

ISAS Working Paper

No. 118 – 06 December 2010

469A Bukit Timah Road
#07-01, Tower Block, Singapore 259770
Tel: 6516 6179 / 6516 4239
Fax: 6776 7505 / 6314 5447
Email: isasec@nus.edu.sg
Website: www.isas.nus.edu.sg



WTO AND RTAs: HOW THE 'SPAGHETTI-BOWL' IMPACTS ON GLOBAL 'TRADE-MEAL'

Dr. Iftekhar Ahmed Chowdhury¹

Asia has experienced an explosion of regional trade agreements (RTAs) in recent years particularly in East and Southeast Asia. Production and institutions across these regions have become further integrated due to these RTAs. The domain of integration now extends to South Asia with India and other South Asian economies getting connected to East and Southeast Asia through formal trade arrangements. Proliferation of RTAs has revived the debate on multilateralism and regionalism. While most regional economies figure in the multilateral framework of the World Trade Organization (WTO), their pursuit of RTAs has raised questions over whether they repose greater faith in regional trade networks. The Economics and Trade Policy research cluster at ISAS organised a workshop at Singapore on 20 October 2010 on 'Trade Policies in South Asia and Southeast Asia : Encouraging Regionalism?' that examined different aspects of the theme including comparative dimensions of trade frameworks, bilateral trade relations and country perspectives on regional trade. The papers are being brought out by ISAS as a working paper series. This paper is the first in this series.

ABSTRACT

The WTO generates more passions in debates or discussions on it than most other international organisations. This is largely because, more than most other bodies, it is concerned with the daily bread and butter issues affecting the common man. It is also because many do not see it as very different from the 'rich man's club' it replaced, the General Agreement on Tariffs and

¹ Dr Iftekhar Ahmed Chowdhury is a Senior Research Fellow at the Institute of South Asian Studies, an autonomous research institute at the National University of Singapore. He was the (Foreign Advisor) Foreign Minister of Bangladesh from 2007 to 2009. He can be reached at isasiac@nus.edu.sg.

Trade (GATT). In reality, however, it is different, both in terms of mandates and membership. It is based on certain principles championing free-trade, and it lays down agreed rules for trade in goods and services. It has also acknowledged the role of 'development' in fostering trade, and the 'uneven playing field' that many members confront. While it was meant to enforce universal norms, over time, a large number of RTAs and cross-regional Free Trade Agreements (FTAs) have been threatening to erode its effectiveness.

This 'spaghetti' or 'noodle-bowl' phenomenon is receiving impetus from the impasse created in the current 'Doha Round' of Trade Negotiations. Asian RTAs are, however, more politically-driven, and therefore should be seen as WTO-consistent. In fact, concepts such as the massive FTA of the Asia-Pacific, to be realized by 2020 as discussed at the APEC Summit in Yokohama in November 2010, will be a powerful factor in stabilizing Trans-Pacific political and strategic relations. As of now, they are not seen as threatening 'core' WTO principles, though a modicum of their erosion is inevitable, and WTO rules allow for such regional FTAs, under certain conditions. Indeed, they are helping the growth of an Asian consciousness and integration at a time when the continent is being seen on the 'rise', leading perhaps someday to the fruition of the concept of an 'Asian Home'.

INTRODUCTION

Few global bodies generate the kind of passions that the WTO does. A decade ago, the streets of Seattle, where the WTO Ministerial Conference was being held, were reminiscent of the streets of Paris during the epochal '*les jours de Mai*' in 1969 with thousands of screaming protesters, smoke bombs and shattered window-panes. That occurred because the WTO's decisions influence the daily bread and butter issues of the common man in both developed and developing worlds in ways much more than that of any other multilateral organisation; and because its detractors see it, albeit unfairly, as having altered little from that of its predecessor, the GATT), which was widely, and fairly, seen as a 'Rich Man's Club'. The fact that the two (the WTO replaced GATT in 1994 as a result of the Uruguay Round of Global Trade Negotiations) are different is not only reflected in their mandates (GATT dealt only with trade in goods while the WTO also includes newer challenges in the trade area such as services and intellectual property) but also in the fact that while GATT was smaller (128 member nations), the WTO membership is nearly universal (153, representing over 97 per cent of global trade, including the 'market-Leninist' economy of China which held GATT in contempt).

