Panel 1

After Bali: Multilateralism and Mega-Regionals

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My task here is to explain why Doha seems to have failed or is stuck perpetually. Before I go any further, let me warn you that, partly due to my experience with NAFTA negotiations and subsequent agreements, I am fairly agnostic in terms of the relationship of mega-regional agreements to the WTO itself. That said, let us move on to some of the key questions, namely: what are the implications of mega-regionals for the Doha system itself? How do we reengineer the system? And, in a nutshell, how do we rebuild the governance of the global trading system?

Let us turn to the first question: why is Doha stuck and why do we have the mega-regional agreements? When considering both of these questions, it is important to consider what has changed *versus* previous rounds of regional agreements. Perhaps mega-regional agreements represent a bid to deal with new issues that the WTO is not set up to tackle yet. In other words, mega-regional agreements may, to some extent, constitute a form of experimentation. What does the WTO handle, which issues is it neglecting and what might we want to change? In my view, one of the key changes in approach is that mega-regional agreements are moving away from talking about *all things* at once with *everybody*. Massive negotiations within a big tent were effective to a certain extent in the 1960s and 1970s when only the OECD was involved, but this kind of approach has become increasingly difficult since then. Now the advantages of covering everything at once are definitely outweighed by the disadvantages. In terms of the WTO, this means that we need to think about different ways of negotiating. The agreement on trade facilitation marked a step in this direction.

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With regard to mega-regional agreements, there are a number of issues that have gained importance in recent years, but were far less significant back when the WTO system was set up. Multilateral trade negotiations (MTNs), for example, have become far more influential. Now that the Dispute Settlement Body (DSB) is working, we should be thinking about using it in other areas as well, which is perhaps another function that the WTO could offer. In terms of services, we will look at what the General Agreement on Trade in Services (GATS) did not deliver, which is another reason for the emergence of extra-WTO talks.

New regionalism

Firstly, let us take a look at the new regionalism. To follow up on Professor Sinn's comments about bilateral agreements, if you match them by country pairs and ask how much trade has been taking place within a bilateral or regional block and how deep such agreements are, it emerges that about a quarter of world trade and trade pairs that are governed by this type of agreements. In other words, a very substantial chunk of global trade is occurring under the umbrella of agreements that are not part of the WTO itself. This share is growing and will increase even further as TTIP moves forward.

The upsurge in interest in regional trade agreements is probably due to the emergence of regional production networks. This means that global trade is mostly in parts and components, which do not only move once, but are transported back and forth several times across borders, leading to far higher nuisance costs, as has already been pointed out. In addition, many firms operate in multiple markets, which means that even if they don't yet produce in some global value chain, they may be developing blueprints for releasing a product in many markets. In many cases this is simply more cost-effective. In pharmaceuticals, for example, if you develop a new drug, you have to run a billion dollar drug trial – and pharma companies do not want to repeat this process two or three times. So as more large companies manufacture products to be sold in multiple

markets, the impact of differences in national regulatory regimes on their bottom line has become more apparent. We need to think about multi-national production in this context – changes in global production chains mean that behind the border measures now matter more. As multilateral trade negotiations gather impetus, the importance of intellectual property is also growing in the context of firms operating in multiple regimes. China, as the 'dragon in the room', has been mentioned several times. With TTP more than TTIP, this is partly what has been driving the whole agenda.

Benchmarking barriers and their costs

Let us now compare the composition of the goods traded between the United States and the EU between 1997 and 2011. By composition I am referring to the share of goods of own value-added in exports *versus* the gross value. For example, for machinery shipped from the EU to the United States in 1997, the gross value relative to value added is 1.3 percent. This means that if there is 130 euros worth of goods, about 100 euros of that amount is European value added and the other 30 euros represents the cost of parts and components from elsewhere. The latter figure has now reached 1.65 percent. These numbers show that a much bigger share of the products that Europe is exporting now comes from elsewhere, and the European development is also seen in many regions around the world. So one answer to the puzzle of why the WTO's annual report has stated for fifteen years that trade is growing faster than GDP is that we were making things differently. The value-added share of trade was not growing rapidly, but the gross value was because companies now move parts and components around to a far greater degree. And because of this moving back and forth across borders, two-percent tariffs that have to be paid three or four times start to add up. In addition, paperwork for these goods needs to be filed, which also adds to costs.

Yet, according to 2008 Eurostat international sourcing statistics summarising the results of interviews with firms operating abroad, 'tariffs' is ranked third on the list of barriers to sourcing abroad, behind 'differences in legal and administrative requirements for firms operating in different regulatory regimes', ranked as the number one barrier, and followed by 'proximity to existing clients needed'.

