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6. HOW TO ENCOURAGE NETWORK TRADE RULES INTERCONNECTIONS? AN APPLICATION TO THE CASE OF NON-TARIFF BARRIERS¹

*Marcel Vaillant*²

6.1 Introduction

The current international trade agenda is usually dominated by market-access issues. How much access in my own market should be provided in order to get better access conditions in neighbors' markets? The fragmentation of international economic activity has strengthened the link between protection of one's own market and foreign market access conditions. Baldwin and Nicoud (2008) have pointed out that this is good news from the perspective of expected results, which are related to the endogenous mechanisms of trade liberalization³. Unilateral domestic trade policies will increasingly become more open if countries perceive that by reducing their own barriers, this will also reduce their neighbors' barriers. This mechanism seems to have started acting gradually in the conditions of trade in goods and particularly in certain manufacturing sectors that tend to converge to a trade of zero for zero. However, there are still areas where a negotiating effort is required as to get improvements in markets of deeper distortion (certain sectors of agriculture and manufacturing). The trade liberalization topics included in the last package of the Doha Round negotiations contained these topics, while proposing a possible path to reach important results in this direction, but the world is still awaiting improvements in this field.

The focus of this paper is different and is also a by-product of the globalization process. As the range of economic activities in the international economy expands, the themes that require necessary consideration in trade agreements also grow. The extension of the set of economic activities in the international economy provokes an extension of the themes that require necessary consideration in trade agreements. The adaptation speed in the multilateral field is structurally slow. Countries are less willing to establish rules on the basis of MFN than within PTAs. Hence the demands to expand and deepen in new topics have been channelled through the proliferation of preferential trade agreements. The content of commitments and themes in the agenda of international trade negotiations between national jurisdictions has widened: from the trade of goods to the trade of services, as well as to the mobility of some production factors. At the same time, the field where commitments are achieved has increased exponentially: bilateral agreements, plurilateral agreements, agreements between groups of countries, and the extension of agreements. For a diagnosis of what is happening, it is necessary to build a complex and large matrix of information that crosses the fields of commitment (columns of the matrix) with its issues or contents ("lines").

The biggest threat that looms over the international trade system is the consistency,

1 ICTSD Trade & Development Symposium 2011. I acknowledge the comments by Professor Marcelo Olarreaga, which I received from a previous version of this brief note.

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3 This mechanism works better in East Asia than in Latin America or sub-Saharan Africa where network trade is more rare. Works better where there is a comparative advantage in the production of a complex good. This comparative advantage may be endogenous too. Where there is too much regional protection, the production of complex goods in networks becomes more difficult.

applicability, and use of the established set of rules. What is committed in a certain “line” of the referred matrix is different and often difficult to translate into what is committed in another, and in some cases rules can be openly inconsistent. It is necessary to find issues that enable a systematic approach to this problem to apply a methodology that is plausible of being applied and then replicated to other themes. It is also necessary to obtain a result based on a new working methodology. Pointing in this direction, this paper chooses, within the wider subject related to goods, the topic of non-tariff barriers, which will be more thoroughly developed in the third section.

6.2 Problem/Opportunity Statement and State of Play

By shifting the focus of attention from liberalization seeking to improved market access, to the consistency, applicability, and use of established rules in agreements, it becomes meaningless to continue with the procedure of basing the agreement on a single undertaking principle, by which all sectors and issues are agreed upon simultaneously. In this proposal, a phased approach, in which issues are selected in accordance with an increasing degree of difficulty, seems to make more sense. What is being proposed is not an attempt to establish an alternative strategy from the prevailing *status quo*, but a complimentary path in which results could be achieved faster than in conventional multilateral negotiations. The aim is to improve the system through the improvement of its consistency, allocating the scarce political resources of negotiation as efficiently as possible. The required systemic order needs to establish some degree of association between “lines” (agenda issues) and columns (fields of negotiation). This establishes an order of prevalence that defines the most suitable fields to use in each case and to expand from that particular place to the rest of the space. In fact, that association exists. Think of a simplified matrix including agenda issues and negotiation fields (see Table 1).

Given the virtual state of paralysis of multilateral trade negotiations this is an excellent time to deal with this subject. It has been repeatedly pointed out that the threats of excessive fragmentation of the system of international trade rules would be exacerbated in a world where multilateralism is undergoing a period of weakness. The current proposal seeks to achieve the opposite result: strengthen multilateralism by imposing a higher degree of specialization in the agenda and allocating the political resources available for the negotiations on goals or results that are likely to be reached fast.

