

# Central and Peripheral Reforms of Global Trade Governance

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*To promote global trade governance, both central and peripheral reforms occur in multilateral and regional trade agreements. The central reforms are suggested to enhance the WTO's efficiency in trade negotiations by engaging in 'mini-multilateral' negotiations and soft law-making or to expand its current advantage in dispute settlement by extending its dispute jurisdiction to investor-state disputes or trade disputes arising from PTAs. The peripheral reforms develop in two different routes; one is rule-based and is carried out by high-standard PTAs, and the other is relation-based and is exemplified by "the Belt and Road" Initiative proposed by China. While peripheral reform fragments international law, various methods of multilateralizing regionalism are suggested, such as the incorporation of the third-party most-favoured-nation clause, the simplification of the rules of origin, and the construction of multilateral agreements through the 'building blocs' of PTAs. Most of these reforms make achievements to some extent, although they also have deficiencies.*

**Keywords:** Central Reform, Peripheral Reform, Global Trade Governance, WTO, Preferential Treatment Agreement

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## I. INTRODUCTION

The General Agreement on Tariffs and Trade (“GATT”) has been an engine for global free trade governance since the end of World War II. Its highest achievement is the establishment of the World Trade Organization (“WTO”). However, the trade negotiations under the WTO are far from successful, as it missed the major agendas set in the Seattle, Cancun, and Hong Kong ministerial conferences. Trade negotiations fail to liberalize members’ markets in sensitive sectors, such as agriculture and trade in service, and only achieved success in the Bali and Nairobi conferences.

As the WTO gradually loses momentum and influences, its status is challenged by preferential trade agreements (“PTAs”), especially by the so-called mega-PTAs or high-standard PTAs. Such PTAs once exerted only peripheral influence in global trade governance, but are gaining more attention now. Recently, the US lost its leadership not only at the Trans-Pacific Partnership (“TPP”) Agreement after its withdrawal but also at the negotiation of the Trans-Atlantic Trade and Investment Partnership (“TTIP”) Agreement due to the incompatible rule discrepancies with China. Conversely, the other high-standard PTAs, such as the US-Korea Free Trade Agreement (“FTA”) and the EU-Korea FTA, are in force and the Comprehensive Economic and Trade Agreement (“CETA”) between the EU and Canada temporarily survived after its recalibration.

To keep global trade governance working, both the WTO and PTAs are undergoing reforms. The WTO needs to re-establish its erstwhile position, not at the centre but near the centre of world commerce,<sup>1</sup> sharing power and responsibility with PTAs in their respective spheres of influence.<sup>2</sup> The peripheral reforms led by high-standard PTAs are taking steps forward in updating international trade rules. Apart from these rule-based reforms, the Belt and Road initiated by China shows another method of reform, which is far from rule-based and shares little commonality with the high-standard PTAs. However, it has immense potential to revitalizing international trade and investments in Asia. Such regional cooperation contributes to the peripheral reforms of global trade and investment law and provides us with a new angle of observing and analyzing the effectiveness of regional trade cooperation.

Hence, the future global trade governance will progress with the co-influence of

the central and peripheral reforms hosted by the WTO, PTAs, or other innovative regional cooperative platforms. This research aims to draw a clear picture of the on-going global trade governance reforms. This paper is composed of seven parts, including a short Introduction and Conclusion. Part two will analyze the factors that cripple the WTO's core function of treaty negotiation and lead to the reforms of mega-PTAs and China's Belt and Road construction. Part three will discuss the central reforms of the WTO and evaluate the feasibility of those reforms and their effectiveness in curing the WTO's deficiency. Parts four and five will review the peripheral reforms and investigate the rule-based PTAs led by the US and the EU and the relation-based the Belt and Road construction led by China. Part six will respond to the fragmentation of international trade law caused by the proliferation of PTAs and discuss three possible reforms of multilateralizing regionalism.

## II. DE-CENTRALIZING WTO IN GLOBAL TRADE GOVERNANCE

The global trade governance of the GATT and the WTO has been applauded by the members for 'multilateralism,' 'free trade,' and 'non-discrimination' since 1947. A half century later, however, it has lost its viability and driving force toward more comprehensive trade and investment. What has exhausted the WTO's vitality and crippled its treaty negotiation function?

The most significant factor is the power shift among its members. Before the Uruguay Round, the power of trade governance was assumed by the top four countries - the 'Quad' (US, EU, Japan and Canada), as led by the US and followed by the EU, Canada, and Japan. The multilateral trade negotiations were concessions among the Quad and their trade-affiliated countries. At the end of the twentieth century, however, the members of the Quad were declining due to their overseas wars, economic downturns, and the Euro crisis.<sup>3</sup> The Quad's global trade shares have been significantly taken up by emerging economies, such as China, Brazil, and India. The decline of the original big powers and the rise of newly emerging economies gives rise to new clashes and makes consent-based solutions harder,<sup>4</sup> mainly because two-thirds of the 164 WTO members are developing countries. These countries are aligning and forming the counter-power to contest

the rules once set by the big powers.<sup>5</sup>

Apart from the power shift, the reconstruction of the global value chain and international trade constrains the trade negotiations of the WTO. The offshore sourcing and trading of semi-finished products requires comprehensive integration of the value chain among the trading nations, producing the needs for multilateral law-making in investment, trade in service, intellectual property, rules of origin, competition, etc. Hence, the negotiation agendas in the Doha Round are far more complex than in former rounds. With the increased flow of international trade and investment, members' statuses in the international value chain have been also changing. The developed countries are losing their comparative advantage in manufacturing industries but are reimbursed by the high yields derived from foreign direct investment, trade in service, and technology transfer. Therefore, liberalizing developing countries' markets of trade in service and investment and strengthening overseas intellectual property protection and competition rules, labour, and environmental protection standards clearly become the mandates of new treaty negotiation in pushing the reform of global trade governance.<sup>6</sup>

