Multilateralism or bilateralism – Which path for Europe?

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Minister, State Secretary, Commissioner, og mine kære danske venner,

I have been asked to comment on multilateralism versus bilateralism in EU trade policy. The question whether there is a contradiction between them may have lost some of its urgency as it is almost self-evident to policy-makers and commentators that these two approaches to trade liberalisation are not mutually exclusive. In the words of my colleague Roderick Abbott, 'multilateral and bilateral trade liberalisation are two sides of the same coin', and any antithesis between them merely artificial. As we enter into a Post-Doha era, the WTO and FTAs will play important, yet different, roles.

First, our trade ministers are now en route to Geneva next week to read the litanies over Doha. The era of big trade rounds under single undertaking is likely over, but the narrative of the WTO system goes beyond attempting impossible trade rounds. The WTO provides a solid framework with enforceable rules, with checks and balances. Its track record in containing crisis-induced protectionism may be inconclusive, but it is undeniable that the organisation has defused more than a handful of trade wars. Also, the organisation provides the ground rules for our trade with parties the EU is less likely to conclude bilaterals with: namely China, and now perhaps also Russia. One might call the WTO the anchor-chain or a FTA with China. It plays the same role in south-south trade, between parties that lack capacity or leverage to conclude bilateral agreements.

Second, the WTO is not dysfunctional – it is just starting show the symptoms of the systemic flaws of multilateralism. In Geneva, we used to call this process the 'UNCTAD-ification' of the WTO, named after its estranged UN sibling. This process is now almost complete with a near universal membership. Many forget that both GATT and GATS started amongst a group of open traders and eventually grew to universal membership. This is why the future of the WTO is likely to return to its original roots of plurilateral deals amongst coalitions of like-minded economies.

Amongst the likely candidates for plurilaterals, a new cluster-agreement for the digital economy remains the most obvious subject. The current IT Agreement dates from mid 90s when few had heard of the internet or smartphones. Software were still delivered on 3.5 inch disks; VHS was market standard while online content, or let alone DVDs, were yet invented. In the time of cloud computing, these limited provisions on select tariffs are still the only WTO accords on the digital economy. The WTO must adapt to how digital trade and trade barriers has evolved or find itself irrelevant.

Next, services has always been an outstanding issue and the Cinderella of the DDA behind NAMA and agriculture, with no new market access on offer for the European Union. There is a strong case for a plurilateral on services that encompass all sectors and modes of delivery. The concentration of services trade is very high, with the top ten economies accounting for 70 percent. Reaching 90% of world trade require only 27 economies, while the remaining tail of minor players account for less than 0.2 percent on average. The question is whether a services plurilateral can be – or is worth pursuing – without the emerging economies.

Regardless of which sector we may pursue the plurilateral liberalisation, previous experiences tell us that clarity of definitions is crucial to avoid backdoors for protectionism. It may be tempting to incorporate non-market access disciplines and rules, but they would render the agreements virtually impossible to negotiate. Finally, managing issue-linkages are fundamental. Trade negotiators are not inclined to make unilateral concessions for free even if their own business demands it – in fact, some even argue that the worst trade barriers are not tariffs nor NTBs, but their own trade negotiators. Sector deals are therefore more feasible and likely to happen where fragmentation has made trade balances and deficits outmoded political concepts. I am less certain about where an agreement on sustainable energy sits in this regard.

Now to the question of EU bilaterals. Many critics of FTAs have pointed to their limited economic value, while bilaterals are eroding the incentives to offer more in the Doha round, effectively arguing that we should focus on the bigger fish. It is true that the EU-Korea FTA was politically significant as the first one to focus on regulatory issues while the effects on jobs and growth was only 0.08 percent of GDP for the EU, or about 7 euros per European.