The Ecorys study (2009)[1] was part of the initial scoping work done by the European Commission when it encouraged Washington to start up the TTIP process. This work consisted of interviews with firms and discussions on classifying the barriers that exist. One category is 'regulatory divergence', which can turn into a barrier. For example, customers want to be sure that the toasters they buy will not burn the house down. There are different ways to ensure this in terms of testing requirements. If a product has to be tested several times, this generates extra costs. Electrical appliances in the United States have a three-foot standard cord, whereas the standard length in the EU is a metre. The cords on toasters therefore have to be changed to satisfy individual country requirements. Simple incompatibilities like this all add to companies' production costs.

[1] Ecorys (2009), Non-Tariff Measures in EU-US Trade and Investment – An Economic Analysis, Study for the European Commission, Rotterdam, http://trade.ec.europa.eu/doclib/docs/2009/december/tradoc_145613.pdf.

Table 1

Estimated transatlantic trade cost reduction linked to NTMs (in %)

Sector	EU barriers against US exports	US barriers against EU exports
Food & beverage	56.8	73.3
Chemicals	13.6	19.1
Electrical machinery	12.8	14.7
Motor vehicles	25.5	26.8
Other transport equipment	18.8	19.1
Metals & metal products	11.9	17.0
Wood & paper products	11.3	7.7
Average goods	*21.5*	*25.4*
Air	2.0	2.0
Water	8.0	8.0
Finance	11.3	31.7
Insurance	10.8	19.1
Business & ICT	14.9	3.9
Communication	11.7	1.7
Construction	4.6	2.5
Personal, cultural, other services	4.4	2.5
Average services	*8.5*	*8.9*

Source: Ecorys (2009).

In econometric literature trade costs are broken down into natural costs and policy costs. The natural costs are those that cannot be negotiated away. The Japanese speak Japanese, and if you do business with them the paperwork is often in Japanese, which constitutes a barrier if you do not speak the language. As they will not negotiate away their legal system of operating in Japanese, this very real barrier is not actionable.

In addition, unlike the geometry relating to tariffs with talk of triangles and rectangles and where there is money collected, with a large share of the NTBs there is no money collected (see also Table 1). If it costs ten percent to refit a car to sell in the North American market, this represents a deadweight cost. Firms know that eliminating such costs by getting rid of regulator divergence or by aligning regulations may yield substantial gains in productivity; and this knowledge has been a driving force behind TTIP.

If we look at intra- *vs*. extra-EU market access, there is evidence that the Single Market has worked. In metals, for example, access has become easier within the EU in terms of non-tariff barriers, which suggests that the barriers still remain in the Single Market, but are lower than for goods coming in from outside. In the European Commission's view, TTIP may lead to a gradual reduction in trade barriers for all participants if a long-term mechanism is set up; and there is evidence that this may be true.

Mega-regionals and TiSA

Let us now move on to services. A massive dataset was recently released by the OECD, reflecting work on the services trade restriction index. This data tells us that the GATS commitments do not seem to be binding. If you look through the regional services agreements, many are also fairly non-committal and even less binding than GATS itself, although they sometimes compensate for this in other areas.

It is clear that cross-border trade is linked to establishments, so establishment rights are very important. FDI in trade is blurring to a growing degree, rendering simple models ineffective when we look at services. The potential gains here are actually quite large. At the end of the Uruguay Round, I remember Bob Stern presenting modelling estimates on the impact of liberalising services trade. He used Berhard Hoeken's indexes (the only measure on NTBs in services available at that time). His estimates were very rough and it is hard to say how accurate they turned out to be, since the service sector is very large and heterogeneous. In some ways modelling trade liberalisation is like lifting rocks and looking for things underneath them: because 'services is big', we expect to find big effects when we lift up the rocks. So Stern's message was not that he had exact numbers, but that he expected large effects potentially because the services sector accounts for seventy percent of a typical OECD economy, and is also pervasive in terms of cost structure. In a sense, services are also on the agenda for TiSA, TPP and TTIP and everyone is exploring ways to move forward in this area.

Furthermore, the World Bank's Services Trade Restrictiveness Index (STRI) reveals that the policies in place are much more liberal and open than the binding arrangements within the GATS and those offered under Doha. So even if the Doha Round had been concluded in terms of the GATS commitments, there would not have been much of a change. To an even greater extent than with tariffs, where there is this issue of binding overhang, there is a huge gap between the policies in place and commitments. Within the GATS, and even with all the negotiations at Doha for the GATS, little progress was made in actually closing this gap. So TTIP and TTP can be seen as a bid to close it to compensate for this failure.