However, the universal and global multilateralism to which the WTO aspires is being confronted with the phenomenon of burgeoning RTAs or other kinds of plurilateral FTAs. There are countries, which doubtless find these more profitable. This paper examines the impact of RTAs and FTAs on the global multilateral system as reflected in the WTO. Most experts, while debating whether these compete with or complement the multilateral trading system, nonetheless appear to agree that the former present ‘major implications’ for the latter.² Jagdish Bhagwati has christened the proliferation of RTAs as the ‘spaghetti bowl problem’, referring to the intertwined agreements.³ The Asia-Pacific version terms it the ‘noodle bowl’.⁴ Prior to addressing the subject of the Asia-Pacific RTA and its relationship with the WTO, it would be appropriate to address the issues of this most powerful world body’s role in global trade.

The near universality of WTO has occurred mainly due to three reasons: First, due to the rapid pace at which the world economy is globalising through international trade and free flow of investments; second, due to the shift in trade policies brought about by the gradual adoption of market-oriented policies with many developing countries replacing import-substitution with export-oriented policies; and finally, due to the fact that such open policies prompted multinational corporations to obtain their components and intermediate products from low-cost locations, and therefore relocate there, a phenomenon requiring complex rules. The result was a WTO that rested upon a tripod. It comprised one, the Multilateral Agreement on Trade in Goods (including GATT 94 and associated Agreements); two, the General Agreement on Trade in Services (GATS); and three, the Agreement on Trade-Related Aspects of Intellectual Property (TRIPS). The WTO itself has the Ministerial Council at the apex as the supreme decision-making body, meeting every two years and sustained by three manifestations of the Organization. First, the General Council comprises Permanent Representatives, having two more *avatars*, a Dispute Settlement Body (DSB) to do just that, i.e. settle disputes and a Trade Policy Review Body (TPRB) to examine and advise on WTO-consistency of the trade policies of its members. Then there is a set of Committees, each focused on a major mandate of the body. The structure is serviced by a small but powerful Secretariat with a paltry budget of only US\$500

² Gary P. Sampson, ‘Compatibility of Regional and Multilateral Trading Agreements: Reforming the WTO Process’, *The American Economic Review*, Vol.86, no. 2 (May, 1996), p.88.

³ See, for instance, Jagdish Bhagwati, ‘Reshaping the WTO’, *Far Eastern Economic Review* (Jan/Feb 2005).

⁴ Robert Scollay, ‘The WTO in the ‘noodle bowl’ world’, Paper presented at Session 4 of *Asia-Pacific Trade Economists Conference* (Bangkok: 2-3 November 2009).

million (less than the figure set aside by the World Bank for Staff travels), but nevertheless it exerts enormous influence.⁵

PRINCIPLES BASING THE SYSTEM

The WTO system is based on certain principles. With regard to the first of the tripod legs on which it stands, the Multilateral Agreement of the Trade in Goods, there are four basic rules. First, protection can be provided to domestic production against foreign competition only by tariffs; the use of quantitative restriction is prohibited though there are exceptions. Second, those tariffs should be reduced and non-tariff barriers (NTBs) eliminated, with the tariffs so reduced bound against any increases being listed in each country's schedule. Third, all members must be given the 'Most Favoured Nation' (MFN) status or equal treatment. However, there are some exceptions, such as those envisaged under the RTAs, seen by some as the bane of the WTO, and those under the Generalized System of Preferences (GSP) schemes, which are politically more acceptable. Finally, 'national treatment' is to be accorded to all, i.e., no distinction is to be made between imported and domestically produced goods, both in the matter of the levy of internal taxes and in the application of internal regulations.

Trade in services, the second leg of the tripod, covers economic activities ranging from banking, insurance and telecommunications, to recreational, cultural and sporting subjects. The WTO has identified well over 150 service sectors, their characteristics being invisibility and intangibility, as opposed to the visibility of goods as trading commodities. Services comprise over 25 per cent of all trade that takes place nowadays. GATS has established a framework for discipline in the four modes in which transactions in services occur (Mode-1, cross-border supply; Mode-2, consumption abroad,; Mode-3, where suppliers move to the territory of the consumers to provide their services and Mode 4, which is movement/presence of natural persons). The two principles of MFN and National Treatment also apply to services as they do to goods with suitable modifications.

