

Does the Transatlantic Trade and Investment Partnership agreement violate the fundamental principles of the World Trade Organization?

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The current negotiations regarding the Transatlantic Trade and Investment Partnership (TTIP) between the European Union and the United States has hardly escaped anyone in its controversy and scope. The agreement is primarily dedicated to increasing jobs and growth for both parties' economic areas by attempting to reduce the already low transatlantic tariff barriers (averaging on 5-7 per cent¹) existing and ultimately removing them².

At the time of writing the negotiations are still taking place and there is no definite consensus. The potential agreement has been contested by various member states to the European Union and their people. Much debate revolves the negotiations, a debate greatly surrounding the controversial Investor-State Dispute Settlement proposal but which is outwith the scope of this article as we attempt to highlight a lesser-known issue, the legality of the TTIP under world trade law. We therefore focus on the trade of goods and the impact such a massive Free Trade Agreement (FTA) could have on world trade.

The principles of the world trade order

The World Trade Organization (WTO) is a unifying trade organisation providing legal ground rules for international trade widely adhered to by its 160 members and 24 observers, thus its organisational framework is universal in nature and with its legal influence on international trade³.

A core principle of world trade is the "Most Favoured Nation"-principle⁴, a principle stemming from the origins of the multilateral trade foundation, the General Agreement on Trade and Tariffs 1947. Under Article I:1 of the GATT 1994, there is an inherent emphasis on every member state to accept a single undertaking of the provisions of the agreement, its main focus being to provide a multilateral agreement on profitable liberalised trade for all parties involved. Under the multilateral trading system the 'Most Favoured Nation'-principle is an obligation undertaken by all members to the WTO in which the

contracting parties treat every member in a non-discriminatory manner. This means that a standardised MFN-tariff is imposed on all imports from members of the WTO⁵ and is subject to any preferential tariffs originating from Preferential Trade Agreements.

"Th[e] object and purpose [of Article I] is to prohibit discrimination among like products originating in or destined for different countries. The prohibition of discrimination in Article I:1 also serves as an incentive for concessions, negotiated reciprocally, to be extended to all other Members on an MFN basis⁶."

Exceptions to Article I:1

"Notwithstanding the provisions of Article I of the General Agreement, contracting parties may accord differential and more favourable treatment to developing countries, without according such treatment to other contracting parties."⁷

Under GATT 1947, and subsequently GATT 1994, exceptions to the MFN-principle are promoted in cases where Regional Trade Agreements could play an important role in expanding liberalisation of trade and increased development. One of which is the "Enabling Clause"⁸ where the contracting parties are to attempt to favourably treat trade from developing countries. This could take numerous forms such as preferential tariff treatments in accordance with the Generalized System of Preferences (GSP) or regional arrangements to eliminate tariffs. In particular, the European Union has devised the so-called 'Everything But Arms'-arrangement in which Least Developed Countries party to it incur no barriers when exporting to the EU⁹. Furthermore, incorporated exceptions to the MFN-principle are found under Article XXIV of GATT 1994. Under Article XXVI, the contracting parties have the right to form customs unions and free-trade areas with another Member State as long as they adhere to the economic reasoning¹⁰ presented in the concluding sentences of both paragraph (a) and (b)¹¹.

¹ A Transatlantic Zero Agreement: Estimating the Gains from Transatlantic Free Trade in Goods, ECIPE Occasional Paper No.4/2010 p.2.

² European Commission MEMO/13/564 - Member States endorse EU-US trade and investment negotiations (June, 2013), p.1.

³ Marrakesh Agreement Establishing the World Trade Organization 1994, Article XXV, Annex A – WTO Membership

⁴ Article I:1 GATT 1994. With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.

⁵ World Bank, WITS on MFN-Tariff.

http://wits.worldbank.org/wits/wits/help/Content/Data_Retrieval/P/Intro/C2.Types_of_Tariffs.htm

⁶ Appellate Body Report on Canada – Autos, para. 84.

