INTERNATIONAL POLICY ANALYSIS

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The Return of Geopolitics

Trade Policy in the Era of TTIP and TPP

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- The future of the multilateral trading system looks bleak. The main reason for this development is the return of geopolitics in a new multipolar world characterized by a declining willingness to cooperate. The lack of progress in the WTO Doha round is the main factor for the current mushrooming of preferential trade agreements. The new and very large US-led trade projects TTIP and TPP exclude the main emerging powers China, Russia, India and Brazil.

- For TTIP and TPP supporters these agreements are answers not only to the standstill at the multilateral trade negotiations, but also to a declining competitiveness vis-à-vis emerging nations and a declining ability of the transatlantic powers to shape the rules of cross-border commerce. In short, if the United States and Europe do not write the rules today, China will write them tomorrow. However, it appears unrealistic to assume that China and the other BRICS will accept rules that were negotiated without them. Instead, the creation of competing systems appears likely.

- Through TTIP, TPP and other preferential agreements, the United States and the EU are not only fundamentally weakening the WTO, but they are also betraying their own principles. Today, the choice is between open global regulation and an economic order built around competing blocs. EU countries, Germany in particular, have nothing of lasting value to gain from such a fragmentation of world trade. They should, therefore, not seek to isolate China and any other BRICS country.

Dialogue on Globalization

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Introduction

For decades, the multilateral trading system enjoyed political support while at the same time facilitating unprecedented economic growth. Member states of the Organisation for Economic Co-operation and Development (OECD) as well as emerging economies successfully pursued deeper economic integration and division of labor. International trade lifted hundreds of millions of people out of poverty. Needless to say, there were also negative effects, but on balance the multilateral trading system seemed to work well. The establishment of the World Trade Organization (WTO) in 1995 symbolized the political will that characterized the 1990s. After the end of the cold war, organizing co-operation without hegemony appeared possible.

The post–cold war trading system was built on organizational principles in place since the late 1940s. The General Agreement on Tariffs and Trade (GATT) had facilitated both economic integration and political co-operation. It is important to recall that GATT's legendary Article 1, the most favored nation clause, was much more than an instrument for trade liberalization. After the disastrous experiences of the 1930s, characterized by competitive devaluations and a dramatic rise in protectionist policies, the architects of the postwar regulatory architecture sought to develop instruments that would facilitate peaceful co-operation. The recipe worked well for GATT member countries or »contracting parties.« After the disintegration of the Soviet Union, the former Eastern bloc was integrated in the existing trading system. Negotiations with the Russian Federation were most difficult, but after almost twenty years of negotiating, the country joined the WTO in 2012 as its 156th member.

Today, the future of the WTO looks bleak, and one of the reasons for this development is the return of geopolitics. Today's multipolar world is characterized by a declining willingness to co-operate. Of course, this sea change has not just hit the multilateral trading system. Whether involving financial regulation or joint measures to fight climate change, it appears difficult, if not impossible, to organize »co-operation beyond the nation-state,« as Michael Zürn noted in the late 1990s. Even the G20—after its elevation to leader level, initially hailed as a new, powerful institution of global economic governance—has been unable to produce tangible results. The G-20 has succeeded in crisis management, but it is failing in joint crisis prevention (Dieter 2013). In 2014 the United States was subject to an ultimatum of the other G-20 countries demanding the implementation of the quota reform agreed upon in 2010. The reform would double the capital of the International Monetary Fund (IMF) to $720 billion, shift 6 percentage points of the total quota to developing countries, and move two of the twenty-four IMF directorships from European to developing countries. The delay demonstrates quite clearly that the United States is unable or unwilling to contribute to the reform of the fund, and this has not slipped the attention of policy makers in developing countries and emerging markets.[1] Adding to the confusion, the United States had itself initiated the reform that it was now blocking. Of course, seasoned observers of US politics would argue that although the administration of Barack Obama continues to be in favor of the reform, Congress is hostile to it. Since congressional approval is required, President Obama could try to persuade Congress on the matter, but the issue appears to be of secondary importance. Advancing multilateral institutions does not seem to be a priority of the current US president.

Departure from the goal of global regulation of trade is resulting in the return of large preferential trade agreements.[2] This is a parallel to the 1930s. Then as now, the global economy was increasingly divided into blocs, and in trade, one observed a distinction between trade with allies and trade with rivals. The new and very large trade projects—namely, the two US-led transatlantic and transpacific schemes—underline this trend. Both the Transatlantic Trade and Investment Partnership (TTIP) and the Trans-Pacific Partnership (TPP) exclude the main emerging powers. China, Russia, India, and Brazil are excluded from participating in these endeavors. Put differently, today, the world's largest economies push processes of regional integration and create projects with each other. This constitutes a sea change.

For decades, regional integration was a concept primarily discussed as an economic policy instrument for developing countries. In the first wave of regional integration in the 1960s, there was great enthusiasm for the potential

1. *Financial Times,* 15 January 2014, 4.