The next major factor that changes global trade governance is the development of information technology. The General Agreement on Trade in Services ("GATS") became obsolete just a few years after its conclusion due to the rapid development of information technology. Today, free data flow is indispensable for the development of electronic commerce and transboundary trade in service, which makes data a new production factor apart from the raw material, land, labour, and capital. Shortly after the International Technology Product Agreement was entered into force in 1997, the developed countries intended to renew the GATS by negotiating the so-called GATS 2000 to reap the benefits of fast development of information technology. However, the consensus was not adopted due to the north-south division in their control of information technologies and each member's different concerns of national security and consumer privacy. Just "free data flow" continues to be a core issue in the negotiation of the Trade in Service Agreement ("TISA").<sup>7</sup>

Despite these challenges, the WTO's institutional structure remains unchanged. It has failed to adapt to new economic and societal needs. The biggest obstacle for reaching consensus is the members' veto power. It would prevent the WTO from adopting new treaties or amending old ones.<sup>8</sup> When developed countries try

to export their domestic rules to less-developed countries without cutting their agriculture subsidies and tariffs to reimburse the developing countries for the direct and inherent costs and risks of rule integration, the developing countries' grievances accumulate, and they refuse to cooperate with their developed partners.

Apart from the consensus requirement, the WTO's government-driven nature is criticized by civic society for its lack of democracy and transparency as well as ignorance of non-trade values.<sup>9</sup> As Petersmann declared, legitimate authority and *opinio juris* in the twenty-first century are no longer derived from diplomatic *fiat*, but from the consent of citizens, their democratic representatives, and progressive clarification of "principles of justice" by impartial and independent courts of justice limiting intergovernmental power politics.<sup>10</sup> The concept of "thick stakeholders consensus" is thus proposed to reshape multilateral and regional trade governance.<sup>11</sup> According to Joost Pauwelyn, the traditional democracy of allowing the consensus of governments joining in the trade negotiation relies on "thin state consent," only producing thin validation and democracy, while the decision-making process allows experts, intellectuals, and stakeholders to influence the decision, which is known as "thick stakeholders consensus."<sup>12</sup> In pursuing a thick stakeholder consensus, civil society demands more participation in the trade negotiations of the WTO, but the current government-driven WTO cannot accommodate such demands without institutional reforms.

### III. CENTRAL REFORMS OF TRADE GOVERNANCE LED BY THE WTO

#### A. 'Mini-Multilateral' Negotiations in Enhancing Decision-Making Efficiency

The plurilateral negotiation, or the *a la carte* approach,<sup>13</sup> which was once popular in the Tokyo Round,<sup>14</sup> was suppressed by the single-taking requirement in the Uruguay Round. As today's trade negotiations consistently let members down, reforms to this rigid decision-making process are proposed by more scholars. Some proposed to give up the single-undertaking requirement and to allow the members to pick up the treaties as they wished, thereby encouraging variable geometry, which embodies the members' different priorities in setting their trade policies through plurilateral agreements and PTAs.<sup>15</sup> Others suggested that

the WTO adopt the weighted voting rule as the IMF.<sup>16</sup> Although negotiating plurilateral agreements instead of multilateral agreements or adopting weighted voting rules could compensate for the inefficiency of WTO's decision-making, these reforms deviate too much from the WTO's current institutional structure as well as the ideology of the multilateralism of developing countries.<sup>17</sup> Instead, the "critical mass approach," as proposed by the Warwick Commission, could bridge certain elements of variable geometry with the principle of consensus to build new and flexible multilateral cooperative networks.<sup>18</sup> We refer to this critical mass approach as mini-multilateral negotiation in this paper, as it could achieve a multilateral agreement with concessions by only a group of members.

The Information Technology Agreement and the Agreement on Basic Telecommunications are founded on such an approach. In 1996, 29 members signed the draft of the Technology Information Agreement in the Singapore Ministerial conference and submitted the draft for other members to ratify. Later, the agreement was ratified by 82 members, representing 97 percent of the market share of computer appliances and computer services, meeting the requirement of critical mass. This Agreement later became a covered one of the WTO on April 1, 1997.<sup>19</sup> The Agreement on Basic Telecommunications followed suit. In 1998, 69 members ratified the Agreement with trade flows in the sector of basic telecommunications, which reached 90 percent. Satisfying the requirement of critical mass, the Agreement finally became the fourth protocol of the GATS.<sup>20</sup> Because both the Technology Information Agreement and the Agreement on Basic Telecommunications adopted 'mini-multilateral' decision-making processes, the parties negotiated and made concessions on a plurilateral basis, but conferred the benefits to all members in accordance with unconditional most-favoured-nation ("MFN") treatment.<sup>21</sup> As a result, this would persuade the others who have not participated in the negotiations to accept the deal and add new multilateral agreements to the WTO scheme.

The idea of negotiating mini-multilateral agreements through the critical mass approach derives from the theory of mini-lateralism. It was proposed by Moises Naims, who advocated simplifying the decision-making process of treaty negotiation within the smallest number of countries to solve issues more effectively.<sup>22</sup> As the WTO membership was increasing to 164, either a consensus or a two-thirds majority became burdensome for any new treaty negotiation,

incurring tremendous costs and uncertainties. Mini-lateralism only requires trade negotiation among a small number of countries that hold substantial market share and can make concessions, while conferring the market access benefits to all. By avoiding Pareto sanction as caused by consensus,<sup>23</sup> eventually, it will enhance the efficiency of members' decision-making processes. In this course, an agreement will only be reached when participants are convinced that no one is worse off by the agreement.<sup>24</sup> The mini-multilateral negotiations enable a multi-speed WTO.<sup>25</sup> Here, 90 percent is deemed to be the magic number<sup>26</sup> for the most efficient trade governance among the members.

