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# ‘Bilateral renaissance’ or multilateralism

## TPP, TTIP and multilateralism: stepping stones or oceans apart?

Trade agenda consists of new and old themes, often closely intertwined. Among the new themes, mega-FTAs– in particular the Trans-Pacific and the Trans-Atlantic Trade and Investment Partnership – have been especially popular. This column discusses the nature of mega-FTAs and their relationship with the multilateral rules. The column concludes that such FTAs promote deep regional integration, but also have positive impact on non-members.

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## ‘New’ and ‘old’ themes in the trade agenda

The world trade agenda is currently comprised of ‘old’ and ‘new’ themes, often closely intertwined. Among the old themes, multilateral negotiations and a successful WTO Bali Ministerial – albeit at a relatively low level of ambition compared to the original Doha Development agenda, but with a renewed recognition of trade facilitation – are clearly getting a lot of attention.

This happens at a time when the global economy continues to face challenging headwinds, stubbornly high unemployment levels, growing protectionism, and world trade flows expected to grow at a slower pace than previously forecasted. Thus, fighting protectionism is by now an old theme, being on the G20 agenda and part of the monitoring mandate for WTO, OECD and UNCTAD for several years now, and possibly becoming a permanent feature of global trade governance.

Among the new themes, global value chains (GVCs) captured a lot of interest in trade policy circles since the launch of the ‘Made in the World’ initiative by Pascal Lamy, the former WTO Director General, a couple of years ago. Several ground-breaking global databases (WIOD, TiVA) are now available showcasing the complex linkages created by large and small companies across the globe, and the importance of trade policy in promoting both imports and exports. The Made in the World idea also indirectly tried to

showcase the importance of multilateralism vis-a-vis bilateralism, given the complexity of global value chains.

The wide interest on GVCs among trade policymakers can also be explained by the fact that it brings to light important linkages between multilateralism and bilateralism and between old and new trade policy debates. Just to pick an example where old and new trade themes come together, the old Vinerian ‘trade creation’ and ‘trade diversion’ concepts need to be adjusted in the light of trade in value added. Today we know that whenever trade among new free trade agreements (FTAs) members contains value-added from non-members (and this can easily be gauged by looking at the WIOD and TiVA databases), there is ‘trade in value added creation’, which should no longer be seen as trade diversion.

However, this GVC debate has remained somewhat theoretical, and has not yet led to a new multilateral revolution. What has emerged instead, and not necessarily driven by such GVC consideration, is a new ‘bilateral renaissance’, notably in the shape of what many commentators called ‘mega-FTAs’. The ones grabbing the news headlines these days are the Trans-Pacific Partnership (TPP) negotiations spearheaded by the US, and the recently launched Trans-Atlantic Trade and Investment Partnership (TTIP) negotiations between the EU and the US. Several other FTAs involving large trading partners are also in the making, such as EU-Japan or EU-Canada, to name just a few.

In the mind of those convinced of the importance of multilateralism, this new wave of mega-FTAs may, at first sight, raise concerns. However, in the remainder of this column, I will argue that this need not be the case, and in many respects the opposite conclusion might be true. And the key to this insight lies in the nature of deep and comprehensive FTAs (such as TPP and TTIP), their relationship with the multilateral rules, and the overall impact on non-members.

## Deep bilateral integration and multilateralism

In the trade literature, for several decades the dichotomy between bilateral and multilateral approach to trade liberalisation mainly revolved around the economic theory behind preferential tariff reductions, often centred on trade diversion and trade creation effects. This was also deeply anchored in WTO legal texts and several key principles and provisions. Art. XXIV of the General Agreement on Tariffs and Trade (GATT) is the most relevant in this context. Then, there is the wider debate between negotiation dynamics, systemic effects, and the role of FTA rules on future development of multilateral disciplines.

All these old theme questions often concluded with ‘it depends’ kind of answers. So, what is new in the possible future interaction between mega-FTAs and multilateralism? Some might argue that not many things are genuinely new but a new angle can clearly be added to various old theme elements.