The third of the tripod's legs, TRIPS, is also governed by certain principles. It must be noted that the objects of intellectual property are the creation of human mind. The rights of the creators of innovative or artistic works are known as Intellectual Property Rights (IPRs). These include

⁵ For an analysis of the structure and influence, see Iftekhar Ahmed Chowdhury, 'The WTO and Its Future: The Slow 'Dhow' to Doha?', *Daily Star, Dhaka* (27 August 2001).

copyrights, patents and industrial designs. They also cover trademarks and other signs of product distinction, which build consumer loyalty and loyalty for their marks and brand names. The TRIPS complements Agreements developed by the World Intellectual Property Organization (WIPO). In particular, it prescribes minimum standards and periods for which protection should be accorded to IPRs. It also extends MFN and National Treatment principles. Standards of protection laid down are legally enforceable.

The multilateral legal instruments, which constitute the WTO system, are treated as a ‘single undertaking’. This means that, in one stroke, all are subject to the provisions of the Agreements and must implement prescribed rules (with varied responsibilities, as some WTO members are eligible for ‘Special and Differential’ treatment because of their low level of development). Over time, four groups linked by common interests, have evolved: developed countries, developing countries, least developed countries (LDCs), and economies in transition. They often meet separately to determine their respective negotiating positions. It is noteworthy that the member-states of the European Union (EU) speak as one unit through the European Commission at the WTO. Decision-making in the WTO is by consensus, which means in theory any member can exercise the power of veto. In reality though all shots are called by the strong and the powerful, meeting in the so-called ‘Green Room’, under the aegis of the head of the Secretariat, the Director General, currently Pascal Lamy of France. (Though negotiating ‘skill’ may have at times reduced the power gap between the rich and poor countries, as evidenced in the role played by the author in the appointment of the Director General in 1999).⁶ There has been talk of something akin to a Trade Security Council, but this is well beyond the rim of the saucer.

DOHA DEVELOPMENT ROUND AND THE AFTERMATH

The current WTO negotiating round is named after the Qatari capital, which hosted the Ministerial Conference that initiated it in November 2001. The addition of the word ‘development’ was designed to placate the developing world and to signal acknowledgment by the WTO of the close links between trade and development. The developing countries did not quite buy it, as later events demonstrated. As of 2008, the talks had stalled over differences on a

⁶ Hilary Clarke, ‘Focus: Trade Wars – The superpower elite that Sidelines the Poorest nations’, *Independent* (18 July 1999). The author was able to broker a deal in which the term of the Director General-ship was split between Mike Moore of New Zealand and Supachai Panitchpakdi of Thailand. In doing so, he was able to break an impasse that had held up substantive work in the WTO for months and caused a chasm to develop between the industrial and developing countries.

variety of issues such as agriculture, industrial tariffs, non-tariff barriers (NTBs), services and trade remedies. The most significant are those between the developed countries led by the United States (US), EU and Japan, and the developing world led by China, Brazil, India and South Africa. Not so insignificant are also the gaps between the US and Europe, particularly on subsidies that both see as being used as trade barriers by the other. Later in 2008, after the breakdown, intense negotiations were held between the US, China and India in order to agree on negotiating modalities, but not much progress could be achieved.

The basic issues in the Doha round are as follows. The EU wants to cover a comprehensive range of issues, largely to facilitate 'give and take' in negotiations across a broad spectrum. This would take the talks far beyond the minimal so called 'built-in agenda' of agriculture and services. It would seek to include 'new issues' such as investment, competition and environmental policies. The US is less enthusiastic about environment and competition policies, and totally opposed to any reforms of the 'anti-dumping' rules that enable a country to place tariffs on cheap foreign products, which are allegedly being 'dumped' in its domestic market at prices lower than the cost prices of the products.

The developing countries are reluctant about anything that can be used, or abused, by developed countries as 'disguised protectionism'. Many of them would like to carve into stone the principle of 'special and differential treatment' for their products. There are also other problems they would like to be addressed. While tariffs in industrial countries are indeed low after the previous Uruguay Round(average of 3 - 5 per cent), the products that are of interest to developing countries such as clothing, textile, footwear, and foodstuffs still face very high tariffs, at over 100 per cent. A more pernicious feature is that of 'tariff escalation', by which manufactures are charged progressively higher in relation to stages of processing, thus discouraging upgradation along the manufacturing value chain. The developing countries have a so called 'positive agenda' of their own for which they receive intellectual support from the United Nations Conference on Trade and Development (UNCTAD).