However, even the most optimistic estimates valued the overall market access of the Doha round at 0.2 percent of GDP, which is roughly the value of two and a half EU-Korea FTAs. The rest was assumptions on services and trade facilitation that was never on offer. This is clearly less than all the FTAs the EU is about to finalise, and it is difficult to envisage any deep and comprehensive agreement on regulatory issues with all the WTO members in their various stages of development and regulatory capacity. Just for reference, static and dynamic gains from removing only tariffs between the EU and the US (TAZA, the Transatlantic Zero-tariff Agreement) would be twice of the Doha round.

This is why only market-deep liberalisation between the world's large traders, e.g. the US, China, Japan (and perhaps India) are likely to have any lasting impact on growth and jobs in the EU. But these bilateral relations reveal challenges and structural problems in EU trade policy.

First, all form of liberalisation rewards competitive firms while speeding up industrial restructuring in inefficient sectors. The crisis-struck EU is less likely to make the difficult trade-offs between sectors that are necessary to conclude big FTAs that can afford to walk away from the negotiation table. It would be unrealistic to assume EU supremacy in all sectors, or that we would gain on every issue. For example, the FTA with Japan would be the biggest FTA in the world to be ever attempted. It is currently obstructed by fears of increased imports in just a couple member states with highly inefficient cars industries, where the sector account for just a couple of percent of total value-added and employment.

Second, all FTAs set precedence while they are rarely subject to renegotiations. The EU-Mexico agreement concluded in 1997 has not been subject to any substantive revision, why FTAs with rapidly emerging economies like India must take into account their future growth. Turning a blind eye to increasingly discriminatory regulations of India erodes our negotiation position with other developing countries. It would be very difficult to argue why other developing countries like China would not pursue same policies, if we give India a free pass on public procurement, foreign equity caps, ICT restrictions or patents.

This leads us finally to the question of China. China has been quick to seize the reversal of our fortunes. While we are in midst of perhaps our worst political and economic crisis, China's growth stands above 9 percent. This is also the first year where GDP growth was notably spurred by China's domestic demand, yet their growth is still fragile and largely induced by investments from West. China's transition towards a service and value-adding economy has barely started.

This however, does not change perceptions of our Chinese counterparts of our weakness. It explains, at least partially, why China has become less inclined to make earnest offers to liberalise their economy, for example on government procurement. It is true that China opened up when she was faced with deals and contexts that were too expensive to stand outside – it was this rationale that drove them into the WTO, or why TPP is seriously amounting a pressure on them to attempt a stillborn RTA with Korea and Japan, and even concluding a FTA with Taiwan.

So what are our bargaining chips when accessing the Single Market is less in demand amongst Chinese domestic constituency, and rather look to exploit its own inner market? Reciprocity and non-MFN conditions only help China to keep its growth to itself, while result in serious loss of face for the EU. There are plenty of things that China wants from the EU, but not necessarily within the area of trade or from European institutions.

This conclusion is also the key challenge of the Danish Presidency, which it will share with the Commission, namely to make the post-Doha and post-Crisis agendas interlock. This entails leadership globally and internally.

My colleagues at ECIPE talk of the waning narrative for free trade, and soft mercantilism taking its place. EU trade policy is not above such accusations, and even prime suspect of such inclination. As a non-ideologue, I argue that the sovereign debt crisis is limiting our policy space on trade. Our options are not only limited by external factors, such as the systemic shift of relative powers or the loss of a few bargaining chips. The policy space on trade is limited from within – when Italy vetoed our FTA with Korea, I likened our difficulties to driving a vintage Fiat 500 uphill with 27 mother in laws in the backseat, each with a hand on the handbreak. With 27 member states, there is always an upcoming elections in a member state where the incumbent risk being ousted, or an irrational romantic nostalgia for national ownership in some manufacturing sector.

Failing to meet these trade policy challenges – either by mercantilism in the member states, or delusions of grandeur and misfired economic statecraft – may lead to its first serious policy failure. If we have made an miscalculation, it will lead to isolationism, subsidised sunset industries and increased government spending – instead of EU firms tapping into world's growth markets.