

Preferentialism and the Multilateral Trading System

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- 1 -

Overview

- I. The Post-War Trade Regime - Non-Discrimination as the core principle
- II. A threat to the system: Preferential agreements and their consequences for the multilateral order
- III. Options for reform: improve regulation on PTAs

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- 2 -

The core principle

- Purpose of Art. 1: Prevent discrimination
- Most-Favoured-Nation (MFN) treatment: Liberalization between two members granted to all other WTO members
- Motives of our forefathers: economic *and* political
- 1930s: Preferential trade agreements, decline of world trade *and* increasing conflicts
- 1934-40: USA 22 bilateral agreements; Germany 25, Great Britain, Japan

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- 3 -

The core principle

- Legal basis: Art. 24 GATT treaty (1947)
- Free trade areas and tariff unions (2 to x)
- Strict conditions - in particular substantially all the trade
- Still undefined - all existing trade or all potential trade?
- Time frame - initially vague, now defined as maximum ten years

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- 4 -

The core principle

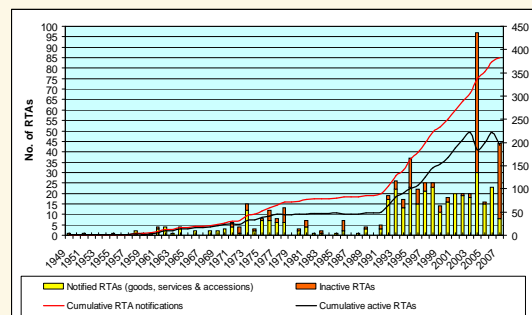
- Post world war order: Preventing the discrimination of third parties
- Art. 24 as an exception from the rule
- Today: Bilateral agreements are the norm
- 2005: More than half of world trade governed by preferential trade agreements
- Not exactly clear - preference utilization
- New trend: Asian actors extremely active; in contrast to before 2000

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- 5 -

Preferential trade agreements 1947-2007



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Preferential trade agreements

Economic disadvantages

- Less efficient than multilateral liberalization (esp. bilateral agreements)
- Complex administration (rules of origin)
- Smaller players lack capacity to comply with rules
- Costs of issuing certificates of origin reduces economic advantages
- Transnational production networks - Paneuro

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- 7 -

Preferential trade agreements

Political disadvantages

- Third parties are discriminated against
- Policy makers distinguish between friends and foes – New Zealand/ Australia
- Trade regulation gets re-politicized
- Potentially: dispute settlement by-passed - forum shopping? (superior regulation in NAFTA – but how make the USA comply?)
- Competition between EU, USA and China

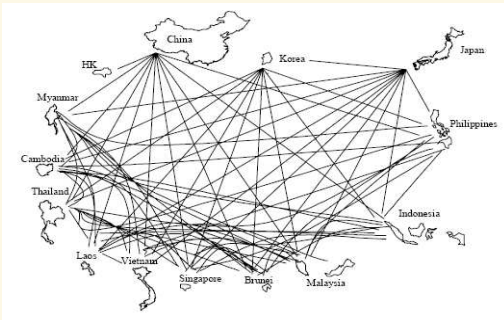
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Preferential trade agreements in Asia

(2006, incl. agreements currently under negotiation)



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- 9 -

Preferential trade agreements - Motives

- Complex search for motives, amongst others:
- Criticism towards Globalization in OECD countries, less support for free trade
- CNN effect : trade deals get media coverage, the WTO doesn't
- And: stalemate in Doha round
- Plus: secure market access (to USA in particular)
- Expression of foreign policy goals

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- 10 -

Proposals for reform

- Proposal 1: Clarify and improve disciplines and procedures, e.g. define „substantially all the trade“, harmonize rules of origin
- Proposal 2: Big economies to refrain from preferential agreements, also large developing economies
- Proposal 3: Improve transparency mechanism on PTAs to improve surveillance and develop best practices
- Best practices - depended on will to consider

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- 11 -

Proposals for reform

- Additional option 1: no dispute settlement in preferential agreements (forum shopping)
- Additional option 2: modify Art. 24 - only permit customs unions – true stepping stones
- Additional option 3: Scrap “Enabling Clause” of 1979 – end of shallow agreements between developing countries
- Of course: First best option – make the WTO the most attractive venue for the regulation of international trade

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- 12 -

Conclusion

- Preferential agreements undermine WTO
- Current situation a dilemma: all WTO members are engaged in PTAs, no country or group of countries willing to end this race
- Yet to happen: PTA between major Asian player and USA or EU (KORUS?)
- Potentially useful: collective effort to distinguish between good, bad and ugly PTAs
- Without: more termites in the system