

**Squaring the circle: Assessing whether the European Union's pursuit of bilateral trade agreements is compatible with promoting multilateralism.**

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*Abstract*

The European Union's trade strategy since 2006 has been justified on the assumption that deep and comprehensive bilateral trade agreements are at worst complementary to and at best promote multilateral negotiations. Drawing from the literature on the impact of the multilateral regime on the formation and objective of bilateral or regional agreements this article challenges the EU's position. While the European Commission claims that the WTO+ and WTO-X nature of the agreements determine the compatibility of bilateral and multilateral trade approaches, we argue that their complementarity is also impacted by what is happening at multilateral level. To this effect we introduce a new variable focusing on the level of difficulties in multilateral negotiations. While multilateral negotiations can spur new bilateral agreements as a strategy of promoting agreement at the multilateral level, bilateral agreements may instead become substitutes for multilateral agreements when the difficulties of achieving the latter become too severe. An empirical assessment indicates that the stalemate in the Doha Development Round post-2008 coincided with a shift in EU bilateral trade policy away from negotiations with emerging economies, to an intensified focus on large developed countries; agreements with the latter offered the EU the best alternatives to, and substitutes for, a multilateral agreement.

**Key words:** European Union, multilateralism, bilateralism, trade policy, Free Trade Agreements (FTAs), Preferential Trade Agreements (PTAs).

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## 1. Introduction

The European Union (EU) is a signatory to a multitude of different multilateral, bilateral and regional agreements, serving as a key player in the international trading system.<sup>1</sup> As such, it has long employed a dual trade policy strategy, pursuing bilateralism/regionalism while also promoting multilateral agreements. Even during its attempt to “manage globalization” by favoring the multilateral approach in the late 1990s and early 2000s, the EU continued to negotiate Preferential Trade Agreements (PTAs), usually Free Trade Agreements (FTAs) (Meunier, 2007). As then EU Trade Commissioner Lamy explained in 2002: “while we have a policy of ‘multilateralism first’, the EU will continue to be an active player in regional trade policy.” (Lamy, 2002: 1401)

The latter has grown in prominence in the 21<sup>st</sup> century, evidenced by two major differences in the bilateral trade negotiations the EU has launched since the mid-2000s compared with earlier agreements. Until 2006 bilateral agreements served principally non-economic purposes (neighborhood and development objectives), while EU economic interests were served by multilateral agreements. Since then PTAs have largely been justified on the basis of economic interests. The EU has either concluded or is negotiating FTAs with numerous emerging market economies, such as Vietnam, Thailand, Philippines, Indonesia, Mexico, and India.<sup>2</sup> The second difference is that the EU has sought to establish new-generation PTAs with non-European developed countries. An agreement with South Korea entered into force in 2011; the EU thereafter concluded agreements with both Singapore (2013) and Canada (2014), and began negotiations with the United States (US) and Japan (2013). Notwithstanding ongoing

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<sup>1</sup> Trade no longer refers only to trade in goods (and advances in the field of agricultural goods and textiles) but also in services (including foreign direct investment, FDI) and the need to protect intellectual property. Trade liberalization no longer refers only to tariffs and quotas but also to the rules related to trade. WTO includes not only the General Agreement on Tariffs and Trade (GATT, for liberalization of trade in goods) but also the General Agreement on Trade in Services (GATS) and the agreement on Trade Related Aspects of Intellectual Property (TRIPS, for the establishment of minimum standards of intellectual property). Codes of conduct regarding standards have become mandatory for all members, but developing countries benefit from the General System of Preferences and the so-called Enabling Clause (Enables developed members to give differential and more favorable treatment to developing countries).

<sup>2</sup> See current updates on all EU negotiations at [http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc\\_118238.pdf](http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc_118238.pdf)

attempts at plurilateral agreements – with negotiations on trade in services and environmental goods proceeding with a subset of WTO members – the flurry of EU PTAs and the stalemate on the latest incarnation of a truly global trade agreement, the Doha Development Round (DDR), begs the question of whether the EU’s new bilateralism endangers multilateralism? Put differently, is bilateralism a substitute for multilateralism?

