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Bilaterals: Bad for Business

By KYLE WINGFIELD

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BRUSSELS -- First there was the spaghetti bowl. Now, meet the electroncollider.

Trade negotiations can be hopelessly arcane, with their talk of NAMA, amber boxes, green boxes, blue boxes, Swiss coefficients and the like. So colourful metaphors are always welcome in describing the effects of trade deals to the public. The "spaghetti bowl" is how Columbia University's Jagdish Bhagwati describes the glut of bilateral trade deals world-wide that businesses find difficult to untangle. Now, Patrick Messerlin of Sciences Po in Paris is using the image of an electron collider to argue that the bilateral initiative launched this week by the European Commission is bad news for business.

Multilateral trade deals are far preferable to bilateral ones. The former create a uniform set of rules that allow goods -- and the resources used to produce them -- to flow most efficiently. But given the still-tenuous status of the World Trade Organization's Doha round, some nations have been hedging their bets by pursuing one-on-one negotiations. The U.S. has completed 10 bilaterals since 2004, with another six awaiting ratification. On Monday, EU member states gave trade chief Peter Mandelson the green light to pursue deals with India, South Korea and the Asean bloc of Southeast Asian nations.

Mr. Messerlin, who was in Brussels yesterday to present a paper critiquing EU trade policy in goods, says this is the wrong course for industry. He depicts bilateral deals as electrons slamming into one another, an image he bases on an idea known as preference erosion. As more bilateral deals are signed, certain sectors will find themselves worse off when a third country negotiates a better deal with an established trading partner. "This is a completely different animal" than what we've had in the past, he says.

To take a current example, Europe plans to negotiate a free-trade agreement with South Korea -- which in turn just inked an FTA with the U.S. If and when an EU-South Korea FTA is reached, some European producers will gain preferential market access compared with their American rivals, who may get bounced out of the Korean marketplace like so many electrons. The European firms might then ramp up production to satisfy these new customers. But what happens if Seoul later signs an agreement with a third country, and suddenly it's the Europeans who are on the outside looking in?

Now look at it from another perspective. If the EU signs a deal with South Korea, some producers in countries that already have FTAs with Europe -- such as Chile and Mexico -- will lose business on the Continent. There go some more companies bouncing off one another.

Ah, but isn't this just good ole competition? Not exactly. For one thing, competition in the usual economic sense pits companies against one another to see which can make goods of the highest value and/or most efficiently. The gains of trade liberalization will be watered down by trade diversion, Mr. Messerlin argues, if less efficient Korean producers replace more efficient Mexican firms in the EU market simply because they get a lower tariff rate. Liberalization is more than a zero-sum game when it encourages nations to focus on the goods and services for which they have comparative advantages. If commercial decisions are made because of artificial constructs such as tariffs, this benefit is lost -- for consumers and producers.

The better solution for business is a multilateral trade deal such as the Doha round that creates standard rules for all entrants, and then lets them compete based on their own merits rather than the strength of their governments' bargaining positions. So what's prompting the stampede toward bilaterals?

Aside from Doha's iffy prospects, one factor is the perception that everyone else is rushing to sign bilaterals and that you're better off climbing into an electron collider than standing pat. Here, Mr. Messerlin says governments have their facts about FTAs wrong.

An oft-cited statistic, he says, is that there were only two bilateral or regional FTAs circa 1960, a number that had grown to 211 by last October. But this is an improper comparison. By 1958 the founding members of the European Community alone had signed 21 bilateral deals for goods and services among themselves. Taking 21 as the starting point, and adjusting for the explosion of WTO membership to 150 nations in recent decades, the number of these trade agreements has barely doubled in half a century. "It's an increase, but it's not the boom everyone's talking about," he says.

He also argues that Doha may not be as hopeless as everyone assumes. The problem with this round has been described in these pages as elsewhere as a mismatch of ambition: The U.S. may have too much of it, while Europe and some others don't have enough.

It's more precise, Mr. Messerlin suggests, to say that the ambition has been misplaced. There is too much emphasis on the formula for cutting tariffs and not enough serious attention paid to the importance of minimizing the number of "exceptions" to tariff restrictions that are granted.

That's one reason why Mr. Messerlin suggests cutting industrial tariffs to a maximum of 15% in all but the 32 least developed WTO members. That's the same level that European industry groups have asked for. It might not be a very large cut in the average tariff charged in countries like China, Brazil and India. But a 15% cap would eliminate the very highest tariffs in those countries and would discourage them from seeking to exempt numerous products from the tariff ceiling. Keeping the number of exceptions low keeps the trading system simple.

Of course that 15% figure doesn't address the sticking points on agriculture that have hobbled the Doha talks. What it does mean, though, is that there's still reason to believe that liberalization can be achieved on a multilateral basis rather than a less beneficial bilateral one. Unless they like extra-bouncy electrons in their bolognese, that's what businesses should keep pushing for.

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