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POLICY BRIEF
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THE WTO AND THE SPAGHETTI BOWL OF FREE TRADE AGREEMENTS

FOUR PROPOSALS FOR MOVING FORWARD

Maria Panezi

Key Points

- As many major trading nations sign trade agreements among themselves, creating a "spaghetti bowl" of trade arrangements that bypass the World Trade Organization (WTO), the organization is becoming less relevant for international trade negotiations.
- The WTO's lack of relevance is worsened by the negotiations impasse within the organization, the so-called Doha Round negotiations deadlock.
- The WTO has taken some steps to deal with the spaghetti bowl, mostly by introducing transparency mechanisms.
- The WTO needs to make these transparency mechanisms more robust and link them to national transparency on the ground, and WTO member states need to consider taking action more formally and systematically to control and monitor the spaghetti bowl.

Introduction[1]

The WTO is a multilateral framework in which more than 160 countries engage in negotiations to reduce tariffs and other trade barriers among themselves. Several agreements contain the rules governing international trade in the WTO. Nothing in the WTO agreements, or its predecessor, the General Agreement on Tariffs and Trade (GATT), prevents countries from entering into other, smaller trade arrangements in addition to the WTO. These arrangements take several forms: they can be free trade agreements (FTAs), preferential trade agreements (PTAs) or regional trade agreements (RTAs). Essentially, these different types of agreements create miniature trade regimes that link countries in a number of ways. It has been suggested that a world map showing the plethora of trading relationships would resemble a spaghetti bowl.[2]

How We Got to the Spaghetti Bowl

WTO agreements are regulated by article XXIV of the GATT, article V of the General Agreement on Trade in Services (GATS) and the Enabling Clause. These provisions recognize five forms of such arrangements: first, free trade areas, in which members, further to their WTO obligations, liberalize trade among themselves;[3] second, customs unions, which are FTAs with a common external

1 This policy brief draws on a forthcoming article: Maria Panezi, "The Two Noble Kinsmen: Internal and Legal Transparency in the WTO and their Connection to Preferential and Regional Trade Agreements" (2016) Special issue on Free Trade Agreements, Brit J Am Leg Stud.

2 The term was initially used by Jagdish Bhagwati, "US Trade Policy: The Infatuation with Free Trade Agreements" in J Bhagwati and A Krueger, *The Dangerous Drift to Preferential Trade Agreements* (Washington, DC: AEI Press, 1995).

3 *General Agreement on Tariffs and Trade*, 30 October 1947, 58 UNTS 187 (entered into force 1 January 1948) at para 8, art XXIV [*GATT 1947*].

commercial policy;[4] third, interim agreements that precede FTAs and customs unions;[5] fourth, PTAs, producing more trade liberalization among less developed countries;[6] and fifth, in the domain of services, economic integration agreements.[7]

This legal framework implies that FTAs, RTAs and PTAs are not only allowed in the WTO but that the organization recognizes the need for further economic integration between and among some of its member states. For example, parties to FTAs can lower their tariffs below WTO baselines without the need to extend these privileges to all other WTO member states, which is known at the WTO as the most favoured nation (MFN) obligation. As with all cases that deviate from the standard MFN treatment, FTAs and PTAs are meant to be not the rule in the WTO, but the exception. If WTO member states resorted to FTAs exclusively, then the WTO, the forum whose main purpose is tariff elimination and multilateralization of obligations, could become redundant.

By early 2016, 419 such agreements had been signed.[8] This impressive number now includes mega-regional agreements such as the Canada-EU Comprehensive Economic and Trade Agreement and the Trans-Pacific Partnership among Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Vietnam. If the WTO is already the multilateral forum for trade negotiations and liberalization, with its members accounting for more than 99 percent of world trade volume and population, why do countries have the need to sign so many of these agreements outside the WTO framework? Do these agreements help international trade liberalization?