2. Throughout this paper, the term *preferential trade agreement* refers to free trade agreements and customs unions. The terms *free trade agreement* and *free trade area* are used synonymously. The term *preferential trade agreement* (as opposed to *free trade agreement*) reflects the fact that the participating economies grant each other preferences, but may not implement a policy of free and unrestricted trade.

of regional integration. By enhancing the size of the internal market, developing countries could reach economies of scale and improve their economic prospects. Today, however, the picture has changed dramatically. Regional integration is no longer a concept primarily applied by small and medium-sized economies. For about ten years now, the United States and the European Union (EU) have increasingly been placing their bets on preferential trade agreements. The most obvious consequence is a structural weakening of the WTO and the undermining of the existing multilateral order. This is a new challenge for large emerging markets, or BRICS countries—Brazil, Russia, India, China, and South Africa. What options do these countries have to respond to the new policies of the United States and the EU? Will they come to the rescue of the multilateral system, or will they seek instead to develop their own trade policy strategies outside the WTO?

This article is organized as follows. First, it analyzes the economic logic of regional integration, followed by a discussion of the political reasons for the current popularity of preferential agreements. The two main contributing factors for this—the lack of progress in the WTO and a change in the global economic climate—are examined, as are the justifications provided by advocates of the TTIP and other large integration projects and the flaws in these types of agreements. Subsequently, the geopolitics of the new »mega-regionals,« the potential responses of the BRICS countries, and the dangers of an economic order built around competing blocs are discussed, followed by conclusions and policy recommendations distilled from the analysis.

1. Regional Integration: the Key Elements of a Political and Economic Concept

Integration and co-operation are frequently used synonymously, but in fact there is a need to differentiate. Co-operation is aiming at limited goals, in trade or infrastructure development for instance. By contrast, (regional) integration aims at a higher level of collaboration and will eventually result in a new, unified political and economic entity.

The typology by the Hungarian economist Bela Balassa (1961, 1987) illustrates the gradual deepening of collaboration and the eventual creation of a new sovereign state, in stage 5, the political union. Balassa suggested that regional integration be organized in five steps:

1. Free trade area
2. Customs union
3. Common market
4. Economic and monetary union
5. Political union

In today's world of mushrooming free trade agreements, one can distinguish between (regional) co-operation and integration quite easily. If participating countries show no explicit interest in moving beyond a free trade area, this constitutes co-operation. If a group of countries aims at the creation of a customs union or higher forms of collaboration, this constitutes regional integration.

The distinction is useful because the level of harmonization of economic policies in a free trade agreement is quite low. Tariffs are eliminated, but the participating economies retain their own, individual trade policy vis-à-vis the rest of the world. Norms and standards are usually not harmonized. The TTIP and TPP projects constitute an exception in this regard, because the harmonization of norms and standards is considered to be an essential component. A country can enter as many free trade agreements as it considers useful and appropriate, but it cannot harmonize norms with many different countries or groups of countries.

By contrast, once a country enters a customs union, it loses the ability to have an independent trade policy. The European experience demonstrates this. Since the creation of the European customs union among the original six members of the European Economic Community in 1968, trade policy has been formulated jointly in Brussels, not separately in Paris or The Hague. A customs union can mark the beginning of an integration process, rather than (limited) economic co-operation. There are, of course, exceptions. The Southern African Customs Union (SACU), founded in 1910, cannot be interpreted as an integration project, but was instead a colonial scheme that has not lead to deeper integration of the participating countries.

The first area that successfully implemented regional integration was what in 1871 became the German Empire. In 1834 the German Customs Union (Zollverein) was established and gradually enlarged. Balassa's typology was clearly inspired by the experience of Germany. Led by Prussia, the largest economy in the union, the small and medium-sized economies began dismantling the economic boundaries between them, and within 40 years the regional integration process was successfully concluded. The participating states ceased to exist. A new state emerged as the successor of the previously independent small German states.

The creation of the German Customs Union was the first example of a group of sovereign states agreeing to the creation of supranational economic regulation without (initially) political union. Countries participating in the German Customs Union continued to be sovereign, until German unification. Even after 1871, Luxembourg continued to be a member of the customs union until 1919, but not part of the German Empire. In fact, the Zollverein stands out not only as the first example of regional integration by economic rather than military means, but also because of its early success in organizing economic relations with non-participating economies. In 1865, the Zollverein created a free trade agreement with Sweden-Norway, linking the customs union with foreign markets.

It should be noted that in the current discussion about the external economic relations of Ukraine, a fundamental misunderstanding has emerged. Policy makers in Brussels contend that the policies of the EU have been neutral and have not been forcing Ukraine to choose between the West and Russia. This, however, is misleading. Ukraine can either have a free trade agreement with the EU or join the customs union of Russia, Belarus, and Kazakhstan. If Ukraine sought to join the customs union, that would prevent the establishment of a free trade agreement between Ukraine and the EU because of the joint external tariff that defines a customs union. The only solution would be to create a free trade agreement between the EU and the customs union led by Russia. EU policies toward Ukraine were either somewhat naïve—assuming that eventual EU membership of Ukraine would have been as technical as, say, Norwegian membership—or were deliberately meant to fuel conflict (Dieter 2014b).