All European Commission trade strategy papers since 2006 (*Global Europe* promoted by Commissioner Peter Mandelson (2004-08); *Trade, Growth and World Affairs* promoted by Commissioner Karel De Gucht (2010-14); *Trade for All* promoted by Cecilia Malmström (2014-)), answer this question in the negative; EU bilateralism, it is argued, is designed to promote multilateralism. The EU’s pursuit of PTAs since 2006 has been justified by the European Commission on the basis that deep and comprehensive agreements are compatible with and promote multilateralism. As the Secretariat of the World Trade Organization (WTO) reaffirms in its report on the Trade Policy Review of the European Communities of 2009: “[The European Communities] consider its preferential trade agreements as part of a broader policy of promoting multilateralism” (WTO, 2009: paragraph 25).

The Commission’s argument is that preferential agreements that allow for progress on what has previously been achieved at multilateral level (WTO+ topics), and includes areas not covered by the WTO (WTO-X items), are stepping stones rather than stumbling blocks to multilateral liberalization because they allow for more trade creation than diversion, and prepare the ground for the multilateralization of PTA provisions. In other words, the EU’s bilateral negotiations and agreements since 2006 are not only complementary to multilateral negotiations, but promoters thereof because they can be multilateralized.

On page 10 of *Global Europe* (2006), the European Commission specifically states that:

Free Trade Agreements (FTAs), if approached with care, can build on WTO and other international rules by going further and faster in promoting openness and integration, by tackling issues which are not ready for multilateral discussion and by preparing the ground for the next level of multilateral liberalisation ... To have a positive impact FTAs must be comprehensive in scope, provide for liberalisation of substantially all trade and go beyond WTO disciplines. The EU’s priority will be to ensure that any new FTAs, including our own, serve as a stepping stone, not a stumbling block for multilateral liberalisation.

The message remained the same in 2010: “the bilateral is not the enemy of the multilateral. The opposite may hold truer: liberalisation fuels liberalisation” (*Trade, Growth and World Affairs*: 5). Five years later the message was even stronger: “The EU needs to pursue bilateral and regional agreements in a manner that supports returning the WTO to the centre of global trade negotiating” (*Trade for All*: 29). This message has also been promulgated to European civil society organizations and environmental

groups concerned with negative effects of a patchwork of bilateral agreements on developing states and the environment (Maybe and McNaully, 1999; Hurt, Lee, Lorenz-Carl, 2013). Furthermore, to increase understanding of the Commission's approach civil society and environmental groups also gained enhanced access to the Commission through institutionalized Civil Society Dialogues beginning in 2010.<sup>3</sup>

While acknowledging that the European Commission's reasoning is sustained by a large body of literature, we challenge the claim that EU's bilateral approach never runs counter to its multilateral approach when PTAs include WTO+ and WTO-X issues (issues going beyond, or which are absent from, WTO agreements). We argue that while EU bilateralism may not only complement but even promote multilateralism, such developments are not guaranteed by the characteristics/nature of PTAs. Any provision of a PTA that makes technically possible the multilateralization of such an agreement is a necessary rather than sufficient condition for compatibility between the EU's bilateral and multilateral approaches. At least one more variable should be taken into account: the state of multilateral trade governance.

The literature addressing the compatibility between multilateralism and bilateralism/regionalism fails to account for how stalemate at the multilateral level impacts the ability to multilateralize bilateral and regional agreements. Our research seeks to bridge this gap in the literature. At a time when bilateralism appears most successful in the international trading system we draw on insights from the literature on the impact of the multilateral negotiations on the formation and objective of bilateral and regional agreements and add a new concept in order to evaluate bilateral trade policies from a new perspective. We argue that the ability of the EU's bilateral approach to promote multilateralism is contingent on the multilateral system of trade governance not being deadlocked. Our analysis thus contributes to the larger literature on the compatibility of bilateralism with multilateral trade agreements. By specifically looking at the EU in drawing attention to this gap our research also contributes to the EU trade policy literature.

This article proceeds as follows. In the second section the strengths of the European Commission's argumentation are spelled out by looking at its underlying premises. We thereafter turn to the limits of the Commission's hypothesis and the need to add a further variable (the state of multilateral trade governance) to the asserted compatibility between the bilateral and multilateral approaches. The fourth section presents insights on recent empirical developments in light of the new variable, while the fifth section concludes.

