



THE REVIVAL OF TRADE REGIONALISM: DETERMINANTS, PATTERNS AND IMPLICATIONS

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Abstract

In recent years, members of the World Trade Organization (WTO) have increasingly resorted to preferential trade agreements (PTAs) as a means to further the market-opening and rule-making agenda. While PTAs are not new to the WTO, they are spreading at an unprecedented rate. Moreover, twenty-first century PTAs are qualitatively different from previous PTAs in their scope, composition, depth and consequences. This paper aims to identify the main factors behind the recent surge in regionalism and also highlight some potential implications for the multilateral trading system. According to our findings, if successfully concluded, the new PTAs will have important systemic implications. Due to further fragmentation of the world trading system and increasing transaction costs, the new regionalism would lead to scattering rather than levelling the playing field, which is economically undesirable for the whole trading community. However, the harmful effects could be mitigated via completing the multilateral Doha Round talks.

Keywords

Preferential trade agreements (PTAs), trade policy, trade negotiations, world trading system, World Trade Organization (WTO), Doha Round

1. Introduction

The recent years have witnessed a remarkable revival of the regional trade agenda, further enhancing the trend of continual growth in the number of preferential trade arrangements (PTAs)¹ concluded outside the multilateral trading system governed by the World Trade Organization (WTO).

The fresh impetus to regionalism worldwide manifests itself not only in the steep rise in the number of new bilateral and regional initiatives, but also their scale and pace. Particularly visible is this trend since 2013, when a whole series of new PTA negotiations were launched by WTO members accounting for large shares of world GDP and global trade and investment. This includes several large regional and bilateral PTAs, the so-called “mega-PTAs”, initiated by the major trading powers. Remarkable is also the pace of these initiatives, namely: (1) the start of negotiations, in March 2013, on an *EU-Japan free trade agreement*; (2) the joining by Japan, in March 2013, of the negotiations on the *Trans-Pacific Partnership Agreement (TPP)*, involving 12 developed and emerging countries in Asia-Pacific; and (3) the launch of negotiations, in July 2013,

on a *Trans-Atlantic Trade and Investment Partnership (TTIP)* between the US and EU.

Moreover, the image of prominent WTO members being strongly involved in the regional agenda should be completed with two further undertakings in 2013, which although not related to PTAs per se, are of particular relevance given the large share in global trade and investment flows of the partners involved, i.e.: (1) the launch of plurilateral negotiations, in March 2013, on a new *Trade in Services Agreement (TISA)* among 23 WTO members (including the EU); and (2) the start of negotiations, in November 2013, on an *EU-China investment agreement*, followed by similar negotiations between the EU and Myanmar/Burma since March 2014.

The unabated push towards regionalism is unlikely to be stemmed as a number of agreements have been signed and will soon enter into force (such as the EU-Canada, EU-Singapore, China-Switzerland, and Australia-South Korea agreements), or are being negotiated, most of them between partners in different geographical regions.

PTA activity has been particularly robust among the WTO membership over the past decade, with the number of PTAs in force increasing exponentially. According to WTO figures, on average 14 PTAs have entered into force annually since 2003 (WTO, 2014). Unlike unilateral preferential trade agreements, PTAs are reciprocal trade agreements between two or more

¹ Throughout this contribution the term *preferential trade agreement* (PTA) refers to customs unions, free trade agreements, and other interim arrangements leading to one of these forms of integration, according to the provisions of GATT Article XXIV and GATS Article V. Its connotation is similar to the term *regional trade agreement* used by the WTO, both being equally usual in the literature.

partners, and WTO members are bound to notify the agreements in which they participate.

As of April 2015, some 612 notifications of PTAs (counting goods, services and accessions separately) had been received by the GATT/WTO, of which 406 were in force. These WTO figures correspond to 449 physical RTAs (counting goods, services and accessions together), of which 262 are currently in force (90% representing free trade agreements and 10% customs unions (WTO, 2015). The WTO Secretariat furthermore estimates that there are almost 100 agreements in force but that have not been notified to the WTO (WTO, 2014).

