

THE FUTURE OF EXTERNAL EUROPEAN TRADE POLICY-THE BILATERALISM VS MULTILATERALISM DEBATE

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Kevin Byrne examines the divisive issue of whether external European Trade Policy would perform better under a bilateral or multilateral approach. He approaches the subject by considering the current configuration of trade policies as pursued by the world's major trading blocks. Through analysing the advantages and disadvantages of bilateral trade policies he finally concludes that multilateralism is the best way forward.

Introduction

There are few more contentious debates in these times than the topic of the European Union (EU)'s commercial relations with the rest of the world, from its richest to its poorest trade partners. It is a question that galvanises not only economists and trade lawyers, but also eighties rock stars and Korean cabbage farmers. Its contentious nature is rooted in the fact that it has become inextricably linked to political and social questions on how we handle the journey we take down the path to increasing globalisation. The social question is simple: how do we harness trade to ensure the most benefit to the global common good? However in its practice, it is a profane debate on economics, far removed from the high-minded ethereal talk of 'saving the world'.

In this article, I will address the effect of the EU's approach to international trade institutions and agreements; namely, is it more effective to work on a grand scale, by seeking to negotiate with all parties at the World Trade Organization (WTO) talks, or should Europe take a country-by-country approach and painstakingly negotiate unique agreements with each country? Naturally for a debate as complex and multifaceted as this, there are important advantages and disadvantages to both.

The present atmosphere in world trade

Under article 133 of the EC Treaty, the 25 nations of the EU adopt a common approach to world trade, known as the Common Commercial Policy. Every Friday, the trade ministers of each EU nation meet in a typically imposing modernist building in Brussels to decide what Europe will do next. The figurehead of EU trade policy is the commissioner with responsibility for trade, currently the British arch-technocrat Peter Mandelson. At all trade negotiations, it is thus the EU that is represented, not Germany or Ireland or Slovenia.

The European Union's approach

The EU's rhetorical commitment to a world of ever-liberalising trade is not in doubt: 'The EU proposes advancing meaningful liberalisation across all non-agricultural products, which represent over 70% of developing country exports, by eliminating tariff peaks and high tariffs, and significantly reducing tariff escalation.' (EU Trade Commission's website)

This is, after all, the *de rigueur* line to be taken under the present economic climate of the liberal Washington Consensus. And the facts do bear this platitude out as more than mere sophistry of appeasement; the EU is in the process of dismantling trade barriers, not erecting them. By a combination of its own volition and the rules that must be adhered to as a condition of WTO membership, the EU has pursued a reduction in tariffs, quotas and other impediments to trade. This has been achieved mainly through the framework of negotiations at the WTO. It is the crucial method by which this process is executed that will have repercussions, and which I will discuss. The one qualification that the EU admits to is the maintenance of resistance towards agricultural imports, due to the provisions of the European Common Agricultural Policy (CAP). The issue of the future of the CAP is a similarly contentious debate and is no doubt addressed elsewhere in this journal. While not doubting the importance and relevance of the agricultural sector in international trade, for the purposes of brevity (and the potential to get seriously sidetracked) I will not seek to debate the internal effects of the CAP in too much detail. However, the external effects and distortions on world markets of the EU's intransigence on the subject of agricultural trade is too large an issue to ignore.

Trouble at the World Trade Organisation

The Doha round of trade negotiations of the WTO began in 2001 in the eponymous Qatari city. Their stated aim was to further liberalise world trade. In pursuit of this goal, the Doha round has experienced ups, but mostly downs; world trade liberalization has almost become a victim of its own success. The WTO now has 148 members, who must agree on all points of a decision for talks to continue – and whose interests often diverge sharply. The main culprit for the *immobilisme* that currently afflicts Doha talks is, predictably, the unwillingness of the wealthy nations (most notably the US, Japan, and naturally the EU) to accede to the demands of poorer countries (whose influence has increased exponentially since pooling their resources under major developing economies such as India and Brazil) to open up their markets to agricultural imports. The G7 and other wealthy nations have come back with accusations of excessive protectionism of those countries' service sectors. All this has taken place before a backdrop of serious protests against globalisation and trade liberalisation (or its present course at least) across the world. In the eyes of many of the citizens the participatory governments claim to represent, the name of the WTO is mud and their nation should have as little as possible to do with it. In short, multilateral trade negotiations are at a low ebb. In the words of Fred Bergsten, writing a few months ago in *Foreign Affairs*, “There is a widespread recognition that failure to keep the trading system moving toward further liberalization could trigger a sharp reversal into protectionism and bilateralism and perhaps erode the WTO itself, causing substantial problems for the economies and foreign policies of all countries involved” (Bergsten, 2005). An atmosphere of pessimism is quite pervasive among all parties.

