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POUR LE DÉBAT

N° 02/2008 | NATURAL RESOURCES

Dancing with Brazil, South Africa, India and China: Large Developing Countries and Bilateralism

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In his analysis of the way in which emerging countries use bilateral trade tools, the author highlights the contradiction existing between the alternative model they advocate at the multilateral level

and the liberal orthodoxy they implement in their bilateral agreements.

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Introduction

The proliferation of bilateral agreements is a new and fascinating trend in the world trading system. The number of bilateral agreements has been steadily increasing since the creation of the World Trade Organization (WTO) in 1995 and the slow progress of the current Doha Round seems to have accelerated this tendency. Today, more than 130 bilateral agreements have been notified to the WTO and approximately 70 are under negotiation. To its square dance repertoire of multilateralism and regionalism, the world trading system is progressively adding the more complex and subtle couple dance of bilateralism.

A key feature of this dance seems to be the political and economic asymmetry of the dancers. Indeed, all the bilateral free trade agreements (FTAs) signed during the last decade by the European Commission, the European Free Trade Association, the United States, Australia, Japan, Switzerland and Canada systematically target developing countries. One of the only exceptions to this rule is the US-Australia agreement, although one could argue that it is also characterized by an asymmetrical relationship.

For developed countries, these North-South bilateral agreements offer the advantage of circumventing countries considered to be impeding progress at the multilateral and regional levels – those that the former United States Trade Representative (USTR) Robert Zoellick called the “won’t do countries”. For example, after it became clear that Brazil could undermine the Free Trade Area of the Americas (FTAA) project, the United States government signed individual FTAs with Chile, the members of the Central American Common Market, the Dominican Republic, Peru, Panama and Columbia. The strong asymmetrical relations underlying these agreements allowed the US government to put forward trade-related rules, notably on investment and intellectual property rights (IPRs), which Brazil would have rejected in the FTAA context. While the United States and the European Union keep pressuring large developing countries to open up their markets, bilateral agreements with smaller developing countries ensure that the wheel of global liberalization keeps turning.

On the other hand, for developing countries, a bilateral agreement with a developed country offers valuable competitive advantages for accessing the world’s richest markets. For most of them, the European Union and the United States figured among their top export partners, ahead of their immediate neighboring countries. Chile, among others, sends 14% of its exports to the United States, representing more than 5% of its GDP. In this context, a privileged duty-free access to the American market could significantly increase Chilean exports, at the expense of other developing countries.

In that context, one may wonder how large developing countries, such as China, Brazil, Russia, India and South Africa, reacted to the proliferation of North-South bilateral agreements. They could have decided to join the bilateral dance and follow a dance routine similar to that of smaller developing countries that seek privileged entry of their products to the world’s richest markets. Alternatively, they could have followed the line of the OECD (Organisation for Economic Co-operation and Development) countries and looked for highly asymmetrical relations enabling them to impose their ideal trade rules. Nevertheless, as this paper argues, it appears that southern regional hegemony are not actively using bilateralism and that the few bilateral trade agreements they signed do not contain the innovative “development-friendly” rules that they advocate at the multilateral level.

Prioritizing square dancing

Large developing countries are committed to various extents to trade liberalization. Most of them are engaged in some sort of unilateral liberalization. While their political leaders may publicly criticize the effects of trade liberalization, they are pursuing domestic reforms and are gradually reducing their consolidated tariffs. Of the two regional powers that are not among the founding members of the WTO, China finally acceded in 2001 after many years of negotiations and Russia is actively engaged in the accession process.

Although large developing countries seem to support trade liberalization, it should come as no surprise that they were not among the first to rush into bilateral free trade negotiations. Contrary to developed countries, their tariffs (especially India's) remain at relatively high levels and their domestic industries are unprepared for drastic tariff cuts. Moreover, contrary to many smaller developing countries, they do not necessarily need privileged access to developed countries' markets in order to sustain their economic growth. Only a relatively small fraction of the Indian and Brazilian GDPs depend on the export of goods and services. Although Russia largely depends on its oil exports, a bilateral FTA is unlikely to increase its oil revenues. Finally, Chinese goods exports have so far been sustained by internal factors rather than privileged access to foreign markets. China benefits from the expiry of textile quotas and could significantly gain from improved access to developed countries' markets, although proportionally less than smaller developing countries without strong internally-driven growth. Thus, large developing countries were unsurprisingly not the first to look for bilateral FTA partners.