2. The Politics of Regional Integration

The debate on Ukraine underlines that regional co-operation and integration can have a strong political dimension. In Europe, this is of course not a new development. The EU has been using accession as an instrument of foreign policy for years. The enlargement of the EU has of course always had a political dimension, most obviously when the formerly socialist countries of Eastern Europe joined in 2004. The EU has also, however, used trade policy vis-à-vis other countries as an instrument of foreign policy. In fact, since the EU still lacks a joint foreign policy, trade policy can be seen as serving in lieu of a European foreign policy.

The political use of regional integration is of course not a European dominion. In recent years, China has been using trade policy to advance its political goals. This was most noticeable when China and the Association of Southeast Asian Nations (ASEAN) agreed on the creation of a free trade agreement in 2002. It is noteworthy that ASEAN had been established as an anti-communist (i.e., anti-Chinese) bulwark in 1967. The ASEAN-China Free Trade Area came into effect on 1 January 2010 and constitutes the world's largest such agreement by population. In contrast to the 1960s and 1970s, when Southeast Asian countries were afraid of an increasing economic and political Chinese influence, today these states have opened up for business with China. The fear of revolution and weapons has been replaced by a desire for trade with Beijing.

In November 2014, China was urging an evaluation of the feasibility of a regionwide trade agreement, the Free Trade Area of the Asia-Pacific (FTAAP). This was not a new idea. In 1966 a Japanese economist had proposed such a scheme. Twenty-five years ago, on the day the Berlin Wall fell, Asia-Pacific Economic Cooperation (APEC) was founded in Canberra, Australia. Since then, there have been numerous debates about the format of trade facilitation in the Asia Pacific. Initially, those advocating an open scheme, called open regionalism, prevailed, but in recent years, a conventional free trade agreement excluding non-participants has been discussed more intensively. China does of course have a very clear interest in establishing FTAAP.

Given that the United States is pushing the TPP, which excludes China, Beijing wants to create a broader scheme in which it can participate. The logic of the Chinese push for FTAAP is clear: Should Washington prevents the establishment of a 21-member FTAAP, including Russia, China can push for RCEP, the Regional Comprehensive Partnership Agreement. RCEP includes Japan and all the ASEAN economies, plus Australia and New Zealand, but excludes the United States and Russia.

The BRICS countries—all of them influential powers in their region—are increasingly inclined to use regional integration to promote political goals. South Africa has been ahead of its peers for more than a century in doing so. SACU is the oldest existing customs union of sovereign states. In existence since 1910, it comprises Botswana, Lesotho, Namibia, South Africa, and Swaziland. Of course, SACU is currently not featuring prominently in South Africa's regional policies, primarily because the other member economies are so small.

Neither China nor India is currently participating in a customs union, choosing instead to pursue free trade agreements. Russia established a customs union, as mentioned above, with Kazakhstan and Belarus in 2010. The eventual goal of this project is the creation of a Eurasian Union, somewhat similar to the European Union. Many successor states of the former Soviet republics have been invited to join, and in 2013 Vietnam expressed interest in creating a free trade agreement with the customs union.[3] Western critics have argued that the Eurasian Union represents an attempt to re-create the Soviet Union. Although it is evident that there is very limited interest in re-establishing a communist bloc, a battle for influence is clearly under way. Moscow is trying to expand its influence, while the United States, with its two mega-projects, is attempting to create an even larger sphere of influence. Regional co-operation and integration have been re-politicized.

Brazil and its neighbors Argentina, Paraguay, and Uruguay have been working on Mercosur since 1991, but the results have been mixed.[4] The Treaty of Asuncion, signed in March 1991, aimed at the creation of a customs union, but that goal has not yet been achieved. Mercosur does, however, have the potential to become a Latin American common market. The main political obstacle is the unresolved rivalry between Mercosur's two largest members, Brazil and Argentina.

From an economic perspective the current mushrooming of preferential trade agreements is puzzling. The dismantling of obstacles to trade is, on balance, welfare enhancing, although the political economy of trade liberalization has to consider winners and losers of liberalization. Today, however, policy makers all over the world apparently prefer to implement preferential trade agreements rather than advancing the multilateral system. What can explain this seemingly irrational trade policy?

From a realist perspective, the main reason for the inability to advance the multilateral system is the emergence of a multipolar world. In the bipolar world, between 1945 and 1991, the two hegemonic powers established economic regulation in their spheres of influence. The United States established and backed GATT. The Soviet Union set up the Council for Mutual Economic Assistance, COMECON. After the short »unipolar moment« (to borrow from Charles Krauthammer) ended and was replaced by a multipolar world, there have been increasing difficulties in maintaining the multilateral trade regime. Geopolitics and the competition for power and influence have returned. Consequently, organizing co-operation has become increasingly difficult. Today's multipolarity appears to weaken, rather than strengthen, the ability and interest of sovereign countries to engage in the establishment of sustainable international regulation.