The number of PTAs has much faster increased in the WTO system than in that administered by its predecessor, the General Agreement on Tariffs and Trade (GATT). In the period 1948-1994, the GATT received 124 notifications of PTAs (relating to trade in goods), of which 50 were active in 1995. However, since the creation of the WTO, over 400 additional PTAs covering trade in goods or services have been notified (WTO, 2015). Several reasons account for the stronger upward trend in regionalism in the context of the WTO as compared to the GATT, which pertain mainly to important changes that occurred inside the multilateral system following the creation of the WTO, and which we refer to as the *systemic drivers* of trade regionalism.

2. The WTO and the systemic drivers of PTAs

PTAs are not new to the GATT/WTO, and nor are the mega-regional agreements under negotiation. The proliferation of these agreements started already in the 90s and has intensified since then constantly, especially after the establishment of the WTO in 1995. Preferential trade deals are permitted under the GATT/WTO system as derogation from the most favoured nation clause, which lies at the foundation of the multilateral trading system.

Not even mega-regional agreements are new, as their predecessors date back to the mid-1990s. Relevant examples are the *European Single Market*, which has been largely completed at the beginning of 1993, and the *North American Free Trade Agreement (NAFTA)* between Canada, Mexico and the US, which came into force one year prior to the establishment of the WTO, not to mention the *Free Trade Area of the Americas (FTAA)*, the project launched in 1994, but failed in 2005, which sought to tie 34 economies in the Western Hemisphere into a single economic bloc. All these initiatives had in common the pursuit of a much deeper regional integration among the partner countries than the global integration provided for among WTO members (Koopman and Wittig, 2014). They also offered models to further extend and refine not only the

original WTO rules and disciplines, but also those embedded in the PTAs concluded later.

It follows, that the new mega-PTAs such as the *Transpacific Partnership (TPP)* currently under negotiation among 12 developed and emerging countries in Asia-Pacific, or the bilateral EU-US *Transatlantic Trade and Investment Partnership (TTIP)* have to be perceived, first and foremost, as the continuation of a trend in regional cooperation that dates back to the mid-1990s, with the US and EU as its main promoters. As such, trade regionalism appears to be a phenomenon embedded in the multilateral trading system itself. Accordingly, the fresh impetus to regionalism worldwide has to be seen as a shift in focus rather than a fundamental course change. And the main factors underlying this shift have to be sought in the structural transformations that have marked the multilateral trading system and the WTO itself over the last decade in the wider context of the changing global political and economic environment.

According to the Marrakesh Agreement on the establishment of the WTO as a result of the Uruguay Round (1986-1994), the organization fulfills five basic functions, namely, it provides for: (1) a set of rules designed to govern the conduct of international trade; (2) a forum for negotiating trade liberalization; (3) a trade dispute settlement mechanism; (4) transparency of trade relations; and (5) coherence in global economic policy making. By virtue of these functions and the whole body of multilateral trade agreements that is administered by the WTO, the organization lies at the heart of the global trading system and has a central role in global trade governance. And precisely the WTO's centrality is at stake when it comes to discuss the outstanding surge in PTAs concluded outside its remit.

Strong global trade growth in the years following the creation of the WTO, that lasted until the outbreak of the financial crisis, has been accompanied by sweeping structural changes in the spheres of international trade and industrial organization, driven by rapid advances in information and communication technologies, but also by market opening worldwide. As a result, new actors and new patterns of trade have emerged, and important changes have occurred in the hierarchy of traders, in the geographical orientation and structure of trade, and in its very nature. In this context, two developments stand out for their major consequences for global trade and global governance mechanisms, namely: (1) the rise of emerging economies and the shift in economic power and influence within the world economy; and (2) the rapid expansion of global production networks or global value chains (GVCs), which combine traditional trade in goods with services, foreign direct investment (FDI) and knowledge – known also as "supply-chain trade" or "21st century trade" (Baldwin, 2012).

