

THE RISE OF MEGA-TRADING BLOCS AND THEIR SYSTEMIC IMPLICATIONS

A paper presented by Ambassador Nathan Irumba, Chief Executive Director, SEATINI during the conference on mega-trading blocs and the failure of African trade organised by The Commonwealth Secretariat and the International Institute for Sustainable Development (IISD), 26-27 May 2015.

Introduction

The multilateral trading system (MTS), originally set up under the General Agreement on Tariffs and Trade (GATT) has since developed through a series of negotiations with the last being the Uruguay Round that led to the creation of the World Trade Organisation (WTO) in 1995. The WTO/GATT rules and agreements provide a framework through which member countries conduct trade and other commercial relations among themselves. This has contributed to a measure of stability and predictability as contrasted to an alternative scenario in which arrangements are dominated by unilateral and bilateral arrangements.

The WTO launched the Doha Round of trade negotiations in 2001 with ambitious and complex agenda which included inter alia areas covering Agriculture, Non-Agricultural Market Access (NAMA), Special and Differential Treatment (S&DT), Services, Trade facilitation etc, which initially was envisaged to be concluded in 2005.

Fifteen years after its launch, the Doha Round remains locked in a strategic impasse arising from differences between developed and developing countries over what should be its development outcomes and agriculture on one hand and the level of market access issues in industrial products and opening in services, on the other. This has given rise to tensions between developed and developing countries with the former pressing for the WTO to move to the so called 21st century issues and the latter insisting that we must complete the 20th century issues such as reform of agriculture before considering the new issues.

It is partly because of this impasse that developed countries especially the United States (US) and European Union (EU) are currently driving negotiations on what is now known as the Mega-Trading Blocs i.e. the Trans-Pacific Partnership (TPP), which incorporates some developing countries and Trans-Atlantic Trade and Investment Partnership (TTIP) covering the US and the EU.

This envisaged Preferential Trading Areas (FTAs) have been dubbed as “Mega” not only because of the participation of the EU and the US as global trading heavy weights, but also because they are aimed at redefining the existing of international trade rules and the attendant obligations which go beyond the WTO rules and which could not be secured under the Doha Agenda. The developed countries have been pressing for “new approaches” within the Doha Round which many developing countries perceived as a precursor to abandoning the Doha mandate in favour of plurilaterals or regional trade arrangements.

In this session, we are expected to discuss the context of these developments and consider the main causes/drivers for the rise of these mega-trading blocs, how they will reshape “the rules of the game” for world trade as well as their implications for the future of the multilateral trading system.

Functions of the WTO in the trading system

Before we discuss the above, I believe it is important to recall the basic functions of the WTO. The agreement establishing the organisation provides that the WTO Shall;

1. Facilitation the implementation, administration and operation of the Uruguay Round legal instruments and of any new agreements that may be negotiated in the future (Article III: I).
2. Provide a forum for further negotiations among member countries on matters covered by the agreements, on new issues falling within its mandate and on further liberalization of trade (Article III:2)
3. Be responsible for the settlement of difference and disputes among its member countries (Article III:3)
4. Be responsible for carrying out periodic reviews of the trade policies of its member countries (Article III:4)

The launch of the Doha Round was part and parcel of the WTO playing its role as a negotiating forum for elaborating multilateral rules affecting trade and remedying the defects in the existing arrangements (Article III:2)

With the conclusion of the Uruguay Round and the strengthened MTS, there was an expectation that exceptions to multilateralism, such as regional trade agreements, even though legally covered by the WTO under certain conditions, would either become less of an alternative policy option for the countries or will need to be adapted and conducted under such a manner as to become outward-oriented, not inward-looking and thus constitute building blocks for the new multilateralism ushered in by the WTO (UNCTAD, 2005).

