

The EU has preferential trade agreements with most of the members of the World Trade Organization (WTO). It has been argued that this tendency to liberalize trade on a bilateral basis is a ‘stumbling block’ for multilateral negotiations. Do you agree? Discuss.

Introduction

The issue which came to be known as the “stepping stone vs stumbling block” debate on the impact of regional and preferential trade agreements on multilateral liberalization, is still a hot topic today. For many economists it seems clear that trade blocs hinder multilateral tariff cutting, although some such as Fink and Jansen (2009) argue that they can be used as a building block for multilateral liberalization. In order to control the effects of regional trade agreements (RTAs), the World Trade Organization (WTO) established Committee on Regional Trade Agreements (CRTA) in 1996. Since then, it seems that the proliferation of RTAs has continued undeterred. As of 10 January 2013, the GATT/WTO has been notified of 546 RTAs, of which 354 were in force (WTO, 2013). Following the shortcomings of the Doha Development agenda, which is the current trade-negotiation round of the WTO, many countries are considering bilateral and regional trade liberalization with increased interest, seeking to expand their trade. As Christine Lagard said during a speech given at the Free Trade Agreement Conference at Bond University in 2007: “Even countries like the United States, India and Australia, which have been major proponents of the multilateral system, are now opting for regional dialogues” (Buckley, Io Lo & Boulle, 2008, p.5).

The purpose of this paper is to review the various arguments in an attempt to find out if preferential trade agreements are a hindrance in the way of multilateral negotiations and free-trade. In Section I, I will look at the arguments supporting the negative view on the impact of bilateral trade-agreements on multilateral trade liberalization. In Section II, I will present the counterarguments of theoreticians claiming that multilateralism and bilateralism are interconnected

and that preferential trade negotiations can have a positive impact on global economic liberalization, as well as the conclusions of an empirical analysis of data on the correlation between preferential trade agreements and most favoured nation clauses in multilateral trade. In section III, I will conclude that there is no definite answer to the building block vs stumbling block question regarding bilateral trade agreements, and that the WTO and EU should base their future efforts for the promotion of free-trade on a solid understanding of the relationship between international economic and trade integration and multilateral liberalization, and learn how to use regionalism as a stepping stone to achieve globalism.

I. Arguments in favor of the ‘stumbling block’ theory

According to proponents of the neo-classical doctrine promoting the significance of free trade for advancing the international labor division, regionalization is a “stumbling block” in the way of multilateral liberalization. In this view, any restriction of the flow of goods, people and capital between two economies is detrimental to general economic welfare. Although RTAs are permitted under Article XXIV, many believe that this goes directly against the goals of the GATT/WTO and that it contradicts Article I, which embodies the main principles of the world trading system. Furthermore, Article XXIV only permits the formation of international economic integrations as long as they follow principles of non-discrimination, transparency and reciprocity and remove all trade restrictions between members, but often these guidelines are interpreted quite loosely, and as a result no trading agreement has been rejected by GATT so far (Brkić & Efendić, 2005, p.7).

Despite the proliferation of free trade agreements (FTAs), which shows that there are clear incentives among WTO members to enter into them, they can present problems both to the WTO as a whole and its individual members. According to Meredith Kolsky Lewis (2008, p.24), FTAs divert resources and attention away from multilateral liberalization efforts under the WTO

framework, as many countries lack the resources required to focus on both types of negotiation. While bilateral agreements do produce reductions of tariffs, “chipping away at the overall wall of impediments”, certain issues can only be solved multilaterally, such as problems relating to inconsistent rules of origin, regulation of anti-dumping and the problems of agricultural subsidies.

What is more, to the extent that FTAs create pathways for liberalization in sensitive sectors, it will become difficult to convince members to liberalize these sectors in the context of the WTO. Focusing on bilateral expansion means that there are fewer incentives which can be provided during negotiations to get members to make the remaining difficult concessions. Adding to all this, the large number of FTAs, coupled with preferential treatment granted under the Enabling Clause, has blurred the significance of a core principle of the WTO, namely the most-favoured-nation (MFN) treatment. Additional challenges stem from the development of FTAs with TRIPS-plus provisions and other features that divert attention from WTO objectives. The more FTAs there are providing intellectual property protection in excess of that mandated by the TRIPS agreement, the more difficult it will become for the WTO to reach a consensus on issues of flexibility (Kolsky Lewis, 2008, p.24).

II. Counterarguments: Bilateralism, a possible ‘stepping stone’ towards globalism?

Over the past decades, trade liberalization has been happening at all levels, although at an uneven pace. Following the Second World War, various international economic organizations and specialized agencies have sprung up, including GATT, the Organisation for Economic Co-operation and Development (OECD) and the United Nations Conference on Trade and Development (UNCTAD). Since then, multilateralism has become a primary goal in international economic relations, although there are many instances of the process derogation in practice. As noted by Brkić and Efendić: “The USA was its main advocate until the early 1990s; the U.S. initiative was focused

on multilateralism and GATT, while the European one was aimed at regionalism and [the] European Community” (Brkić & Efendić, 2005, p.2).