The challenges arising from these economic and geopolitical developments constitute – in our opinion – the major *systemic factors* that are driving the current surge in trade regionalism, with which the WTO will have to cope. Indeed, the organization has experienced important transformations in terms of both composition and issues on its trade agenda, and not least geopolitically. Its membership expanded to 161, accounting together for 98% of world trade. The continual expansion of WTO membership and the integration into the multilateral trading system of a number of large emerging economies (e.g. China, Russia etc.) have radically changed the structure of the organization, hindering consensus-based decision making, reducing the effectiveness of its activity and affecting the conduct of multilateral negotiations. Besides, trade policies and trade agreements have increased in complexity, since the very nature of trade barriers has evolved. Nowadays, trade deals are no longer confined to negotiating just the reduction of tariffs, but also non-tariff barriers and behind-the-border regulations, which have gained enormous importance but are more difficult to tackle (Lamy, 2013).

Hence, the first round of multilateral trade negotiations hosted by the WTO – the Doha Round, launched in 2001 – has evolved under much more complex and difficult circumstances than similar rounds of negotiations under the auspices of the GATT. So, no wonder that the round could not be completed till now, though the initial deadline was set for 2005. Moreover, the Doha Round negotiations practically stalled in 2008 over a major divide between developed and developing countries, and with this impasse two of the WTO's central functions have been also blocked, namely those responsible for market-opening and developing new trade rules and disciplines, respectively. Therefore, the WTO rule-book could not be adjusted so as to keep pace with the dramatic changes that have marked the global trade landscape over the last decades. Basically, the bulk of these rules remained stuck in the mid-90s when they were negotiated and agreed as an outcome of the Uruguay Round. Under these circumstances, the market-opening and rule-making agenda required by 21st century trade shifted increasingly towards PTAs concluded outside the WTO.

Undoubtedly, lack of progress in the Doha Round has increasingly reinforced the perception that decision-making at the multilateral level is inefficient. Indeed, for the private sector both in developed and developing countries trade liberalization and rule-making via PTAs has proven to be more effective than multilaterally, the latter being seen as a cumbersome and too lengthy undertaking, and also unpredictable and overly politicized. But it is also true that the growing interest of major players in global trade in finding solutions for

regulating and liberalizing markets outside the WTO has diverted substantial energies from the multilateral negotiations, by channeling them towards PTAs. And not least, opening trade and devising new multilateral rules has been further affected by the biggest economic crisis since the 1930s, which distracted attention from the global trade agenda and spurred the promotion of defensive trade policies and even protectionist actions worldwide. It was not until the Ninth WTO Ministerial Conference in Bali (Indonesia), in December 2013, that a window of opportunity arose for overcoming the deadlock in multilateral talks and finalizing the Doha Round (Ghibuțiu, 2015).

3. Patterns and economic relevance of the twenty-first century PTAs

Like agreements in force, most new PTA negotiations are bilateral. Among the key bilateral negotiations in terms of the parties' share in world trade rank: the *TTIP* between the EU and US, EU-Japan, EU-India, EU-MERCOSUR, as well as Australia-China, Canada-South Korea, and Canada-India. However, a more recent development relates to establishing plurilateral agreements or consolidating existing bilateral agreements among a group of members, such as the *Trans-Pacific Partnership (TPP) Agreement*, currently negotiated between 12 parties, including the US and a number of American and Asian states, and the *Regional Comprehensive Economic Partnership Agreement (RCEP)*, aiming to harmonize existing bilateral agreements between the 10 ASEAN members and 6 other WTO members (Australia, China, India, Japan, South Korea, and New Zealand) (WTO, 2014).

The numerical proliferation of PTAs is only one facet of the process of greater integration of the world economy and closer interdependencies among economies. Along with their growing number, PTAs increasingly also take the form of deeper integration. Their major focus is regulatory behind-the-border barriers to trade rather than only tariff measures at the border. In this regard, the new PTAs go well beyond existing provisions in the WTO and even previous PTAs, striving to promote deep integration between members. In other words, they aim at high-standard integration through WTO-plus or WTO-extra provisions on regulatory measures, such as technical regulations, standards, sanitary and phytosanitary regulations, services, investment, intellectual property, state aid, public procurement, competition policy, environment, and labour market regulations (UN/DESA, 2014). Especially the mega-PTAs, such as the *TPP*, *TTIP* and *RCEP*, differ qualitatively from previous agreements in their size, depth, as they are generally drawing on a template developed by major players and are aimed at deep liberalization and high-standard, cutting-edge

regulatory harmonization that covers an increasing share of world trade (UN/DESA, 2015).