The 'mother of negotiating battles' is being fought in agriculture. Progress of liberalisation on this item is very slow. Tariffs remain high and trade has not expanded in any appreciable way. This is because some key countries protect this sector passionately for a variety of reasons, often other than economic. Hundreds of billions of dollars are being provided as support to the farmers in the EU, the US and Japan. The rationale behind this, particularly in the EU and Japan is the 'multi-functionality' of agriculture, which provides benefits such as environmental protection, food security and rural culture (preservation of the beauties of the French countryside, for

instance) that cannot be measured in pure economic terms. Pitted against this position is the so-called Cairns Group (named after that Australian town), comprising of some developed and also developing countries with keen interest in agricultural trade and who demand drastic changes in this area, in favour of liberalisation. It should also be noted that in some other developing countries, such as those in South Asia, agriculture provides most rural livelihood (as evidenced in the protests by Indian farmers), and ‘non-trade concerns’ in this sphere which are very much categorically political imperatives.

THE GENESIS OF RTAs

In recent years there has been a proliferation of RTAs. Of course they come in different waves, usually mixing political and economic goals. Indeed the EU is among the most important RTAs with multiple goals. In fact, between 2000 and 2007, 185 such arrangements were concluded. A number just under half of the 374 that were done in the whole of the twentieth century.⁷ Out of these, most have been concluded by the Asia-Pacific Region (234), followed by Europe (232) and then by the Americas (166). Indeed, at the APEC Summit in Yokohama in November 2010, it was announced that, by 2020, a massive Free Trade Area of the Asia-Pacific (FTAAP) will eliminate trade barriers on both sides of the Pacific.⁸ It may be stated here that the WTO allows for such derogation from its principles through GATT Article XXIV and GATS Article V, though the language has been kept deliberately vague. The Doha round actually vetted those, only adding some clauses to ensure ‘transparency’, the broad rule of the thumb being don’t ask too much, don’t tell too much.⁹ This has irked free-traders like Bhagwati who has claimed, ‘This is a fool’s way of doing business. Not only does it destroy the efficient allocation of resources, but it flies in the face of the fact that today it is becoming almost impossible to define whose products are whose. It is hard to believe that the sensible men in charge of trade policy today... are damaging the world trading system through discriminatory PTAs as much as the

⁷ Gary Clyde Hufbauer and Jeffrey J. Schott, ‘Fitting Asia-Pacific Agreements into the WTO System’, Paper presented at a Joint Conference of The Japan Economic Foundation and the Pearson Institute for International Economics, Washington DC (27 November 2007). Later statistics on the numbers are also derived from this presentation.

⁸ ‘Turning dream into reality’, *New Straits Times* (15 November 2010).

⁹ Gary Clyde Hufbauer and Jeffrey J. Schott, ‘Fitting Asia-Pacific Agreements into the WTO System’, Paper presented at a Joint Conference of The Japan Economic Foundation and the Pearson Institute for International Economics, Washington DC (27 November 2007). Later statistics on the numbers are also derived from this presentation.

protectionists did in the 1930s'.¹⁰ Nevertheless, the fact is that RTAs have come to stay, and expand.

ASIAN RTAs

The growth in Asian RTAs was a product of the 1997 Asian financial crisis. When the response from the IMF was inadequate, Japan called for an Asian Monetary Institution. The Chiang Mai Initiative was a watered down version of the same. Hence, economic and political regionalism went hand in hand. Ironically China, after it joined the WTO in 2001, became the chief contributor to the 'noodle-bowl' phenomenon, first by linking up with Association of South East Asian Nations (ASEAN), which to date had shown little positive intra-trade inclinations as evidenced in the ASEAN+1 framework in 2002. This occurred, despite the belief that China's 'WTO membership status also meant that Beijing agreed to treat all WTO member nations equally, meaning that the same tariffs and the same regulations had to apply equally for everyone'.¹¹ Eventually, however, it entered into similar arrangements with many others; the thrust appeared to be political rather than economic, in many ways, looking like a bid for regional leadership. As an analyst has observed: '...The recent East Asian Regional Arrangements are less threatening to the world trade system than they appear. They do not threaten the MFN tariff structure in a meaningful way, and if they can promote trade facilitation this will likely benefit Asia traders from all countries. The major threat is political rather than economic, if the struggle for Asian leadership becomes disruptive to harmonious relations. Non-Asian policy makers should worry more about soothing these antagonisms than about the economic threat of regionalism.'¹²