## **2. The European Commission's hypothesis**

Based on the EU's trade strategy communications noted above it is clear the Commission's line of reasoning is based on the hypothesis that *the compatibility of*

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<sup>3</sup> Evaluations of the impact of the dialogues and other background information contributing to this paper stem from personal interviews with numerous civil society organizations and pan-European labor union representatives, as well as members of the Civil Society Dialogue. Brussels, April, May and June, 2016.

*bilateral and multilateral trade approaches depends upon the nature of the bilateral agreements. The deeper and more comprehensive the regional/bilateral trade agreement (the more WTO+ and WTO-X), the greater the compatibility.* This hypothesis takes into account several decades of debate on the complementarity of bilateral and multilateral approaches to trade, addressed from different perspectives by experts in international law and international economic policy. It relies upon three premises. The first is that bilateral and multilateral approaches need not be mutually exclusive. The second premise is that preferential agreements have the capacity to either bolster or undermine the WTO depending on how they are designed. The third is that the potential technical feasibility of multilateralizing bilateral or regional agreements is ensured by the WTO+ and WTO-X nature of the agreements.

Regarding the first premise, currently all WTO member countries have at least one PTA with another member. As Lamy put it in 2002: “Half the world’s economists seem determined to prove that policy-makers should choose between being a multilateralist and a regionalist, and tell us that we can’t be both at the same time. The problem is that life is messier and more complicated than economic theory.” (Lamy, 2002:1400). Both instruments may be needed to deal with the complexities of an interdependent world. The multilateral trading system contemplates the possibility of breaking with its fundamental principle of non-discrimination in certain circumstances. Since its inception after World War II the General Agreement on Trade and Tariffs (GATT) allows for bilateral agreements establishing FTAs or customs unions through Article XXIV. In the 1970s, moreover, the GATT agreement introduced, as a result of pressure from developing countries, the possibility of granting special trade treatment to developing countries; the 1995 General Agreement on Trade on Services (GATS) allows for PTAs covering commitments in services (Acharya, 2016). Notwithstanding ambiguity in, and debate over the interpretation of, article XXIV (see e.g. Mavroidis, 2015; Hilpold, 2003), bilateralism and multilateralism have thus coexisted throughout the GATT/WTO’s history, and the bilateral exception has been extended to trade in services and granted especial treatment when the partners are developing countries.

The second premise of the European Commission’s hypothesis is that any regional/bilateral agreement can be designed so as to bolster or undermine the WTO because “the economics of regionalism is by no means unambiguously positive” (Lamy, 2002: 1410). From an economic policy perspective, analyses of the relationship between bilateralism and multilateralism are based largely on Viner’s (1950) argument that regionalism has the capacity not only to liberalize trade (trade creation effects) but also restrict it (trade diversion effects). Baldwin (2006), among others, argues that bilateralism and multilateralism feed back into each other, due largely to the trade creation that result from bilateral agreements. He deems the latter the potential building blocks of multilateralism in the medium to long term because they change the political economy forces within the countries involved by strengthening export sectors while weakening import-competing sectors. Others, such as Bhagwati (2008), argue instead that bilateralism erodes multilateralism due to trade diversion; that is, the inherent

discrimination in market access these agreements entail (cf. Armanovica and Bendini, 2014). From this perspective bilateral agreements are stumbling blocks to the multilateral system, part of an entanglement of agreements – “a spaghetti bowl” – that hinder multilateralism.

Since both the “stepping stone” and the “stumbling block” positions are based on empirical evidence, it is logical to assume that the content of a particular PTA determines its compatibility with the multilateral system: the more an agreement favors trade creation over trade diversion the more likely it is to support the multilateral system and vice-versa (Antimiani and Salvatici, 2015; Mavroidis, 2015; WTO, 2011).<sup>4</sup> In fact, Article XXIV only allows for bilateral agreements establishing FTAs or customs unions if they meet certain conditions:<sup>5</sup>

- 1) They must affect all commercial exchanges or an “essential” part of them.
- 2) In the case of customs unions, the common external tariff should not imply greater protection against third countries. If this is so, the union should compensate for the added protection with tariff reductions in other tariff headings.
- 3) Regional arrangements should be carried out within a maximum of 10 years.