As the mini-multilateral negotiation would have the potential to speed up the WTO's decision-making process, it was proposed to be adopted in the negotiations of TISA and Investment Framework Agreement.<sup>27</sup> The question then may arise: Can we count on this mini-multilateral negotiation to revitalize the WTO's treaty negotiation function? Although the mini-multilateral negotiation relieves the burden of the WTO's decision-making, it also has limits. In negotiating a market-access issue, members' trade flows could be easily quantified to determine whether the critical mass requirement has been met. In negotiating the trade regulation<sup>28</sup> or rule-integration issues, such as intellectual property, environmental protection, labour standards, and competition policy, however, it will be difficult to quantify the influence of trade flows.

Moreover, is 90 percent really the magic number that reaches the Pareto efficiency in balancing the members' participation and the efficiency of their decision making? This is doubtful because 90 percent is rather a high benchmark to accomplish in many negotiations. To receive support from the members of the critical mass, the negotiating issues should be carefully chosen to avoid those with sporadically distributed trade flows. The successful achievement of the Technology Information Agreement is due to the high concentration of the trade flows relating to computer services and computer appliances, which gives the US sufficient incentives to propose the negotiation and seek support from other trade alliances.<sup>29</sup> Twenty-eight parties negotiating the Government Procurement Agreement only covers 50 percent of the trade flows in the sector of government procurement, making it a plurilateral agreement. The mini-multilateral negotiation also raises the concerns of fairness in trade negotiations. As compared to the conventional multilateral negotiation, variable geometry would give preference to

certain issues above others, so that it would respond to the interests of the selective WTO members.<sup>30</sup>

If the negotiation of the TISA undertakes the critical mass approach, it will be difficult to obtain the approval of the critical mass as the service trade flows of the BRICS countries (Brazil, Russia, India, China, and South Africa) comprise 12 percent of the total (among which China and India hold 8 percent together), although they do not participate in the current negotiations.<sup>31</sup> The negotiations of the Investment Framework Agreement in the following years will face the same dilemma if it takes this fast track, as China was the third largest investment importing and exporting country in the world in 2015. If BRICS countries are invited, the leading developed countries might be unhappy, as China holds significant bargaining power and wishes to exert more power of discourse than ever.

Thus, if the magic number of the critical mass is not as high as 90 percent, more mini-multilateral agreements could be adopted and save the WTO's treaty negotiation function. Thus, why can critical mass not suffice through a substantial coverage of trade flows in question to reap more benefits of mini-multilateral negotiation but stay at 90 percent? There may be no substantiated evidence proving that the perfect Pareto state of mini-lateralism should be 90 percent. Instead, it is safer for the critical mass to stay at 90 percent by preventing emerging economies from freeriding the benefits of any new agreements.

## **B. Soft Law-making to Break the Constraints of Formal Legislation**

As the mandates of multilateral trade negotiations led by the WTO are to make mainly formal laws, such as treaties, there is little room for soft law-making. However, the formal legislative structure of the WTO has become a constraint, preventing the adoption of new rules in international trade.<sup>32</sup> It not only blocks the new agreements on substantive issues, but also fails to push the reform of procedure issues, such as dispute resolution. It is suggested that the WTO should be more attentive to informal law-making and learn from the experience of other economic cooperative platforms in forming cooperation through soft laws.<sup>33</sup> One example is the Santiago Principles, as proposed by the IMF in developing the best practice of management of sovereign funds, which are voluntarily adopted by more sovereign funds of developed and developing countries. The International



Competition Network advocated by the US also functions well in coordinating the competition rules among 120 countries by making model laws and principles. The success of soft law is derived from its informality, flexibility, and *esprit de corp*,<sup>34</sup> which might remedy the deficiencies of formal law-making in international law, as they are persuasive in adducing countries' voluntary efforts even while having no enforcement.

On June 22, 2016, Canada suggested to amend the dispute resolution rules of the WTO through the soft law-making approach by voluntarily adopting the Informal Procedure Innovation Framework Agreement. Although the dispute settlement mechanism is regarded as the crown jewel of the WTO, its confidentiality, close nature, and exclusiveness to third parties and non-governmental organisations ("NGOs") are criticized to run counter to the idea of the thick stakeholder consensus.<sup>35</sup> The Informal Procedure Innovation Framework Agreement, as proposed by Canada, could make the dispute resolution procedure more open and responsive to outsiders.<sup>36</sup> Canada also suggested that the dispute settlement body apply the Informal Procedure Innovation Framework Agreement to those members signing the Agreement after the exchange of the opinions or on an *ad hoc* basis upon disputing members' approval of an application in a certain dispute.<sup>37</sup>

As the Informal Procedure Innovation Framework Agreement is not a treaty, no formal ratification is needed for the members to adopt it. Therefore, the Dispute Settlement Understanding ("DSU") does not have to be amended. Such soft law-making also offers a kind of variable geometry to the members, especially in dealing with the rule-integration issues, as not all members are ready for further integration of domestic laws on intellectual property protection or competition rules. For these issues, the significant north-south discrepancies have made a consensus difficult. Albeit the critical mass approach is impossible, the soft law approach might be more workable for the members to update their trade rules gradually from a bottom-up approach. However, the soft law approach is less helpful in liberalising market-access issues, as it might not incentivize members to open their markets voluntarily if no benefits are given back, especially in the case where no measure is taken to avoid freeriding by outsiders. Lack of enforceability is another shortcoming of these soft rules, as disobedience of the rules cannot be handled through dispute settlement, and the soft laws are not covered agreements

of the WTO.<sup>38</sup>

### C. Expansion of the WTO's Dispute Settlement Mechanism

The other direction of reforming the WTO is to expand its current institutional advantage to maintain its status in the 'centre' of global trade governance. Hence, the author would propose the re-orientation of the WTO as a world trade court instead of a trade negotiation forum.<sup>39</sup>