SUPACHAI, LAMY WEIGH IN

Acknowledging that RTAs are an inevitable reality, trade-policy realists feel that that the aim should therefore be to evolve a *Modus Vivendi* between multilateralism and plurilateral-bilateral arrangements in trade. Since, in the WTO, the head of the Secretariat is always considered a key

¹⁰ Jagdish Bhagwati, 'Reshaping the WTO', *Far Eastern Economic Review* (Jan/Feb 2005).

¹¹ Thomas L. Friedman, *The World is Flat: A Brief History of the Twenty-First Century* (New York: Picador, Farrar, Straus and Giroux, 2007), p.139.

¹² Richard Pomfret, 'Asian Regionalism: Threat to the WTO-based Trading System or Paper Tiger?', *Vox* (22 June 2007), <http://voxeu.org/index.php?q=node/309>. Accessed on 27 September 2010.

player, it is important to examine their views on this emerging trend. The immediate past Director General Supachai Panitchpakdi commented, “The emergence of diverse and relatively complex regional regulatory structures can reduce trade policy options for WTO members and seriously hinder multilateral trade negotiations. In a world of scarce resources it is clear that the increased resources required for negotiation and administration of agreements at the regional level, may divert attention away from efforts at the multilateral level. Also, as RTAs proliferate and their scope broadens to include policy areas not regulated multilaterally, the risks of regulatory confusion, distortion of regional markets and severe implementation-al problems are likely. This will be to the detriment of all members, but small countries which already suffer from limited negotiating leverage and capacity will be disproportionately affected”.¹³ The solution he proffers is for sustained efforts to be made in the Doha Round.

The current Director General of the WTO, Pascal Lamy, is also naturally concerned. To bring the RTAs into consonance with multilateralism, he has suggested four ways. First, the Doha round should be brought to a successful closure, since it would also further reduce the scope for discriminatory trade policy, not to mention all the other benefits from trade cooperation that would induce governments to enter into these kind of negotiations. Second, to fast track the transparency decisions negotiated in the Doha Round and make it operational as it would help the understanding of different RTAs. Third, to operationalise the negotiating mandate under Doha to examine the WTO rules governing regionalism. Finally, to look systematically at the characteristics and design of RTAs, not only in terms of legal compliance questions but also in terms of whether their architecture will, more or less, be likely to foster multi-lateralisation in the future.¹⁴

CO-EXISTENCE

It seems that if the WTO and its component bodies like the TPRM monitor the phenomenon closely, it could work to buttress multilateralism. In a much earlier study, Kemp and Wan looked at such possibilities theoretically with regard to customs unions. They have said, ‘...There is a big incentive to form and enlarge a customs union, until the world is one big customs union, that

¹³ Supachai Panitchpakdi, ‘The Doha Development Agenda: Challenges Ahead’, *Fourth EU-ASEAN Think Tank Dialogue*, (European Parliament, Brussels 25-26 November 2002). *WTO News: Speeches- DG Supachai Panitchpakdi*, http://www.wto.org/english/news_e/spsp_e/spsp07_e.htm. Accessed on 24 August 2010.

¹⁴ Pascal Lamy, ‘Proliferation of Regional Trade Agreements Breeding Concern’, *WTO News, Speeches- DG Pascal Lamy* (10 September 2007), http://www.wto.org/english/news_e/sppl_e/sppl67_e.htm. Accessed on 24 August 2010.

is until free trade prevails.”¹⁵ This is unlikely to happen anytime soon because much depends on how these agreements are drafted. Another analyst, Whalley, correctly assesses that ‘if the content of these RTAs remain vague, the agreements primarily are diplomatic arrangements negotiated for geopolitical linkage rather than significant economic impact’.¹⁶