Much the same can be said of Article V of the GATS. It permits the formation of “economic integration agreements” (preferential agreements covering services) only if they have substantial sectoral coverage, include the four modes of supply, and do not raise barriers towards non-signatories (Acharya, 2016). Bergsten (1997: 549) concludes his comparison of the “stepping stones” and “stumbling blocks” by saying:

The only irrefutable conclusion is that the interrelationship between regionalism and globalism depends on the management of the process by the countries involved. If they seek constructive synergism between the two, the historical record suggests that they can achieve it. If they wish to pursue one at the expense of the other, the outcome in earlier eras reveals that is quite possible too.

The third and last premise of the Commission’s hypothesis is that WTO+ and WTO-X regional agreements both favor trade creation over trade diversion and facilitate the multilateralization of their provisions.<sup>6</sup> WTO+ issues involve progress on market access

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<sup>4</sup> It should be noted that for some authors like Baldwin, trade diversion, that is, any bilateral or regional agreement containing inherent discrimination against third countries can actually encourage third countries to seek participation in the preferential agreement, and thereafter trigger a domino effect where others seek participation. This argument has further been developed by Baccini and Dür (2014).

<sup>5</sup> Article XXIV takes into account the *Understanding* signed in the Uruguay Round intended to clarify and specify some aspects of the article that had led to controversies and different interpretations.

<sup>6</sup> It should be remembered that “the EU has developed the position that it will wait to conclude a regional trade agreement until a country has become a member of the WTO” (Cremona, 2010: 268). In other words, EU’s PTAs are at least grounded on WTO commitments and disciplines. As Lamy (2002: 1408)

for both goods and services with provisions reducing or eliminating discriminatory measures (such as tariffs on goods) and/or regulatory convergence in the technical, sanitary and phytosanitary areas. WTO-X issues involve progress in rule convergence. Following the *World Trade Report 2011* (WTO, 2011), the main policy areas covered by WTO-X provisions are: competition policy, investment, movement of capital, and intellectual property rights not covered by the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). A second group of policy areas are sometimes addressed: environmental laws, labor market regulations, and measures on visa and asylum. The European Commission therefore assumes that the more ambitious the agreement in terms of regulatory and rule convergence, the more positive the net effect on trade creation and trade diversion and the more plausible the multilateralization of its provisions.

Since multilateralization occurs through the non-discriminatory extension of PTAs to additional trading partners (Baldwin and Low, 2008),<sup>7</sup> this rationale is supported for two main reasons. The first reason is that a large part of the reduction of trade barriers resulting from such PTAs automatically extend to the rest of the world. The WTO itself accepts that when PTAs focus primarily on reducing non-tariff barriers their results are expected to benefit third countries (less trade diversion effects), since: “By their very nature, some deep integration provisions are de facto extended to non-members because they are embedded in broader regulatory frameworks that apply to all trading partners” (WTO, 2011:168). Provisions regarding competition policy or state-owned firms, for example, would immediately benefit all foreign producers. Other deep integration provisions such as common standards are expected to have net trade creation effects (called ‘reverse trade diversion’ effects) with third countries after an adaptation period (Baldwin, 2011). As Mavroidis (2015:118) put it: “regulatory policies must be applied on a MFN [Most Favored Nation] basis even if contracted within PTAs.” Lastly, PTAs provisions regarding intellectual property rights must be implemented in a non-discriminatory manner vis-à-vis third country WTO partners because the TRIPS agreement does not have a general provision permitting WTO members to discriminate against each other (as GATT Article XXIV and GATS Article V do respectively for goods and services) (Acharya, 2016)

The second reason is that the EU’s complex network of bilateral/regional agreements can assist in the inclusion of new partners to WTO+ and WTO-X provisions (it is equivalent to open membership or to an offer to generalize the reduction of barriers to all non-members that agree to take similar steps). Several comparative analyses of EU PTAs with third countries indicate that, while the EU does not have a PTA model (unlike the US), its bilateral agreements would fulfill the requirement of being WTO+ and WTO-X (Acharya, 2016; Woolcock, 2007 and 2014; Horn et al, 2009). These studies show that the EU’s agreements are adjusted according to the partner and, in

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put it: “WTO rules constitute the floor in two senses: in the sense of basic minimum, but also in the sense of underpinning additional commitments at the regional level”.