First, it is advocated to extend the WTO's jurisdiction to the trade disputes arising from PTAs, thereby fostering the common law of international trade and coherence.<sup>40</sup> The regional trade agreements are much more effective in liberalizing the trade rules among its enclosed members than the multilateral trade agreements. However, dispute settlement under most PTAs is still weak or absent, as no legal and procedural machine and expertise can be built under agreements except for *ad hoc* arbitration.<sup>41</sup> Moreover, there would be a waste of judiciary resources when the same disputes are trialled by parallel judicial proceedings. As shown by the *Brazil Retreated Tyres*, the measures adopted by Brazil to execute the arbitration report made by the MERCOSUR panel was later found void by the appellate body of the WTO, as it was not justified by the Chapeau of Article 20 from the GATT.<sup>42</sup> If the dispute settlement mechanism of the WTO could be extended to the trade disputes arising from PTAs, it might avoid the double cost caused by parallel proceedings. It might also ease the contestation of dispute settlement between the PTA and the WTO, offering reliable and valid suggestions to members in making their domestic rules and measures conform with the regional and multilateral trade agreements. Because such a suggestion appears to be workable, as authorised by Article 25 of the DSU, the members could submit their disputes to the WTO for arbitration.

However, two legal issues remain unsolved if the WTO's arbitration panel accepts the case. One is whether the relevant PTA should be reviewed to determine the qualification to meet the requirements of Article 24 of GATT or Article 5 of GATS, as the prerequisite of such jurisdiction is that the disputed PTA is valid under the WTO. The other is how to enforce the arbitration report. As the WTO's jurisdiction on arbitration is not compulsory, especially concerning the implementation of the arbitration reports, "all the members should authorize" it in accordance with Articles 21 and 22 of the DSU is required.<sup>43</sup>

There is also another suggestion in contemplating the possibility of extending the dispute jurisdiction of the WTO to the investor-state disputes.<sup>44</sup> The WTO's dispute settlement mechanism only applies to the on-going trade disputes, while the investor-state dispute settlement mechanism has been developed since the 1960s on the commercial arbitration rules. However, the offshore manufacturing practice of transnational corporations has blurred investment disputes with the trade disputes. The conventional trade dispute settlement mechanism does not touch on the issue of parallel proceedings of the trade disputes and investment disputes. It allows the transnational corporations to resort to different dispute mechanisms on the same issue, which produces more legal blackholes in international law.<sup>45</sup> In *Mexico-Soft Drinks*, the American enterprises not only successfully lobbied their home country to bring a trade dispute under the WTO, but also brought an investor-state dispute to the International Center for Settlement of Investment Disputes ("ICSID") to question the tax imposed by the Mexican government on DHS.<sup>46</sup> The adoption of the Tobacco Plain Package Act and revision of the Trade Mark Act in Australia also forced Australia to defend itself before the dispute settlement body of the WTO and an *ad hoc* arbitration panel after both trade dispute and investor-state dispute were brought against Australia by several giant tobacco corporations.<sup>47</sup> The disparate routes taken by trade disputes and investor-state disputes reduces the efficiency, optimal compliance, coherence, and equality of the rule of international law.<sup>48</sup> As the rules of investor-state dispute settlement are under reform, the EU proposes to establish a multilateral investment court in CETA with Canada and its FTA with Vietnam. If such a multilateral investment court could be set up by the WTO, the possibility of investors' abuse of judicial resources could be reduced, and the WTO's influence could be extended to other spheres, which might also be beneficial in accelerating the negotiations of the Investment Framework Agreement.

The legitimacy and effectiveness of the dispute settlement by the WTO receives the same respect as the International Court of Justice and domestic supreme courts.<sup>49</sup> However, if the WTO's jurisdiction is expanding as proposed, the amendments of DSU are necessary under the consensus requirement of the WTO. The former reform is contrary to the intention of the US of establishing regional trade courts or panels that could better take care of its interests,<sup>50</sup> while the latter reform intends to replace the fully fledged investor-state dispute settlement

(“ISDS”) by the WTO’s dispute settlement, which will also be rejected by the inventors and beneficiaries of the ISDS rules, such as the US and the EU.

#### **IV. PERIPHERAL REFORM UNDER RULE-BASED PTAs**

As the central reform is unlikely to be successful, both the developed countries and newly emerging economies place more resources on the peripheral reforms by signing high-standard PTAs to reshape the trade rules and develop other routes of regional economic cooperation. The following discussion first analyzes the rule-based PTAs to see what reforms have been taken and whether they are effective.

