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# **The Emergence of the Transnational Competitive State**

Bilateralism in Trade Policy

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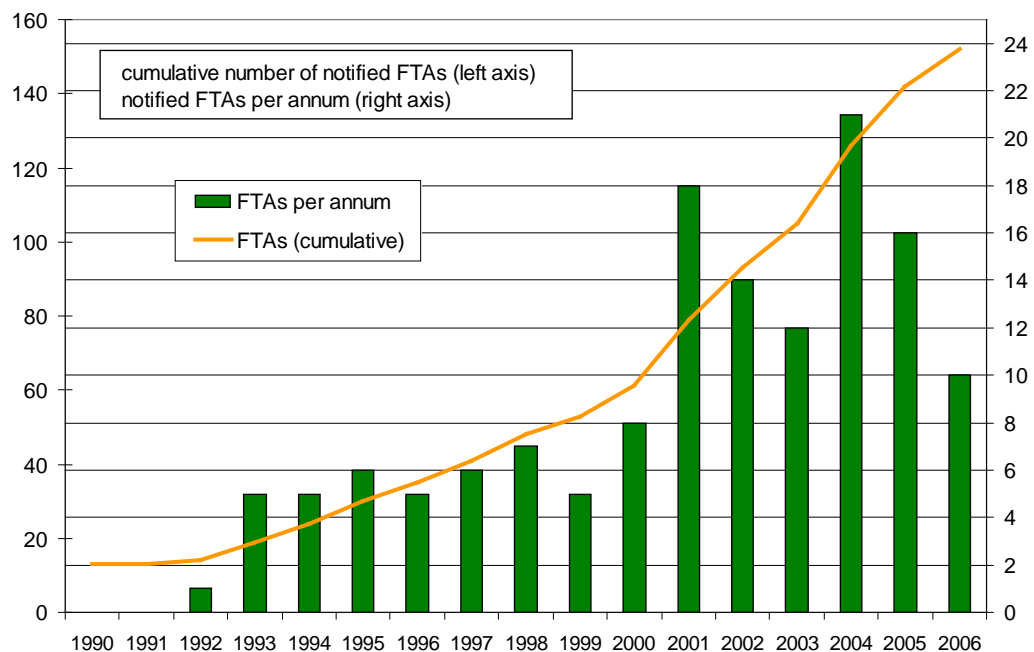
## 1 Introduction

According to proponents of liberal institutionalism the globalisation process limits the acting capability of states, a deficit they can only make up for by pooling their sovereignty on an international level. In the post-national constellation of international relations – as Zürn (2002) has labelled it – international institutions promote the coordination and harmonization of politics between different states through principles, norms, rules and decision-making processes. In this process the state is continuously internationalised. Given the augmented requirement for rules and regulations which help solve problems arising during a collision of norms, and to furthermore to ensure rules are adhered to, international institutions are transforming from intergovernmentalism to supranationalism and – when including transnational actors – toward transnationalism (Knodt & Jachtenfuchs, 2002: 16). Due to these changes states continuously lose their monopoly in foreign policy.

From this functionalist perspective, the world trade regime may be regarded as an empirical success story. While the old intergovernmental GATT-1947 channeled interests between states primarily through diplomatic means, the world trade agreement of 1994, within the Uruguay Round framework strengthened the WTO's dispute settlement mechanism by establishing legal and judicial elements. The panel's decisions can now only be blocked by a resolution member states unanimously support. Hence, states lost the possibility of politically tilt panel-decisions, and are left with the sole option of submitting objections to the permanent Appellate Body. The new regulations enforced the mandatory nature of WTO-rules (Keohane et al., 2000), a transformation which is interpreted as a limited supranationalization (Neyer, 1999). The current blockage of the world trade round in Doha/Qatar is blamed credited to the difficulty to convey interests between a heterogeneous member structure in particular. From this point of view, the political order of the world trade regime is not endangered, but we are dealing with a seemingly solvable conflict on regulation matters.

The regionalism of the 1990s/2000s (NAFTA, Mercosur, Asean) may be regarded through the integration-theoretic lens and perceived as complementary to the world trade regime: transaction costs may be reduced through regional cooperation by dismantling trade barriers. Furthermore, the small number of cooperation partners simplifies the implementation of steps toward liberalization and widen their scope. Accordingly, regional free trade agreements (FTAs) are spearheads or building blocks forming a larger structure of an additional liberalization of world trade. Article XXIV of the WTO is based on these assumptions, and allows the signing of FTAs under certain circumstances. The exponential increase of bilateral FTAs since the early 1990s (see Graphic 1) can, however, not be explained by resorting to liberal institutionalism theory: the new bilateral FTAs are detached from the regional context, and are ergo not integrational projects in the common sense. Furthermore, one can observe a notable increase in the number of FTAs signed between industrial and developing countries; characterised by asymmetrical rather than a symmetrical relationships of interdependence. Based on these findings, several questions arise: How relevant is the rise of bilateral FTA numbers for world trade? What characterizes a typical bilateral FTA under the conditions of asymmetrical relationship of interdependence? And finally: how do bilateral FTAs effect the world trade regime?