The trend towards Bilateralism & Regionalism

Despite the general consensus that multilateral trade liberalisation is ultimately more effective and utility-maximising for all concerned in the long-run (the economic reasoning behind which I will discuss below), the relative failure of the WTO multilateralism in the past few years has been contrasted sharply by its bilateral antithesis. The United States, the number one economic power by a considerable distance (and as such a trendsetter on issues such as this), has been an enthusiastic pursuant of bilateralism and regionalism since the 1980s, when they began to sign Preferential Trade Agreements (PTAs) with Israel, Canada etc. This tendency was notable under the Clinton administration and has become even more pronounced

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since the Bush administration took office just over five years ago. The most famous example is the North American Free Trade Association (NAFTA), which the US established with Canada and Mexico. This wide-reaching series of trade-barrier reductions will create a large amount of trade deflection from other nations seeking to enter the US market. Other examples include APEC (Asia-Pacific Economic Cooperation) a potentially economically enormous trade bloc including Japan and China. The US has also pursued pure bilateralism, nation-to-nation trade agreements. A recent agreement linked the US with South Korea, itself one of the world's biggest economies. The US already has trade deals in South-East Asia with Thailand and Singapore, and is believed to be pursuing more (Bergsten, 2005), giving it wholesale access to the Association of South East Asian Nations (ASEAN) trade bloc. Several other PTAs have been signed that belie heavy political motivation. Arab countries that have cooperated with recent US policy in the Middle East have been rewarded by the US department of trade, Bahrain and the United Arab Emirates (UAE) among them. The fact of American enthusiasm for this bilateral/regional approach and a seeming lack of enthusiasm for reform at WTO negotiations (*vis-à-vis* the intransigent stance on agricultural imports) could potentially undermine the WTO itself and make this an ineffective path for our EU trade negotiators to follow. They must ponder the old question; where does an 800lb gorilla sit? Answer: anywhere it wants to. In the case of world trade negotiations, the US is the figurative ape. Anything less than full US cooperation with the WTO would render it impotent to pursue further liberalisation of trade in the future. Parties to global trade will not waste their time at a forum that is incapable of creating real progress in trade negotiations.

EU bilateral PTAs up to this point have been limited, mostly to those justified by pressing political or security concerns. The Cotonou Convention (formerly the Lomé Convention) is a system of tariff and quota agreements between the EU and its constituents' former African colonies, and is largely a relic of the process of decolonisation that took place in the 1970s and 80s. The Global Mediterranean Policy is a PTA agreed with countries neighbouring the EU, largely in North Africa and on the Levant, and is intended to ensure the future prosperity and stability of the EU's neighbourhood, and to glean the advantages that this scenario would bring.

The advantages to Europe of considering a more exclusively bilateral/regional approach to trade negotiations

Economic logic would suggest that Peter Mandelson and the EU are correct when they insist that Europe must continue to do all it can to revive the Doha round of WTO talks and other multilateral routes to trade liberalisation. But I feel it is a betrayal of what is a complicated argument to disregard the advantages of shelving Doha for now and seeking to sign bilateral agreements with preferred markets, for a number of reasons:

Europe may miss the boat, so to speak, if the WTO negotiations do in fact reach an insurmountable impasse. During this time, Europe's commitment to the multilateral talks will have led it to not hedge its bets and agree back-up bilateral schemes – unlike the US, and other major importers such as Japan should they choose to create their own safety net of PTAs. Thus, there will be major trade deflection of essential imports (e.g. basic resources used in industry such as bauxite or uranium) of goods coming from markets that have sign trade agreements with other major importers. These will be diverted away from Europe, and towards those nations that have pursued the bilateral path. These goods would then become much more expensive within Europe, which would have a serious adverse effect on EU economies depending on the goods' importance to the European economy.

Political factors: The European Project, while primarily conceived as an economic endeavour, has always had political motivations too. The old Gaullist dream of a United Europe being the world's leading superpower – or at least a rival to the other collection of states across the Atlantic – has spurred leaders on to the process of increasing political integration we see today. In the absence of any kind of military strength on the EU's part, bilateral treaties are unquestionably Europe's most powerful weapon in spreading its influence across the world. Mark Leonard has argued that the EU has an ability to spread its influence to other nations unparalleled in the world, by offering them the prospect of membership (witness the enormous changes that the countries of central Europe went through at the EU's behest in order to join, and the lengths Turkey is currently going to) (Leonard, 2005). This, of course, only works on neighbouring European countries, not halfway across the globe. But the prospect of a preferential trade agreement with Europe - and its 450 million or so enthusiastic potential consumers of their exports from Dublin to Lublin – would be a powerful incentive to be influenced by Europe.

The disadvantages of moving to a more bilaterally orientated approach

While moving to replace Europe's commitment to the WTO and multilateralism with bilateral and regional PTAs would seem like a wise idea in the current atmosphere of multilateral inefficacy, it is not borne out in the long run when the ultimate microeconomic effects are ascertained.