The high-standard PTAs, such as TPP and CETA, effectively respond to the newly emerging needs of international trade. Despite the US’ withdrawal from TPP, it not only complements the multilateral trading system by making breakthroughs and breaking the deadlock in negotiating new rules, but also establishes the new high land for trade liberalization.<sup>51</sup>

The peripheral reform led by the high-standard PTAs brings more unconventional trade issues covered by the PTAs. What is or is not a trade issue is becoming more blurred as the mega-PTAs extend the boundaries to the domestic domains, which were previously not covered by the PTAs. Global trade governance is no longer just coping with the discriminatory measures taken alongside the border. Instead, it is responding to the pre- and post-entry issues. Today’s trade negotiation in a PTA covers issues like trade in merchandise goods, trade in service, investment, intellectual property, government procurement, competition, and anti-bribery, among which many of the issues are not even trade relevant. Henrik Horn, Petros Mavroidis, and Andrè Sapir once conducted research on the subject matter signed by the two main hubs (the EU and the US) between 1992 and 2008. They have found over 50 areas that are subject to provisions in one or more PTAs.<sup>52</sup>

In addition, many new areas are included to respond to the new economic and societal needs. *E.g.*, the US-led PTA set a new chapter for electronic commerce to shelve its dispute with the EU on whether e-commerce should be in the domain of trade in goods or trade in service. Such a chapter is later found in the EU’s PTAs.<sup>53</sup> These rules respond to the needs of economic cooperation with advanced information technology. The in-depth integration of the value chain requires

simplification of administrative procedures in trade regulation and enhancement of fairness and transparency of administrative procedures through rules of anti-corruption, transparency, digitalized administration measures, and judicial review of disputed administrative measures. Such new areas not only blur the boundaries of international trade law and administrative law, but also make more effective regulation on non-tariff barriers.<sup>54</sup>

The rule updates of both market-access and trade regulation issues were successful, especially compared to the multilateral trade negotiations. The market access of trade in service in the newly concluded mega-PTAs far exceeds members' commitments in negotiating the GATS 2000. The intellectual property protection of the PTAs has never yet stood upon the minimum standard as required by the Agreement on Trade-related Aspects of Intellectual Property Rights ("TRIPS"). They kept pushing the coverage of intellectual property protection and pushing the boundaries to reach the TRIPS-plus standard.<sup>55</sup> The Singapore issues, such as government procurement and competition policy, as dropped by the WTO in the Doha Round, have also reached consensus in many high-standard PTAs, thereby providing a basis for the negotiation of TISA.<sup>56</sup>

Furthermore, the mega-PTAs reshape our conceptions of the regulation of non-tariff barriers. Beyond the anti-discrimination governance, the high-standard PTAs set up the best practice for the central and local governments and enterprises, providing effective measures targeting parties' weaknesses in enforcing trade rules.<sup>57</sup> The regulation on East Asian countries' commercial fishery of marine mammals and consumption of shark fins, and Malaysia's minimum age of child labour in TPP are such examples. The pre-entry governance through negative lists and pre-establishment of national treatment further liberalize members' trade in services and investments. The regulatory cooperation, uniform technology standards, and rule integration on intellectual property protection and competition rules facilitate harmonizing various domestic laws to reduce the trade costs and uncertainties caused by the behind-the-border barriers.

Finally, stakeholders' participation in negotiating and enforcing PTAs is more welcomed. It suits civil society's needs better and develops a more open, competitive, and market-oriented trade cooperative structure.<sup>58</sup> The environmental attachment of the North American Agreement on Environmental Cooperation ("NAAEC") to the North American Free Trade Agreement ("NAFTA") establishes

citizens' rights of supervising and reporting government's rule-breaching measures. In the TPP, governments are required to inform stakeholders, including foreign investors and traders, and to allow stakeholders to express their concerns and opinions in the decision-making process before the technology standards are made.<sup>59</sup> The participation and transparency of the investor-state dispute settlement mechanism are also improved in the PTAs.<sup>60</sup>

The recent PTAs have been successful in reforming the international trade rules by covering more trade-related issues, regulating the trade barriers more effectively, and providing more room for citizens to participate. Could these reforms then be consistent with each other, although different PTAs might have very different rules?

The development and evolution of the PTAs demonstrates a more open and liberalized tendency, while developing countries tend to adopt more sophisticated rules mirroring PTA models from developed countries. Such tendency could be explained by the export of legal norms from the developed countries to their developing partners via PTAs. Among all the factors, the competitive liberalization as generated by high-standard PTAs, exerts the most significant influence on developing countries to accept the rules as proposed by the developed countries.<sup>61</sup>

Moreover, NAFTA offers a good example to analyze the effects of competitive liberalization. While NAFTA should have been ratified by its three members, the negotiation of the Uruguay Round was struck, as the European Commission ("EC") intended to withdraw from the negotiations. The negotiation and ratification of NAFTA by three members showed a practical north-south cooperative framework for the EU and the developing members, with integrated rules governing trade in goods, trade in services, and intellectual property in a single package. The EC returned to the negotiations and the Uruguay Round finally succeeded.<sup>62</sup> This competitive liberalization effect inspired the US trade representative Zoelick to adopt PTAs as a strategy.<sup>63</sup>

The competitive liberalization of NAFTA produced further repercussions in the formation of similar PTAs in Central America, Europe, and Asia. After concluding NAFTA, Mexico's huge trade benefits made Central American countries frustrated because their export to the US remained flat in the following ten years. It finally pushed them to sign a similar PTA with the US in 2003.<sup>64</sup> The Agreement also influenced Europe. As the trade flow between the EU and Mexico dropped to 6.5

percent in 1994 from 10.6 percent in 1991, the EU-Mexico PTA was put on the agenda and was adopted to combat such negative effects.<sup>65</sup> The formation of the Asia-Pacific Economic Cooperation (“APEC”) was also believed to be relevant to NAFTA’s competitive liberalization.<sup>66</sup>

Furthermore, NAFTA shows that, once a high-standard PTA is formed, the trade advantage caused by cutting tariffs and removing non-tariff barriers inside the trade bloc will strengthen the rule advantage of such a PTA. It further attracts other countries to copy the rules and triggers formation of similar PTAs. With competitive liberalization, the global, regional, and bilateral trade agreements could complement and reinforce each other.<sup>67</sup> In addition, each PTA could be a foundation for the further liberalization of other trade rules, so that it will finally update less liberalized trade rules.