Graphic 1: FTAs registered with the WTO (1990–2006)



Source: WTO, Regional trade agreements, [http://www.wto.org/english/tratop\\_e/region\\_e/region\\_e.htm](http://www.wto.org/english/tratop_e/region_e/region_e.htm), rev. March 3, 2007, graphic by the author.

This article is based on the thesis that the macroeconomic welfare effects of bilateral FTAs with developing countries are not seen as pivotal reasons by the US and the EU to sign one. In the asymmetric relationship of interdependence, the aspect of power is more influential as it enables states to further and implement its strategic goals not only in economic fields, but also in non-economic areas. Therefore, it is to be expected that the structures of dependence will deepen more, instead of – as the classic liberal economic theories assume(d) – being dismantled by free trade's welfare effects. Instead, the stronger states enforce protectionism, hollowing out and weakening the world trade regime. Concerning the question on the transformation of statehood, note that the large trade powers, such as the US and the EU, are incrementally transnationalizing parallel to their internationalisation. In my definition, a transnational competitive state is to be understood in allusion to the national competitive state as proposed by Hirsch (1998)<sup>1</sup>:

Attribute of the transnational competitive state is its outward strategy of creating necessary institutional conditions in weaker states, in order to open and ensure foreign markets for its own domestic enterprises (such as protection of investment, public procurement) and also to protect domestic sectors that unable to compete on an international level. While a transnational enterprise, as an economic actor, (re)settles its production facilities to foreign markets, the transnational competitive state, as a political actor, imposes its national norms and regulations on other political systems. Additionally to gaining economic power, the state also raises its institutional power level. Regarding these measures, the transnational

<sup>1</sup> According to Hirsch (1998) the national competitive state is characterized by its task to optimise the conditions under which capital is exploited, meaning to render the terms and conditions on site as attractive as possible (see as well Strange 1996). Optimising the terms and conditions on site leads to an enlargement of the economic and social inequalities within the national societies as well as on an international level.

competitive state can thereby count on the support of domestic enterprises and groups of civil society, as well as on the assistance of transnational enterprises. The transnational competitive state thus expands the legitimacy of its power. Precondition for domestic support and increased legitimacy is either way the existence of an asymmetrical interdependence in international relations.

The first chapter of this article introduces an evaluation of the trade political conflicts from a realist and neogramscian perspective on which the definition of the transnational competitive state is based. The second chapter delves into the development of bilateral FTAs. US and EU trade political motives for signing FTAs are analysed by means of own empiric investigations. The third chapter includes an analysis of the effects these new US and EU foreign trade strategies have on the design of FTAs negotiated with developing countries. Finally, chapter four discusses possible consequences of previous points of the article for the world trade regime, and contains the presentation of results from studies conducted by economic science on the efficacy of FTAs. The results are examined for potential implications they might have on political power.

## **2 Trade Conflicts in the World Economic System from a theoretical Perspective**

Until the end of 2007, agreement on central questions - such as the dismantling of agrarian subsidies – was not reached within the Doha world trade round. Even the Uruguay-Round seemed short of failure in 1988 and 1990. However, on a structural level and in view of the current goals fundamental differences between the current Doha-Round and the Uruguay-Round can be noted. On a structural level, the power relations between the US and the EU changed. Due to its eastward enlargement, the EU rose to be a similarly strong economic power able to compare to that of the US. From a realistic perspective, the US has consequently lost hegemonic power. Additionally, one should consider the new challenges posed by the emerging markets China and India. We can thus speak of observing the structural transformation of a now bipolar world trade system that was formerly unipolar. According to hegemonic stability theory, hegemony promotes multilateral free trade because of the stark profit it can count on from doing so. In his study, Mansfield (1992) proves the correlation between power constellation and the signing of trade agreements. In case of a hegemonic power decline, he concludes that a stronger protectionism will be implemented. The decreasing hegemonic position of the US can in turn be explained by resorting to hegemonic stability theory and also give the new regionalism context. Nonetheless, Mansfield's study (1992) related to the old regionalism and does not distinguish between the different types of states agreements might be preferentially signed with. FTAs closed under the conditions of an asymmetrical relationship of interdependence are hence not specifically referred to in the study and thus on that account no explanations on the effects of these agreements on the multilateral trade regime are presented.