To understand why countries are turning away from multilateralism, one need only look at the early days of the WTO and the Doha Round (formally called the Doha Development Round) of trade negotiations. The WTO was created in 1995, emerging out of the GATT, which had existed since 1947. Every two years since the creation of the WTO, a high-level meeting, the WTO Ministerial Conference, has taken place, with the participation of heads of states, trade ministers and high-ranking diplomats. Trouble was already brewing immediately after the creation of the WTO: anti-trade, environmental, labour and anti-globalization groups protested trade rules and their impact on the world economy. Things got very serious in the second ministerial, which took place in Seattle in 1999. Not only did protesters block the streets, but the negotiations became deadlocked in the sieged hotel and conference buildings: WTO member states could not agree on how to proceed with trade liberalization. Some wanted to move forward, while others, experiencing the strong forces of globalization and pressure in their local economies, wanted to push back and re-examine the negotiations agenda and existing rules. Despite major difficulties in finding a compromise, at the next ministerial two years later in Doha, WTO member states launched the Doha Development Round. There was minimal progress for the next two years, until the Cancun Ministerial, where the standstill became even more obvious. The Doha Round was supposed to place "developing countries' needs and interests at the heart of the Work Programme adopted in this Declaration" and "continue to make positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in the growth of world trade commensurate with the needs of their economic development. In this context, enhanced market access, balanced rules, and well targeted, sustainably financed technical assistance and capacity-building programmes have important roles to play."[9] The Doha Round's promise of a rebalanced trading system has yet to be realized.

What happened instead was the beginning of feverish state efforts to conclude other agreements. Attempts to reduce tariffs, liberalize trade and promote trade cooperation through FTAs were best summarized in 2003 in an op ed by then US Trade Representative Robert Zoellick:

> [W]hat should the U.S. do if other nations choose protectionism over free trade? Under the WTO's procedures, one nation can block progress. It would be a grave mistake to permit any one country to veto America's drive for global free trade. Our strategy is based on a concept that any economics professor should appreciate: competition. If some countries hide behind the false security of protectionism, the U.S. will work with those that believe true economic strength is achieved through openness. The strategy is simple: The U.S. is spurring a competition in liberalization. […] That is why the U.S. has pressed forward with a portfolio of free trade agreements

4 *Ibid* at para 5(a), art XXIV. See also Anne O Krueger, "Free Trade Agreements versus Customs Unions" (1997) 54 J Development Economics 169.

5 *GATT 1947* at paras 5(a), 5(b), art XXIV.

6 GATT, *Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries* (Enabling Clause), 28 November 1979, GATT Doc L/4903, at para 2(c) online: <www.wto.org/english/docs_e/legal_e/enabling1979_e.htm>.

7 *General Agreement on Trade in Services*, 15 April 1994,1869 UNTS 183, ILM 1167 (1994) (entered into force 1 January 1995) at art V. Economic integration agreements will be referred to here as PTAs, FTAs and RTAs, or simply FTAs.

8 Gregory Shaffer and L Alan Winters, "FTAs as Applicable Law in WTO Dispute Settlement: Was the Appellate Body Wrong in Peru-Additional Duty (DS457)?" (2016) 43 UC Irvine School of Law Research Paper at 2.

9 WTO, *Doha Ministerial Declaration* (adopted on 14 November 2001), WTO Doc WT/MIN(01)/DEC/1 (20 November 2001), at para 2, online: <www.wto.org/english/tratop_e/dda_e/dda_e.htm>.

> while doing all we can to make the WTO negotiations succeed. Our FTAs are encouraging reformers — many in fragile democracies — in Latin America, Africa, the Middle East, and the Asia-Pacific region. These partners have become some of the WTO's foremost champions for open markets. […] We will do our best at Cancun to keep the Doha negotiations on track. But if others falter, the Bush administration will keep negotiating for free trade — to create jobs, keep America competitive, and create opportunities for modernizing reformers around the world.[10]

The plan to move forward with trade liberalization, regardless of WTO stalemates, is still holding strong in international trade governance. FTAs do produce some trade liberalization, although there is no consensus on the extent to which they can replace multilateral liberalization at the WTO level. Another positive outcome of FTAs, RTAs and PTAs is that these agreements allow for more state cooperation, which benefits not only the few participants but can have positive effects in general.[11] For example, if these agreements require better national review mechanisms for trade disputes, or more transparency and public resources for international trade, these can be accessed by anyone.

To date, there is very little the WTO has done to reverse the wave of new FTAs. However, the organization is making significant efforts to keep track of all FTAs, PTAs, RTAs and mega-regionals. In 2006 and 2010, the main decision-making body in the WTO, the General Council, consisting of country representatives, decided on two mechanisms, called the Doha Transparency Mechanisms, comprising the RTA 2006 Transparency Mechanism and the PTA 2010 Transparency Mechanism. These two were provisional surveillance mechanisms to ensure that all non-participant members immediately receive notice of new FTAs and PTAs. Additionally, the WTO established electronic databases available to the public on its website.[12] During the 2015 Nairobi Ministerial Conference, WTO member states reached the decision to make permanent the two Doha Transparency Mechanisms. According to the Nairobi Declaration, WTO member states:

