

**Regional and Bilateral Trade and Investment Agreements
Remarks at the Chatham House Conference Sustainable Development
in the WTO. Trade, Investment and Environment after Cancun**

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The Cancun WTO Ministerial Conference collapsed because a group of developing countries—including most of the large developing countries—refused to accept the negotiating traditions of the GATT/WTO where the United States and the EU reached agreements that everybody else was then allowed to accept. Just ten years ago, the final negotiations of the Uruguay Round involved only the United States and the EU. That model has ceased to function. It is unclear what will take its place but the experience was traumatic for the United States and the European Union.

Following the collapse of the Cancun WTO Ministerial conference, both the United States and the European Union indicated that they would pursue their bilateral and regional negotiations more vigorously. The similarity in response actually hides some significant differences when it comes to such agreements.

US diplomacy, like that of any dominant power, has a long tradition of divide and conquer. While declaring its support for European integration, the United States has never hesitated to attempt to split European countries when this was in its interests. The Iraq conflict is but the latest of a long string of such maneuvers. It is therefore all the more striking that the United States did not pursue a bilateral strategy in trade negotiations but has tended to give priority to the GATT/WTO. It is party to only one regional agreement—the North American Free Trade Area—and is pursuing another in the Free Trade Area of the Americas. Both are institutionless, multi-unilateral agreements. They have no mechanism for implementation other than transparency and dispute settlement. The United States also participates in the strange non-agreement that is the Asia Pacific Economic Forum (APEC), which resembles the G-7 process more than the WTO, reflecting the resistance of several major participants to any move towards greater integration. The US announcement after Cancun that it would pursue more bilateral agreements was significant because it represented a departure from past priorities.

The United States has certainly pursued these negotiations with vigor, yet the initial results have actually been quite ambiguous. The FTAA negotiations are in the process of being scaled back, possibly to meaninglessness. Negotiations with a group of Central American countries have been concluded, but only after Costa Rica initially refused to join and forced negotiations on key US demands concerning its insurance industry that the United States wanted to open up. Negotiations with Australia, in many respects the most compliant of partners, have recently been concluded but the United States was unable to achieve some of its key goals. It wanted to block practices of the Australian national health insurance system that keep pharmaceutical prices much lower than in the United States and it wanted investor-state dispute settlement for investment but achieved neither. The US-Australian FTA seems quite traditional in its focus on manufactured goods. Negotiations with South Korea are stymied over US insistence that it abandon existing preferences for its domestic audio-visual industries, an issue that was the proximate cause of the failure of the OECD negotiations for a Multilateral Agreement on Investment (MAI). The United States has also had to give up important aspects of investment agreements it concluded ten years ago with eight Central and Eastern European countries that are now acceding to the European Union. The eight accession countries did not hesitate when they were forced to choose between accession and the US BITs. The result is unprecedented recognition that US BITs are incompatible with internal EU law and, more importantly, with certain development priorities of the EU. The obvious question must be whether such agreements are suitable for any other country.

It is hard to view the results as anything but a confirmation that the multilateral trade regime is much more accommodating to US interests since the details that bedevil bilateral and regional agreements can better be swept aside in pursuit of a grand compromise. In addition in bilateral negotiations the impact of certain decisions are difficult to hide, bringing out domestic constituencies while the benefits are, by definition, much more modest for each of the parties.

The European Union response to Cancun has been more consistent with its previous approach. EU trade policy has long had a bias in favour of regional agreements, perhaps as a reflection of the EU's own experience. The EU has accepted the reality of Mercosur and is engaged in negotiations with it, whereas the United States has thus far preferred either bilateral agreements (with Chile) or the grand scheme of FTAA, an approach that must be interpreted as distaste for the process of integration in South America. The EU has even embedded its bilateral negotiations with Mediterranean countries in a quasi-regional framework. For obvious reasons there is little cohesion between the non-EU Mediterranean countries so that there is no negotiating partner for a regional agreement. Yet the EU has sought to create and maintain a broader framework for its bilateral negotiations. Finally the recent Cotonou Partnership Agreement (CPA) between the EU and a group of African, Caribbean and Pacific (ACP) countries includes provisions for the negotiation of Economic Partnership Agreements (EPAs) with regional groups of ACP countries, resulting in a strong emphasis on regional integration among them. The EU approach to these negotiations has generally been less confrontational than that of the United States.