According to Susan Strange (1989:24f), in addition to material or relational power, structural power is another factor of hegemonic predominance. For Strange structural power is “the power to shape and determine the structures of the global political economy within which other states, their political institutions, their economic enterprises and (not least) their scientists and other professional people have to operate.” Robert W. Cox (1981) uses a comparable definition which lists material resources, institutions and ideas as essential factors of power. These powers may be translated into the areas of international economic politics as the Economy, Politics and Society (Hummel 2000). Cox postulates the existence of a consensus between the elites of these three areas, that they have a common opinion concerning the direction of economic policy. Translated to the transnational level this concept

is understood as a hegemonic consensus. Neoliberalism was implemented toward the end of the 1970s, and is regarded as a hegemonic consensus of the world economic relations, a consensus institutionalised in the WTO. The current blockage in the Doha/Qatar world trade round would as follows be an expression of consensus' dissolution encompassing the society within the US and the EU, a common opinion on the future direction of world trade policy. The increased pressure of unions within the US shows, that they are no longer willing to continue promoting world trade policy's neoliberal direction. Also, EU member states are increasingly faced with pressure from NGOs which insist the world trade regime comply with human rights and environmental standards. After all, the Ministerial Conference in Seattle in 1999 was accompanied by massive protests on part of national and international NGOs. The heightened transnational trade conflicts between the US and the EU within the WTO framework (key words: GMOs, Airbus/Boeing) can thus be linked to the lack of consensus within society.

The problem of legitimacy and the shift in power relations between the US and the EU contributed to the disintegration of the transatlantic alliance in foreign trade politics. This alliance, founded on a neoliberal consensus, worked as glue bridging the conflicts between industrial and developing countries. These conflicts have now resurfaced and ultimately led to the negotiation blockage in the 2004 Ministerial Conference in Cancún. Should the findings verify the thesis that consensus on the future direction of world trade policy is crumbling, the blockage within the world trade round would not only be a conflict concerning regulation, but it would also be a conflict on order, and will in consequence either lead to a failure or the transformation of the world trade regime. Following up on these postulations, the recent development of bilateral trade agreements will be empirically examined. To assist this effort, Cox' hegemonic power factors will be applied to US and EU foreign trade strategies and be translated into economic policy power, institutional power and power of legitimacy.

### **3 The Strategy of Bilateral Trade Agreements**

To not hinder the European integration process, Article 24 of the WTO permits the signing of regional FTAs under certain circumstances: an FTA may not position higher tariffs or other non-tariff trade barriers than those agreed within the world trade framework. FTAs aim at erecting free trade areas. FTA-members commit to mutually abolish all tariffs and non-tariff trade barriers within ten years (Paragraph 5c of Article 24 of the WTO).

During its eastward and southern enlargement, the EU signed some FTAs, whereas the US rejected the option of regional and bilateral FTAs, claiming these agreements contributed to the weakening of the multilateral world trade regime. In fact, by 2001, the US had only finalized two (Israel and Canada) of the 130 FTAs it had registered with the WTO (Schott 2004).

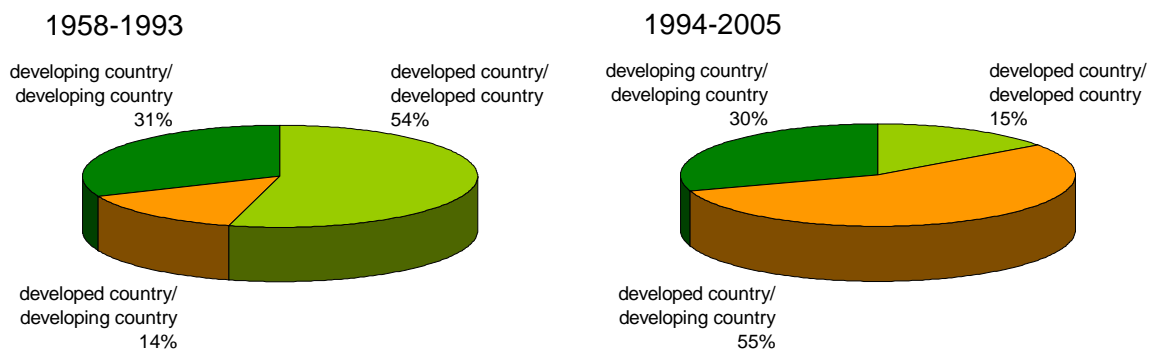
From 2000 onward, powers within the US gained leverage. They voiced concern that the EU and its planned enlargement eastward might outweigh the US economically and in economic-political terms (Fergusson, 2006). During the following years, the US closed a number of FTAs and is negotiating with different states (Cooper 2006). The EU responded to the US' participation in the race for FTAs from 2000 onward by publishing the foreign trade policy strategy paper *Global Europe* in 2006, which stresses the intention to continue signing bilateral contracts with new intensity (EU-Commission 2006a).

*“The Commission will propose a new programme of bilateral free trade agreements with key partners in which economic criteria will be a primary consideration” (EU-Commission 2006b).*

Since then a race to open new markets has ensued between the US and the EU. FTAs the EU has already agreed to concentrate regionally on the Mediterranean countries (Tunisia 1998, Israel 2000, Morocco 2000, Jordan 2002, Lebanon 2003, Egypt 2004, Algeria 2005). Further agreements were signed with South Africa (2000), Mexico (2000), Croatia (2002) and Chile (2005). Due to the EU's decision to maximize the closing of bilateral FTAs in the upcoming years, it is to be expected that the number of FTAs will rise once more. Currently, negotiations on the following FTAs are underway: MERCOSUR (since 1999), India (2007), ASEAN (2007) and South Korea (2007) (EU-Commission 2007).<sup>2</sup>