<sup>7</sup> Such extension can occur “either through the inclusion of new members in existing agreements, or by replacing existing agreements with new ones that extend to new members.” (Baldwin and Low, 2008: 1).

particular, to the partner's level of development. Moreover, the EU does not use its rules aggressively with developing countries. These are asked, at least at first, to implement international rather than EU standards. Nevertheless, in recent years, the EU has been including WTO-X items in its preferential agreements negotiations with both emerging economies (Chile, South Africa, India and Brazil) and developed countries (Singapore, Canada, South Korea, Japan, and the USA), as well as with its traditional partners (new agreements with the countries of the southern Mediterranean).<sup>8</sup> Since these PTAs include deeper disciplines on the WTO-covered areas as well as beyond-WTO disciplines, their provisions should have the potential to become multilateral, especially if these provisions are similar across different bilateral or regional agreements (see e.g. Khorana and Garcia, 2014 regarding public procurement). Cremona (2010: 268) argues that through its deep free trade approach, the EU "is bilaterally and regionally building support within the WTO for its own regulatory positions."<sup>9</sup>

Mega-regional PTAs such as TTIP and plurilaterals such as the Trade in Services Agreement (TiSA) could therefore have the capacity to transform "spaghetti bowls" (chaos resulting from many different FTAs) into "lasagna dishes" (Estevadeordal et al., 2013; see also Acharya, 2016). These would be separate processes from the WTO but complementary in their aim of reducing transaction costs inherent in the "spaghetti bowls" (Trakman, 2008). As Abbott puts it: "The WTO might, in effect, 'free-ride' on all the PTA activity taking place" (2007: 582). For Mavroidis (2015: 119): "PTAs in a way are the hothouse where tomorrow's multilateral agenda is being tested." In fact, one frequent example of how bilateral agreements can be regionalized and even become multilateral is the creation of the pan-European system of rules of origin in 1997 (Baldwin, 2013; see also Acharya, 2016).<sup>10</sup> Moreover, in *Trade for All*, the European Commission explicitly commits itself for the first time to an open approach to bilateral and regional agreements so as to "develop contributions to address key challenges facing the WTO based on solutions achieved in bilateral and regional initiatives" (p.30). This open approach entails a readiness to enlarge its PTAs to third countries willing to join them (including the TTIP) and explore the possibility of extending "accumulation of origin" rules.<sup>11</sup> Sticking with the metaphor, creating lasagna would be a step towards the development of a multilateral super-pizza.<sup>12</sup>

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<sup>8</sup> According to Horn *et al* (2009), however, EU agreements show a significant amount of "legal inflation", i.e. commitments that are not legally enforceable.

<sup>9</sup> Research has identified certain patterns among groups of countries PTAs, or the existence of "families" in distinct geographical regions (Acharya 2016). Such families are usually the result of hub and spoke relationships.

<sup>10</sup> The system led to the homogenisation of the rules of origin the EU had agreed with eastern European countries through a system of diagonal accumulation creating a "customs union of rules of origin" in the words of Baldwin (2013: 6). The EU has extended this system of rules of origin to its Mediterranean partners and other bilateral agreements.

<sup>11</sup> Further, the Commission accepts that a plurilateral approach may be another step towards multilateralism. In *Trade for All*, the European Commission states its willingness to "support the objective of critical mass of members to advance initiatives within the WTO framework" (p.29)

<sup>12</sup> Another way to multilateralize bilateral agreements in the area of at-the-border barriers would be to make them irrelevant by binding "most favored nation tariffs" or WTO tariffs to zero for a set of goods (as the Agreement on Information Technology did in 1996). If tariffs are zero for all imports, irrespective