In fact the EU is pursuing a vision of the global system that is markedly different from that of the United States. The US vision, embedded in much commentary and economic analysis, is actually quite traditional, drawing on 19th century concepts of sovereignty, with each country an individual actor in a "democracy of nations." In such a system there is only one country that can hope to get its way. The EU vision revolves around regional association. It has never been clearly articulated, presumably also to avoid direct confrontation with the US approach.

In addition to these developments involving the United States and the European Union there are a surprising number of developments in Asia and South America, involving the countries that were at the heart of the Cancun breakdown. In South America there is a growing movement to pull the countries of the region together under the umbrella of Mercosur. The obvious problem with this approach is the potential dominance of Brazil and it remains to be seen whether solutions can be found. In Asia, the emergence of

China has finally given impetus to the further integration of ASEAN and has resulted in the 10+1 negotiation involving ASEAN plus China. At the same time, the countries of South Asia have formalized their incipient regional trade regime.

These developments were dramatic enough to move the WTO last November to organize a symposium on Regionalism and the WTO. The problem is that there is now a serious mismatch between the assumptions that are built into the GATT/WTO agreements and what is happening in practice. The GATT has been effective because it is simple. It is built on the theory of comparative advantage, which allows negotiators to assume that any deal is better than no deal because everybody will benefit, by definition. The GATT's institutions are correspondingly simple: non-discrimination is circumscribed by the principles of MFN, national treatment and the achievement of a basic level of transparency. The implementation of the GATT/WTO rules is multi-unilateral in the sense that every member can, and does, interpret them independently. There is no mechanism for authoritative interpretation. Dispute settlement is available if one country feels that its rights are impaired by the interpretation another country has given the rules. Yet the enforcement mechanism for the decisions of the dispute settlement system is problematic. Countervailing measures are contrary to the most fundamental assumptions of the regime and large countries have shown that it is possible to game play the system for long periods of time. Countervailing measures are meaningless when small countries win disputes against large ones. The stark truth is that the institutional capabilities of the GATT/WTO are insufficient to meet the needs of a global economy.

The development of regional agreements is one response to the inadequacy of the GATT/WTO. What it is not is an issue of legal interpretation. GATT Art. XXIV has been largely inoperative, precisely because it has no enforcement mechanism. Indeed it has no implementation mechanism. In the absence of any such institutions, the political reality obtains that as long as the rule of consensus holds it will remain impossible to reject any bilateral or regional agreement under Art. XXIV. Changes can be induced in regional agreements only when their effects can be cast in the form of a traditional dispute, as happened in the bananas case—leading to replacement of the Lomé Agreement by the

Cotonou Partnership Agreement and the move to obtain a formal waiver from the Doha Ministerial Conference. Even in this instance the political rather than the legal process dominated.

The regional dynamic owes its vitality to two significant factors:

- In trade, geography matters
- In most other policy issues, geography matters even more

Geography in Trade

People trade first with their neighbors. Absent other factors, countries trade first with their neighbors. Neighbors are well known, so it is possible to judge when to trust them and when not, and transport and transaction costs are likely to be lowest for neighbors. Even within the European Union, where obstacles to trade have been dramatically reduced, a large proportion of all trade between countries occurs over a distance of 100kms or less. These simple facts tend to be obscured by all the talk of globalization. They are actually reinforced as barriers to trade are reduced because in a regional economy transaction costs fall and economies of scale apply at smaller volumes. Small and medium enterprises, the dominant force in any successful economy, can enter regional international markets.