Some economists argue that bilateral agreements are a natural intermediary phase towards global integration, which cannot simply happen overnight. In this case, regional trade agreements would be only a bypass towards the creation of a unified world market. This attitude is evident in this statement by Vlatko Mileta: “What could not be achieved in global relations was achieved within regions, through multilateralization of the European economic area. These achievements were later followed by many countries in other world regions, in their mutual relations practice. Practically, we thus got regional multilateralisms” (Vlatko Mileta, quoted by Brkić & Efendić, 2005, p.3). Despite the current shortcomings of the GATT/WTO system, recent research has shown that bilateralism is consistent with global liberalization, since many members of regional trade agreements have expressed their willingness to increase trade with non-members after they have intensified mutual trade. The network of preferential trade agreements developed by the EU - in itself a PTA and one of the largest integrations in the modern world - after it intensified intra-regional trade strongly supports the previous claim. The EU has made a number of agreements liberalizing its exchange with third countries at different levels (Brkić & Efendić, 2005, p.15).

Another example of the above described connections between multilateral and regional processes also comes from the old continent: the liberalization of regional exchange conducted within the framework of the Stability Pact for Southeast Europe. As Brkić and Efendić write: “By signing the Memorandum of Understanding on Trade Liberalization and Facilitation (MoU) in June 2001, eight countries - Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FR Yugoslavia (Serbia and Montenegro), FYR Macedonia, Moldova, and Romania - took the commitment to create a network of bilateral agreements on free trading in the region by the end of 2002, aiming to create a regional free trade area in the SEE” (Brkić & Efendić, 2005, pp.5-6).

Reasons to be optimistic are also coming from the empirical research on the relation between bilateralism and trade tariffs. If regional trade liberalization is an impediment for

multilateralization, that means that preferential (PTA) and most-favoured-nation (MFN) tariffs are substitutes, and we should expect to see that nations that engaged in high levels of regional tariff cutting applied low MFN tariff cuts. What is more, the tariff lines where one nation has cut tariffs most preferentially should be the sectors with the lowest MFN tariff cuts. With these facts in mind, Baldwin and Seghezza look at the data on tariff lines for the world's largest traders, in order to show if there is a positive or negative correlation between MFN and preferential tariffs (Baldwin & Seghezza, 2007, p.2). The data, which is collected from the TRAINS database accessed through WITS for the year 2005, is gathered at the most detailed level possible, estimating the tariff line up to ten digits in HS system,. Because they do not respect the same political economy logic when setting tariffs, large oil exporters such as Saudi Arabia have been excluded from the study, as well as countries which are not members of the WTO (Baldwin & Seghezza, 2007, p.7).

The data seems to show that MFN and preferential tariffs are complements, not substitutes, because the margins of preferences tend to be low or zero for products where nations apply high MFN tariffs. Baldwin and Seghezza interpret this as showing that regional trade agreements are neither stumbling blocks nor building blocks (Baldwin & Seghezza, 2007, p.1). Rather, the political and economic environment produces factors that influence the selection of both MFN and PTA tariffs. Specifically, it is a third factor, the strength of sectoral vested interests, that simultaneously determines MFN and PTA tariffs. As Baldwin and Seghezza write: “In the nations and sectors where a political consensus has been marshalled behind liberal trade policies, tariffs were cut on both an MFN and preferential basis. In other nations and/or sectors where there is a political consensus for protection, tariffs are high both multilaterally and preferentially.”(Baldwin & Seghezza, 2007, p.12).

III. Conclusion

In Section I, I looked at the various arguments supporting the claim that bilateral agreements can be harmful and slow down multilateral negotiations. In Section II, I analysed the counterarguments and presented empirical evidence which indicates a more interdependent relationship between international integration and multilateral liberalization. It is clear from the arguments presented in this paper that, while bilateral agreements can sometimes be “stumbling blocks” in the way of wide-scale trade liberalization, they are also an intrinsic component of the entire liberalization process, and can also have a positive correlation with multilateralism. Even if FTAs are the second best choice for the WTO, this does not imply that they cannot be used as a stepping stone to achieve the first best, and further multilateral negotiations. In conclusion, in lack of a clear answer in the stumbling block vs building block debate, the WTO and EU, as well as other important international institutions, should refrain from using this dichotomy which opposes bilateralism and multilateralism and seek to understand how these two perspectives correlate, in order to promote fair-trade and the welfare of the global economy.

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