The rule evolution of PTAs not only updates trade rules, but also enlarges the imbalance of comparative advantage among nations. It may result in forcing countries with fewer resources to pay dearly and become an advantage for countries with plenty of resources.<sup>68</sup> To generate such competitive liberalization, even big powers usually have the contributing factors for their PTAs as follows.

First, it is vital to choose the right partner to negotiate a high-standard PTA. A big power usually chooses trade-affiliated countries who are willing to make political and economic reforms with a high-standard PTA. Then, the big power will offer tariff benefits to the export products of the parties in exchange for their acceptance of high-standard rules on investment, service, intellectual property, and competition. Once they sign it, the PTA diverts the trade within and beyond its treaty parties, triggering the non-parties who lose export shares to surrender their disputes and sign similar treaties with the big power.<sup>69</sup>

Second, in producing the competitive liberalization, the PTA needs to adopt conditional MFN treatment and restrictive rules of origin to lock in trade benefits inside the region to avoid free riders. Eventually, most of the US-led PTAs maintain strict rules of origin that require high levels of local content, some of which even burden the parties to keep a record and certificate of the rules of origin for five years.<sup>70</sup>

Then, to further strengthen the rule advantage of such high-standard PTAs, the big power will guarantee the consistency of its trading rules with different countries because competitive liberalization might be interfered by contesting

PTAs adopted by other big trading nations. Since the 1990s, the US has insisted on their adoption throughout its negotiations, developing NAFTA and the WTO Plus model.<sup>71</sup> These two models ensure consistency and integrity of the US trade rules around the world and allow each PTA signed by the US to act as a precedent, or serve as a catalyst and benchmark for broader trade agreements.<sup>72</sup>

When the global economy is in recession, however, emerging economies' rising advantage in manufacturing industries has pressured the developed countries, such as the US, to abandon the TPP and renegotiate NAFTA. It is worried that once the achievements are obtained by the high-standard PTAs, they would roll back, and even the further liberalization of global trade would be influenced by the emerging anti-globalization sentiments.

## V. PERIPHERAL REFORM UNDER THE BELT AND ROAD INITIATIVE

### A. Background of the Belt and Road Initiative

The peripheral reform of international trade law has been primarily taken up by the high-standard PTAs, which are rule-based. However, a different route of regional cooperation has been also developed by China in its reforming of international trade law. The Belt and Road Initiative is a remarkable case of relation-based trade cooperation among eastern countries.

The Belt and Road Initiative was first proposed by President Xi Jinping in his visit to Kazakhstan on September 5, 2013. To many Western countries, the Belt and Road construction appears to be a “paying rather than receiving” investment. Why did China choose such a different route of regional cooperation? Its “paying rather than receiving” feature suites China’s geopolitical consideration of maintaining a good relationship with its neighboring countries, sharing similarity with Close Economic Partnership Arrangement between mainland China and the Hong Kong district, and the Association of Southeast Asian Nations (“ASEAN”) 10+1. By offering what the other parties need, giving unilateral concessions, and embracing others’ exports to China,<sup>73</sup> allowing them to ‘land’ the Chinese markets first,<sup>74</sup> China has established a relation-based culture within its territory and maintained a good relationship with its neighboring countries.



First, there have been already various PTAs under negotiation between China and its neighbouring countries, such as the Regional Comprehensive Economic Partnership (“RCEP”). If the Belt and Road Initiative is proposed via a PTA, it would not be workable. The Belt and Road Initiative chooses a relation-based route from the beginning to offer new momentums for the cooperation among Asian countries.

Second, the Belt and Road Initiative is a nonexclusive proposal. Among the existing 65 countries covered by the Belt and Road, there are still 14 countries that are not the WTO members and 11 countries that have no BITs with China. In this situation, the rule-based PTAs with complete treaty terms and enforceable dispute settlement mechanism will incur huge negotiation costs.

Finally, the cooperation among the Belt and Road countries pursues the objectives of trade and investment facilitation, infrastructure development, mutual understanding of politics, and the strengthening of citizens’ trust and friendship in the region.

## **B. Achievements of the Belt and Road Cooperation**

After three years of cooperation, the Belt and Road construction has made productive achievements, especially on trade, finance, and infrastructure investment. By the end of June 2016, China had announced declarations with 56 countries in collaborating on the Belt and Road construction, and dozens of memorandums of understanding and agreements have been signed between China and the Belt and Road countries.<sup>75</sup>

To facilitate trade payment, by March 31, 2016, nine Chinese commercial banks had established 56 branches in 24 Belt and Road countries, and 56 foreign commercial banks from 20 countries had established seven subsidiary companies, 18 branches, and 42 representative offices in China.<sup>76</sup> On one hand, the increasing demands of steel, cement, and glass triggered by the infrastructure developments in the Belt and Road countries have relieved China’s overcapacity problem. On the other hand, by the construction of infrastructure projects, China has also strengthened its high technology advantages in the sectors of high speed trains, civilian nuclear power plants, and satellite navigation services.

## VI. MULTILATERALIZING REGIONALISM AND REFORMATION OF GLOBAL GOVERNANCE

### A. Third-Party MFN Approach

The idea of multilateralizing regionalism was first proposed by Richard Baldwin. He proposed to insert the third-party MFN clause in PTAs.<sup>77</sup> With such a clause, any further preferential treatment offered by one party in future treaties will be given unconditionally to the other party. Such a third-party MFN clause could make the preferential treatment in future PTAs spill back to the former PTAs. If most of the PTAs have such a third-party MFN clause in place, preferential treatment will be equal among different trading partners.

The third-party MFN clauses are also frequently found in the chapters of trade in service and government procurement in the US-led PTAs. The EU also has made this clear in its Economic Partnership Agreement with the African, Caribbean, and Pacific (“ACP”) countries. It requests that any more preferential treatment offered by the ACP countries in the future to other countries be extended to the EU unconditionally.<sup>78</sup> The benefits of third-party MFN clauses could be thus further explored in future PTAs.