Optimists could argue that the WTO has returned to the stage, after the successful conclusion of its December 2013 conference in Bali. They suggest that the previous unwillingness of member countries to advance the multilateral trading system may have ended with Bali, possibly allowing the WTO to regain the strength it had in the first decade of its existence after its establishment in 1995. However, only low-hanging fruit was harvested in Bali. None of the difficult issues were put on the table (Dieter 2014a). Trade facilitation—the most important component of the Bali agreement—is useful, but on balance the Bali deal is probably not much more than »a tropical fling,« as the *Financial Times* described it. The key reason for this skeptical view is that important countries, in particular the United States, have ceased to push for an advancement of the multilateral trading system. While the EU and the United States have been implementing preferential trade agreements in the past (e.g., the North

3. Tran Thu, »Vietnam to start FTA talks with Customs Union in 2013,« *Saigon Times,* 13 September 2013, http://english.thesaigontimes.vn/Home/business/vietnam-economy/25534/.

4. Venezuela joined in 2012.

American Free Trade Agreement, NAFTA), the number and scope of preferential trade agreements have risen sharply in recent years. The United States and the EU are contributing to the creation of a post-WTO world.

3. TTIP and the Mushrooming of Free Trade Agreements

Few trade projects have been welcomed more enthusiastically by the business community and various policy makers than the Transatlantic Trade and Investment Partnership between the EU and the United States. The initiative, however, will send both down the wrong track. For Europeans, the TTIP project does not make much sense, economically or geopolitically. The economic gains would be moderate, but the political damage enormous.

It is not the first time that a transatlantic free trade area has been discussed. The idea was debated intensively during the 1990s, although no formal negotiations were opened (Siebert et al. 1996). The two most important reasons for the skepticism at the time were the successful establishment of the WTO and the trust bestowed on concepts of global governance, which at the time seemed modern and promising.

Roughly 20 years later, the excitement over the WTO has evaporated. As the negotiations of the Doha round trudge along, governments around the world are pursuing the new approach of creating free trade areas, which is labeled trade pragmatism, rather than aiming for multilateral regulations. The EU and the United States, and also China and many smaller economies, have altered their trade policies over the last few years. Globally, preferential discriminating trade areas are on the rise. Every WTO member, Mongolia excluded, is party to at least one free trade area or customs union. According to WTO data, in January 2014 there were 377 preferential treaties in force and about 200 more were being negotiated.[5]

There are numerous reasons for this expansion, but two factors stand out. The first and most important factor is probably the lack of progress of the Doha round; few observers believe that the negotiations can still be brought to a successful conclusion. In retrospect, labeling the Doha negotiations the »development round« was a mistake. As a consequence, traditional supporters of a multilateral trade order—for example, industry associations like the Federation of German Industry (BDI)—lost interest in the further development of the WTO. Attaching the label »development round« to the negotiations, although well intended, has had disastrous consequences.

Much of the blame for the lack of progress in the Doha round has been placed on India and other developing countries. That might be a misreading. Joseph Stiglitz has argued that the Doha round was torpedoed by the United States' refusal to reduce agricultural subsidies (Stiglitz 2013). In general, and although hardly discussed, the negotiating strategy of the United States appears quite implausible. At the beginning of the Doha round, in 2002, the United States suggested abolishing all tariffs on industrial and consumer goods, indeed, a bold proposal, which was rejected by developing countries and emerging markets.[6] Was that proposal, however, borrowing from poker, a bluff? Without access to US government archives, it is difficult to assess the sincerity of the proposal by the George W. Bush administration. In recent years, the Obama administration has emphasized the importance of »fair trade,« a synonym for moderate protection against perceived »unfair traders.«

Moreover, the United States continues to apply tariff peaks in important sectors. Surprisingly, half of the US vehicle market continues to be protected by a 25 percent tariff. About 8 million so-called light trucks are sold in the country each year, and due to the high tariff, there is virtually no foreign-made light truck on American roads.[7] Turnover in the segment is an estimated $200 billion, so it seems fair to assume that the US auto industry very much enjoys the protection afforded its light trucks (Dieter 2014c). The United States has not even been debating a reduction of that tariff, which is noteworthy because a 25 percent tariff for a mature industry represents a remarkable level of protection

The changed global economic climate since the beginning of the Doha negotiations is the second major factor

5. See the WTO database, http://www.wto.org/english/tratop_e/region_e/region_e.htm.

6. »Can America Kickstart the Doha Round?,« *Economist,* 29 November 2002, http://www.economist.com/node/1464668.

7. Many studies on transatlantic trade overlook the importance of tariff peaks. For instance, Beck and Ohr (2014: 346) suggest that the trade-weighted average tariff is below 3 percent, but their assessment ignores tariff peaks that are so high that no measureable trade exists.

that has greatly contributed to reduced interest in the WTO. The year 2001 not only marked the start of the Doha round, but also the accession of China to the WTO. The rocket-like takeoff of the Chinese economy has since continued and is now met with growing concern in the established industrialized countries. OECD countries are asking whether they can still compete globally with China and other emerging countries. For the moment, this does not apply to Germany, but certainly to a number of EU member states and definitely to the United States.