- One fundamental difference between old FTAs and the new mega-FTA lies simply in their size. TPP and TTIP are set to deepen the trade and investment linkages for a huge chunk of the world economy. Their critical mass and possible systemic implications are now not just theoretical conjectures but an impending reality.

- A second fundamental difference is their declared scope and level of ambition. Unlike most old FTAs, mega-FTAs are not primarily about reducing tariffs (which in the case of the US and the EU are, on average, at very low levels). Instead, mega-FTAs have a very ambitious agenda on ‘beyond the border’ issues that affect a whole range of regulatory and non-tariff measures that are critical for the future GVC-driven competitiveness.

The importance of this 21st-century regulatory agenda in mega-FTA negotiations holds the key not only for maximising the gains from trade liberalisation, but also for understanding the positive role FTA negotiations can play at multilateral level. Not all non-tariff measures and regulations are discriminatory trade barriers. And not all regulatory barriers can be negotiated away. But reducing the costs of diverging regulatory processes can be achieved in many ways in successful trade negotiations.

## Reducing the costs in successful trade negotiations

Take, for instance, the importance of regulatory issues in the TTIP negotiations and how this will impact non-TTIP members. If, for example, the process through which such regulatory cost reduction is achieved involves some reference to current or future international standards, any trading partner adhering to such standards would see its overall trading costs with both the US and EU unilaterally reduced, without being a TTIP member. This is a most favoured nation (MFN) direct positive spill-over effect from TTIP on non-members, which dovetails nicely with several well-known economic and legal arguments from the old RTA theme, be it connection with the Kemp-Wan theorem of Pareto optimal preferential liberalisation.<sup>1</sup>

The Kemp-Wan theorem, extended by Panagaryia and Krishna (2002) to the case of FTA formation, stated basically that any new FTA could enhance global welfare if, member countries within the FTA individually import the same vector of quantities from the rest of the world in the post-FTA equilibrium as in the pre-FTA equilibrium. For a traditional FTA, this condition could be achieved, for instance, by simultaneous multilateral liberalization. However, given their very ambitious regulatory agenda, mega-FTAs can satisfy the Kemp-Wan-Panagaryia-Krishna condition thanks to the MFN direct and indirect spillover effects that would increase trade between FTA partners and rest of the world, and potentially even among non-FTA members.

Furthermore, one can also imagine a second-round spill-over effect in the case when regulatory costs are reduced among mega-FTA members by developing a new common standard, notably in new areas where the standardisation process (both technical and in terms of trade rules) is underdeveloped. In such cases, the economic weight of the mega-FTA (be it TTIP or TPP) and their proposed standards on transparency, inclusiveness, and procedural fairness would give a strong incentives to non-members to gradually evolve towards greater convergence with these new standards.

