



Wilfried  
**Martens Centre**  
for European Studies

**The Future of Global Trade**

**IN FOCUS**

**Between Multilateralism and  
Regionalism**

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## Summary

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This paper briefly describes how international trade has been transformed in recent years and what has determined its increasing politicisation. It argues that the two main pillars of the global trading system—international trade regulation and the dispute settlement mechanism—are being put under strain due to various developments. The whole system is being challenged by opposing tendencies: on the one hand, the multiplication of global risks and opportunities demands common action and multilateral rule-making; on the other, we are witnessing increasing fragmentation and regionalisation. The realistic objective that can now be set for the future development of world trade is the preservation of as much as possible of the present system and its improvement in specific areas.

**Keywords** International trade – Multilateralism – Globalism – Nationalism – World Trade Organisation



# Introduction

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International trade is being tested by a growing number of economic, political, ideological, institutional and legal challenges. On the one hand, the future of the global trading system depends largely upon the development of these 'external', uncertain challenges, with their various attendant risks and opportunities. On the other hand, international trade, and the functioning of the global trading system, is one of the major factors that has a significant impact upon the shaping of the present and future world order. The purpose of this paper is to understand how the global trading system is changing, the challenges it is facing and whether its important achievements can be safeguarded.

## Recent transformations in international trade

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Trade has always been the driving force of economic growth, employment, prosperity and the progress of humanity. However, the forms, objects, technicalities and rules of trade have continuously changed throughout history. These changes are accelerating rapidly, but the substance and function of the exchange of the products of human activity on the local, regional and global levels have remained essentially the same: creating wealth and promoting welfare. What used to be limited to the exchange and physical movement of goods has been extended to the exchange of services of all kinds and, today, is increasingly engulfing the flow of data too.

The fundamental shift in the relationships between trade in goods, trade in services and the flow of data due to the breath-taking development of technology has created the impression that trade is losing its importance and that the major transformations are taking place outside of trade in its traditional sense. However, technological change does not diminish the role of trade in the broadest sense, that is, in the exchange of everything that is created physically or intellectually by humans, including algorithms for robotisation, automation and, ultimately, artificial intelligence.



It is true that the volume of goods moved around the world—in particular those goods carried by sea—is not increasing (indeed, it is on the wane, not only relative to trade in services, but also to global economic growth).<sup>1</sup> However supply chains are becoming ever more complex, increasingly relying on new technologies, in which data takes the place of components. All in all, the ancient saying *navigare necesse est* is still valid; indeed, in an abstract sense it is more relevant than ever.

## Increasing divisions in international trade

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Because of the deep-rooted and sweeping transformations in the nature, structure and forms of international trade, both macroeconomic theory and political doctrine are becoming fundamentally divided on a wide range of issues previously considered as settled based on conventional wisdom.

Are bilateral trade imbalances still (or again) relevant or, in a multilateral global economic system, can they be considered irrelevant? What are the main causes of perennial bilateral deficits? Are there general macroeconomic causes behind these imbalances, such as excessive spending and saving on one side or the other? Or is it the ‘manipulated’ value of some countries’ currencies, or the unfair rules established by multilateral or regional agreements or, indeed, the persistent violations of them, that are to be primarily blamed for all of these disequilibria?

Conflicting economic theories, and diverse and opposing ideas and arguments are swirling around in academic, as well as public, discourse and are becoming part of heated political debates. Political ideologies have come into play, and as a result, subjects that were once somewhat neglected in political debates have become areas of fierce debate and battlefields for ideological clashes. The Transatlantic Trade and Investment Partnership, the Trans-Pacific Partnership (TPP) and the North American Free Trade Agreement are just some of the cases in point. The war is therefore equally economic, political and cultural, and the conflicts between national interests are compounded by deep ideological divides which have been appropriated by political movements for their own purposes.

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<sup>1</sup> See International Monetary Fund, *World Economic Outlook* (Washington, DC, 2014). Similar conclusions can be found in the same publication for 2015 and 2016, as well as in the projections for 2017.