> …reaffirm the need to ensure that Regional Trade Agreements (RTAs) remain complementary to, not a substitute for, the multilateral trading system. In this regard, we instruct the Committee on Regional Trade Agreements (CRTA) to discuss the systemic implications of RTAs for the multilateral trading system and their relationship with WTO rules. With a view to enhancing transparency in, and understanding of, RTAs and their effects, we agree to work towards the transformation of the current provisional Transparency Mechanism into a permanent mechanism in accordance with the General Council Decision of 14 December 2006, without prejudice to questions related to notification requirements.[13]

Very importantly, WTO member states noted here that FTAs and RTAs cannot become a substitute for multilateralism and the WTO, and that it is crucial to address the proliferation of RTAs. Moreover, states expressed the need for a more permanent and coherent relationship between transparency and the proliferation of FTAs and RTAs. Transparency is gaining a progressively important role in managing the spaghetti bowl.

Despite the transparency reforms, developing countries still remain mostly outside the spaghetti bowl, which is dominated by major trading states. This produces de facto asymmetrical trade outcomes: FTAs may be allowed by the WTO, but without meaningful multilateral negotiations and with a growing number of agreements excluding weaker countries, FTAs are becoming tools of exclusion for developing and least-developed countries. Additionally, the WTO appears to be on the path to redundancy, at least in terms of negotiating further trade concessions, when these are, for the most part, negotiated in other, smaller fora.

A Way out of the Spaghetti Bowl? Recommendations for Change

The WTO is struggling to remain relevant in the face of proliferating trade agreements, small and large. Thus far, all institutional responses have been inadequate. There is also significant civil society backlash against all FTAs signed around the world. The following four proposals could help the WTO resume its place as the cardinal trade negotiations forum.

First, the WTO cannot remain a bystander as PTAs and RTAs proliferate. Mega-regionals and other trade agreements are fundamentally changing the landscape of the world trading

10 Robert Zoellick, "Our Credo: Free Trade and Competition", *Wall Street Journal* (10 July 2003).

11 Chad P Bown, "The sky fell on the U.S. poultry industry last year. But NAFTA and the TPP helped protect U.S. exports", *The Washington Post* (30 August 2016), online: <www.washingtonpost.com/news/monkey-cage/wp/2016/08/30/the-sky-fell-on-the-u-s-poultry-industry-last-year-but-nafta-and-the-tpp-helped-protect-u-s-exports/>.

12 See WTO, General Council, *Transparency Mechanism for Regional Trade Agreements* (decision of 14 December 2006), WTO Doc WT/L/671, online: www.wto.org/english/tratop_e/region_e/trans_mecha_e.htm; and World Trade Organization, Database on Preferential Trade Agreements, online: <http://ptadb.wto.org>.

13 WTO, *Nairobi Ministerial Declaration* (adopted on 19 December 2015) WTO Doc WT/MIN(15)/DEC, at para 28, online: <www.wto.org/english/thewto_e/minist_e/mc10_e/mindecision_e.htm>.

system, in a number of ways. Not only do they create specialized trade regimes, they also establish regulatory frameworks that are less about free trade and more about standardization. They include investment, services, intellectual property and other provisions in domains that the WTO has also tried to expand. Even if the GATT, which has been around since 1947, is a strong agreement that will remain relevant, GATS, the Agreement on Trade-Related Aspects of Intellectual Property Rights, the Agreement on Trade-Related Investment Measures and others, have not all had similar institutional histories. Investment, for example, is one of the challenging areas for the WTO. With the new FTAs and PTAs taking over the investment field, there is diminished will from various parties to push for negotiations in the WTO that would link trade and investment, at a time when international investment law is also facing increasing pressure to reform. To stay relevant, the WTO needs to assert itself as an active "third party," systematically monitoring the spaghetti bowl. The 2015 decision to make permanent the two Doha Transparency Mechanisms was a good first step. Strong monitoring mechanisms contribute by informing non-parties to FTAs on progress and status of these agreements. More importantly, a vigorous transparency regime in the WTO will signal to all WTO member states that the organization is closely following FTAs, RTAs and PTAs.