This points to a central problem of preferential trade treaties: Many do not contribute to a further liberalization of trade, but are meant instead to function as protection from all-too-powerful competition. That thinking plays a central role in the approach taken by the Obama administration; the focus is not so much on free trade, but on fair trade.[8] In other words, the aim is to exclude allegedly unfair competitors, and from an American perspective, that is mainly China. Therefore, the TTIP and TPP projects at one level are defensive in nature—attempts to create a trade regime without China. That said, what sort of arrangement is really about to be negotiated between the EU and the United States? What are the advantages and disadvantages of the TTIP?

4. Questionable Justifications and Serious Construction Flaws

TTIP and TPP supporters usually advance three reasons why these agreements are desirable: first, because the competitive advantage of industrialized nations is being eroded by emerging nations such as China and India; second, because multilateral trade negotiations have come to a standstill; and third, because the rise of the BRICS, China in particular, will result in a declining ability of the transatlantic powers to shape the rules of cross-border commerce. In short, if the United States and Europe do not write the rules today, China will write them tomorrow.

These claims, made by advocates of TTIP and other large integration projects, are quite astounding. Undeniably, the WTO Doha round advances only at a snail's pace if at all, even after the temporary deadlock on the Bali agreement seems to be broken, but the other arguments do not hold water. Even if one accepts the dwindling competitiveness of the EU and the United States vis-à-vis the emerging countries, which is highly debatable looking at a number of European companies, a discriminatory trade agreement would be the wrong answer. Rather, wide-ranging structural reforms would be the remedy for lost competitiveness. A treaty that disadvantages third parties does not strengthen the competitiveness of companies. Of course, the danger is that reforms will be delayed because a single transatlantic market would convey a deceptive sense of security. The exclusion of strong competition has rarely led to strong economies.

The assumption that the transatlantic powers could establish the rules for the future regulation of cross-border commerce is of course dependent on the perception of other countries. Will China and the other BRICS and other OECD countries accept rules that were negotiated without them? Considering the increasing self-confidence of policy makers in the BRICS countries, it appears unrealistic to assume that they will accept a done deal. Instead, the creation of competing systems appears likely. The policies of China (RCEP) and Russia (Eurasian Union) provide a hint of potential developments.

In addition, free trade areas have a serious construction flaw that even the most capable negotiators cannot resolve—the origins of duty-free traded products need to be documented. Free trade areas do not function without so-called rules of origin. What does this mean exactly? Within free trade areas, products from participating countries can be traded duty free, but not those from third countries. Therefore, the origin of a given product needs to be documented carefully (which means higher costs) with certificates of origin. The more complex a product is, the more expensive the drafting of its certificate is. It really gets complicated when inputs from third countries must be accounted for. Furthermore, within the almost 400 free trade areas in existence today, the procedures to determine the origin of a product vary widely. The most complex is the most common one—measuring the percentages of value added.

The result is that for small and medium-sized companies, preferential agreements are of limited benefit. For developing countries, such complex rules are high hurdles as well. The abolition of tariffs is bought with the obligation to document the origins of products. This considerably

8. State of the Union address, 12 February 2012, in which Obama speaks of »free and fair trade.«

reduces the value of the envisaged mega-regionals for many players. With tariffs in the lower one-digit region, companies are right to question whether it would be easier and cheaper for them to waive the preferential treatment and pay the tariff. This has the additional advantage of greater clarity. After paying an import fee, no further costs are to be reckoned with. As tariffs are negligible in transatlantic trade these days (apart from a number of tariff peaks in a few tariff lines), it is highly likely that many companies will opt for paying tariffs and against drawing up certificates of origin. Estimates suggest that the provision of a certificate of origin costs companies about 5 percent of the value of the product (Dieter 2004). On average, current tariffs are at 3.5 percent for the EU and 2.5 percent for the United States.

The United States has carefully acted to safeguard American interests within every free trade area it is party to. The rules of origin have contributed to this; the regulations cover 200 pages in the NAFTA document. The origins of raw materials allowed or prohibited are listed in great detail. The so-called fiber-forward rule states that cotton needs to have been produced in the NAFTA area to be traded without tariffs. This rule was pushed through by Washington to protect US cotton producers. It is likely that similar rules would be incorporated in the TTIP. The victims would be African cotton producers, who would no longer be allowed to supply cotton for Spanish or Italian fashion products for export to the United States. Although it is difficult to forecast the impact of TTIP on all developing countries, the effects will probably be negative. Sourcing inputs from non-TTIP-countries will result in the risk of non-qualification for TTIP origin, and companies will not want to face that. Rather than buying from the cheapest source, they will buy from the cheapest TTIP companies, thus diverting trade from developing countries.

5. Geopolitics and the Dangers of Fragmentation of the International Trade Regime

Through TTIP, TPP, and other preferential agreements, the United States and the EU are not only fundamentally weakening the WTO, but they are also betraying their own principles. The multilateral trade regime established after World War II was specifically designed to overcome the discriminatory trade agreements of the interwar period, which greatly contributed to the rise in tensions during the 1930s.