As a result, the international trading system is regulated not only by multilateral WTO rules and disciplines, but also a growing number of PTAs, most of which represent deeper trade deals that address rules beyond traditional tariffs or traditional preferential access. Consequently, the share of world trade covered by PTAs is increasing continually. As of 2012, nearly 60% of trade in developed countries has been covered by some PTAs, and each developed country had preferential access to an average of 23 countries in the same year (UNCTAD, 2013). Obviously, these figures are going to substantially increase due the effects of the plethora of new PTAs, including the mega-PTAs launched in 2013 by countries with considerable weight in global trade and investment.

4. The economic and geopolitical drivers of PTAs

Beyond the *systemic factors* favouring the proliferation of trade regionalism, which are associated with the multilateral trading system, the conclusion of PTAs is mainly driven by economic and commercial motivations.

The most obvious reason for pursuing trade agreements is to achieve improved market access for exports of goods and services and FDI. Among the traditional motives of the public and private sector for using PTAs to expand access to international markets include, are: the search for growth markets, diversification of markets and risk, economies of scale, the enhancement of competitiveness, export-led growth, insertion and/or increased participation in global supply chains, and the use of trade agreements to self-impose domestic economic reforms (Schwab and Bhatia, 2014).

Furthermore, conclusion of PTAs brings about another series of such arrangements, usually as a trade policy response from excluded countries, triggering a "domino effect". According to numerous observers, trade regionalism generates a competitive dynamic: if two countries negotiate preferential reductions of trade barriers, one or more non-participating countries will be hurt. As a result, the excluded countries will have an incentive to negotiate PTAs themselves, and this process would go on until achieving the goal of global free trade, at least theoretically (Subramanian and Kessler, 2013). Actually, the guidelines currently underlying the US and EU's trade policy options are basically rooted in the theories of regionalism as promoting competitive liberalization.

Under the impact of the global financial crisis and the slow and uneven recovery in the world economy, the economic motivations driving PTAs have become more acute, particularly as the major advanced

economies failed to wholly overcome the adverse effects of the crisis. From this angle, the large trading powers' recent offensive to conclude new PTAs is an attempt to definitely exit the crisis (Ghibuțiu and Oehler-Șincai, 2013). By promoting aggressively business opportunities for their firms in international markets, the EU, US and Japan aim to stimulate growth domestically, especially as the slowdown in global production and trade in the post-crisis years is largely caused by subdued economic activity and weak import demand in these countries.

The new mega-regionals also aim to meet the need of developed countries to liberalize trade and investment flows through promoting the creation of high-level standards that would enable them to tap the potential of trade and investment constrained by the existing rules and regulations imposed by the WTO (Yong, 2014). These new deals are essentially meant to place these countries at a competitive advantage, as they are used as vehicles for breaking new ground on tackling regulatory barriers to trade and setting a global template for regulatory issues, especially as tariffs continue to come down around the world, and behind-the-border regulatory measures are increasingly gaining importance as barriers to international trade.

But beyond the purely economic motives, the explanation for the hasty rise in PTAs in general and mega-PTAs in particular has to be sought in *geopolitical factors*. The new mega-PTAs are, above all, policy responses by the big trading powers to the challenges raised by the shift of economic and commercial power towards emerging countries. Their recent initiatives demonstrate a firm option for PTAs as a swift way to ensure market opening by their trading partners in the wider context of reconsidering the fundamentals of their economic and trade policies. Actually, we are witnessing an attempt to counter the growing erosion of their position in world trade and to reposition themselves in the global economic and trade scene (Ghibuțiu and Oehler-Șincai, 2013).

Though the cumulative weight of the US and EU does not exceed one third of world GDP (at PPP) and a quarter of world trade, the two great powers are traditionally viewed as the "regulators of the world" since they account together for around 80% of the norms governing the functioning of world markets (Horn *et al.*, 2009). And the fact that all "WTO-extra" provisions (i.e. new rules, that are not covered by WTO rules) in the US and EU's new trade deals relate to domestic regulations (e.g. investment protection, competition policy, labour standards and environmental protection) suggests that they are effective tools for the two superpowers to export their own regulatory systems to their PTA partners and preserve thus their primacy in

determining the rules applicable to trade and investment in the 21st century.