In South America, the unrealized gains from regional trade are presumably very large, in particular between Chile, Argentina and Brazil. To understand the survival of Mercosur through the Brazilian devaluation and the Argentine crisis one must assume large benefits for the border region between Brazil and Argentina.

Similarly, significant benefits must be assumed to exist in the opening of borders in Asia, even though infrastructure is weak.

Africa's greatest disability is that it has few significant markets—a problem that is particularly acute for South Africa. Most African borders have been open to informal

commerce, so the available benefits from regional association are less dramatic in every respect. It remains to be seen whether the EPA process under Cotonou changes this logic.

It has been observed that some of the highest tariffs are currently maintained by developing countries that have not been forced by GATT/WTO rules to dismantle them. Whether reducing these tariffs towards all countries will be beneficial is not as clear as the likelihood that reductions towards other developing countries are likely to be so. This is a logic that cannot be accommodated by the multilateral trade regime but that regional agreements are indeed in a position to explore.

It is not widely appreciated that trade models tend to view countries as single points. In developed countries with highly evolved infrastructure that is an abstraction that may be acceptable. In developing countries, where coastal urban centers are closer to New York, Paris or Madrid than to the rural regions of their own countries, this abstraction risks being seriously misleading. Regional arrangements are again much more suited to capturing the opportunities for economic growth that global agreements are missing.

Geography in Other Matters

The debate about regional trade agreements tends to focus on the issues that are handled by the multilateral trading system and to miss the degree to which regional agreements are capable of addressing what might be called the policy agendas that interlock with the trade regime.

Perhaps the easiest way to approach these issues is through the concept of “distributed governance” and the trade regime. The reach of the trade regime has grown steadily, both internationally and behind national borders, without any significant change in the institutional capabilities of the WTO. It has become increasingly clear that the trade regime relies heavily on numerous other regimes to create the substantive rules and implementing institutions that are necessary to avoid debilitating trade disputes. This relationship has been codified in the case of standard setting organizations such as the

International Organization for Standardization (ISO) or the Alimentarius Commission. The relationship between the trade regime and the World Intellectual Property Organization (WIPO) is distorted by the fact that dispute settlement in the WTO is being used by proponents of IPR to implement rules that could not be made effective through WIPO. The relationship between the WTO and the so-called multilateral environmental agreements (MEAs) is unsettled, currently the subject of negotiations within the WTO (but not with the MEAs). Yet it is increasingly obvious that the rules established by the MEAs provide a legal framework that protects the WTO from environmental disputes. In some instances such as “domestically prohibited goods, the MEAs have been able to create an institutional framework where the GATT tried and failed. A pattern of institutional relationships is in the process of emerging that can best be described as distributed governance.

While some of the issues subject to distributed governance are as global as the WTO, for example climate change or marine pollution, others have significant regional variability that is difficult to capture in the WTO context. Environmental management in particular is subject to the forces of subsidiarity. For these issues, regional governance structures that include trade and related issues are clearly preferable. A significantly diversified international system of governance is called for, and regional (trade) agreements provide an attractive option. This becomes particularly clear when the economic policy agenda is expanded beyond trade in goods to trade in services, investment, or even competition. In all of these areas, rules must be applied in a manner that reflects local conditions, a requirement that is almost impossible to meet at the global level.

Conclusion

The Cancun Ministerial Conference has widely been described as a failure. It may yet come to be viewed as an essential step in finding the right balance in the WTO negotiating agenda and moving global governance forward. It is increasingly likely that negotiations on the Doha mandate will resume with a pared-down agenda, arguably a more focused agenda that lends itself to the peculiar institutional environment of the

WTO. At the same time, the process of regionalization is likely to continue, and may in time help to remove some of the pressures that currently impact the multilateral trade regime. Whether bilateral trade agreements have much to contribute still remains to be seen.