Although it appears to be practical to incorporate the third-party MFN clauses in more PTAs, as the treaty parties generally have the incentive to acquire the best treatment in negotiating PTAs, such a hypothesis is flawed in several scenarios. First, the *ex post* nature of the third-party MFN clause makes it difficult to predict the trade benefits and costs in signing PTAs. The spill back effects of the clause will generate huge uncertainties in regional trade relations. Contrary to the principle of legal certainty pursued by international trade law, it might produce some unpredictable impairments to certain industries of the parties that accept such clauses.

Take the following case as example. Country A signs a PTA with Country B. If the textile industry of Country B is weak, but the automotive industry is robust, Country A offers preferential treatment to Country B in textile products but not in the automotive industry, and includes such a third-party MFN clause in the PTA. When Country A later negotiates an agreement with Country C, whose automotive industry is less competitive than that of Country A, the preferential treatment in the automotive industry offered by Country A to Country C could roll back to

Country B and hurt Country A's automotive industry. In the author's opinion, the uncertainty of such third-party MFN clauses might make the parties think twice when considering whether to include such clauses in the negotiations.

Next, the third-party MFN clause might also turn into a stumbling stone rather than a stepping stone in liberalizing the markets. When the spill back effects generated by such clauses flows to the major benefiter, it may have a chilling effect on third parties that were previously interested in concluding a PTA. They were worried, however, if any benefits would go back to the major benefiter,<sup>79</sup> without the trade alliance. Ultimately, the driving force of the parties to engage in the domestic reform of trade rules is the conditional MFN treatment acquired via trade negotiations and forced compromises rather than unconditional MFN or open regionalism.<sup>80</sup>

Furthermore, in negotiating a PTA, due to the unequal bargaining power of the parties, whether to adopt the third-party MFN clause and who shall bear the duty are decided by the country that dominates the negotiation. Its expectation is in accordance with whether it could benefit from such clauses. It is doubtful if such a third-party MFN clause would be a common case in other chapters apart from those of trade in services and government procurement, especially in the sensitive areas of agriculture and textiles. As the domestic laws of the US and the EU in investment or services are more open and competitive, they would be the general beneficiaries for further liberalization. However, both would be reluctant to include their sensitive sectors in the list of third-party MFN treatment. This indicates that the duties generated by the third-party MFN clause are usually borne by developing countries. It is contrary to the spirit of more preferential treatment to the developing countries as advocated by enabling clauses in multilateral trade agreements.<sup>81</sup>

Lastly, the PTAs are driven by not only economic, but also by political and security reasons. *E.g.*, the US patterns its security goals in trade agreements. It pre-emptively protects the US from the rise of other superpowers, specifically Europe and China<sup>82</sup> and rewards alliances to those who are willing to reform to its domestic rules and adopt the American-style free market economy and democracy.<sup>83</sup> The PTAs are not just economic cooperative frameworks, but also complex political and security initiatives. The third-party MFN clauses would not be a customary practice beyond political alliances.

## B. Simplifying the Rules of Origin

A less direct route to multilateralize regionalism is to simplify the rules of origin to obscure the country of origin of a product and remove the ‘frictional’ trade barriers.<sup>84</sup> It allows more countries to benefit from the preferential treatment of PTAs. The rules of origin are decisive factors in measuring the boundary of economic benefits generated by a regional trade agreement and identifying its beneficiaries.<sup>85</sup> The more restrictive the rules of origin are, the more severe the fragmentation of the international trade law will be. Thus, simplifying the rules of origin is believed to reduce the disparities among the PTAs themselves.

When a manufactured product is not fully acquired in one country, most of the rules of origin identify the ‘substantial change’ of the product according to the change of tariff classification. It will meet required local value contents or adoption of specific manufacturing procedures.<sup>86</sup> Lowering the value contents criteria could benefit more countries and promote *de facto* multilateralization of regional agreements. Currently, the rules of origin adopted by the US- and EU-led PTAs are most complex and trade restrictive in nature, especially in sensitive areas, such as textiles, agricultural products, and automotive parts.

The rules of origin in NAFTA have a general requirement of local value content between 50 percent and 60 percent to make a product of NAFTA origin.<sup>87</sup> The Mexican manufactured textile products need to use yarns planted and harvested in the two North American countries to enjoy the tariff benefits. The general rules of origin in TPP also require a local content of 65 percent; for the textile products, it requires that the plantation, fabrication, and manufacturing of the product all take place in the region to acquire the TPP identity.<sup>88</sup>

The local value contents of the Pan-European rules of origin are also high and set to 50 percent for many products.<sup>89</sup> Instead, the developing countries from the South America, Africa, and Asia are inclined to adopt looser rules of origin. The Western Africa Economic Community recognizes a product as a local product if the local value content reaches 30 percent.<sup>90</sup> The ASEAN 10+1 concluded between the ASEAN and China and the FTA between the ASEAN and Korea both identify a local product when its local value content reaches 40 percent.<sup>91</sup> The lower the value content requirement is, the more developing countries with incomplete industry chains could benefit from the regional trade agreements.<sup>92</sup>

When a product is manufactured in several countries, it allows the accumulation

of value contents acquired in different countries and could also reduce the trade distorting effects of the rules of origin. The EU's diagonal and complete accumulation allows the importers of its treaty partners to accumulate the domestic value with that acquired in the EU and other countries. These accumulation rules maintain the PTAs with the EU implementing the same rules of origin<sup>93</sup> and benefit the spoke countries who have signed PTAs with EU.<sup>94</sup> They are also found in the PTAs signed by the US. *E.g.*, the US-CRAFTA-DR allows Central American countries to accumulate the values acquired in the processing of a textile product in Canada and Mexico.<sup>95</sup>

Apparently, lowering the value content requirement and adopting flexible accumulation rules encourage the spillover of preferential treatment of a PTA and extend the zero tariff benefits to more countries, thereby indirectly multilateralizing such agreements. Could the rules of origin really become friendlier to smaller countries? This is doubtful, as it runs counter to a PTA's geopolitical objective. Such rules would be more frequently found between the hub and its spoke countries. However, the hub will be cautious in designing its rules of origin, not allowing the trade benefits to spill over to their competitors or non-trade alliances.