The internal conflicts and challenges of the world trading system are being aggravated by the geopolitical challenges and the tectonic shifts that are happening all around the world. The changes in the economic and geopolitical power structure of the world; the absence of a single dominant power or hegemon; the growing fragmentation of the economic, geopolitical and cultural world order; the rise of a multi-actor, multi-stakeholder world; the re-emerging spheres of influence; and the growing antagonisms, and all the risks and threats these changes entail, are challenging an international trading system that is fighting for its survival and to save the tremendous achievements of the last 70 years.

## The challenged pillars of the global trading system

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The global trading system, as established and developed by international trade law, stands on two—interconnected—pillars. The first is international—multilateral and regional (bilateral)—rule making; the second is the adjudication of disputes on the basis of these regulatory instruments.

### International trade regulation

As is well known, developments in multilateral trade regulation came to a standstill around 20 years ago and have since appeared to be frozen. Minor developments have been achieved, such as the Trade Facilitation Agreement (Bali, 2013) and the Information Technology Agreement (extended in Nairobi, 2015), but most of the original aspirations of the Doha Round have simply failed and are not expected to materialise, even in the long term.

The substantial increase in the number of participants in the global game, the changes in their relative economic weights and political clout, and the absence of a timely adaptation to their presence have certainly contributed to the deadlock in multilateral rule-making. Another factor is how the scope of the regulations has been over-stretched. The existing structure is no longer able to carry the multiplied weight of the growing number of targeted areas of law-making. In the wider context, the freezing of the multilateral regulatory process also reflects the overall gridlock in the functioning of global institutions and global governance.



The realistic objective that can now be set for the future development of the multilateral regulation of world trade is, first and foremost, the preservation of the present system with all of its substantial achievements. At the same time the ‘global *acquis*’ of the regulatory system should and can be improved, developed and aligned with the new demands and realities that exist in some specific, limited areas, as has happened in recent years. These should be the basic aspirations for multilateral (global) rule-making in the present situation. At the same time, developments on other regulatory levels will unfold further, and are in many fields equally or even better suited to tackling the issues of international trade,<sup>2</sup> which—as we have seen—is undergoing a deep and accelerating transformation. It is not only trade in the widest and most abstract sense that is rapidly changing, but also the social, political and economic demands and expectations of trade that are intensifying and having an even stronger impact upon all kinds of rule-making.

## The dispute settlement system

While multilateral trade regulation seems to have reached its limits, which also appear to be in line with the apparent—structural or conjectural?—slowing down of globalisation, the other pillar of the world trading system is still in fairly good shape and functions satisfactorily. The Dispute Settlement System (DSS) of the WTO is often referred to as the ‘bright spot’ of the international trading system,<sup>3</sup> handling a growing number of complex and serious disputes between various members of the WTO with a very high ratio (90%) of compliance. Because of the freezing of the rule-making branch of the system and the unfulfilled need for the adjustment and development of the rules, the dispute resolution mechanism has been obliged, in a way, to take over some of the tasks of regulation and to resolve issues that would normally be tackled by the organic development of the legislative process. The DSS has therefore become a victim of its own success: it is being flooded with a growing number of disputes of increasing complexity, non-trade issues are on the rise and the system is becoming ever more overloaded. At the same time, it is a mistake to believe that the DSS, that is, the judicial function of the WTO, can take on not only the responsibilities

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<sup>2</sup> Most notably in the field of bilateral and regional trade agreements.

<sup>3</sup> ‘[T]he Dispute Settlement System (DSS) of the WTO continues to be considered a success story, and rightly so’ (G. Sacerdoti, ‘The Future of the WTO Dispute Settlement System: Consolidating a Success Story’, in C. A. Primo Braga and B. Hoekman (eds.), *Future of the Global Trade Order*, Badia Fiesolana (European University Institute and IMD, 2016), pp. 46).



of part of the legislative function, but also the ‘whole pain of the world’, from environmental protection to labour law, from sanitary measures to social welfare or from data protection to human rights. The result is that procedures are taking an increasingly long time to complete and that there has also been a fall in prompt compliance.<sup>4</sup>