As pointed out in the 2011 World Trade Report, the Uruguay Round (1986-1994), coincided with a period of a growing regionalism and FTAs which addressed several issues including services and Intellectual property rights going beyond the remit of GATT. The Doha Round negotiation period has not diminished the proliferation of these FTAs - there are now more than four hundred of such arrangements in the existences and we are now witnessing the evolution of mega-trading blocs.

The Emergence of Mega-Trading Blocks

The rationale of FTAs

Generally the reason given for establishing PTAs or FTAs include, inter alia; serving political and strategic objectives of countries, going further and faster in the direction of integration that can be achieved in WTO, fear of exclusion as competing countries secure market access to markets of their interest, as

insurance policy against future protectionism and as signalling device to attracting Foreign Direct Investments etc. The reasons for establishing the mega-trading blocs and the emergence of TPP, TTIP include the above and go beyond that.

In the world economic forum report on Game-changer or costly distractions for the world trading system, *Susan Schwab and Karan Bhatia* point out that the motivation behind any given mega-regional depends on the nature of the agreement being negotiated, on the particular countries involved, and often on the point in time the decision is being made to engage or close the deal. While the decision to launch a mega-trade agreement may be informed by geopolitical considerations, the ultimate success and the long term viability of the arrangement depends on strong economic and commercial considerations.

The TPP which encompasses a number of East Asian North and South American countries aims at achieving extensive liberalisation both of goods and services and entailing comprehensive coverage of trade in services, investments, government procurement, non tariff measures and many regulatory topics which would constitute “a land mark, 21st-century trade agreement, setting a new standard for global trade and incorporating next-generations issues”. As tariffs are not a major impediment to trade between Europe and USA, the Transatlantic Trade and Investment Partnership focus on trade liberalisation behind the borders and other non tariff barriers as well as harmonisation of regulations and standards governing services, investment and public procurement.

Here below are some of the reasons why TPP and TTIP:

Frustration with lack of progress in the Doha Round under the auspices of WTO - When the Doha Round was launched, in 2001, the major countries namely the USA, EU and the other OECD countries expected the Round to address and develop WTO disciplines on the Singapore issues namely, investment, competition policy, government procurement, and trade facilitations. They were greatly disappointed when the developed countries refused to play ball in this regard at the Cancun ministerial meeting and subsequently apart from trade facilitation, these issues were dropped from the Doha Work programme. These countries have had high ambitions in developing the modalities for reduction of tariffs in industrial products as well as services which would significantly offer them market access especially in the markets of the emerging countries without them making significant concessions with regard to agricultural subsidies. This failure has been attributed to emergence of the G.20 which includes the Brazil, China, India and South Africa who neutralised the ability of the QUAD countries to solely determine the agenda as well as the decisions of WTO.

Marck Thiriwell (2013) states that the rising importance of emerging economies as global powers and the consequent arrival of new trading hubs and patterns of international exchange. As well as providing significant momentum to global trade growth overall, this development has also produced a dramatic shifts in the balance of power in international trade negotiations by giving a much greater weight to emerging economies, and has simultaneously increased the number of 'serious players' in global trade negotiations from around ten at the time of the Uruguay Round to perhaps 25 now"

This has prompted them to seek other alternatives including the development of Mega-trading blocs as a way of regaining the initiative and neutralising the emerging countries. This approach is not new. It will be recalled that at the time of Uruguay Round, the Reagan administration signalled their willingness to advance their interest through bilateral arrangements where multilateral activities were perceived to be ineffective (Jackson .H, 1997). When addressing a senate Finance Committee in November 1985, Ambassador Yeutter of the US stated

“We simply cannot have a handful of nations with less than 5 percent of world trade dictating the international trading destiny of nations which conduct 95 percent or more of international commerce in this world..

We would still like to go the GATT route with a new round... that is the preferred course of action; but if those discussions bog down Geneva 2 weeks from now to where it becomes evident that a new GATT round is not likely to occur, or simply could not occur with those issues included, then we would prefer to pass on a GATT round. In our judgement, this is not a negotiable issue. Services, in particular, must be in the round or we are just not going to have a new GATT round from the US standpoint, and we will have to confront those issues in a different way-plurilaterally or multilaterally.”