That being said, large developing countries are actively engaged in regional integration processes. Over the past decade, Brazil and its Mercosur partners entered into FTAs with many other South American countries, including Chile, Bolivia, Columbia, Ecuador, Peru and Venezuela. Similarly, Russia signed bilateral FTAs with other Commonwealth of Independent States members and is simultaneously pursuing two regional customs union projects: the Eurasian Economic Community and the Single Economic Space. For its part, India signed the South Asia Free Trade Agreement (SAFTA in 2004), which may eventually lead to a full-fledged South Asia Economic Union. China has reached a framework agreement and an "early harvest program" covering trade in goods with the 10 member countries of the Association of Southeast Asian Nations (ASEAN). This will pave the way for a broad FTA scheduled for 2010. Each of these large developing countries aspires to play a key role in their respective regional integration.

This trend can hardly be explained by a "natural regionalization theory". Just like most other developing countries, large developing countries export more to remote developed countries than to their immediate neighboring countries. Hence, the value of Brazilian exports to the United States is almost three times higher than exports to Argentina, its Mercosur partner. Moreover, a large share of Brazilian exports to the United States is made up of high-tech products, which are more beneficial to the Brazilian economy.

In fact, the primary objective of large developing countries' commitment to regional trading arrangements is to build strategic and political alliances, rather than to generate net trade creation. Similar to France and Germany in the 1950s, Argentina and Brazil signed the Treaty of Asunción, which established Mercosur in the early 1990s in the hope of overcoming their traditional rivalry. In Africa, the Southern African Development Community (SADC) originated in the 1980s as a coalition of countries opposed to apartheid and has paradoxically turned into a free trade area in which South Africa is supposed to serve as a growth pole for its former detractors. Similarly, many hope that the SAFTA agreement will help to ease tensions between India and Pakistan.

Although these political objectives of regional FTAs and customs unions are praiseworthy, some political economists, among them Jagdish Bhagwati¹, worry that they may become stumbling blocks for the world trade system. They argue that regional integration does not generate net trade creation, but shifts imports from suppliers in third countries to less efficient regional firms. Once integrated, a regional block will be inclined to raise its trade barriers against third countries in order to protect these inefficient regional firms. The multilateral system would then be stuck, as regional blocks will clash against each other. This assertion could be turned upside down by arguing that the multilateral negotiation process would move more rapidly if the number of negotiators were reduced to a few regional powers that act as spokespersons for their respective block. Nevertheless, both of these scenarios are unlikely to happen given that large developing countries have started establishing privileged trade relations beyond their traditional regional areas.

Entering into couple dance

After long being exclusively focused on regionalism, large developing countries seem increasingly interested in cross-regional bilateral agreements. According to Richard Baldwin's domino theory², the proliferation and expansion of trade agreements harms non-participating countries, which are disadvantaged in a greater number of markets. To nullify this harm, they enter into similar trade agreements with participating countries. Indeed, it is probable enough that developing countries that cannot aspire to become regional economic powers (such as Mexico and Chile, which signed bilateral FTAs with both the United States and the European Union) significantly increased their export shares to developed countries at the expense of a southern regional hegemon.

In this context, some large developing countries are gradually thinking about signing trade agreements with developed countries, all the while pursuing their regional integration and preserving their positions as regional leaders. This double strategy is known in China as the "two wheel policy": one turns for economic and technological cooperation with neighboring developing countries and the other for trade and investment liberalization with developed countries. Large developing countries could strategically become the axle between the developed and the developing worlds.

Although none of the large developing countries has yet reached this strategic position, most have taken the initial steps in this direction. Brazil and its Mercosur partners signed a Framework Agreement with the European Community in 1995 and both parties are currently negotiating a broad FTA. China is about to sign an FTA with New Zealand and is exploring the possibility of starting negotiations with Australia. South Africa, for its part, has reached an FTA with the European Community and is negotiating with the United States. Finally, Russia and the European Community are constantly strengthening their economic cooperation and seem determined to negotiate a free trade agreement once the former enters into the WTO. Only India remains without any credible prospective developed country partner.

While large developing countries are negotiating bilaterally with developed countries, they are also increasing their cooperation among themselves. South Africa is considering FTAs with China, Mercosur and India. Similarly, India is negotiating with Mercosur and has initiated a joint feasibility study on a bilateral FTA with China. In addition, India, Brazil and South Africa (IBSA) created a loose trilateral alliance in 2004 with the aim of coordinating their respective positions in multilateral forums, including the WTO. They are attempting to become voices as

¹ *In Defense of Globalization*. Oxford University Press (2004).