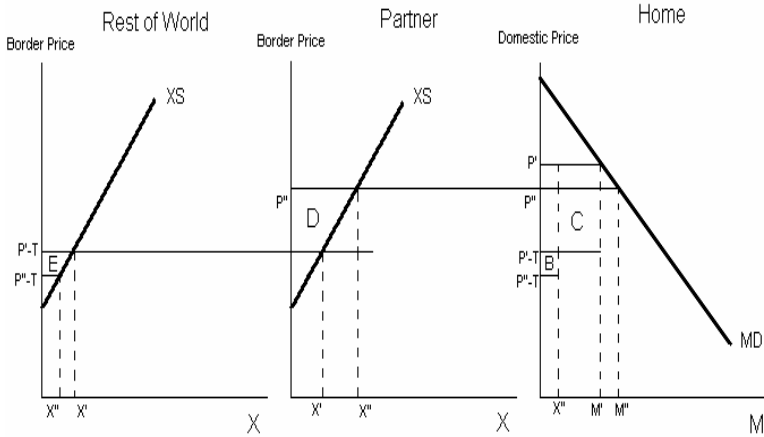
The seminal study of the negative effects of PTAs on trade is *The Customs Union Issue* written in 1950 by Jacob Viner. He was the first economist to illustrate the gains and losses that PTAs bring to trade; the ambiguity that bears his name.

To elaborate, Viner (1950) (and many economists since then) demonstrated that while goods from a partner nation in a PTA are cheaper and more plentiful than under a more universal Most Favoured Nation (MFN) tariff approach (what Viner (1950) called 'trade creation'), the overall welfare benefits are more, as is put, ambiguous. This is because potential imports from nations outside the PTA are much more expensive to the domestic consumer, causing a sharp drop in trade, what Viner (1950) called 'trade diversion', leading to a sharp drop in welfare in the excluded nations. Ideally, we should look at the aggregate of welfare effects around the world to ascertain the right course of action (if world welfare benefit is our goal, of course...)

It is helpful to use a graphic demonstration of the effects both MFN tariffs and PTAs have on international trade. These results can then be applied to the EU's current circumstances to judge the best course of action.

Some assumptions must be made, and some factors held constant when modelling the effects of MFN tariffs and PTAs on trade – it is not possible without the aid of serious computational power to do so otherwise. The classic system used in analysis of this sort is the NICNIR framework, an acronym for 'No Imperfect Competition, No Increasing Returns'. Obviously in the hugely complex real world, neither of these conditions exists, but it is nonetheless necessary to hold them for logistical reasons, and it does not overly distort the results.

Figure 1: The Welfare Effects Of Customs Unions



Where: X=exports, M=imports, P=price, T=value of tariff

The above diagram represents the welfare effects caused by the adoption of a customs union with another market (known as Partner). It shows the welfare effects in the home market, in partner's market, and in trading partners not party to the trade agreement. Both home and Rest Of World supply the same amount of exports to Home, shown by the supply curves XS. Goods from both areas are considered to be symmetrical.

The most obvious effects of the instigation of the discrimination between Partner and Rest Of World are the welfare effects caused in those markets. Partner gains D in welfare, as its trade volume is increased under the beneficial new terms of trade. For the opposite reason, Rest of World loses E. Home's overall welfare increase is A+B, minus the area C. This diagram shows a trade scenario where the welfare gain of Home is negative. If the parameter T (the tariff) is altered the sum of areas A and B will be greater than that of C.

These trade diversionary effects are supported by empirical evidence. During the period 1960-1990, a time of slowly deepening trade integration in Europe, the share of intra-EEC/EC trade rose from 40 to 59 per cent (Srinivasan et. al, 1993), a remarkable figure given that in that time it has become increasingly logistically possible to trade further afield. The subsequent provisions of the Maastricht Treaty have only increased the

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potential for diversion of outside-EU goods, tempered only by the multilateral provisions of the GATT/WTO.

Hence, it is not in doubt that overall the net welfare effects all round of the standard MFN tariffs within a multilateral framework are better than those from a system of bilateral and regional PTAs.

Conclusion

The world market in which the EU acts today is a hugely complex system of overlapping interests and risks. As well as the obvious goal of increasing the welfare of its citizens, the EU is increasingly under pressure from those same peoples to ensure that developing nations are not subjected to a sort of twenty-first century mercantilism. The bare bones of the argument are that multilateralism (embodied by the WTO) is ultimately the best and most equitable way of increasing everyone's welfare. It is when politics becomes involved and those involved in formulating trade policy seek to promote a dogmatic ideal, often at the cost of ignorance of fact to the contrary, that the path to fair, equitable and efficient trade is complicated. It will continue to be a long, painstaking process involving sacrifice on all sides, but – despite some convincing arguments to the contrary – Europe's interests are seemingly best served by following a road towards multilateral trade liberalisation.

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