Additional driving forces behind TTIP

A comparison of the revenues (measured in terms of FDI income) earned by European firms abroad through affiliates, and the revenues earned by US firms abroad shows that most of European firms' revenues come from the United States; and *vice versa.* In other words, the same firms are operating on both sides of the Atlantic. I would argue that TTP is being driven by the US State Department; while TTIP is being driven by firms operating on both sides of the Atlantic. Whether they be developing drugs or car models, these firms are present in both markets, operating and producing, and as such they would stand to benefit from the regulatory aspect of a successful TTIP. So, even if you exclude agriculture and cultural exceptions, the brick and mortar industry is pushing for changes in how we regulate. This push is different to the NAFTA of the 1960s, or other efforts that have been seen roughly every decade since. This time per-

haps it is different because production chains have changed so radically and the firms involved are more multinational than in the past.

Conclusion

Although, as I already mentioned, I am agnostic with regard to mega-regional agreements, they may nevertheless prove to be incubators for dealing with new issues. The old quad is pursuing regional initiatives outside of the multilateral framework and there are legitimate fears of countries being left out. In a sense, however, I think they are pursuing such initiatives firstly because, as far as regulatory costs and divergence are concerned, the same population of firms is operating on both sides; so there is enough political support to move forward in this direction. These are not the FTAs our fathers negotiated – the new trade-investment initiatives are deeper and reflect regional production by global firms. The welfare calculus is very different as a result. Since there is a lot we do not know, we must 'guestimate'. As I said, there are productivity linkages due to the reduced production costs of shipping parts abroad. There may be third-country spill-overs. So if the United States and the EU can agree to recognise standards, Switzerland, for example would welcome this move, as it would be make it easier for its firms to gain entry to the US market thanks to Switzerland's existing agreement with the EU on standards. So in terms of regulations, it is not clear that it is discriminatory when negotiations bring two sides together. You can have a tariff that discriminates against many countries. Indeed, there may be some ways in which, as things move closer together, third countries may actually stand to benefit. I do not know how big this effect could be, but it's possible.

When we look at TTIP, it is worth remembering the Treaty of Rome and how long it took for the treaty to eventually lead to the Single Market. If progress is to be made on regulations, it requires a process and an institutional setup; and it may take decades. Although this fact does not feature in any of the models and cannot be quantified, it is crucially important. Nobody is aiming to set up a 'Fortress Atlantic'. Moving forward, ways will be found to let other countries sign up; once the strengths and weaknesses of TTIP become clear, but this process has to start somewhere. There is a new set of issues to deal with, multilaterally or bilaterally. Despite all the worries and caveats, TTIP should be seen as an opportunity to find solutions that can be developed further in Geneva and tried out elsewhere.

Panel

Are mega deals going to overtake the Doha round? Panel chairman **Quentin Peel,** Contributing Editor, Financial Times, London, invited **Karl-Ernst Brauner,** Deputy Director-General, WTO, Geneva, to give his insider view. Brauner's response was a confident negative. On the contrary, he hopes that the Bali success will give the WTO a chance to reinvigorate the multilateral system. In his view, bilateral agreements are a second-best option. Confronting Bali's critics, Mr Brauner quoted conference guest **Simon Evenett,** Professor of International Trade and Economic Development at the University of St. Gallen, who said that Bali was "1 percent substance, 9 percent promises and 90 percent public relations". He insisted that the 1 percent substance was very important because it restarted the negotiating process. He also claimed that the 1 percent estimate was rather unfair, because trade facilitation, currently being implemented in Geneva, is expected to generate real gains for companies. He then moved onto the question of the Doha agenda to be designed within 12 months. Opinion is divided over whether the agenda should be limited or expansive, noted Brauner. However, once the agenda has been set, hard core issues like agriculture, non-agricultural market access and services need to be tackled, he warned.

Mukhisa Kituyi, Secretary-General, UNCTAD, Geneva, kicked off with a brief take on Bali. In his view, Bali gave multilateralism a boost, but to what extent are its fruits deliverable in the marketplace? Kituyi argued that, faced with the difficulty of democratising rule-making, the WTO has lowered its ambitions over the past 10-15 years and limited its agenda to achieve success, meaning that little was actually achieved. In his own words: "if you can cherry-pick what items to put on the table, and you mobilise international public opinion to accept this as important and sufficient as a harvest, then perpetually the developmental promise of Doha walks out of multilateral rule-making". While acknowledging that mega-regional agreements constitute a far more immediate response to the challenges facing the main players than the Doha round, he added that "we must not let the

pragmatic side that drives mega- regional agreements destroy the essence of the collective good that can only be dealt with multilaterally".

Nakgyoon Choi, Commissioner, Korea Trade Commission, Republic of Korea, began his presentation by describing Bali as a big step towards simplifying, harmonising and modernising customs procedures and substantially reducing global trade costs. Returning to an issue already touched upon by other speakers, Mr Choi asked what form the Doha Development Agenda should take? He urged countries to take a multi-track approach to pursue the three approaches simultaneously and, specifically, WTO members need to place more emphasis on plurilateral agreements. To revitalize the WTO, Mr Choi called for multilateral review and monitoring of regional trade agreements; and for the WTO to strengthen its role as part of a new system of global governance.