With this historical lesson in mind, there is no convincing reason to jettison the multilateral trade order. Emerging economies still conduct the bulk of their trade with the EU and the United States and prefer to use the mechanisms of the WTO. A coordinated counterproposal on their part for an alternative to the existing trade regime is currently not discernable. The EU and the United States cannot influence the further rise of China and other countries, but they can make sure that international trade relations will continue to be shaped by the order established by the United States and its allies in the 1940s (Ikenberry 2008).

The current multilateral trade order is deemed to protect the interests of all states—including those less powerful—in the complexity of the twenty-first century. However, the EU in particular, which has repeatedly stressed the importance of multilateral rules for emerging countries, has weakened the trade order with its foreign trade policy.

The EU would, by agreeing to a preferential treaty with the United States, end up being used by Washington for US geopolitical goals. As mentioned, the United States is not only pursuing a transatlantic, but also a trans-Pacific project, the Trans-Pacific Partnership agreement, to which twelve countries are currently party, including the economic heavyweight Japan. With the exception of South Korea and China, the largest economies of the Pacific are participating. South Korea already has a free trade agreement with the United States and thus can be considered a special case. Significantly, China is not invited to join. Should the United States succeed in both concluding a transatlantic and a trans-Pacific agreement, the result would be a new bipolar world order. The United States would then no longer be dependent on the WTO and could push ahead in its trade confrontation with China, as has been demanded by various American politicians over the last few years.

Washington's European accomplices, first and foremost Germany, have nothing of lasting value to gain from such a fragmentation of world trade. German and other European companies prove their competitiveness on world markets every single day. Europe in particular should support a multilateral order not only rhetorically, but also strengthen it actively. In other words, Europe, especially, should not erect parallel structures that weaken the WTO.

Such insights, however, are rare in Brussels these days. The last EU trade commissioner who understood the fragility of the multilateral order, and imposed a moratorium on EU preferential trade agreements in 1999, was Pascal Lamy, the former WTO chief. After the Briton Peter Mandelson took over as EU trade commissioner in 2004, the EU set out on the wrong track, concluding more and more preferential treaties.

With the creation of a transatlantic free trade agreement, the historic success of multilateral trade would be carelessly abandoned. In bilateral or other preferential trade agreements, neither the inclusion of developing countries nor the very successful WTO dispute settlement mechanism, stemming from a transparent and coherent rulebook, could be preserved. TTIP and TPP will degrade the WTO to irrelevance, and neither would enhance the competitiveness of participating economies. Of course, the WTO will continue to exist, but it will not be the venue for further advancement of the trading system.

If the above outlined analysis is correct, and the advantages of TTIP and TPP are limited, what are the motivations of the United States in particular for pushing these mega-regional agreements? Since the United States is the only player participating in both projects, US policy matters more than any other. Political considerations must play an important role, since many of the economic gains could either be achieved by unilateral liberalization or by regulatory harmonization without a discriminating preferential trade agreement. Stiglitz (2013) has suggested that the United States aims to create a managed trade regime, i.e., to serve special interests in the US economy.

International relations, however, also play a role. In a July 2014 interview, Anthony L. Gardner, the new US ambassador to the European Union, underlined the political importance of TTIP. Perhaps unintentionally, Gardner asserted, »[T]here are critical geostrategic reasons to get this deal done.«[9] What are the geostrategic aims of the United States?

Implementing two mega-regional projects with the EU and important economies in the Asia Pacific enables Washington to isolate China and seek confrontation with America's only rival. Rather than negotiating with China, the United States is actively promoting the return to a bipolar world. Of course, supporters of both TTIP and TPP will argue that the motivations are primarily economic. Given the rhetoric and statements of the Obama administration, however, the geostrategic motives appear to be quite important, and that has not gone unnoticed in China.

Today, the choice is between open global regulation and an economic order built around competing blocs (Stevens 2013). In essence, as Philip Stevens has suggested, »[T]he west has given up on the grand multilateralism that defined the postwar era. … The exclusion of the world's second biggest economy is more than a coincidence« (ibid.).

For Europe, being the United States' junior partner is not a sustainable strategy. Of course, the EU should not seek to isolate China or any other BRICS country. A return to a cold war, whether with Russia or China or both, does not serve the interests of the Europeans, who have much more to lose in a lasting conflict than the United States. Regrettably, the long-term effects of TTIP for Europe's position in international relations are hardly debated. Instead, discussions on poultry and its sanitization dominate the debates.

Seasoned observers of trade negotiations have been skeptical about the prospects for a rapid conclusion of the TTIP negotiations. Lamy, the former EU trade commissioner and WTO head, expects the talks to drag on for many years.[10] He argues that the envisaged harmonization of norms and standards requires complex changes to regulation both in the United States and the EU, and those changes will not be agreed upon quickly. Either norms could be harmonized on the lower level, resulting in political opposition by consumer associations, or the EU and the United States could agree on higher levels of consumer protection, raising costs in the territory previously having laxer standards.[11] Either way, a rapid conclusion should not be expected. Should negotiations

9. »US Ambassador: Beyond Growth, TTIP Must Happen for Geostrategic Reasons,« *EurActiv,* 16 July 2014, available at http://www.euractiv.com/sections/trade-industry/us-ambassador-eu-anthony-l-gardner-beyond-growth-ttip-must-happen.