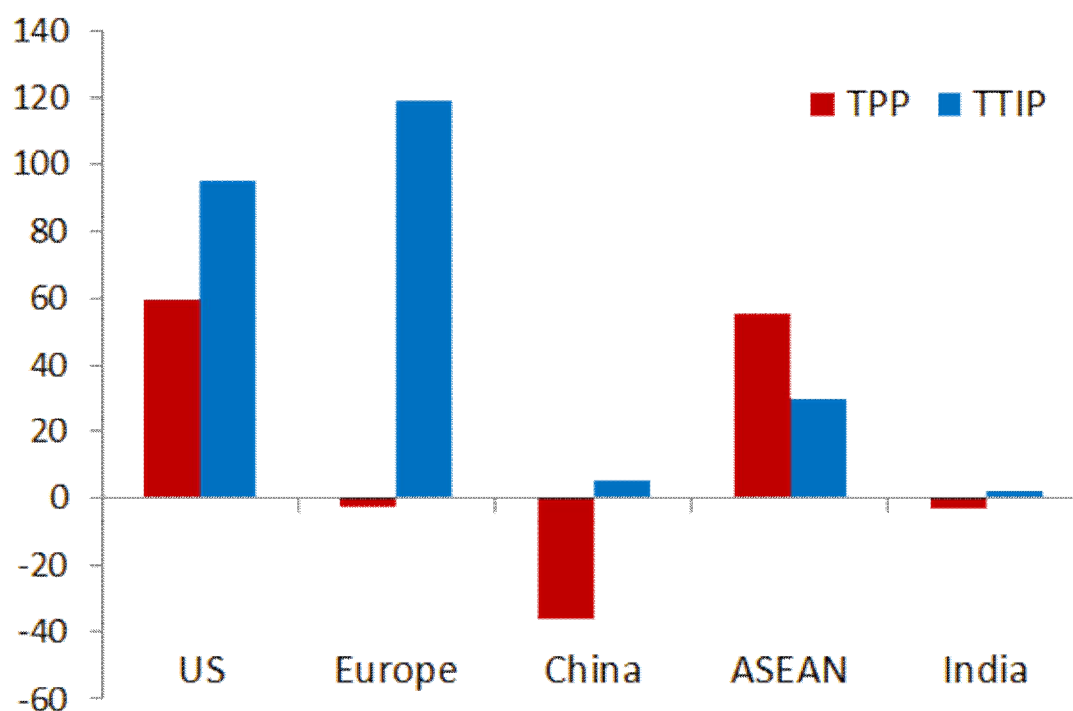
In doing so, the mega-FTA will reduce costs reciprocally both between members and non-members, and among non-members, on an MFN basis. This MFN indirect positive spill-over from mega-FTAs would increase the chances for eventually multilateralising the mega-FTAs – a process bound to have both economic and systemic positive effects at multilateral level.

The CEPR (2013) report is one of the most comprehensive and robust attempts to quantify the overall economic effects of TTIP, including the role of regulatory cost reductions. The report used state-of-the-art computable general equilibrium (CGE) modelling technique, newly collected regulatory data and reasonable assumptions about the cost reduction effects to be expected from TTIP. The report also tried to quantify and illustrate these two spillover effects described above, and factor that into the overall estimations of the TTIP economic gains, both for members and non-members.

What the CEPR report clearly suggests is that, if TTIP would involve a purely bilateral process of tariff reductions, the effect on certain trading partners would likely be net (albeit rather small) trade diverting. But once the regulatory aspect is taken into account, as Figure 1 suggests, the benefits for the EU and the US arising from TTIP will not be at the expense of the rest of the world.

- On the contrary, the benefits from liberalising trade between the EU and the US would have a positive impact on worldwide trade and income, increasing GDP in the rest of the world by almost €100 billion, in line with the Kemp-Wan-Panagarya-Krishna theoretical predictions.

**Figure 1.** TPP and TTIP: Long-term estimated GDP effects on members and non-members (billion euros)



Source: Author's compilation, based on CEPR (2013) and Petri et al. (2012). For further details on the CGE modelling assumptions, caveats and simulation parameters, see the original reports.

Given their size and level of ambition, mega-FTAs may also spur greater regional integration, notable in particular among Asian economies. As Petri et al (2012) - one of the most comprehensive and robust analysis of the estimated TPP effects - has shown, the launch of the TPP process coincided with a new impetus for further regional integration in, and the various policy-spillovers that TPP might generate in Asia could lead to sizeable economic gains. TTIP carries also an impressive economic potential. Best available estimates suggest that TTIP might bring greater economic benefits than TPP, for both the US and the EU (see Figure 1).

# Conclusions

In short, two important elements stand out from this short assessment.

- First, once we take into account the MFN spillover effects of deep regional integration, mega-FTAs produce positive economic effects on non-members, something that in the old RTA debates did not feature prominently.
- Second, given the ambitious negotiating agenda in addressing regulatory barriers and the similar objectives sought across various negotiating fora, the newly launched FTAs among pivotal trading partners, such as the EU and the US, have the potential to produce coherent results and act as a good platform for improved global trade rules.

In doing so, TPP and TTIP may act as powerful stepping stones for further MFN liberalisation under the aegis of the WTO, while promoting deeper regional integration around the world.

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1 See Kemp-Wan (1976) for the original theorem, Panagarya and Krishna (2002) for its extension to the case of FTAs and Cernat et al. (2008) for an empirical assessment.

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