The world of economic relations works as a network that has interconnection mechanisms that can be differentiated by the subset of countries included in the sample. This lack of harmonization for movements from the jurisdiction of one agreement to another can be expressed as an additional transaction cost and can potentially become an irreversible obstacle leading to the fragmentation of the international trade system as a whole.

To understand the current situation we can think of different types of interconnected systems that require mechanisms that enable them, at a minimum cost, to work efficiently in their interlinkages. A simple example is the one of electric grids: despite the fact of being basic, mature, and associated with a homogenous service, it is possible to find many differences between systems belonging to different national jurisdictions that entail a restriction on mutual interconnectivity. If one adopts the perspective of a travelling user of electronic devices you can see the type of problems we are facing. Different connection-chips are used all over the world. These differences in connection modes can be counted by tens. Being a relatively simple and old problem, universal chips have been invented to overcome this difficulty. Trouble emerges when those chips do not exist. This chips situation is comparable to the current state of the international trade system in many of its agenda topics. It could also be exemplified with physical transportation networks and the capacity to develop interlinkages between different types of transportation and national systems. In this case,

we can observe a transition from isolated national systems with different means of transport that retain a certain autonomy to an integral development of different types of transport that seek to articulate themselves in an international system that links them together. From their very origin information technologies exemplify interconnected systems that were created on a global and universal scale, in contraposition with electric systems that were created on national bases and norms. Even so, it is still possible to present examples of fragmentation in the design of more basic operative systems that can become an obstacle to its proper functioning. Again we see that the system's capacity to properly function depends on its ability to establish interlinkages. The international trade system requires an operative system that works behind all the other existing networks of trade agreements and that provides support and robust functioning. This is precisely the role that the WTO should play, which widely transcends any specific negotiation round in which market access is exchanged on a reciprocal basis.⁴

With respect to the international trading system, multilateralism established exceptions to the MFN principle (discrimination) that enabled the development of multiple preferential commercial agreements, but later multilateralism worked as if these agreements did not exist. The international community built systems that overlap and that work in isolation with very weak interconnections. Only recently, in the Doha Round, a more defined movement can be perceived that tries to consider this other part of the system through the basic and fundamental objective of promoting transparency through an adequate information system.⁵

6.3 Responses

This section outlines a concrete proposal and presents a specific example to implement the above proposal. The proposal involves establishing a list of issues that have systemic effects that generate a different negotiation dynamic and set forward a new method. This proposal would involve dealing with issues that are ranked according to their relevance inside the system. Dealing with them on an individual basis decoupled from the conventional agenda that will follow its own known track. This list should be short and essential. Long agendas that include issues of different relevance and with no hierarchy are the starting point of a new failure in trade negotiations. Besides, the proposal involves a new method that combines both the preferential and multilateral spaces. It is also necessary to build or adapt new rules of approval for the consolidation of obtained results. The process should have a defined institutional leadership and the necessary attributes to exercise it.

6.3.1 Non trade barriers (NTBs)

I chose the issue of NTBs applied in the trade of goods, because it is a mature and well-known subject, and there is consensus about the need to advance toward its eradication inside the international trade system.⁶ It is a well-known fact that the NTBs erode efforts undertaken in any trade agreement that seeks to reduce barriers in reciprocal trade. As the trade liberalization processes advance, lower tariffs tend to be partially replaced by NTBs

4 This necessity to concentrate on the systematic aspects and consistency of the international trade system has been pointed out with different intensity over the past years. A central reference in this regard is in Baldwin, R. E. and Low, P. *Multilateralizing Regionalism, Challenges for the Global Trading System*,. Patrick LowWorld Trade Organization, Geneva: Cambridge University Press. 2009.

5 Important steps have been taken in this direction with the creation of the database on RTAs, available online on the ITO web page. There is still a long way to go, as, for example, there is still no consistent and universal database for international trade that contains information on all preferential trade relations and its degree of usage.