⁷ Differential and More Favourable Treatment Reciprocity and Fuller Participation of Developing Countries, Decision of 28 November 1979 (L/4903), para. 1.

⁸ Ibid.

⁹ The arrangement involves full duty free and quota free access to the European Union for all exports originating from the 49 benefiting parties excluding arms and armaments. European Commission, 'Everything But Arms- Who benefits?' (2013)

http://trade.ec.europa.eu/doclib/docs/2013/april/tradoc_150983.pdf

¹⁰ Appellate Body Report on Turkey – Textiles, para 55.

¹¹ XXIV:5, GATT 1994, Accordingly, the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a

Proliferation of regionalism

Recently there has been a proliferation of regionalism within the multilateral trading system, meaning an increasing number of Preferential Trade Agreements (PTA). Richard E. Baldwin argues a ‘domino theory of regionalism’¹² claiming that the creation of PTAs causing trade diversion instigate a ‘pressure for inclusion’¹³ that increases depending on the size of the block, however the block depends upon how many nations join it¹⁴. If the PTA is open to inclusion, regionalism will expand in a multilateral order, whilst if it were confined to its members it would cause unhappy non-members to seek to create their own PTAs in response¹⁵.

It is however claimed that PTAs can have beneficial impacts on the multilateral trading system and the liberalisation of trade. Another favourable position for the creation of PTAs is the ability to undertake and develop concrete regulation regarding sensitive issues for which the multilateral trading system cannot form a consensus¹⁶. However PTAs established between developed and developing countries entail larger systemic implications to the multilateral trading system by diverging trade and forcing the developing country to adhere to the regulatory framework of the developed country. It also refers to the distortion of trade these preferences cause, as it requires much energy to optimise trade and minimise costs in adherence to the numerous rules currently in place by countries entering into various PTAs¹⁷.

The rules are ambiguous in nature and unsurprisingly so, in the modern age the production of goods rarely originates in one geographic area, but rather different components are acquired

customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area; *Provided that:* (a) With respect to a customs union, or an interim agreement leading to a formation of a customs union, the duties and other regulations of commerce imposed at the institution of any such union or interim agreement in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement, as the case may be; (b) With respect to a free-trade area, or an interim agreement leading to the formation of a free-trade area, the duties and other regulations of commerce maintained in each of the constituent territories and applicable at the formation of such free-trade area or the adoption of such interim agreement to the trade of contracting parties not included in such area or not parties to such agreement shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation of the free-trade area, or interim agreement as the case may be; and (c) Any interim agreement referred to in sub-paragraphs (a) and (b) shall include a plan and schedule for the formation of such a customs union or of such a free-trade area within a reasonable length of time.

¹² Richard E. Baldwin, *The Causes of Regionalism* (1997) p.877

¹³ Lawrence, R. (1996), *Regionalism, Multilateralism and Deeper Integration* (Washington: Brookings Institute)

¹⁴ Richard E. Baldwin 1997, *The Causes of Regionalism* p.878

¹⁵ *ibid.*

¹⁶ Michael J. Ferrantino, *Policy Anchors: Do Free Trade Agreements and WTO Accessions Serve as Vehicles for Developing-country Policy Reform? Do Free Trade Agreements and WTO Accessions Serve as Vehicles for Developing-country Policy Reform?* Palgrave Macmillan (2010)

¹⁷ Luis Abugattas Majluf, *Swimming in the Spaghetti Bowl: Challenges for Developing Countries under New Regionalism*, UNCTAD Policy issues in international trade and commodities, study series no.52 p.5

and assembled across the ‘global supply chain’. Such ambiguity in the rules may therefore serve the purpose of imposing barriers to trade outwith the tariff scheme collectively known as non-tariff barriers. This could be seen as a measure to reduce the costs of free trade by imposing strict rules of origin, and as Mr. Jagdish Bhagwati noted: “*they take away with one hand what they give with the other*”¹⁸. By removing the barriers to trade for transatlantic trade there will be a more substantial onus on third parties to adhere to non-tariff barriers not accounted for under WTO rules, thus increasing the scope of arbitrary notions such as “rules of origins” which would be beneficial to the signatories of TTIP but detrimental to third parties.