The fact that deep and comprehensive bilateral agreements are increasingly viewed benignly is in part due to globalization and the emergence of value added chains of production. Economic analysis has shown that multilateralism, by reducing tariffs, has enhanced the incentives for and the chances of implementation of PTA (Mavroidis, 2015; Freund, 2000). In order to be a competitive exporter in a context marked by transnational production chains a country must be a large importer, implying that a clear regulatory framework in areas such as services and investments would be necessary. The then Director General of the WTO, Lamy (2013) argued that this governance demand is being met through the conclusion of preferential agreements, the key condition being that these agreements promote coherence between divergent regulatory regimes.<sup>13</sup> Under such conditions, the preferential and multilateral approaches would be mutually supportive. This was in fact one of the recommendations presented in April 2013 by the reflection group on the Future of Trade established by Lamy in 2012 (WTO, 2013).<sup>14</sup> Regarding TTIP, a European Commission Economic and Financial Affairs Economic Brief (Galar, 2013) highlights that EU exports to and imports from the US are higher in value added than in gross terms. The author also contends that TTIP (as well as a bilateral agreement with Japan) aids the EU in strengthening global production networks and by so doing reinforces the case for multilateralism (assuming that these agreements are open to new members).<sup>15</sup>

To sum up, the European Commission rationale regarding the affinity between the EU bilateral strategy and multilateralism is based on a rich body of research on the effects upon the multilateral system, not only of preferential tariffs but also of deep integration areas regarding non-tariffs barriers and value added chains of production. Its bilateral strategy justification, including for TTIP, cannot be accused of lacking analytical support. However, in the next section we discuss a missing element which affects the link between bilateral agreements and multilateralism.

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of origin, granting bilateral or regional preferences would no longer make sense (Baldwin, 2006). This is in fact the case for nearly 50% of world trade.

<sup>13</sup> Along this line, Lawrence (2011: 2) points out that “The optimal area for trade might be the world, but global federal government is not widely seen as the optimal area for governance. Thus viewed as joint governance arrangements, a mixture of multilateral and regional arrangements may actually be first best”. In the words of Mavroidis (2015: s113): “The ‘natural’ place for deep integration is ‘clubs’ and PTAs are the club par excellence in practice.” Since negotiations on regulatory cooperation are more likely to succeed across like-minded countries, club arrangements are not only inevitable, but appropriate as well.

<sup>14</sup> Another group of reflection on how to strengthen the multilateral trading system, The E15 Initiative of the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, reached similar conclusions in December 2013.

<sup>15</sup> Though civil society organizations (CSOs) have voiced serious concerns about certain bilateral agreements they argue threaten workers and the environment (e.g. TTIP, see Eliasson and Garcia-Duran, 2016; Gortanutti, 2016; Gheyle, 2016), they remained subdued over others (e.g. EU-South Korea), and refrained from any opposition to many other bilateral negotiations (e.g. EU-Vietnam, EU-Japan). At the same time, in the case of EU relations with its most important trading partner the U.S., there is less of a distinction today between import competing firms and export dependent producers (Young, 2016); resulting in transnational coalitions advocating and promoting a bilateral agreement between two developed regions

### 3. The need for a better hypothesis

In this section, we discuss the limits to the European Commission's hypothesis and justify the need to include the multilateral context into the equation. The former is done by turning to the insights provided by detractors of the premises on which the European Commission's hypothesis is grounded. The latter is done by highlighting another body of literature that stresses that the multilateral regime may influence the formation and objective of bilateral or regional agreements.

Some researchers have argued that regional agreements, notwithstanding all the WTO + and / or WTO -X topics they may cover, may not promote multilateralism. As Bhagwati (2008: 94-95) remarks: "Lasagna cannot be made from spaghetti: it needs flat pasta. And pizza cannot be made from lasagna either!". Most observers agree that while there has been a wave of regionalism/bilateralism since the 1990s, what is observable empirically is less the extension (that is, by admission of new members; except in the case of the EU) than the proliferation of PTAs (Kono, 2007).