Second, the WTO should take additional steps to promote transparency. In the WTO agreements, many provisions exist that create obligations for all WTO member states to be transparent regarding their trade laws and administrative practices that could affect international trade. This type of substantive, on-the-ground transparency is meant to be useful to companies and individuals in their day-to-day trade activities. Ensuring FTA monitoring, together with reliable and transparent trade processes in WTO members' jurisdictions, will mitigate the exclusionary effects of FTAs for those excluded countries and their citizens and corporations. In that sense, the two "transparencies" — at the WTO level with the transparency mechanisms and on the ground in member states — are complementary. Developing and least-developed countries can participate in FTA monitoring in the WTO. They can take advantage of the know-how obtained and negotiate better RTAs for themselves.[14] Opening up their jurisdictions to become more transparent will attract more trade and investment and, conversely, their traders will get better market access if other jurisdictions are more transparent. Only if regionalism is coupled with these two types of transparency can it really help developing and least-developed countries. Thus, the WTO should explicitly link the different aspects of transparency as part of the organization's strategic communications.

Third, until all extant agreements are assessed, there should be a moratorium on signing any more agreements.[15] Proper monitoring of FTAs, PTAs and RTAs is a time- and resource-consuming process. Considering the already large number of such agreements and the likelihood they will continue to expand into many sectors, the WTO's limited institutional capacity will not be able to keep pace. The third proposal may be more difficult since it has to be initiated by WTO member states and currently there exists no consensus to stop the wave of regional and other agreements.

Finally, there could be legal consequences for failing to comply with proper notification of an FTA or for not cooperating during the monitoring process. For example, the WTO's judicial branch, the Panels and the Appellate Body, is sometimes asked to solve disputes among parties that have both WTO parameters and regional trade parameters. Such was the case in a recent dispute between Peru and Guatemala regarding Peru's agricultural tariffs. The relevant laws were the GATT and an FTA between Peru and Guatemala.[16] Hypothetically, WTO members could decide on a new rule that says members cannot draw rights from an agreement, or invoke it during the dispute-settlement process, unless the agreement has been properly notified and reviewed. Again, consensus for a rule like this would be difficult to establish in the current international trade politics environment.

The Dispute Settlement Body has not, to date, actively engaged in checking any of the FTAs for their compatibility with WTO law. Indeed, even in the case between Peru and Guatemala, the Panel and Appellate Body did not examine or rule on the compatibility of rights and obligations between the two systems, since one of the two parties to the FTA had not yet ratified it and, thus, it was not in force. Considering the difficulties of achieving political consensus for the formal and extensive review of FTAs and RTAs, the Dispute Settlement Body, with its prolific case law, may become a front-runner by taking up the task of examining the balance between regionalism and multilateralism in a concrete case in the future.

14 S Bilal and S Szepesi, "How Regional Economic Communities Can Facilitate Participation in the WTO: The Experience of Mauritius and Zambia", in P Gallagher et al, eds, *Managing the Challenges of WTO Participation: 45 Case Studies* (Cambridge, UK: Cambridge University Press and WTO Secretariat, 2005) at 389–390.

15 Paul Blustein, *Misadventures of the Most Favored Nations* (New York: Public Affairs, 2009) at 277.

16 See WTO, *Peru — Additional Duty on Imports of Certain Agricultural Products*, Appellate Body Report, WTO Doc WT/DS457/AB/R, conclusions, and Add 1 (20 July 2015) at paras 7.25ff; WTO, *Peru — Additional Duty on Imports of Certain Agricultural Products*, Panel Report, WTO Doc WT/DS457/R, and Add 1 (27 November 2014) as modified by WTO, *Peru — Additional Duty on Imports of Certain Agricultural Products,* Appellate Body Report, WTO Doc WT/DS457/AB/R (20 July 2015).

Conclusion

The WTO is still considered the principal international trade regime. However, in the two decades since the Uruguay Round produced so many trade agreements and fundamentally changed the landscape of international trade, the WTO has not managed to produce a significant agreement to celebrate.

This is not to say that the WTO is irrelevant: the GATT has put in place a multilateral platform that has been successful for 70 years. The spaghetti bowl has become one of the most significant — if not *the* most significant — challenge to the WTO's relevance and the WTO can no longer continue ignoring this fact and responding with relaxed and underfunded mechanisms that produce no binding outcomes.

WTO members should seriously consider formally adopting a more assertive approach that allows FTAs, RTAs and PTAs to continue to exist, although not to the detriment of multilateral rights and duties, especially for developing and least-developed countries. Currently, there may not be much consensus in that direction. It is a task for those still having faith in multilateralism to push for change that at least allows weaker trading nations to make sense of, and thereby be empowered to gain something from, the very large spaghetti bowl.

About the Author

Maria Panezi is a post-doctoral fellow with CIGI's ILRP. She holds a Ph.D. in law from Osgoode Hall Law School at York University, where she was a Nathanson Fellow and a Comparative Law and Political Economy Fellow.