While the language might have changed, this seems to be the approach the US representatives have taken in the Doha Round of trade negotiations following the impasse.

It is apparent that in an effort to recover what could be termed as “the lost power” in trade negotiations, traditionally powerful members like the US and EU are moving to regional negotiating forums, including the mega-trading blocs, where they can have more space to manoeuvre the multilateral agenda in their favour.

Strategic considerations; the drivers of these mega trading blocs include both economic and strategic considerations. According to the US Congressional Research Service report (March 2015), maintaining American influence in Asia, amidst growing Chinese assertiveness and influence in the region was perhaps one of the most influencing reasons behind the US to engage in TPP negotiations. The report observes that the TPP has potential implications beyond U.S. economic interests in the Asia-Pacific. The region is increasingly seen as being of vital strategic importance to the United States. Throughout the post-World War II period, the region has served as an anchor of U.S. strategic relationships, first in the containment of communism and more recently as a counterweight to the rise of China. The report also notes that the US National Security Advisor Thomas Donilon on March 2013 stated that

“The centre piece of our economic rebalancing is the Trans-Pacific Partnership (TPP)-a high standard agreement the United States is crafting with Asia-Pacific economies from Chile and Peru to New Zealand and Singapore.[...] We always envisioned the TPP as a growing platform for regional economic integration.” –Thomas Donilon, U.S. National Security Adviser, March 11, 2013.

Response to the economic crisis; with regard to TTIP, stimulating economic growth in an era of tight budgets was another driver. The US and EU are still recovering from the 2007/08 global financial and

economic crisis which had devastating effects on both economies with attendant high unemployment. TTIP therefore presents an opportunity to give an economic boost to industrial growth in on both sides of the Atlantic at a point when the two economies face financial constraints which affects their ability to effectively increase financial stimulus packages or introduce more monetary stimulus. While low tariffs already apply on trans-Atlantic trade and significant FDI already exists, removing basic barriers at the border and eliminating regulatory friction promises to leave billions of dollars/euros in the pockets of small, medium-sized and large importing and exporting enterprises.

Another aspect of the TTIP is that they expect at a later stage that the high standards and regulations they have harmonised with regard to behind the border issues will be multilateralised.

The emergence global value chains is one of the considerations motivating mega-trading blocs. According to Pascal Lamy, in until not long ago, we thought of products in terms of a single national origin, bearing a label saying “made in China” or “made in Germany”. The expansion over the last two decades or so of global value chains means that most products are assembled with inputs from many countries. In other words, today’s goods are increasingly “made in the world”. Trade in intermediate goods-a proxy for global value chain production-now comprises close to 60 per cent of total trade in goods, and continues to be a dynamic sector in international trade. The main constraints for the global value chains are not tariffs measures and this explains why behind the boarder measures have taken a pride of place in the mega-trading blocs negotiations.

Susan Schwab and Karan Bhatia outlines the major reasons for mega-regionals to include among others the following;

- 1) Achieving higher ambition agreements.
- 2) Addressing new issues and creating potential precedents for future multilateral agreements.
- 3) Improving competitiveness, keeping the bicycle moving forward.
- 4) Fear of being locked out which includes participating in writing rules now that would have been difficult to accede to later.
- 5) Protecting existing preferential trade arrangements.

As indicated above, they also point out “mega-regionals symbolise the will and determination of the US and EU to keep a decisive say on the rules applicable to trade and investment in the 21st century, many analysts point out that the TTIP and TPP will ensure that the US and Europe remain “standard makers, rather than standard takers” in the global economy, subsequently ensuring that producers worldwide continue to gravitate towards joint USEU standards, and that they would set the international “rules of the road” (Bollyky and Bradford, 2013; Kaeser, 2014).” We agree.

The Systemic Impacts of mega-trading blocs

The emergence of mega-trading blocs being forums for negotiation of discipline has clear systemic implications for WTO. As indicated above, the WTO is expected to be forum for continued negotiations.

