, it is far more likely to be willing to allow investment from other nations. This enhances the possibility that it would sign other plurilateral or multilateral investment treaties. Many European countries, for example, have become accustomed to granting other European countries mutual recognition in the context of the EU. Their experience makes it easier for them to conclude mutual recognition agreements with the US. For the US, however, the approach presents challenges. But if the US adopts forms of mutual recognition in the TTIP, others seeking deeper integration with the US may find the going easier.

These potential integrative benefits need not only be indirect. They could (and should) also be consciously cultivated by those concluding the agreements. Especially in the case of the US-EU, for example, there are opportunities to make important contributions towards helping unravel the spaghetti bowl of RoO that currently lead regional arrangements to fragment the global economy. The line of least resistance in the TTIP would be to negotiate another unique set of rules that cover only the agreement and would be overlaid on the RoO that govern the US and EU agreements with others. Imagine the possibilities if the TTIP RoO were constructed to serve as the basis for all the RTAs signed by both partners. Implementing the same RoO (and allowing for diagonal cumulation) in all RTAs in which either the US or the EU participate would achieve far more conformity than anything the WTO could feasibly achieve. However, the existing rules have been carefully crafted to meet particular protectionist pressures, and it will take great political will to resist them.

PROPOSAL: MULTILATERAL IMPACT STATEMENTS

In the US, federal policymakers are encouraged to take account of the environmental impacts of their actions, by requiring all qualifying measures to be subject to an environmental impact statement.² The purpose of these exercises is not necessarily to prevent the measures from being implemented, but rather to raise awareness and to encourage policies that minimize environmental impact. Similar awareness should be raised in an effort to encourage the negotiators of regional arrangements to put their money where their mouths are and design agreements that would (a) create contestable markets that provide benefits to outsiders as well as participants, and (b) serve as the modular components of a more integrated global trading system. One mechanism for doing this would be for an independent authoritative body—either a think tank or distinguished panel of trade authorities—first to lay out a set of relevant criteria and then to apply these to an analysis of RTAs. Ideally, suitable methodologies and criteria would be widely available, and it should become standard practice for drafts of agreements to be analysed prior to being finalized so that negotiators would be given opportunities to correct major deficiencies.

CONCLUSION

Some would like to see the WTO eliminate RTAs or subject them to stringent disciplines. But this will not happen. Countries have already proceeded too far with their commitments. Moreover, RTAs should not be eliminated. Some functions are, in principle, better carried out at a sub-global level. Viewed simply as tariff reducing exercises, preferential arrangements are said to be “second best” because they can divert trade. But the WTO also does not eliminate all barriers, and its partial multilateral trade liberalization, the realistic alternative to preferential arrangements, is also “second best” in the same way. So the choice is between two second-best approaches, and it is an empirical matter as to which is superior. Indeed both can promote trade.

2

As noted, “Contrary to a widespread misconception, NEPA does not prohibit the federal government or its licensees/permittees from harming the environment, but merely requires that the prospective impacts be understood and disclosed in advance. The intent of NEPA is to help key decision makers and stakeholders balance the need to implement an action with its impacts on the surrounding human and natural environment, and provide opportunities for mitigating those impacts while keeping the cost and schedule for implementing the action under control” (http://en.wikipedia.org/wiki/Environmental_impact_statement).

Regional agreements can be discriminatory and can introduce unwarranted complexity to the trading rules. However, by creating markets that are more easily contested; by implementing standards that others voluntarily adopt; and by setting precedents that make countries more accustomed to signing deeper agreements, RTAs could make deeper agreements at the WTO easier to negotiate. At the end of the day, therefore, the old question still arises—will these agreements serve as stumbling blocks that prevent multilateral integration or can they actually be building blocks? Trade policies should be focused on trying to ensure that they are building blocks.

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