Indeed, almost each and every member of the WTO belongs to one or several RTAs. Each RTA is different and the WTO members do not perceive these as threatening WTO’s core principles. This is where pragmatism appears to be triumphing over pure theory. The RTAs accommodate aspirations of some members more directly and the merger of this phenomenon with WTO values would enhance the image and effectiveness of the WTO with most members. This WTO-plus perspective would therefore be more acceptable than a pristine and narrow WTO. The global body provides many useful services. First, the Ministerial Conference meets every two years, and the General Council more regularly, to provide a forum for members, both weak and powerful, to deliberate on issues of global interest. Second, the TPRM actually renders immense service through ‘peer-reviews’ to sharpen and hone their trade policies; the DSB has actually helped resolve some key trade disputes, though a methodology would need to be evolved for poorer countries to use this costly mechanism more effectively. Third, the theoretical acceptance of the principle that trade is linked to development is a positive advance in globally acknowledged norms by developing countries. Finally, the WTO also provides effective technical assistance to countries that require it.

So, in the foreseeable future both the WTO and the RTAs are likely to continue to coexist. Neither can or does seek pre-eminence over the other, as indeed should be the case. But if globalism in trade norms is to hold forth, the Doha Round should be brought to a closure. Its remaining in limbo helps none. The negotiations will continue to be long and arduous but if there is a hill to climb waiting will not make it any smaller.

¹⁵ See, for this quote and further argument on this line, M.C. Kemp and H. Wan, ‘An Elementary Proposition Concerning the Formation of Customs Unions’, *Journal of International Economics*, Vol.6 (1976), pp.95-8.

¹⁶ John Whalley, ‘Recent Regional Agreements: Why so many, Why so much variance in form, Why coming so Fast, and Where are they headed?’, *CESIFO Working Paper No.1790, Category 7: Trade Policy* (August 2006), presented at CESIFO Venice Summer Institute (July 2006).

A FINAL WORD ON ASIAN REGIONALISM

There is also a growing sense of Asian regionalism that is somewhat distinct from relations with the WTO. This merits serious examination. The initial *'primum movens'* was economic as political relations were still murky. Of course, the concept of Asian regionalism or indeed Asian integration gained traction following the crisis of 1997 and 1998. The Ewes a good model and the success of the single European currency set a good example. During the Asian Development Bank (ADB) meeting in Hyderabad in 2006, the two issues discussed were the agglomeration of Asian economies culminating in the Asian Free Trade Area, and the formation of an Asian Monetary Union with a single currency. Both proposals converged into one single objective: an Asian Economic Union.

But there is a flip side of the coin from Europe. The EU comprises countries with homogenous characteristics and with the same social and religious fabric. There is a large element of economic, political and cultural cohesion. Asia is far more diverse and disparate. In Europe, which has lived through the Westphalian State system for over three and a half centuries, national borders, over time, have assumed less importance. On the other hand, Asian states are still at a point in time where, politically and intellectually, they are stressing distinctiveness rather than commonality vis-à-vis one another to underscore individual sovereignty. Also in Europe, the three major players Britain, France and Germany, have largely made up their differences. Whereas in Asia, can the three major actors- the Japanese Godzilla, the Chinese Dragon and the Indian Elephant tango together? (This is of course metaphorical for in this dance two is the requirement, and three is a crowd.)

Nonetheless, there is a remarkable sense of burgeoning Asian-ness. Today the phenomenon of the 'rise' of Asia is being witnessed particularly that of the two Asian 'mega-states': China and India. Some would even argue that the Asian Age has come upon sooner than expected. In 1935, the Japanese economist Kaname Akamatsu had developed a multi-tiered hierarchical 'flying geese model' to demonstrate how industrialisation travels from developed to developing countries. Can the flying geese paradigm be applied to Asian integration, with the big countries leading and the small ones following? Can the Asian groupings like ASEAN, South Asian Association for Regional Cooperation (SAARC), Gulf Cooperation Council (GCC), and Shanghai Cooperation Organisation (SCO) come together, someday, under the umbrella of a single 'Asian Home'? It is true though that the consciousness of being Asian is beginning to take root among the people of the region. The concept of the loose Asian Home is just an idea, but

one that surely deserves some attention. As the mighty poet and Nobel Laureate Rabindranath Tagore had said, 'You cannot cross the sea by standing at its edge and staring at the water'!