Moreover, due to the post-Brexit influences of anti-globalization and the US' withdrawal from the TPP, it is infeasible for big trading nations to simplify their rules of origin to benefit more countries from their PTAs. Donald Trump's 100-day action plan manifests his intentions of ending the Outsourcing Act and raising tariffs to the US companies building overseas factories but selling products back to US. He labelled China as a currency manipulator.<sup>96</sup> Although Trump has taken back some of his radical proposals after being elected, trade protectionism has regained its vitality. If a new round of trade protectionism has been on track, the rules of origin in the PTAs will continue to be used as a tool of trade distortion. This round will lock up the trade inside the region rather than allow more outsiders to benefit from it.

### **C. Multilateralizing Regionalism through the Building Blocks of PTAs**

The third possible route of multilateralizing regionalism is to build the multilateral agreements with the building blocks of PTAs. The optimistic view of the fragmentation of international law shows that the regional trade agreements could act as the new glue of multilateralism.<sup>97</sup> When there are sufficient building blocks

made by the bilateral and regional trade agreements, multilateral rules will also develop.

Such a building block theory has been proved to be workable through the American experiences to some extent. From the 1980s, the US has enlarged its PTA partners gradually from nearby neighbours to strategic alliances around the world. When the bilateral agreements were first signed between the US and its small trade-affiliated countries, more small countries lined up hoping to reach a trade agreement with the US to offset the trade distorting effects produced by former agreements. Because the US bilateral connections are sufficiently dense, regional trade agreements could be linked to the bilateral PTAs and then trans-regional agreements or mega-FTAs, such as TPP and TTIP. It would eventually be put back on the agenda to link the major economies in the world together.<sup>98</sup>

The TPP and the TTIP with TISA are negotiated to renew the international trade rules with those standards compromised by the US and the EU. The TPP is expected to be the foundation rule of Free Trade Agreement of the Asia-Pacific (“FTAAP”),<sup>99</sup> a potential to integrate the trade rules in the whole Asia-Pacific region. The TTIP negotiation is also anticipated to shoulder the responsibility of coordinating the trade rules between the US and the EU. It sets new standards for international trade, investment, intellectual property, and competition, thereby updating the trade rules for the major trading nations in America, Europe, and Asia. Undoubtedly, the TPP and the TTIP would change the multilateral trading system. Even though both failed, their negotiating objectives would shape the future of the WTO.<sup>100</sup> Today, the inter-regionalism and new regionalism might finally supplement the multilateral agreements or lead to new multilateralism.<sup>101</sup>

Even though the new multilateral agreements would not be realized successfully soon, the mini-multilateral negotiations will be less difficult to reach consensus, considering that the PTAs are successful in coordinating the trade rules among the major trading nations. Mini-lateralism would be the mainstream for the global trade governance as the biggest trading nations would be governed by high-standard PTAs, and the WTO-covered agreements would be named as multilateral agreements only in the sense of the members covered. Regarding the TISA negotiation, *e.g.*, 49 negotiating nations for TISA cover 75 percent of global trade in service and 70 percent of investment flows.<sup>102</sup> Most of these negotiating parties have already included comprehensive market access on service trade in

their PTAs, which would act as building blocks for the negotiation of TISA. If the current negotiating parties reach consensus with the BRICS countries, its gap regarding the critical mass would be filled. Even though TISA has failed to make compromises between the developed countries and BRICS, it results in a PTA rather than a critical mass agreement. The competitive liberalization effects that it releases after its conclusion might also enhance its acceptability by other countries.

However, multilateralizing regionalism through PTAs will generate legal uncertainties and huge costs. Another concern is that such multilateralizing regionalism will only benefit the big powers, as competitive liberalization is supported by the imbalance of power in treaty negotiation and could only be utilized by those countries with strong bargaining power. Multilateralizing regionalism through building blocks of PTAs is a law-making process led by big powers. Facing challenges from the developing countries regarding its fairness, arguably, it only benefits the hub country with the sacrifice of the spokes.<sup>103</sup> If this reshaping process incurs more grievances in the future, the building blocks could turn into stumbling blocks.<sup>104</sup> In this regard, international law will be more fragmented.

## VII. CONCLUSION

The multilateral trade rules formed in the 1990s can no longer suffice for the needs of economic cooperation among the members. It deprives the WTO of its central status in global trade governance. The massive PTAs recently proliferating stand alongside the WTO-covered agreements and have launched a new era of coexistence of central and peripheral governance. The various routes of central reform are not very promising. However, the two distinct peripheral reforms have produced some positive effects, even though each of these two routes has its own deficiencies. To defragment international trade law, different routes of multilateralizing regionalism have been advocated, such as inclusion of third-party MFN clauses in PTAs, simplification of the rules of origin, and construction of multilateral agreements through the building blocks of PTAs. By the experiment of developed countries, the building block theory was once promising to reach new international trade rules through high-standard PTAs among some major powers. In addition, we believe that there will be more reforms in the future, and

both developed countries and emerging economies will explore their routes to push the global trade governance forward eventually.

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