Emerging markets in Asian are also of special interest to the US. An FTA with Singapore exists since 2004, the US and Malaysia are currently negotiating an FTA (2006). Talks with Thailand (since 2003) seized in the fall of 2006, after the military coup. In South Korea the US was able to sign an FTA on June 30 2007, and thus outran the EU. South America is highest on the US' FTA-priority-list. The attempt to create to a holistic Free Trade Area of the Americas (FTAA) failed 2006 due to resistance by MERCOSUR. However, the US signed bilateral FTAs with Chile (2004), Panama (2006), Peru (2006) and Columbia (2006). In 2004, the US, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua signed a regional FTA (CAFTA-DR). Another regional focus of US efforts to close FTA deals is the Middle East. After signing FTAs with Jordan (2001) and Marocco (2006), particularly the FTAs in Bahrain (2006) and Oman (2006) are seen as an anchor for the US in this region. The US is negotiating an FTA with the UAE since 2005. By 2013, the US hopes to have implemented the Middle East FTA (MEFTA) including all countries in the region (USTR 2007).

Graphic 2: FTAs sorted by state groups



Source: EU-Commission, *Bilateral Trade Relations*, [http://ec.europa.eu/trade/issues/bilateral/index\\_en.htm](http://ec.europa.eu/trade/issues/bilateral/index_en.htm), rev. July 24, 2007.

Distinguishing between different types of state groups, as depicted in graphic 2, confirms the increase of FTAs signed between developing and industrial countries since the mid-1990s. In comparison, the FTAs signed within the state group of developing countries and within the group of industrial countries are much lower.<sup>3</sup> In FTAs signed between developing and industrial countries, however, the economic interdependence is substantially lower, as is the case of FTAs signed between industrial countries as well. For example, exchange of goods

<sup>2</sup> EU-Commission, *Bilateral Trade Relations*, [http://ec.europa.eu/trade/issues/bilateral/index\\_en.htm](http://ec.europa.eu/trade/issues/bilateral/index_en.htm), rev. July 24, 2007.

<sup>3</sup> FTAs between transitional countries were not considered for these numbers, even if they make out about a fourth of all FTAs. However, these states cooperated already prior to the implosion of the Soviet Union. Through FTAs these cooperative relations are only renewed.

between the EU-27 and its free trade partners is worth a mere one percent – excluding India, South Africa and South Korea.<sup>4</sup> The numbers in case of the US are similar (Ludema, 2007: 1219). This brings up the question why the US and the EU sign FTAs with countries, whose economic welfare effects are negligible? An analysis which differentiates according to sectors, however, shows that the imports from developing countries concentrate on few sectors, most often on the agrarian. Next to the Singapore Issues, such as investment, trade and competition policy, and transparency in government procurement the US and the EU insist on adhering to environmental and social standards. This positive rule-making is labelled by William Dymond and Michael Hart (2000: 2138) as an attribute of a „post-modern trade policy“, which – according to Falke (2005) – stands in particular for the European foreign trade policy within the multilateral negotiation system. Sure enough the EU tried with little success to include environmental and social standards on the agenda of the world trade round, but failed due to resistance by the US and developing countries. In contrast, in its bilateral FTAs, the EU strives to implement its norms:

*“In considering new FTAs, we will need to work to strengthen sustainable development through our bilateral trade relations. This could include incorporating new co-operative provisions in areas relating to labour standards and environmental protection”* (EU-Commission, 2006a: 12).

Falke considers this post-modern trade policy to be an element of a concept of global governance that relies on positive rule-making (Falke, 2005: 341). Instead, the economic sciences label this phenomenon as “export protectionism”: according to this definition, the introduction of environmental and social standards deprives developing countries of their comparative cost advantages. This is done with the goal of protecting the non-competitive sectors within the EU from cheap imports (Bhagwati, 2007: 13).

The US’ new trade policy does not concern itself with questions of global governance, but like it is also the case within the EU, its own interests are shaped by inner political forces. On 11 May 2007 both congressional parties and the administration presented a joint proposal for a “New Trade Policy for America”. This proposal bridges the differing republican and democratic approaches toward globalisation, and laid an existing schism within Congress to rest. The administration’s interest to reach an agreement with Congress is easily explained, knowing that the Trade Promotion Authority is up for renewal. The recently presented new trade agenda is a shift in a new direction of the former trade policy by the Bush-administration. For example, the administration had still refused to include environmental and socio-political standards on the agenda of the world trade round until recently.

The new US-trade agenda will now consider social and environmental standards – in accord to international regimes - in FTA-negotiations. Thus, the following conditions are now part of a bilateral trade agreement:

*„A fully enforceable commitment that FTA countries will adopt, maintain and enforce in their laws and practice the five basic international labor standards, as stated in the 1998 International Labor Organization Declaration on Fundamental Principles and Rights at Work”*

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<sup>4</sup> see Eurostat, *External Trade*, <http://epp.eurostat.ec.europa.eu/>, rev. November 2, 2007.