10. *Frankfurter Allgemeine*, 15 July 2014, 24.

11. A third alternative would be the mutual recognition of standards, which would be simple but would also require political will. European cheese could be sold in the United States, US beef in the EU. Given the

drag on for years, cynics could argue that the WTO might once again become more popular among its traditional supporters, e.g., industry associations.

6. Potential Responses by the BRICS Countries

Of course, conflict between the transatlantic powers and the BRICS countries is not limited to trade issues. Russia's annexation of Crimea has deepened the rift between Moscow and the West. At the same time, however, ties between China and Russia have been strengthened (Singh 2014). Beijing has effectively endorsed the annexation as well as the continuing intervention of Russia in eastern Ukraine.

The conflict is much deeper than many observers in the West are willing to acknowledge. For decades, policy makers in the West assumed that the rest of the world, including China and Russia, would over time converge politically with the transatlantic powers, but China, Russia, and other emerging economies are increasingly frustrated by the double standards of the West and their exclusion. Of course, in 2014 policy makers in Washington and Brussels do not want to be reminded of the brutal violations of international law of George W. Bush's administration. In the past, Moscow warned several times that the West's repeated military interventions in Kosovo, Serbia, Iraq, and Libya would undermine international law, but to no avail (Lukin 2014). Condemning Russia while tolerating violations of international law in one's own political camp is hypocritical and does not result in holding a credible position in international relations.

Stevens (2014) has put forward a gloomy analysis of the current situation: Two key players in BRICS countries, Chinese president Xi Jinping and Russian president Vladimir Putin, do not foresee a joint future with the West. Instead, they have opted for competing with the old powers:

> Not so long ago policy makers in the west assumed that China and Russia would eventually decide they wanted to be like »us.« China would develop as a responsible stakeholder in the existing international order and Russia, albeit with missteps, would see its future in integration with Europe. Mr Xi and Mr Putin have decided otherwise. The world is waking up from postmodern dreams of global governance to another era of great power competition. (Stevens 2014)

The inability of Western policy makers to consider economic and political models beyond capitalism and democracy—not for the West, but for other countries—has backfired. Henry Kissinger has suggested that the demonization of Putin is an alibi for the absence of a policy. Moreover, »treating Russia as an aberrant to be patiently taught rules of conduct established by Washington« ought to be avoided (Kissinger 2014).

Whether the policies implemented by the West are a matter of inability or the result of a strategy is difficult to assess. Some observers have suggested that the West, not Putin, is responsible for the current crisis. John Mearsheimer has argued, »[T]he United States and its European allies share most of the responsibility for the crisis« (Mearsheimer 2014: 77). The EU's expansionary strategy is part of what Mearsheimer calls the West's triple package of policies—NATO enlargement, EU expansion, and democracy promotion (ibid.: 80).

The effects, however, are clear. The world is drifting apart instead of growing together. The result is new rivalry, as suggested by Jaswant Singh, who has served as India's minister of defense, finance, and foreign affairs. According to Singh (2014), »In Putin's authoritarian capitalism—similar to that of China—the Western-style liberal democracy, which was supposed to reign triumphant, has a new rival.«

The question of course is how the BRICS countries are likely to respond to the processes outlined above. There are two potential avenues. The first option is to form an alliance against the destruction of the multilateral trading system. The BRICS countries, together with African, Asian, and Latin American developing economies, could form a group that aims at revitalizing the WTO. Global economic governance, in particular the multilateral regulation of trade, would be the platform for that group. However, the likeliness of such a concerted action is limited indeed. The BRICS countries are most probably not sufficiently unified in their foreign (economic) policy to push such a campaign. Even if they were, their ability to

debate over TTIP so far, it appears unlikely that this alternative will be chosen.

force the United States (and the EU) to return to Geneva might not be sufficient.

The second option is certainly less optimistic, but probably more realistic. In a multipolar world characterized by the limited willingness for co-operation, the BRICS countries perhaps have no other option but to push their own political projects. A race for alliances is the inevitable result. Of course, some of this is already happening. Russia does not want Ukraine to become associated with the European Union. China is ensnaring its neighbors and is eager to form a Chinese-led Asian bloc. Brazil and South Africa both see themselves as legitimate, leading regional powers. Only India, lacking neighbors willing to co-operate, is an exception in this game.

The increasing division between the United States and the BRICS countries is not limited to trade-related issues. In 2014 the BRICS countries started creating their own facilities in finance, announcing the creation of the New Development Bank (NDB) as well as the Contingent Reserve Arrangement (CRA). The former is competing with the World Bank, financing development projects; the latter is a facility to provide liquidity in the event of a financial crisis and thus is a direct competitor to the IMF (Eichengreen 2014).