6 The WTO's 2012 trade report is on non-tariff barriers.

(both at the extensive margin of new barriers, as well as the intensive margin in the use of pre-existing ones).⁷

The current period of financial and economic crisis has been especially critical in this sense as the use of these measures has proliferated.⁸ Several studies illustrate this point. Even when many NTBs have a conjuncture root and are likely to gradually disappear governments' inertia in the application of such measures may prolong the effects. Trade relations are currently affected by what is known as murky protectionism, the proliferation and intensification of the use of unconventional measures with a protectionist objective.⁹

The proliferation of NTBs attacks one of the basic principles that should guide the international trading system as a whole: the transparency of trade rules. Transparency is a cornerstone for the construction of a consistent international system. Saez and Vaillant argue that transparency is a general goal regardless of the level of specific restrictions applied in each of the negotiated rules.¹⁰ It has the advantage that it can be achieved with each country's unilateral effort. Transparency is a prerequisite for any trade negotiation. It is necessary to reclaim it to the partner and it is essential to have the ability to provide it unilaterally. It is a topic where every possible area of rule building is combined.

The distortion effect of a NTB exceeds the concrete size that it may have in terms of an equivalent tariff that generates the same short-term effects. NTBs have prolonged effects through the expectations they generate about the uncertainty related to the rules of future trade and have permanent consequences in the allocation of production, consumption, and trade.

The primacy of the multilateral framework in the BNA issue should be unquestioned. It is unreasonable to justify the existence of NTBs applied on a discriminatory basis.¹¹ Trade agreements should be designed in a way that exceptions to the principle to the MFN are possible only when the applied trade barriers are known. This might imply a modification of Article XXIV so there are no doubts about its interpretation. It might also require adjustments in the content of many preferential trade agreements. The issue calls for action not only at a multilateral level, but also by implementing a global dynamic of trade agreement adjustments.

6.3.2 Case Study

The key is to generate procedures that ensure a friendly link between multilateralism and regionalism that is applied to the detection and elimination of NTBs on the basis of the MFN principle. Regional agreements provoke a dynamic of information exchange between

7 See Kee, H, Nicita, A. and Olarreaga, M. "Estimating Trade Restrictiveness Indices". *Economic Journal*, 119: 534 (January 2009) 172-199. They show that there is substitution between tariffs and NTBs and that NTBs are the market access problem today (SPS and TBTs more generally).

8 See the ten reports of Global Trade Alert (<http://www.globaltradealert.org>), particularly Evenett, S. "Trade Tensions Mount: The 10th GTA Report". Global Trade Alert, CEPR, London-Geneva, 2011.

9 Baldwin R. and Evenett S. *The Collapse Of Global Trade, Murky Protectionism, And The Crisis*, Institut Universitaire de Hautes Etudes Internationales, Geneva, 2009.

10 Saez, S. and Vaillant, M. "The Negotiation and Management of Regulations in the Trade in Services, 2010", in *The Negotiation and Management of Regulations in the Trade in Services*, World Bank, Washington, D. C., 2010.

11 Note that even NTBs that are applied non-discriminatorily may have a discriminatory effect. See Crozet, M., Milet E., and Mirza, D. "The discriminatory effect of domestic regulations on international services trade: evidence from firm level data" (Unpublished conference paper presented in 2011).

members that is deeper and more detailed than what is possible in a multilateral space. Besides, given the greater relative proximity, higher reciprocal knowledge among members allows a better detection of these barriers. Moreover, possibilities of retaliation are higher and appear quicker and more convenient. All of these elements are oriented in the direction that the scope of the preferential agreements may be used as a stage for a strategy with this objective.

Trade disputes in the context of regional agreements that result in the removal of NTBs must become extensive in the multilateral trading system and their application mandatory on a non discriminatory basis. The system requires the construction of a strong interlinkage between the preferential trade system and the multilateral system, reinforcing compliance paths between them. This creation of fluid and almost automatic interlinkages should gradually extend to other matters.

By reporting the facts of one case we can illustrate the central point of this paper. The case relates to the recent barriers to the imports of refurbished tires into Brazil. This case began as a regional trade dispute (Paraguay and Uruguay against Brazil) and then led to a case in Geneva with the EU in the context of the dispute settlement understanding of the WTO.¹² Since the early 1990s Brazil prohibited imports of used tires.¹³ In the past decade, this prohibition was extended to include refurbished tires. In the 2000s, while culminating the process of creation of a free-trade zone within MERCOSUR that liberalized inter-regional trade for these products, a possible trade flow from the region to Brazil was anticipated. Neighbour countries would import used tires from the rest of the world, refurbish them in the region and export them to Brazil. To avoid this trade flow, Brazil extended the ban on imports of used tires to refurbished ones. This measure led to a dispute within MERCOSUR that resulted in a ruling that mandated Brazil to lift the measures for Paraguay and Uruguay. Brazil complied with the ruling but only lifted the measure for its regional partners. This generated a response from the EU, which filed a case before the WTO, arguing that the discriminatory treatment from Brazil was unjustified. The process involved the creation of a special group that primarily ruled in favour of Brazil. The EU appealed before the appellate body of the WTO's dispute settlement understanding, which ruled in its favour. In order to comply with the WTO ruling, Brazil re-established its ban at a regional level, thus violating the ruling of MERCOSUR's Permanent Revision Tribunal.