*„A fully enforceable commitment that FTA countries adopt, implement and enforce in their laws and practice obligation under seven common major multilateral environmental agreements (MEAs<sup>5</sup>), including CITES and the Montreal Protocol. Provision to add additional, new common MEAs”<sup>6</sup>*

Furthermore, the provisions include binding commitments prohibiting FTA countries from lowering these standards and to use the same dispute settlement mechanisms as other FTAs obligations. According to its new trade agenda, the US could not have signed FTAs with Oman and Bahrain, because they have not signed all environmental regimes. FTAs waiting for approval by Congress (Peru, Columbia, Panama and South Korea) were later equipped with environmental and social standards in reference to respective conventions. Norm-setting reveals that contract partners are negotiating in an asymmetrical relationship of interdependence. The new FTAs only require compulsory adherence to conventions which the US has already ratified. Conventions that remain unratified by the US, but which the FTA-contract partner might have ratified (for example, the Cartagena Protocol on Biosafety in the case of Peru) are not listed in the FTA.

An analysis distinguishing between different types of contract partners shows that the asymmetrical relationship of interdependence functions as an enabler, allowing the US to promote its political security interests, as well. In a speech at the Institute for International Economics in May 2003, then-Trade Representative Robert Zoellick stressed that FTA-negotiations with the US would be linked to pre-conditions. Supporting the US' foreign political interests would not only be expected during the current world trade round, but also supporting their security policy. Deciding on a country's eligibility for FTA-negotiations are made based on a 13 point-catalogue. Criteria include the FTA's influence on democratic development and economic reform processes of the negotiating country. Another standard for eligibility is the state's geo-strategic relevance. The bilateral FTA with Bahrain, for example, is seen as an anchor in the Middle East, ensuring further regional access. Zoellick (2003) clarified that it is not simply a "competition for liberalization", but that it is also a highly selective process future trade partners undergo before being chosen based on their strategic security criteria. In a speech at the University of South Carolina in May 2003, US-President Bush stated to be striving to implement a Middle-East-Free-Trade-Agreement (MEFTA) by 2013. Hereby, US economic interests in this region are secondary, as the entire GDP of the Arabic states in sum is lower than that of Spain on its own. The following quote illustrates clearly that instead security policy interests dominate the motivation behind these steps:

*„We're determined to help build a Middle East that grows in hope, instead of resentment. Because of the ideals and resolve of this nation, you and I will not live in an age of terror. We will live in an age of liberty”.<sup>7</sup>*

Bush's proposition of building a Middle-East-Free-Trade-Zone was supported by Congress. Republican senator John McCain and Democratic Senator Max Baucus jointly submitted the

<sup>5</sup> MEAs: Multilateral Environmental Agreements (Convention on International Trade in Endangered Species, Montreal Protocol on Ozone Depleting Substances, Convention on Marine Pollution, Inter-American Tropical Tuna Convention, Ramsar Convention on the Wetlands, International Convention for the Regulation of Whaling, Convention on Conservation of Antarctic Marine Living Resources)

<sup>6</sup> US-Congress, House Committee on Ways and Means: *Congress and Administration Announce New Trade Policy*, Friday, May 11, 2007, <http://waysandmeans.house.gov/Media/eNewsLetter/5-11-07/07%2005%2010%20New%20Trade%20Policy%20Outline.pdf>, rev. July 22, 2007.

<sup>7</sup> White House, Office of the Press Secretary, *President Bush Presses for Peace in the Middle East*, <http://www.whitehouse.gov/news/releases/2003/05/20030509-11.html>, rev. March 11, 2007.

“Middle East Trade and Engagement Act of 2003” (S. 1121) to the Senate. The legal text undermines in Article 2.2:

*„Congress views democratization and economic progress in the countries of the greater Middle East as important elements of a policy to address terrorism and endemic instability.“*

When signing Trade and Investment Framework Agreements (TIFAs), which function as a precondition prior to negotiating for an FTA, states have to oblige to support the US’ security policy (particularly in the Middle East Conflict).<sup>8</sup> Also, Preferential Treaties (Generalized System of Preferences, GSP) are linked to preconditions. GSPs - in the sense of the word - are limited to decrease tariffs on selected products. GSPs are supposed to support the economic growth of developing countries, by trading tariff-free products with the US. Nonetheless, within the treaties parties agree on extended regulations concerning non-economic fields such as worker’s rights, protection of investment, tax and customs, protection of the environment, human rights and intellectual property rights. Linking economic matters of the FTA to security aspects are part of the preconditions a state has to fulfil before it is even considered as a negotiation partner. States ineligible for negotiations are (Federal Register, 69(126), 2004, 39997) those ruled by a communist regime (1), those which deprive the international trade from vitally important commodities or offer these at an unreasonable price (2a), offer products specified in a preferential agreement to a developed country other than the US, leading to significant disadvantages for the US-economy (3), those which support individuals or groups involved in international terrorism, by offering them protection from legal prosecution on their soil or have not taken steps to support the US in the War on Terror (6). Not only the US, but also the EU, uses the asymmetrical relationship of interdependence to promote non-economic interests. In an analysis comparing the different EU bilateral trade agreements Hettne and Söderbaum conclude the EU proclaims to support its goal of carrying EU values such as human rights, democracy, law and good governance into the world by means of regional agreements. In contrast to the EU-candidate-negotiations they observe a strategy of soft imperialism in the treaties with developing countries:

*“The latter [soft imperialism] refers to an asymmetric relationship and the imposition of norms in order to promote the EU’s self-interest rather than a genuine (interregional) dialogue as a foundation for sustainable global governance” (Hettne & Söderbaum, 2005: 549).<sup>9</sup>*

The EU could increase the legitimacy of its power within its own ranks by demanding adhere to environmental and social standards. NGOs, but also enterprises unable to compete on an international level, as well as unions, welcome the EU’s post-trade-policy. Toward the within, the EU has created a consensus on its foreign trade strategy in bilateral trade agreements.

The trade powers examined in this article, the US and the EU, are offered the possibility of transferring their respective norm and rule system onto the weaker contract party due to the asymmetrical relationship of interdependence and implement this ability by signing bilateral FTAs with developing countries: Positive rule-making enables them to open new markets for their national enterprises (Singapore Issues) and in the same breath allows them to protect domestic markets from cheap imports from developing countries by demanding they implement environmental and social standards.

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<sup>8</sup> see Middle East Trade and Engagement Act of 2003, S. 1121

<sup>9</sup> see also Meunier & Nicolaidis, 2006.

In form of the strategy that Hettne and Söderbaum (2005: 549) labelled as soft imperialism – or with the term “export protectionism” hailing from the economic sciences – the transnationalisation of norms and rules of the EU and the US is taking place in developing countries. The transnationalisation of norms and rules are characteristics of the emerging transnational competitive state, which not only continues to strengthen its economic power by liberalizing the world trade in form of negative rule-making, but which also uses the protectionist characteristic of positive-rule-making at the same time in order to increase the legitimacy of its power within society.

But which effects does the transformation of the national competitive to the transnational competitive state under the conditions of asymmetric interdependence have on developing countries as well as on the world trade regime? The following two chapters seek to answer these questions.

#### **4 Bilateral Trade Agreements conditioned by an Asymmetrical Relationship of Interdependence**

While for industrial countries the signing of FTAs with developing countries are of subordinate importance on a macroeconomic level, developing nations promise themselves better access to industrial nations markets and their technological know-how from signing FTAs with developed countries. For most developing countries the US and the EU are already today the most important market(s) for agrarian produce and for commodities with a low production level. General statements on the long-term effects of FTAs on the relationship of dependence between industrial and developing countries are currently not possible, as the duration of most FTAs is still too brief. However, some studies suggest an increase in asymmetrical interdependence due to FTAs. Analysing the FTA NAFTA one can see the increase of interregional trade and a rise of Foreign Direct Investment (FDI) on the one hand, especially for Mexico. Simultaneously, on the other hand, the concentration of Mexican exports on the US-market increased: while the contingent of Mexican exports to the US was still at an average of 62 percent p.a. in the 1980s, it rose to about eighty percent between 1990 and 1995, and in the period between 2001 to 2006 even to a contingent of 86 percent of total Mexican exports.<sup>10</sup> In turn Mexico’s dependence on the US as its most important export market heightened.

Mexico tried to reduce this dependence by signing further FTAs. In fact, it was Mexico’s strategy to decrease its dependence from the US through closing further FTAs – alas with little success. In negotiations with the EU concerning an FTA it is apparent that the EU was promoted its non-trade-related demands: In April 1997 the European Council accepted Guidelines include the liberalization of intellectual property rights, movement of financial capital an public procurement as well as regulations on environmental issues and the adhering to human rights and the promotion of democracy. After Mexico initially refused to accept the democratic clause, the country eventually decided to accept EU-demands (Szymanski & Smith, 2005).

From a normative perspective linking FTAs to norms and rules - such as abiding to human rights, environmental and social standards - are to be welcomed, as the debate concerning European normative power shows (see Behrens, 2008). Yet, for developing countries this type of positive rule-making implies a loss of national capability and its scope of action, as clarified in an example by Mahnkopf in the case of NAFTA: Most bilaterally negotiated agreements on investment within the FTA framework surpass WTO regulations, which are supposed to grasp in case of a state-to-state dispute settlement process. But now, bilaterally

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<sup>10</sup> IMF, *Direction of Trade Statistics*, database, see also: UNCTAD, 2007: 70.

signed investment agreements also allow enterprises to sue states. A Spanish investor sued Mexico at the International Centre for Settlement of Investment Disputes (ICSID) of the World Bank for five million US-dollars, because the Mexican government – pressured by local and environmental political protests – did not extend the license for a landfill (Mahnkopf, 2005). Cases like this one hardly promote democracy in developing countries.