Discriminatory nature of the Transatlantic Trade and Investment Partnership

We can see that the proposed TTIP agreement adheres to all of the requirements presented by the WTO for the exception to the MFN-principle under Article XXIV:5(b). Thus it is not *in jure* in violation of the principles of the WTO, as imposing non-tariff barriers to trade does not constitute a violation of the MFN principle but does distort trade substantially. Due to the magnitude of the economic and market powers of the parties to TTIP it has a substantial universal impact. Moreover, it was observed by the Appellate Body in the *Canada-Autos* case:

“...We observe that Article I:1 does not cover only ‘*in law*’, or *de jure*, discrimination. As several GATT panel reports confirmed, Article I:1 covers also ‘*in fact*’, or *de facto*, discrimination”¹⁹.

We therefore must look to the potential *de facto* discrimination imposed by such a large FTA and the consequences it would have on the multilateral trading system of today. Most notably it would be the increased non-tariff barriers²⁰. These account for the most “profitable” and discriminatory aspects of international trade and also affect free trade and the multilateral trading system the most due to its arbitrary nature. It must in some way be more beneficial to trade with one’s FTA party than to trade with third parties, thus it is natural for any FTA or PTA to include non-tariff barriers to trade. The obligations imposed under Article XXIV:5 for the creation of customs unions and free-trade areas allow no scope for interpretation when referring to tariff barriers to trade, a customs union or a free-trade agreement should not impose detrimental tariffs on non-members to the agreement, but a non-tariff barrier is not accounted for²¹.

Due to the already low level of tariff barriers in place between the parties, the direct increase in GDP growth from merely eliminating tariffs would not be substantial - only 0.1 per cent within the EU and 0.15 per cent for the US²². It is however the elimination of non-tariff measures and harmonisa-

¹⁸ *ibid.* p.69

¹⁹ Appellate Body Report on *Canada-Autos* para. 78.

²⁰ “Non-tariff barriers comprise all measures other than tariffs that restrict or otherwise distort trade flows”. OECD Trade Policy Study— Looking Beyond Tariff Barriers: The role of non-tariff barriers in world trade (2005) p.11

²¹ Article XXIV GATT 1994

²² A Transatlantic Zero Agreement: Estimating the Gains from Transatlantic Free Trade in Goods, ECIPE Occasional Paper No. 4/2010 p.2.

tion of regulatory framework that would have the more prominent increase to real per capita income²³ to all member states to the EU and US.

It would thus influence countries that predominantly export to either the EU or US by a loss in market share, a natural effect to the elimination of bilateral tariffs²⁴.

“The goal will be to eliminate duties and other restrictions for trade in goods. Freeing up commercial services, providing the highest possible protection, certainty and level playing field for European investors in the US, and increasing access to American public procurement markets are also objectives. Removing unnecessary regulatory constraints on trade is a key issue for the EU, as are obtaining stronger protection of European Geographical Indications, facilitating customs formalities and addressing competition rules.”²⁵

There are strong incentives on both sides to the agreement to attempt to eliminate NTBs such as ‘behind-the-border’ obstacles by reducing the unnecessary costs they pose, furthermore the harmonisation of rules of origins would be vital in order for the spill-over effects below to materialise. Moreover the adherence to global challenges and the promotion of regular dialogue of trade defence measures shows an acknowledgement of the importance this potential TTIP would have globally, and it is important that both parties address these issues.