Of course, it is impossible to evaluate the effects of these two institutions a few weeks after their establishment. Barry Eichengreen (2014) has been suggesting that the effects of the New Development Bank will be moderately positive, but he believes the CRA will not have a big effect, calling it »empty symbolism.« The facility might be too small for the BRICS countries, in particular China, but over time, the BRICS countries might contemplate using their own monetary fund to provide liquidity to third countries should they face trouble. In a few years, developing countries could have the choice between borrowing from the IMF or from the CRA. The transatlantic dominance of the IMF would not be broken, but there would be systemic competition between the funds. Of course, today it is impossible to forecast the evolution of the NDB or the CRA, but the foundation of both institutions reflects a persistent uneasiness of policy makers in the BRICS countries with the existing institutions of global governance and the unwillingness of the established powers to implement meaningful structural changes.

7. Conclusion

Trade policy has been massively re-politicized in recent years. For trade economists, this is a regrettable development. The first-best solution—the multilateral regulation of trade—has been replaced by second-best approaches. In part, the unwillingness of OECD countries to continue with trade liberalization can be explained by the hardening of popular sentiment against free trade.[12] Put differently, the political costs of further liberalization simply are too high, so policy makers have refrained from confronting an increasingly skeptical domestic audience over issues that warrant only limited political returns.

For political scientists, the main concern is that the political lessons of the 1930s have been forgotten. Discrimination in trade is back, and this may result in greater conflict and less co-operation in international relations. None of the great powers has an explicit interest in advancing the multilateral trading system. Geopolitics has replaced the post-1945 liberal consensus in trade policy.

This is both a dangerous and a regrettable development, but considering the domestic debates in the major economies, there is little hope for a revision of policies. The world economy is sliding toward a situation characterized by hostile economic blocs. The United States is more comfortable with its coalitions of like-minded countries than with multilateralism (Stevens 2013). Time and again, the Washington has shown that its cascading preferences—unilateral approaches first, coalitions second, and multilateralism as a last resort—do not facilitate notions of »collective leadership« or other postmodern concepts of shared responsibility for global regimes.

The United States and its allies forget that their inward looking, self-interested policies will create backlashes. The BRICS countries in particular will create their own regimes in trade and finance. Of course, it is inappropriate to blame the BRICS countries for a game whose rules they cannot determine. They as well as the other developing countries and emerging markets have no alternative but to prepare themselves for an uncertain future in trade and financial regulation.

12. *Financial Times,* 1–2 March 2014, 9.

Policy Recommendations

■ The multilateral trading system is confronted with systemic competition by preferential trade agreements. Policy makers should refrain from creating closed economic blocs and should conclude the Doha round. While this recommendation may currently sound like naïve wishful thinking, the seemingly convincing alternative to the WTO—preferential trade agreements—has considerable costs. Over time, this will lead to a balkanization of trade regulation.

■ The mega-regional projects pose a particular risk to developing countries. Since these projects by definition require the documentation of the origin of products and inputs, developing countries will probably be excluded from cross-border production networks, even if they are competitive. Restrictive rules of origin in mega-regionals could severely damage the prospects for participation by companies from developing countries in international trade. Projects involving the United States, i.e., the Transatlantic Trade and Investment Partnership (TTIP) and the Trans-Pacific Partnership (TPP) should refrain from using the tight rules of origin of previous US-led projects, e.g., NAFTA.

■ Conventionally, the debate on preferential trade agreements emphasizes the economic dimension of discrimination in trade. However, policy makers in Europe ought to consider the political cost of excluding the BRICS countries as well as other emerging and developing countries from new forms of regulation.

■ Potentially, the mega-regionals could be opened up to all member countries of the WTO, but even that option is not plausible. It is hard, for example, to envisage China joining an agreement that does not permit input by Beijing. Joining a »done deal« is politically unacceptable to most policy makers from developing countries.

■ Developing countries and emerging markets, including the BRICS countries, are already preparing themselves for a new phase of confrontation in international economic relations. It is an illusion to expect these economies to remain loyal to the WTO when both the EU and the United States are defecting from multilateral solutions.

■ Over time, the BRICS countries will aim at consolidating their influence on their neighboring countries. The current conflict in Ukraine may thus mark the beginning of a new phase of regional power play. As the United States and the EU try to enlarge their spheres of influence, the BRICS countries will most probably not stay behind and watch in awe.

■ In both trade and finance, it is highly implausible to expect significant progress in multilateral regulation in the short and medium term. Neither the G20 nor any of the established institutions of global governance, such as the International Monetary Fund or the World Trade Organization, currently enjoy a high level of political support in their member countries. Since neither the IMF nor the WTO has the power to move ahead without political support, from the point of view of BRICS, alternatives have to be developed, even if they are suboptimal.

■ If developing countries and emerging markets develop their own co-operation schemes, learning from nineteenth-century Germany and the postwar European experience is recommended. Deep regional integration requires the establishment of at least a customs union. Shallower forms of co-operation, such as a free trade agreements, rarely lead to the creation of deep integration. Any sovereign country can join numerous preferential trade agreements, but it can only join one customs union.

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