Moreover, deep and comprehensive preferential agreements can be designed to create new trade diversion effects, especially through different standards recognition schemes and a plurality of "rules of origin" rules. Blanchard (2015: 92) shows that "preferential agreements can allow governments to harness the trade liberalizing potential of [vertical] international ownership" by creating potential trade-investment complementarity. De Ville and Siles-Brügge (2015) argue that TTIP is unlikely to lead to global standards because the prevalent mode of regulatory cooperation will be neither harmonization nor *erga omnes* mutual recognition as in the European Single Market, but rather *bilateral* mutual recognition of regulations. In other words, these authors believe that most regulatory equivalence will not be extended to suppliers from outside TTIP, leading to what Lamy (2002: 1408) had called the danger of "regulatory regionalism". Trackman (2008: 377) adds the possibility of states using PTAs to shield themselves from sanction, that is, to disregard international instruments. As a result of such trade diversion effects, the adjustment costs (those incurred when transferring production factors across sectors) of a PTA are larger making it more difficult to reach a multilateral agreement (because the adjustment costs to be incurred to achieve global free trade have grown larger after a PTA implementation) (Antimiani and Salvatici, 2015; Mavroidis, 2015).

Furthermore, multilateralization may not take place even if bilateral agreements are technically compliant with multilateral rules; other forces and interests might push in the contrary direction. These agreements can divert multilateral negotiating capacity (what Bergsten (1997: 547) calls "attention diversion") and instead create valid alternative market access for key economic actors (Eliasson and Garcia-Duran, 2016; Conceição-Held, 2013). In Mavroidis (2015:114) words: "PTAs risk becoming the 'termites' of the world trading system not because of the trade diversion that they have provoked, but because of the forum diversion they represent." They can also provoke a negative reaction from third countries. Some economists argue that a multilateralization

of TTIP rules may not occur because China and other large emerging markets are big enough to reject an adaptation to TTIP rules – thus leading to global market fragmentation – even if they are not yet in a position to set up their own systems of deeper integration. While the exporters among the emerging trade powers will have to adapt to TTIP-based norms, their public authorities may reject them and “continue to attract offshored factories with a ‘my internal market for your factories and technology’ deal” (Baldwin, 2012: 20). On the other hand, such deep and comprehensive regional PTAs may set up overly forward-looking rules in areas that less developed economies would struggle to accommodate (Mavroidis, 2015; Trakman, 2008).<sup>16</sup> The countries that tend to lose most decision-making power in the context of bilateral negotiations are thus often the least economically powerful (González, 2015; UNCTAD, 2014; Bhagwati, 2008; Abbott, 2007).

These insights indicate that while the European Commission’s argument is plausible, there is no guarantee that its bilateral approach will feed its multilateral approach; put differently, there is a probability that bilateralism may not lead to multilateralization even in cases when such multilateralization is technically achievable. In the words of Ash and Lejarraga (2014: 81): “whether, when, and how to multilateralize WTO-plus and WTO-beyond provisions in PTAs is primarily a political question...” From this perspective, the European Commission’s hypothesis needs amending: the nature of a PTA, on which the hypothesis is grounded, should be deemed a necessary rather than sufficient condition. Which begs the question of what other necessary conditions should be included?

Baldwin and Evenett (2011) have argued that bilateralism can complement multilateralism when the multilateral system is active, and may be a substitute when the multilateral system is stagnant. In their words:

... regionalism per se was not the problem. Multilateralism and regionalism have gone hand in hand throughout the GATT/WTO’s history. Regional and bilateral arrangements were embedded in a vibrant and reactive multilateral system – a system that could and frequently did update its disciplines on preferential arrangements. Regionalism in a world where multilateralism was permanently deadlocked would be a very different proposition – regionalism would begin to act as a substitute to multilateralism rather than a complement (Baldwin and Evenett, 2011: 5-6).

A similar idea was put forth by Jeffrey Schott in 1995 in a paper presented at a seminar on trade policy issues at the International Monetary Fund Institute. The author claimed that while “regionalism and multilateralism [had] worked in lockstep since the founding of the GATT”, regionalism in the absence of a strong multilateral system “generates protectionist pressures to maintain the

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<sup>16</sup> Business Desk of *The New Zealand Herald*, “TPP risk weaker world trade system –ex WTO boss”, 21 July 2014. Interview with Dr Supachai, former WTO Director-General (2002-2005). As Lamy (2015: 6) explains, in the world of regulatory convergence special and differential treatment disappears.

discrimination inherent in preferential trading pacts (or even to raise barriers to third-country trade).” (Cited in Bergsten, 1997: 549, footnote 7)