Richard Baldwin (2014, World Economic Forum Report) sees both bad news and good news for the world trade system. He notes that the mega-trading blocs could be used to tidy up and build on the multilateral trading system but the bad news is that the agreements undermine trade governance and the functions of WTO as explained.

Bahgwati (2005) observed that the bilateral and less-than-bilateral FTAs are therefore dangerous, not merely in constituting a threat to the support for multilateralism that will not indulge the rich-country lobbies demands for inserting trade-unrelated demands into trade negotiations, but also because they multiply preferences worldwide and create a “spaghetti bowl” of multiple tariffs depending on the source of a product and, in turn, a flood of rules of origin to determine which source is to be assigned to a product.

The basic WTO trade norms are accepted and respected almost universally but this emanates from the way they were promulgated i.e. in multilateral negotiations where the GATT/WTO principle of consensus and they draw their legitimacy from that very principle. However, lacking the legitimacy that comes from multilateralism and consensus, it is not at all clear that the new norms (mega-trading blocs) will be universally respected or at least accepted as quoted below;

“For example, some emerging markets – China, India and Brazil – are large enough to attract foreign investment and technology without signing deep RTAs, and they have so far shunned them. China in particular might decide to reject the rules – creating something like a “Cold War of deeper trade disciplines”.

The relevance as well as effectiveness of dispute settlement mechanism under the WTO will also be threatened by mega-trading blocs. Since one of the issues under negotiation of these mega-trading blocs is a mechanism to settle trade disputes, subjecting more than half of world trade to a different juridical process rather than the one provide by the WTO through a deal between these countries would greatly undermine the relevance of a multilateral process to address the disputes. Already under existing bilateral investment agreements which gives recourse to corporations to sue states, there is discontent about the Investor-State Dispute Settlement (ISDS) mechanism and in many of these bilateral arrangements, these are instead being enhanced.

On the whole, the agenda for mega-trading blocs negotiations has been set by the major powers and mostly deal with issues of specific interest to them, which on the whole constrains the policy space of developing countries of developing countries in areas of investment, government procurement, intellectual property etc. there is an asymmetry of power in this, which makes developing countries

appear like supplicants which does not appear at the WTO. They have been careful to leave out issues like agriculture which are of interest to developing countries in the multilateral trading system.

As Peter Drapper et al observed in ECIPE occasional Paper (2/2004), these mega-regionals have the potential to reshape the global trading system. On the one hand, if successful they will establish new global norms and regulations that may find their way back into the WTO at some point in the future, and also into reciprocal FTAs with non-parties. Under this scenario developing countries not participating in the formulation of these rules in the mega-regionals will be confronted by a changed regulatory landscape; one not necessarily in keeping with their interests and capacities... If other significant developing countries sign on to these norms under the TPP especially, it will be difficult for outsiders to resist the regulatory wave.

Conclusion

In conclusion, the rise of mega-trading blocs has been driven by both economic and strategic interests. The failure of developed countries to secure a deal in their favour at the multilateral level has made them to focus on securing a regional deal that guarantees market access while at the same time countering the ever increasing influence of China in global trade and particularly in Asia, which literally threatens the US dominance in the region, what has been upheld since the post war era. The invariably involve WTO plus obligations.

The systemic impacts of these meg-trading blocs could be seen in two ways; 1) as building the MTS in simple terms and 1) undermining the WTO functions and in this process threatening the MTS itself. As Lamy said, as an international community, we must continue to fight protectionism, but in the WTO in particular, we must fight policy fragmentation.

Africa's priority objectives as enunciated by its heads of states are the promotion of regional integration and intra-African trade as a building bloc for our participation in the global system. This ECA as indicated requires policy space. While following up and monitoring the evolution of mega-trading blocs, we should be careful not be entangled in a cobweb free trade arrangements whose effects it will reduce our policy space for regional integration and industrial development.

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