And certainly, apart from the US and EU's interest to keep a decisive role in the formulation of global trade and investment rules, there are also other geopolitical considerations, that relate especially to US endeavours to mitigate the growing influence of China in the world economy and prevent the emergence of a China-centred East Asia economic bloc (Yong, 2014). An agreement by the US and the EU to common regulatory standards through the conclusion of the *TTIP* deal would pre-empt China from imposing its own standards in international markets and even force China to adhere to these common standards (Subramanian and Kessler, 201). Ultimately, at issue is how the US and EU deal with the shift in economic power from the advanced countries towards the emerging countries in general, and the rise of China in particular.

5. Concluding remarks

The outstanding revival of the regional agenda since 2013 and especially the major trading powers' new trade initiatives have prompted worldwide discussions on the future of the world trading system. While the proponents of PTAs and especially mega-PTAs view them as alternatives to multilateral liberalization and updating of trading rules, the opponents raise serious doubts over the reach and effectiveness of PTAs in general and the TPP and TTIP in particular, arguing that the surge in PTAs reduces transparency and uniformity in the global trading system and increases transaction and administration costs, particularly for developing countries.

To the extent that the new PTAs will include issues not currently covered by the WTO multilateral agreements this represents an opportunity to negotiate new trade rules and disciplines on these issues, thus helping to build the edifice of global trade rules and trade liberalization. However, these PTAs may discriminate against those WTO members who are not parties to the agreements and result in trade negotiations at two speeds. Moreover, with behind-the-border policy regimes becoming so important in PTAs, the multilateral trading system runs the risk of regulatory divergence and a resulting fragmentation of markets, which ultimately reduces trading opportunities. There are also serious concerns about the potential effects of the mega-PTAs on countries that are not part of them, since they will cover an overwhelming part of world trade and will establish new global rules and regulations, including standards, that might be inappropriate for their level of development or trade interest. Moreover, a significant number of countries are excluded from their coverage, including both the most dynamic emerging economies (such as the BRICS) and

the smallest and most vulnerable ones. Fear of marginalization and negative consequences for their competitiveness could lead many outsiders to intensify their efforts to promote South-South regional integration schemes, including new PTAs (Ghibuțiu, 2015).

Indeed, unlike other similar undertakings in the past, the new bilateral and regional initiatives have the potential to cover most of global trade and thus trigger substantial changes in the world trading system. If successfully concluded, the mega-PTAs are likely to reshape the global trading system as well as the international investment regime given that they encompass a significant proportion of both world GDP and global trade and FDI.

Actually, the new PTAs initiated by the three major trading powers are pushing preferentialism further than ever before in the history of the GATT/WTO. In other words, the new trade rules and disciplines developed through PTAs outside the remit of the WTO have the potential to further erode the organization's centrality in the world trading system and even further undermine multilateralism.

As the process of liberalizing trade and devising new multilateral trade rules has virtually stopped in the last decade, and the major traders are pushing more aggressively than ever for PTAs, there is a real risk for the world trading system to be again dominated by power politics, similarly to the 19th century, with the smaller and poorer countries being deprived of the ability to negotiate on an equal footing with the great powers.

Hence, the current trend towards regional and bilateral trade arrangements does not seem to meet the urgent need for closer and more efficient multilateral cooperation required by an increasingly interconnected global economy and interdependent world. Instead, we are witnessing a paradox that the former Director General of the WTO, Pascal Lamy, described as follows: "While the world is *multipolarising* at an unprecedented scale and speed, and GVCs are *multilateralising*, trade governance seems to be *bilateralising*" (WTO, 2013). There is no doubt that the plethora of bilateral trade agreements would produce a multitude of regulatory standards with which businesses will hardly comply. Therefore, the question arises whether these bilateral rules will adequately respond to the needs of the GVCs that now make up a majority of world trade. Furthermore, how can be ensured that the current tendency towards regional and bilateral PTAs does not lead to an even greater fragmentation of the world trading system and the world economy? There is a real risk of scattering instead of levelling the playing field, which is economically detrimental for the whole trading community.

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