Despite these and other challenges, the multilateral DSS remains the most successful part of the world trading system. It is not perfect, but it is fair and efficient. This is why the multilateral DSS seems to be more popular than the dispute settlement mechanisms of the regional trade agreements (RTAs). While there is an ongoing academic discussion on the relationship and the possible jurisdictional conflict between the DSS and other mechanisms, the fact is that the ‘vast majority of RTA – [dispute settlement mechanisms] have not been used at all’, and even ‘[free trade agreement] partners continue to use the WTO dispute settlement mechanism to resolve disputes between them’.<sup>5</sup> One of the reasons for this preference for the WTO mechanism is no doubt its more legalistic character, both in a substantive and a procedural sense.

The bright spot of the international trading system is, however, exposed not only to legal or procedural risks, but also to threats of a general and fundamental nature. The dark clouds that seem to be assembling on the horizon of the multilateral trading system, that is, the general political and economic environment, will have a negative impact upon the judicial function as well. If this function is severely damaged, the overall system could receive a mortal blow. This is why all efforts must be taken to improve the DSS itself, by adapting it to the new challenges it is facing, as well as to the political and economic realities.

Procedural improvements to the DSS are needed and would, undoubtedly, be helpful. Whatever these changes might be, it must be made clear that the judicial function cannot, by itself, save and secure the future of the multilateral trading system. The DSS will be unable to appropriately fulfil its function without a solid legislative basis, that is, a foundation of rules that are not frozen, but evolve, adapt and develop according to changes in the economic and political environment.

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<sup>4</sup> Ibid., 47–9.

<sup>5</sup> C. Chase, A. Yaovich, J.-A. Crawford and P. Ugaz, ‘Mapping of Dispute Settlement Mechanisms in Regional Trade Agreements—Innovative or Variations on a Theme?’, in R. Acharya (ed.), *Regional Trade Agreements in the Multilateral Trading System* (New York: Cambridge University Press, 2016), 610.



The legislative and judicial functions cannot be separated and are ultimately not only interlinked, but also interdependent—one cannot survive without the other.

## The challenge of RTAs

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It cannot be contested that one of the main reasons for the rapid growth of RTAs has been the deadlock in the multilateral rule-making of the WTO. At the same time, the differentiation of the multilateral system started well before the slowdown or the standstill in multilateral rule-making occurred. It began with the birth of the system in 1947, with the provision in the General Agreement on Tariffs and Trade (GATT) for exceptions from and derogations to the principle of equal treatment as implemented by Most-Favoured-Nation treatment.<sup>6</sup> The interpretation of this provision broadened, both in law and in practice and, at the time that the WTO was established, what had been the general rule with limited exceptions had, in reality, become the exception.<sup>7</sup>

This tendency was substantially accelerated by the special bilateral or regional (plurilateral) agreements allowed by the GATT itself.<sup>8</sup> While the cornerstone of the multilateral system is the fundamental principle of equal treatment and the objective is to achieve progressive multilateral liberalisation, not to establish free trade, the purpose of the RTAs is precisely the opposite. Their objective is to establish special regimes, in most cases free trade between the parties. These agreements are by their very nature discriminatory, granting special rights and benefits for their parties and, by the same token, depriving non-parties of the same rights and benefits.

By the end of 2016 the total number of RTAs in force and of which the WTO had been notified under the Transparency Mechanism of RTAs was 271.<sup>9</sup> Of all the RTAs in force, 20% are European, 17% are in East Asia, 12% are South American and 9% are operational in the Commonwealth of Independent States. The EU has by far the highest number of RTAs and these are increasing in number in line with its growing global outreach. The US (20) and China (14) follow the EU at a significant distance. The disparity

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<sup>6</sup> See General Agreement on Tariffs and Trade (Geneva, 30 October 1947), art. XXIV.

<sup>7</sup> J. Martonyi, 'The Decline of Equal Treatment in World Economy, Foreign Trade', *Legal Studies* 2015/1 (2015), 1–13.

<sup>8</sup> See GATT, art. XXIV; or WTO, General Agreement on Trade in Service (Marrakesh, 15 April 1994), Enabling Clause, art. V or paragraph 2c.