Bilateral agreements extend so-called spill-over effects upon third parties as a result of bilateral liberalisation of trade, they either take the form of direct spill-overs or indirect spill-overs. Below are the most probable scenarios to the TTIP spill-over effects:

Due to the magnitude of this FTA the indirect spill-over effects of TTIP would cause parties wishing to continue trade with the EU and US to adhere to these common standards allowing them to become global in nature. This would allow for reduced non-tariff barriers such as adherence to regulations and export/import standards as the standard of trade would essentially be the same. However, this also allows for the introduction of more arbitrary non-tariff barriers or for “rules of origins” to be of stricter nature. The purpose of an FTA or any other regional agreement is to exclude third parties and benefit the signatories, no matter how much a country adheres to the rules set out in TTIP they would still be considered a third party to the agreement and thus subject to strict non-tariff barriers which would benefit the signatories and their mutual trade.

However these indirect spill-over effects are subject to assumptions made in regards to the rest of the world’s ability to streamline these standards in order to allow them to truly

²³ Transatlantic Free Trade: Winners, Losers and Necessary Accompanying Measures 19 Law & Bus. Rev. Am. 445 (2013), p.481

²⁴ Joseph Francois, Miriam Manchin, Hanna Norberg, Olga Pindyuk, Patrick Tomberger, Reducing Trans-Atlantic Barriers to Trade and Investment, TRADE10/A2/A16, Centre for Economic Policy Research (2013) p.28

²⁵ European Commission MEMO/13/564 - Member States endorse EU-US trade and investment negotiations (June, 2013), p.2.

become global in nature. Such a possible scenario would reduce the impact of the trade diversion generated by the tariff liberalisation between the TTIP parties²⁶. As a result of negotiations for such harmonisation, traders within the EU and US would have marginally larger capital and technological advances to internalise these modifications, and as current negotiations between the parties are subject to public consultation of key market actors²⁷ they would have an active say in the matter, an opportunity not extended to third parties.

Thus the scenario in which the EU and US act as regulatory hegemon is a highly possible one that would propose a potential coercive nature as countries wishing to continue trade with the EU and US would have no other choice but to internalise these common standards and divert their operational focus to adhering to these changes. It would be of particular difficulty to LDCs lacking the capital for such modifications. However, upon the effects of the initial ‘hurdle’, the trade costs for these countries should be marginally less due to the assumed GSP adherence of TTIP in which they would continue to enjoy low or zero tariff and quota-barriers²⁸ and non-tariff barrier-costs such as regulatory adherence would be decreased.

Furthermore, based on the CEPR-report the rest of the world would see an increase in GDP with a 20 per cent spill-over effect from TTIP by 2027²⁹, notably ASEAN countries would benefit largely from a drop in global trading costs as a result of the indirect spill-over effects. Such a positive increase in worldwide GDP growth correlates with the objectives of the multilateral trading system in which there is scope for regional preference to be extended bilaterally in favour of multilateral trade creation and multilateral welfare increase.³⁰

However figures established by the OECD suggest the GDP increase for High Income Countries would amount to €36 billion as opposed to the €2.4 billion in GDP increase Low Income Countries would achieve through the same agreement³¹. The Commission is emphasising the importance of the global reach of the TTIP agreement, claiming the global impacts to economic growth will be substantial enough to justify its fulfilment and the trade diversion it would generate. However as we can see it is not the developing countries but the already developed high-income countries that will benefit, primarily the EU and the US. An elimination of tariff barriers between the parties to the TTIP will result in a loss in market share for the immediate trading partners currently trading with the EU and US as is the nature of any regional agreement. However many of these countries constitute neighbouring

²⁶ Joseph Francois et. al, Reducing Trans-Atlantic Barriers to Trade and Investment (2013) p.86

²⁷ TTIP Round 8 – final day press conference, comments by EU Chief Negotiator Ignacio Garcia Barcero, Brussels, 5 February 2015

²⁸ Assumption made based on the objective by TTIP negotiators to continue adhering to the global responsibilities undertaken both on EU and US level.