Maria's doctoral dissertation is titled "Through the Looking Glass: Transparency in the WTO." She received her first law degree from Athens University in Greece, and was called to the Athens Bar. She has published articles on issues related to public international law and was a W. C. Langley Scholar of International Legal Studies at New York University School of Law, where she received her LL.M.

Maria has been an adjunct professor at Osgoode Hall Law School and has taught ethical lawyering in a global community, as well as law and economics, for which she received the Ian Greene Award for Teaching Excellence. She has also been a visiting scholar at Harvard Law School and the Fletcher School of Law and Diplomacy.

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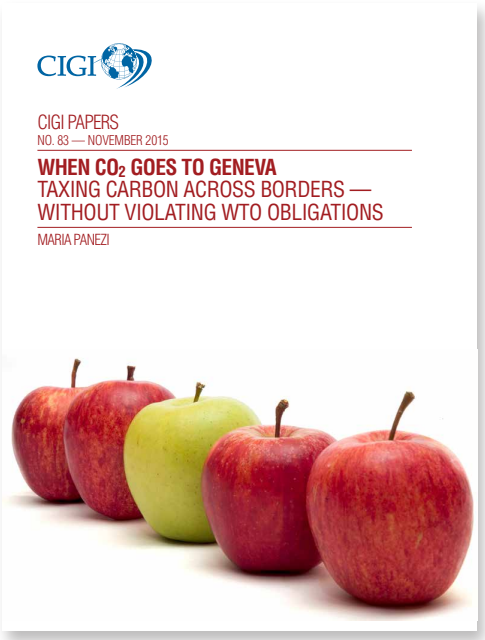


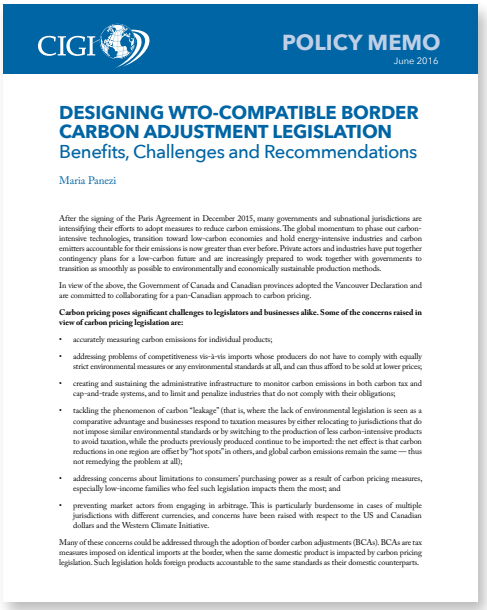
When CO^2 Goes to Geneva: Taxing Carbon across Borders – Without Violating WTO Obligations

Paper No. 83

Maria Panezi

This paper discusses how trade and the environment can intersect in the case of carbon taxes. Carbon taxes become relevant for international trade when they are coupled with border tax adjustment (BTA) legislation for imported products. BTAs are optional taxes or duties imposed on imports in order to ensure similar market conditions for similar domestic and imported products, when the domestic products are already taxed nationally. BTAs, in the case of products with a high carbon footprint, are equivalent to taxation imposed on similar domestic products with the same amounts of CO^2 emitted during their production. BTAs are intended to level the playing field between domestic and foreign products. Such tax schemes, if not designed properly, can be found to violate a country's international commitments before the World Trade Organization (WTO).

This paper argues that environmentally conscious governments can impose a WTO-compatible BTA to offset domestic CO^2 legislation, following a set of requirements laid out in the main WTO agreement, the General Agreement on Tariffs and Trade (GATT). In order to benefit from the WTO-compatible offsetting BTA, federal governments need to engage in coordinated efforts to harmonize treatment of high CO^2 emitters domestically, since domestic industries will not bear the burden of environmental regulation alone.



Designing WTO-Compatible Border Carbon Adjustment Legislation: Benefits, Challenges and Recommendations

Policy Memo

Maria Panezi

Many concerns about carbon pricing, especially concerning the trading of goods and services across international borders, could be addressed through the adoption of border carbon adjustments (BCAs). BCAs are tax measures imposed on identical imports at the border, when the same domestic product is impacted by carbon pricing legislation. Such legislation holds foreign products accountable to the same standards as their domestic counterparts.

This policy memo offers recommendations to policy makers regarding the design of BCAs in order to ensure that the ultimate goal of such taxes is achieved: the reduction of international carbon emissions.

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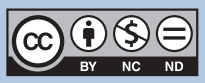

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