<sup>9</sup> WTO, 'Recent Developments in Regional Trade Agreements', INT/SUB/RTA/153, July–December 2016. It is unknown how many RTAs the WTO has not been notified of and therefore how many do not appear in the WTO Transparency Mechanism.



between the US and the Chinese in terms of the number of agreements will soon be reduced and probably reversed due to two main factors. The first is the US decision to step back from the TPP—and possibly other similar agreements in the future. The second is Chinese expansion, which will not only fill the Asian vacuum created by the US, but also reflects the nation's global geopolitical and economic ambitions. The new bilateral or 'transactional' approach taken by the US and the more active Chinese trade policy, driven by its growing assertiveness, global vision and aspirations, might not only reverse the present ratio in terms of the numbers of free trade agreements and RTAs, but may also affect the geopolitical and economic balance between the two superpowers in China's favour.

The growth in RTAs has not been limited to their numbers but also extends to their coverage, as their scope has become more and more comprehensive, including provisions on intellectual property, competition, government procurement and investment, and also regulations on the protection of human and animal health, the environment, labour, social welfare and human rights. This overreach in scope has led to RTAs encountering very similar challenges to those that have halted the progress of multilateral regulation. However, the consequences of these extensions to the areas regulated differ widely between the multilateral rule-making process and the RTA process. Since RTAs are essentially free-trade agreements, their regulations go much further 'beyond the border' and interfere with the national regulatory autonomy of the parties much more.

This is where serious political conflict enters the scene and turns an economic matter into an ideological clash between two increasingly divided sides; the subject is increasingly being appropriated for political purposes. Such a conflict provides an ideal space for 'globalists' and 'sovereignists' to display and advocate their emotionally laden ideological prejudices, and such clashes can jeopardise efforts aimed at promoting freer, fairer and more rules-based trade: these rules have the basic function of protecting and safeguarding the interests of the smaller and the weaker.

One way of easing the tension created by these conflicting world visions could be to exercise more restraint in widening the scope of the agreements, the original function of which was, after all, limited to promoting free and fair trade. Political controversies are, in any case, difficult to avoid, given not only contrasting ideological convictions, but also the underlying material, indeed, economic interests. It should also be noted that quite frequently the same political and societal movements that demand respect for the regulatory sovereignty of nations strongly request the validation of





social, labour and human rights in other countries, hence the inclusion of such provisions in the agreements.

Out of the four drivers behind the establishment and shaping of RTAs—geographic proximity, economic policies, supply chains and geopolitics—the third and fourth factors have been steadily gaining in importance for at least a decade. When RTAs first emerged, it was clearly the geographic factor that was the most visible: free trade areas or customs unions were essentially developed between or among neighbouring countries. The economic and social philosophies determining the political and social order, as well as the economic and trade policies of the potential partners of an RTA, also used to play a decisive role, as free trade was (and still is) unimaginable without a certain level of market economy and, accordingly, WTO membership. As time has passed, however, RTAs have increasingly come into being not only between geographically remote countries, but also between parties whose economic, social and political orders show significant discrepancies. The Association of Southeast Asian Nations was the first, but is not the only clear example of this, where ‘ideological diversity’ has been compounded by huge differences in the level of economic development. Now new RTAs are being negotiated or have been concluded between parties separated both by geographic distance and political philosophy (e.g. between the EU and Vietnam, China and Chile, and China and Switzerland).

Both regional economies and the global economy are now based on supply chains, which have become major factors in the establishment of RTAs. Equally however, RTAs support the supply chains by stimulating and facilitating the free movement of goods and services, and thus become part of the supply, as well as the value, chains themselves.<sup>10</sup>

In line with general geopolitical developments, in particular the exacerbation of power struggles and confrontations between differing economic interests, geopolitical factors have also had a significant impact upon the establishment of RTAs. The best and most well-known example is the TPP. The US’s geopolitical objective for this RTA was evident: create an economic area; develop closer ties with the other 11 Asian, North- and Latin-American nations; and exclude its great geopolitical rival, China. The withdrawal of the US will also have geopolitical consequences, precisely the opposite of those originally intended. China will probably take the place of the US, and this will not only shift most of the economic benefits to the Mid-