Bali is "the deal that didn't happen in the real world" according to **Paul Donovan,** Global Economist and Managing Director, UBS Investment Bank, London. Mr Donovan, an outspoken critic of the WTO, claimed that the Bali deal has not registered with companies or financial markets. On a more positive note, he expressed the hope that simplifying customs may reduce corruption related to trade. Donovan also welcomed the fact that Bali was not about tariffs and exchange rates, which tend to dominate political discussions. In his view, the first negative related to Bali was the "absolutely terrifying" exemptions related to food. He identified the second problem as the rise of regionalism. If TTIP comes to pass, he speculated that it will, "move us away from multilateralism and towards imperialism in terms of trade". Although TTIP may be a force for trade globalisation, the latter would be "on the terms of the EU and the US" warned Mr Donovan. Finally, he argued that the liberalisation of the banking sector and of trade is intertwined. Global capital flows are substantially below pre-crisis levels and subject to increasing protectionism. "We are ending up with a parochialisation of capital for political purposes", warned Mr Donovan.

The last panellist **William Zhang,** Chief Executive Officer, China Elderly Foundation, Beijing, began by highlighting the restricted nature of the WTO agreement from the very outset. It makes little or no provisions for freedom of labour force and technology transfer, observed Mr Zhang. But in his view, these are: "two pressing issues for developing countries who are eager to export their labour force and import technology, which is desperately needed for their economic development". These issues were deemed too strategic and sensitive to individual countries to be included in the WTO agreement, which focuses instead on intellectual property rights. Exclusion of this area, argued Mr Zhang, makes the WTO's approach to international trade unbalanced, although for understandable reasons. Commenting on speculation by other speakers that the WTO may be replaced by regional agreements, Mr Zhang highlighted the need to restructure the WTO's methodology and its way of thinking if the organisation is to remain a guideline for international trade. He also called for the establishment of a fair international trading order: "I think we, the Chinese people, respect the WTO, but at the same time we are not against any bilateral or regional agreements", concluded Zhang.

In the first round of questions from the floor, **Christoph von Marschall,** Diplomatic Correspondent of Der Tagesspiegel, Berlin, asked Mr. Zhang for China's perception of TTIP. Does China see its lack of involvement in TTIP and TTP as a disadvantage or even as political exclusion? Or is it perceived as good for China to be challenging standards from a consumer/corporate perspective, asked Mr von Marschall?

In response Mr Zhang stated his belief that it would be better to involve China in TTIP and TTP. However, he expressed personal doubts as to whether the proliferation of mega-regional agreements will have a positive impact on the international order of world trade. In his opinion, "it is better to sit down at the negotiating table and discuss things in a smooth way and see how we can cooperate. We do not want to enter a sort of trading conflict, which is not good for both sides".

Coming into the debate himself, Mr Peel returned to the topic of free trade in agriculture and asked Mr Choi whether it will poison the whole negotiation system until it is dealt with? Mr Choi agreed that agricultural subsidies are a complex and thorny issue. Some of the developing countries, he noted, are highly dependent on the agricultural sector, but WTO negotiations have three pillars: services, industrial goods and agricultural. A balance needs to be struck between these pillars, he argued. If developing countries only focus only on agriculture, this creates a problem. In Mr Choi's opinion, leadership by players like the

United States, the European Union, India and China is needed to resolve the deadlock situation.

In the second round of questions Simon Evenett, provocatively asked why we need the WTO if everything is settled within regional agreements? Mr Brauner gave a very clear answer: to design universal rules of origin. The WTO also deals with issues of common good that are not covered by mega-regional agreements like fishing, he added.

Oliver Wieck, Secretary General, International Chamber of Commerce, Berlin, asked the panel why they were optimistic that governments may now be readier to reset the negotiations on tariffs and start something really new? Why, in other words, are we now in a better position than in 2008 or 2009, wondered Mr Wieck? Because a great deal of tariff liberalisation has already taken place, responded Mr Brauner. Countries have not lowered their bound tariffs, but their applied tariffs have dropped considerably. This unilateral lowering of tariffs, he explained, was a bid to attract investment and gives us a better starting point for negotiations. Mr Wieck responded that Brazil had raised its tariffs, but Mr Brauner countered that this was an exception and Brazil's response to the crisis, but that the general trend in tariffs was downward.

Mr Zhang wrapped up the first panel on an upbeat note with a pitch in favour of the WTO. Since its foundation in 1995 the WTO has generated considerable profits for its member states, noted Mr Zhang. "If global trade is divided up by regional organisations the individual cakes will become much smaller", he warned, which could result in a "turmoil situation for international trade".