²⁹ Joseph Francois et. al, Reducing Trans-Atlantic Barriers to Trade and Investment (2013) p.84, table 41

³⁰ The objectives of Art. XXIV GATT 1994

³¹ European Commission, The Transatlantic Trade and Investment Partnership – The Economic Analysis Explained, (2013) p.10

countries that belong to the high-income country list³², these countries have the operational means to respond to harmonised standards between the EU and US, it is also probable that they do already meet these standards today, which would significantly reduce the impact posed by the harmonised standards under TTIP. Furthermore, what is considered the solution to this problem is distributing a mere €2.4 billion between 84 countries³³ that will suffer the consequences to their own economies to a much larger extent than the 73 high-income countries that will find it easy to restructure their trade in order to adhere to the TTIP rules due primarily to the difference in capital and technological advances. It is disproportionate that the GDP increase for developing countries is as low as it is when it is these countries that suffer the consequences of the TTIP. What can be established is that TTIP indeed is an agreement to benefit the already developed countries, increasing growth, and within the ambit of the agreement, jobs too.

It looks probable that TTIP would make the EU and US regulatory hegemony for the world trade common standards to trade as a result of the indirect spill-over effects caused by the magnitude of the FTA. Thus we would be shifting regulatory powers from an outstanding third party like the WTO onto two large market actors of world trade that combined account for almost half of the trade and capital of the world. What proves problematic in this scenario is the inherent nature of both parties to deal primarily with their own economic growth and secondly with their global responsibilities, if TTIP would to become a reality the common regulatory frameworks the rest of the world would have to adhere to would naturally be beneficial to these parties.

Upon the harmonisation of regulatory structures between the parties, trading parties wishing to continue such trade would require to adhere to the framework set out in TTIP. Due to the compelling nature of this agreement and the substantial market power both parties hold in the multilateral trading system it is inevitable that the large majority of countries in direct trade with one or both of the parties would have to adhere to the provisions established by the two parties in order to continue the trade. These parties hold such large market power that no trading partner would be able to desist trading with one or the other.

We thus conclude that the proposed TTIP does not *in jure* violate the fundamental principles of the WTO of liberalised

trade in a multilateral trading system as it adheres to Article XXIV:5(b) of GATT 1994 serving as an exception to the MFN-principles under Article I:1. Moreover, the WTO order does not only cover *in jure* discrimination but also *de facto* discrimination, we therefore addressed whether TTIP would be *de facto* in violation of WTO principles.

The implications of full elimination of tariff barriers between them would benefit them slightly, but it is the potential elimination of numerous non-tariff barriers and the harmonisation of regulatory framework that pose the significant economic growth to be achieved through TTIP. These same non-tariff barriers would have to be imposed on third parties and stricter more arbitrary rules implemented so as to not divert trade from the parties of the TTIP. We have left an era where only tariffs and quotas were the main source of barriers to trade, today in a highly globalised society where technological advances are high and disproportionate welfare distribution is prevalent non-tariff barriers are the real source of trade discrimination and due to the lack of legally binding rules regarding these measures they may be as arbitrary as can be. These barriers are stifling the growth of less developed countries but are allowed as tariffs and quotas are kept low or mostly not applied at all. However when it comes to the reality of exports and imports more often than not these countries will face barriers not accounted for by the world trade order that affect the multilateral trading system and with it free trade.

We therefore conclude that the TTIP convey many *de facto* discriminatory aspects, not least its coercive force would divert trade from LDCs and force them to adhere to their rules, rules and standards which would inherently be beneficial to the parties to TTIP but do not necessarily have to be beneficial to any third parties. It is the opinion of this essay that the proposed TTIP agreement is *de facto* in violation of the fundamental principles of the WTO due to the great possibility of hegemonic powers both the EU and US stand to gain as an indirect result of an *in jure* FTA. There would be a shift from a multilateral trading order overseen by an external party to regulations imposed indirectly by parties whose priority is self-interest and not the welfare of all the members of the WTO.

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³² The World Bank list of high income economies - http://data.worldbank.org/about/country-and-lending-groups#High_income (3/3/2015)

³³ The World Bank list of low income economies - http://data.worldbank.org/about/country-and-lending-groups#Low_income (3/3/2015)