In addition to the uneven distribution of material power, asymmetrical relationships of interdependence are also characterized by unequal institutional power. Developing countries partake an inferior position to industrial nations in FTA-negotiations in norm-setting but also in norm-assertion. In negotiations the US and the EU are not only able to promote their interests through positive rule-making, but can also exclude sensitive areas from FTA-reign - such as the agrarian sector - or by inhibiting certain sector's liberalization by writing exemption-clauses into the agreements.

Also, developing countries are disadvantaged in asserting the norms and rules of an FTA. Paying the high administrative costs to ensure rules of origin are adhered to – for example – are much more intensive, higher and more difficult to raise for institutionally weaker developing countries as it is to cover the costs for industrial countries. Additionally, rules of origin leave a lot of room to be arbitrary. In his study on the effect of institutions in FTAs Borrmann et al. conclude that states with a weak institutional system profit less from free trade than states with a strong(er) institutional system do. At the same time they warn to simply endorse the opinion that developing nations can just copy industrial nations institutions to make up for this deficit/gain equally:

*“Institutions that are effective in industrial countries can have quite different outcomes in developing countries, which, for example, have fewer complementary institutions, weaker administrative capacity, higher per-capita costs, lower human capital levels, different technology, and different levels and perceptions of corruption”* (Borrmann et al., 2006: 364).

The UNCTAD Trade and Development Report of 2007 also indicate the danger of bilateral FTAs for developmental measures on the political level. Referring to the Singapore Issues the Report clarifies that developing countries have a significantly smaller scope of action in FTAs signed with industrial nations – particularly concerning the promotion of specific sectors or in trying to increase certain enterprises competitiveness (on an international level) – in comparison to the scope's width under current WTO-rules. Thus the UNCTAD recommends developing countries not only consider the positive trade effects or the rise of FDIs, but to also think about „the impact of these agreements on their ability to use alternative policy options and instruments in the pursuit of a longer term development strategy“ (UNCTAD, 2007: 65).

FTAs not only narrow the developing countries developmental scope of political action, but studies have proven that bilateral FTAs lead to an erosion of regional integration projects such as Mercosur (Ribeiro-Hoffmann & Kfuri, 2007) or Asean (Dieter, 2005). Under the condition of an almost wholesome symmetrical interdependence FTAs may definitely create positive welfare effects. Instead, in asymmetrical relationships of interdependence, the power factor exerts more influence and in consequence developing countries' dependence on industrial nations strengthens a change which will not remain without effect on the world trade regime.

## 5 The Effect of Bilateral Trade Agreements on the World Trade Regime

The debate on the effects of FTAs in the economic sciences has a long tradition. There have been many economic scientific model-calculations which will not be described further in this article. These studies centre around the question of whether FTAs contribute to trade creation, trade diversion or even to trade deflection. Most examinations are founded on Viner's study conducted in 1950, in which he questioned the efficiency of customs unions for the liberalization of world trade in his two-commodity-model. The results of these studies differ greatly from one another. The question, if FTAs are rather stumbling stones or building blocks contributing to a larger world trade regime, is not explicitly answered anywhere (Lloyd & Maclaren, 2004). Differing results can *inter alia* be explained by stating that the asymmetrical relationships of interdependence are not included in these models, and thereby neglect the power aspect. More recent studies, however, do include the asymmetrical relationships of interdependence.

Nuno Limão's study (2007) is particularly noteworthy. On the basis of mathematic models, Limão proves that linking economic and non-economic interests effectively block the multilateral trade regime. Linking these two fields is most often found in trade agreements between large and small states. FTAs signed between the US and smaller states or developing countries cannot be explained with the regular economic models of welfare effects for the US, as its effects are just marginal. Rather, these agreements are driven by non-economic forces (worker's rights, war on drug production and trade). Limão points out an interesting phenomenon: large states buy the non-economic conveniences by receiving advantages in customs on certain commodities, which by granting developing countries tariff levels below the multilateral tariff applicable to all other WTO members. Yet this implies, that large states are not interested in promoting lower tariff-levels on these commodities within the framework of the multilateral regime, as doing so would lower the tariff-level accessible due to the negotiation process with developing countries and the trade agreements signed with them. Limão's study feasibly proves the blocking effect of bilateral FTAs for the world trade regime.

Another argument speaking for the blocking effect are the interests of the US and the EU for within their societies, that they can more easily promote in a bilateral FTA. Apart from protests by unions and NGOs, which massively helped the implementation/considering of social and environmental standards in FTAs, it is particularly enterprises – who are unable to compete on an international level – who are interested in bilateral FTAs, as they create access to new markets. Due to the lower tariff levels agreed on in an FTA, these enterprises are granted the opportunity to establish business in a market in which said company would have immediately failed without the FTA and the protectionist measures benefiting the stronger contract party the agreement entails in place (trade diversion).

These enterprises therefore prefer FTAs to the promotion of liberalization within the multilateral world trade regime framework, as these would imply economic disadvantages for them (Kono, 2007). This effect can be noted in FTAs under conditions of an asymmetrical relationship of interdependence, but also in FTAs with a symmetrical relationship of interdependence.