Synergies did not develop in the expected direction to create a virtuous circle, and the story unfolded in a vicious circle. According to this paper's perspective part of the problem was the inexistence of operative interconnections between the set of rules of preferential agreements and the WTO's multilateral agreement, which would have created consistency between both decisions toward of the elimination of the discriminatory NTBs. It is necessary to design linkage mechanisms that create consistency and enable the extension of the capacities that agreements have of obliging Members to comply with the content of the agreements to which they subscribe. A considerable amount of NTBs are protectionist detour mechanisms that use undercover instruments that were designed with other objectives. For this reason, its control requires an efficient and timely use of information.¹⁴

12 Lavopa F. and Vaillant M. "Options for a friendly relation between multilateralism and preferential trade agreements: the case of tire imports in Brazil". Regional Course on WTO Trade Policy, Sergio Arboleda University. (Colombia, forthcoming).

13 Brazil justifies this measure to preserve the environment through preventing an increase in stock of used tires. According to the objectives of public health, it is said that used tires stock is positively related to the mosquito population that transmits Dengue

14 This would also avoid the problem of "forum shopping" as Pawlyn et al (2009) called it.

6.4 Where to Start?

As in the majority of trade policy affairs, the first battle is for transparency. It is necessary to have precise definitions and an updated taxonomy of the non-tariff measures (NTM) that enable their precise identification. Overall, any NTM can become a barrier if it is applied in a way that discriminates against suppliers by origin. However, some NTMs have a greater potential for being used with that aim. The international community is not at a starting point in this matter. Several multilateral agencies related to the international trade system have begun a work process that has, among other results, established an updated classification of the NTMs.¹ Besides, there is the objective of updating and extending coverage of the global database, including measures implemented by country and product. The working process indicates that to some extent the proposed methodology is reasonable. Work was carried out with national cases, with regional integration organizations, and coordination between multilateral agencies. The efforts toward the identification of the problem are clear and the progress made, as well as the proposals, are feasible to consider given the degree of autonomy that the technical structures of the involved international agencies can exercise. If the proposed program is respected there would be a major step toward transparency.

However, a deeper political involvement is required from countries through the legitimization of a program of elimination of NTBs that should be led by the WTO and not restricted to developing economies.² For the purpose of reaching an operative mechanism of interconnection between the multilateral trade system and preferential agreements, it is necessary to create a space that directly involves them. In other words, it is essential to consolidate the commitment of countries, their preferential agreements, and the multilateral framework into a single programme. This programme should be capable of identifying measures and establishing proper incentives to generate a dynamic of gradual elimination, as well as making harder the emergence of new measures. Inside this scheme it may be necessary to establish temporary tariff safeguard mechanisms that are easy to implement and discourage the use of diffuse NTMs.³

The proliferation of NTBs reveals that there are incentives for their implementation. The key element that protects them is the opacity they may have and the capacity of generating protection without being detected or without giving the affected country the possibility of establishing an effective retaliation mechanism. It is clear that it also reveals a weakness in the dispute settlement mechanisms that have been established in the different trade agreements. The following are some important issues to consider that serve as an indicative guide of what is left to do:

- I. Create a program for eliminating and controlling NTBs that combines participation of countries within the preferential agreements they integrate with the trade multilateral framework.
- II. Make the conventional trade negotiation programs independent, generate a different

1 Following a UNCTAD initiative, in the year 2006 the Group of Eminent People on NTBs gathered and worked alongside a technical team called Multiagency Support Team (MAST) (UNCTAD, World Bank, WTO, ITC, IMF, OECD, European Commission, USDA, USITC). See UNCTAD. *Non Tariff Measures: Evidence From Selected Developing Countries And Future Agenda, Developing Countries In International Trade Studies*, Geneva: United Nations, 2009.

2 The restrictiveness of NTBs in developed countries is often very high and therefore of an important concern. See Kee, H, Nicita, A. and Olarreaga, M. "Estimating Trade Restrictiveness Indices". *Economic Journal*, 119: 534 (January 2009) 172-199.