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<sup>10</sup> With regard to the UK’s withdrawal from the EU, it is hoped that it will be possible to avoid what would be the catastrophic consequences of a situation where a long-standing and well-functioning free trade regime, indeed a single market, ceases to exist. However, if negotiations are not successful, then the innumerable vital supply chains, built up over decades, will face inevitable disruption.



dle Empire, but will reinforce China's geopolitical position and power in, and well beyond, the Asian region.<sup>11</sup>

There is an older and, for us, closer demonstration of the sometimes significant role of geopolitics in creating RTAs. It is the European integration process, whose original purpose was preponderantly political. It was only after the treaty on the European Defence Community was voted down by the French National Assembly in 1954 that the idea of progressively creating economic integration, and thereby laying down an economic basis for the ultimate political union of Europe (*'finalité politique'*), was suggested by the ingenious technocrats that included Jean Monnet. These individuals were also responsible for inventing the *'méthode communautaire'*, which has been the key driver of the organic and incremental development of the European construct for at least half a century.

## Conclusion

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RTAs show a very high level of diversity, and their rise reflects the growing differentiation within the overall trading system. The trend towards differentiation and fragmentation originally started within the multilateral framework, and has since been continued and deepened by the spread of all sorts of bilateral, regional and plurilateral free-trade agreements (as well as customs unions). Behind this overwhelming trend, however, there are apparent commonalities, principles and general features that may represent the groundwork for a future reunification of international trade rules. After all, we should not forget that the historical and legal basis for the establishment of the GATT was the sophisticated network of bilateral trade agreements based upon Most-Favoured-Nation treatment that was ingeniously multilateralised in the situation that emerged after the Second World War.

All the developments that are taking place in the international trading system reflect and demonstrate general economic and geopolitical trends. Globalisation may have slowed down but it continues, while regionalisation and localisation are on the rise, but are linked by universal and common elements.

Geopolitical power and responsibility are progressively being devolved to regional levels, and this diffusion of power is decentralising governance and rule-making. However, global risks and opportunities demand common action and universal (multilateral) rule-making.

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<sup>11</sup> Whether the US's economic withdrawal can be offset by increasing its military capabilities and power is an open question.



These two competing and, at the same time, complementary tendencies are present not only in geopolitics, the global economy and the international trading system, but also in what is called ‘soft power’—or indeed, culture in the widest possible sense. Since most of our attention is focused upon the economic and geopolitical parts of the equation, we tend to belittle culture’s role as the ultimate mover of all the other areas. However, it is culture that essentially creates and forms the economy, politics and every other area of human social activity.

Rule-making is part of culture and, as such, not only reflects, but also develops and shapes geopolitics, as well as the economy. Thus this allows us not only to describe and analyse what is going on and why, but also gives us the ability and the responsibility—through local, national, regional and universal rule-making—to influence, shape and improve the world’s security, stability and prosperity.

Rules are becoming more universal and yet more fragmented at the same time; the world, which was supposed to be flat and integrated, is becoming more and more divided; and power is becoming more devolved. The economy and trade are inherently interdependent and multilateral, but regional and bilateral endeavours are increasingly pervading the whole system. Culture is diverse and collective identities differ, but they cannot dispense with some of the universal values that many believe are absolute in nature. In this complex, tumultuous competition, trade—free, fair and rules-based, with a strong multilateral dimension—has a vital role to play.



## About the author

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Professor **János Martonyi** has taught at many universities, including the College of Europe (Bruges and Natolin) and the Central European University (Budapest). He is a politician, attorney, international arbitrator, and the author of publications, primarily in the fields of international trade law, competition policy and law, European integration, cooperation in Central Europe and international relations. He has held numerous public offices, including as Hungarian minister for foreign affairs for the periods 1998–2002 and 2010–14. Currently (2017) he is the Chair of the United Nations Commission on International Trade Law (UNCITRAL).

## Credits

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