FTAs render a special interest-structure which contributes to a weakening of the world trade regime. Strong economic powers, such as the US and the EU can better further their interests in FTAs under the conditions of an asymmetrical relationship of interdependence than they can in the WTO comprising of 150 member states. FTAs, particularly those signed with Asian states, create the possibilities for the US and the EU to open new markets for their transnational enterprises and to expand their economic power at the same time. In order to benefit from first-comer-effects, the US and the EU have just about begun a race for the

signing of FTAs. In bilateral foreign trade policy it is vital to expand economic political power. In FTAs with developing countries, the US and the EU can much easier take advantage of their institutional benefits (agrarian clauses) as with Asian states and may continue fostering their institutional power (Singapore Issues) by taking their norm- and rule system to the transnational level. Finally, the US and the EU can regain legitimacy within their societies by including social and environmental standards, clauses concerning human rights and good governance and re-attain and increment legitimacy in face of domestic enterprises who are unable to compete on an international level as well as in the eyes of NGOs. In summary, the US and the EU can catch three flies with one swat: power on the economic political, institutional and legitimacy level rise simultaneously. Hence, the US and the EU renouncing from bilateralism quite unlikely middle- to long-term. This changed strategy in foreign trade policy is carried out on the back of the world trade regime and hollows this structure out continuously.

Do all of these developments imply the end of the WTO? Not at all. It is definitely thinkable that on a long-term-basis the transaction costs of bilateral FTAs will exceed the benefits of their use. The processes required to adhere to the rules of origin are incredibly complicated and linked to high administrative expenses. Furthermore, the spaghetti-bowl full of FTAs is ever more difficult to overlook. Parallel to the increase of transaction costs for the US and the EU (but also for their respective enterprises) an erosion of regional integration projects by FTAs is occurring. A consequence might be that the developing countries alliance of interests, such as it existed in Cancún, will weaken even more. Eventually the more developing countries accept social and environmental standards within an FTA framework the more likely these standards will be integrated into the norm system of the WTO on a long-term basis. Should – however - the already known results of the deepening asymmetrical relationships of interdependence strengthen by further examinations of FTAs signed between industrial and developing countries, the developmental disparities between the north and south will rise further, including all their conflict potential such as migration or terrorism.

## **6 Conclusion**

The exponential increase of bilateral FTAs since the beginning of the year 2000 cannot be fully understood by theories of liberal institutionalism. As FTAs have detached from their regional context, integration theory approaches of explanation no longer grasp as a justification either. Alas, the new types of FTAs are not a “competition for liberalization” converging with the world trade regime and can therefore not be accounted for from a liberal perspective. The attribute of this bilateral FTA is rather the following: they are highly motivated by protectionism and linked to non-economic interests.

Protectionist phases in the world trade system are not a new phenomenon. Instead, they mark a state of upheaval in the international relations and entail high insecurities for states. A phase of upheaval, for example, is the end of the East-West-Conflict. The US lost their hegemonic position of predominance as the EU grew stronger. The US as well as the EU are confronted with new challenges due to the emerging markets China and India. These shifts in the structure led to an erosion of the former neoliberal consensus in world trade policy. The US and the EU now both attempt to promote their individual power interests by signing bilateral FTAs.

In world trade policy a transformation of the state from a national competitive state to the transnational competitive state can be observed, a change facilitated by the existing asymmetrical interdependence in international relations. Differentiating the term of power in allusion to approaches of realistic and neogramscian theory toward economic political power, institutional power and power of legitimacy render it possible to specify the transformation

processes more clearly: In bilateral FTAs the US and the EU cannot only expand their economic political power, but also their institutional power, by transferring their norms and rules beyond their own borders into other states.

Thus, not only an internationalisation of state sovereignty is occurring, but parallel a process of transnationalization is taking place. By means of the integration of non-economic norms and rules in FTA-negotiations - such as social and environmental standards or human rights - they can count on an almost wholesome support by western civil society and hereby increase their power of legitimacy. Through these non-economic norms and rules, the US and the EU simultaneously protect their domestic sectors and enterprises not fit enough to compete on an international level ("export protectionism").

While the large trade powers gain power in all three dimensions (economic, institutional, legitimacy), developing nations are counted among the losers of the game. They not only lose comparative cost advantages (albeit normatively questionable), but also their scope of action for development policy measures is reduced. Based on these findings it is to be expected that developmental disparities will increase and that asymmetrical interdependence will strengthen.

Simultaneously the world trade regime is weakened as the US and the EU align their foreign trade strategies less multilaterally, and chose to point it toward a transnational direction. However, it is imaginable on a long-term basis that a new consensus on the direction of world trade policy will crystallize, a consensus which could be called "re-embedded liberalism" as it includes social and environmental political protective mechanisms. These might be multilaterally institutionalised in a reformed world trade regime. The asymmetrical interdependence - previously strengthened by the transnational competitive state - will then be incorporated in this consensus.

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