3 Temporary is the crucial concept in this framework. The safeguards need to have a maximum limit, otherwise we introduce the uncertainty that we were talking earlier.

mechanism for these systemic aspects that have the objective of improving the functioning of international trade systems through more fluid interconnections between the multilateral and regional level.

- III. Strengthen the role of preferential agreements since they entail fewer actors who know each other closely and are more effective than the multilateral system in detecting the trade-restricting NTMs. Particularly, in a first stage it is relevant to include plurilateral agreements that have a greater capacity of acting as a technical secretariat to enable them to develop an ambitious and complex agenda.
- IV. Perfect the exception to the MFN principle in the WTO - the accepted discrimination should be restricted to include only tariff discrimination (modification of Article XXIV).
- V. Establish a coordination mechanism between regional and multilateral dispute settlement mechanisms that tends toward the harmonization of criteria and procedural aspects, as well as establishes criteria of predominance among them. For example, if a regional tribunal detects a NTB it could trigger the removal on the basis of the MFN. Consequently, more and better regional market access should imply more and better access on the bases of the MFN.

6.5 Conclusion

The failure of the multilateral system in bringing together the required political support for concluding the trade negotiation round is freezing many new ideas and proposed routes toward the development of the trade system. In 2008, a possible format for the completion of the Doha Round was reached but, unfortunately, it never came through. The task that is left is not very different from the one presented three years ago, and there is still no prospect of it being reached.

The only noticeable activities from which it is possible to establish results are the different preferential trade agreements that are still being subscribed. It is audacious to make a general judgment on the potential contribution of the new trade agreements to the construction of a more consistent international trade system. On the contrary, it is well known that the proliferation of preferential trade agreements in a weakened multilateral context is not a desirable scenario as it can provoke fragmentation in rules and an increase of inconsistency and related conflicts.

The diagnosis made on the network of trade rules is that it poorly interconnects different areas. These shortcomings are related to the fact that the multilateral framework - which should act as a global link articulator (a sort of background operating system of the international trade system) - in fact has evolved ignoring the implications of the preferential trade agreements it helped create. The interconnections between the different types of agreements must be strengthened, and this process should be used as a weapon to strengthen the multilateral agreement. A short and substantive list of issues that can be decoupled from the logic of round negotiations should be created. This list would allow a dynamic of permanent evolution and generate faster results than the trade rounds that have been taken forward until now. It's all about innovating the work methodology.

The case of NTBs is one of the relevant areas in which it is feasible to apply the proposed methodology. Non-tariff barriers erode the results obtained in all kind of agreements. It is an element that reduces clarity in the system, has both static and dynamic negative effects and obstructs the development of trade. Despite being a well-known and mature matter it poses a threat to the consistency of a system that remains totally valid. The recent evolution, during the current crisis period, illustrates this point.

The referred ongoing efforts and work dynamics should be reinforced and complemented with a defined political involvement from countries through all the preferential agreements to which they are parties. The key is to build a self-sufficient mechanism - as Baldwin and Nicoud identified in the case of tariffs - to be applied to NTBs.⁴ Today, facts reveal the opposite: as the current system structure provides incentives for a gradual increase in the use of NTBs. Besides, interaction between fields in many cases does not generate virtuous circles. In fact, as exemplified in the case of tire imports to Brazil, the opposite happens.

Strategies toward the elimination and control of NTBs should be harmonized and unified, and multilateral and preferential trade spaces must be interconnected in a more fluent and efficient way. This paper schematically developed some concrete ideas on how to develop this interconnection. Some of the challenges related to NTBs include increasing transparency and strengthening the linkages between areas in order to create a set of trading rules that generate adequate incentives. This approach could later be extended to other aspects that have a systemic impact.

4 Baldwin, R. E. and Robert-Nicoud, F. *A Simple Model of The Juggernaut Effect of Trade Liberalization*, Centre for Economic Performance, London School of Economics and Political Science, 2008.

Table 1. Information Matrix: Issues by Type of Agreement**(Degree of relevance)**

ISSUES/TYPE OF TRADE AGREEMENT		MULTILATERAL	PREFERENTIAL
Goods	Market Access barriers	XX	XXX
	Rules	XXX	X
Services	Market Access barriers	XX	XXX
	Rules	XX	XX
Complementary matters		X	XXX

XXX - High relevance; XX - Medium relevance; X - Low relevance

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**PART III:
DEVELOPING COUNTRIES AND THE
MULTILATERAL TRADING SYSTEM**