² *A Domino Theory of Regionalism*, [CEPR Discussion Papers](#) (1993).

regional leaders of the developing world in order to better influence the current multilateral negotiation.

Dancing to Western music

Bilateral FTAs could have other objectives than establishing political alliances and strengthening trade relations with a specific partner. They could also act as institutional laboratories for testing new rules, prior to their diffusion via regional or multilateral negotiations. Developed countries have used this strategy for decades. The WTO agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) is, to a large extent, based on prior bilateral agreements. Similarly, the OECD project for a Multilateral Agreement on Investment (MAI) was directly inspired by the NAFTA (North American Free Trade Agreement) experience. However, it seems that large developing countries are reluctant to use bilateralism as a way of progressively propagating their favored norms. The cases of investment and IPRs are illustrative.

At the multilateral level, large developing countries repeatedly expressed their opposition to the adoption of rules on the liberalization and protection of foreign investments. India, for example, claimed at the WTO that it should remain free to adopt investment measures that promote domestic manufacturing capabilities and stimulate technological transfers. Nevertheless, this position is not reflected in Indian bilateral investment treaties (BITs). In fact, India, like China, South Africa and Russia, signed even more BITs than many developed countries, including the United States, Canada and Japan. Their BITs duplicate standard rules, such as the prohibition of discriminative measures, actions tantamount to expropriation, money transfer bans, performance requirements, and violations of the minimum standard of treatment. To ensure compliance with these substantive obligations, they entitle investors of signatory nations to binding international arbitration actions against the host government. No mention is made about the states' right to promote domestic manufacturing capabilities or to the investors' duty to transfer their technologies. Developing country's BITs are still far from the "development-friendly" model drafted and promoted by the International Institute for Sustainable Development.

It is difficult to explain why large developing countries reproduce Western BIT models. They are apparently not coerced by developed countries since there are now more South-South BITs than North-South ones. One can hardly claim that they seek to attract more foreign investment because a number of recent studies have shown that BITs do not, or only marginally, increase investment flows. Arguably, some large developed countries, notably China, cumulate BITs to protect their own investments as they become major capital exporters. But they are still far from reaching developed countries' level of foreign investment stock. One of the most likely explanations of paradoxical behavior is that the signing of a BIT serves as a diplomatic ritual and as a testimony of goodwill in economic relations, especially during ministers' official visits.

Similarly, large developing countries do not use bilateralism to implement their vision of international IPR law. At the multilateral level, they argue for a paradigm shift, especially in patent law, to foster their development. Even if some of them are becoming technological powers, exporting high-tech products and graduating more engineers and scientists than the United States, they act as spokespersons for the developing world at the WTO and the World Intellectual Property Organization (WIPO). They advocate the adoption of new rules facilitating technology transfers, ensuring better access to medicines, creating a synergy with the Convention on Biological Diversity and protecting their traditional knowledge. However, none of them propose these new rules at the bilateral level, although they could be drafted in a way compatible with existing multilateral IPR treaties. Their only bilateral IPR agreements,

notably the United States-China Memorandum of Understanding signed in 1992, resulted from pressure from developed countries. Thus, while large developing countries do not experiment with new international rules among themselves or with other developing countries, developed countries sign bilateral TRIPs-plus agreements every year that can serve as models for a future multilateral treaty on substantive patent law.

Conclusion

Large developing countries are strongly committed to regional integration, but they are still hesitant to follow the new cross-regional bilateral trend. In comparison with their neighboring developing countries, they are in less need of creating a hub-and-spoke structure or gaining privileged access to developed markets in order to sustain their economic growth. If they progressively enter into bilateralism, it is mostly to build political alliances and to increase their cooperation with strategic partners. However, an inherent contradiction lies at the heart of this policy. On the one hand, their regional agreements reinforce their positions as regional leaders and legitimize their role as regional spokespersons in multilateral forums. On the other hand, they fail to use bilateral agreements to globally propagate the “development-friendly” rules they advocate at the multilateral levels. They sign substantially fewer FTAs than most developed countries, but their contents are largely similar. This lost opportunity illustrates the incoherence between large developing countries’ multilateral discourses and their actual trade liberalization programs at the bilateral level. South-South cooperation remains to be realized.

For more information

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