The existence of a nexus between the multilateral context and bilateral agreements has also been underlined in other research. In their preliminary evaluation of the North American Free Trade Agreement (NAFTA), Bergsten and Schott argue that: “The startup of NAFTA negotiations in 1991 gave renewed impetus to the Uruguay Round in the GATT, which had stalled in 1990 because of US-Europe differences over agriculture, by reminding the Europeans that the United States could pursue alternative trade strategies” (1997: 3). The authors further argue that the congressional passage of NAFTA in November 1993 together with the launching of a new era of cooperation via the Asian Pacific Economic Cooperation (APEC) summit in Seattle “played a critical role” in bringing the Uruguay Round to a successful conclusion in the following month. In a similar vein, Doctor (2007) argues that the most active periods in the EU’s negotiation with Mercado Común del Sur (MERCOSUR) from 2001 to 2006 tended to coincide with peaks in perceived US influence in the zone, as well as with progress in WTO talks on the DDR. Regarding the latter, the author explains how “although neither side seemed willing to move forward while chances of a multilateral agreement remained alive, equally neither side wanted to abandon definitely inter-regional talks in case they proved to be the only alternative left on the table” (Doctor, 2007: 291).

Mansfield and Reinhardt (2003) argue that “developments at the heart of GATT/WTO encourage its members to form PTAs as devices to obtain bargaining leverage within the multilateral regime” (2003: 829). Reciprocal preferential arrangements is said to both furnish states with insurance against the emergence of conditions within GATT/WTO that could threaten their economic interests (such as a failure to reach agreement in multilateral talks) and provide them a greater voice in multilateral trade talks by increasing their market power. Mansfield and Reinhardt’s econometrical analysis indicates the periodic multilateral trade negotiations sponsored by GATT/WTO (data from 1948 to 1998) incentivize the creation of PTAs. This result has been vindicated by Baccini and Dür in a more recent quantitative analysis (with data from 1990 to 2007). These authors also find that “countries are more likely to sign an agreement in tandem with negotiations at the WTO level” (2012: 75).<sup>17</sup>

From a strand of the economic literature that focuses on how PTAs impact multilateralism come insights that in non-cooperative multilateral settings the emergence of PTAs can serve to push members to adopt higher tariffs on third countries

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<sup>17</sup> Gradeva and Jaimovich (2014) question the existence of such a link after 1993. The authors replicate the Mansfield and Reinhardt analysis including data up until 2007 (that is the DDR) and limit the PTA definition to effectively implemented FTAs and Customs Unions. They show that while their results are congruent with Mansfield and Reinhardt up until 1993, the correlation between multilateral negotiations and regionalism is not statistically significant from 1994 to 2007. The difference between Gradeva and Jaimovich’s results and those by both Mansfield and Reinhardt and Baccini and Dür may be due to the way each research defines PTAs. The narrower the definition (taking into account the year of entry into force rather than the year of signing the agreement or of starting negotiations for example) the weaker the correlation after 1993.

rather than to reduce their bilateral external tariffs. However, things change in a cooperative (feasible) multilateral environment. In such an environment "multilateral cooperation is actually more effective in bringing trade barriers down and enhancing global welfare when it is accompanied by regionalism" (Ornelas, 2008: 204).

Lastly, there are also insights from the international relations field regarding regime creation that help us understand the nexus between bilateralism and multilateralism. Keohane and Morse (2015: 17) argue that the alternative to established multilateralism is not only unilateralism or bilateralism but also what they call 'counter-multilateralism'. The latter occurs when, for example, the objective of the members is not to substitute multilateralism with bilateralism but rather to create an alternative to established multilateralism (in our case, the WTO); to create a new form of multilateralism through 'competitive regime creation' (Keohane and Morse, 2015: 22). Of course, not all bilateral agreements have the potential to be counter-multilateral, yet, as we have argued elsewhere (Eliasson and Garcia-Duran, 2016), TTIP could be such a bilateral.

Taken together, these studies highlight that the multilateral context has an effect on the compatibility between bilateralism and multilateralism. This effect may be positive or negative depending on the severity of the difficulties facing multilateral negotiations. When difficulties are moderate, a multilateral accord would be perceived as possible and members will negotiate bilateral agreements as a strategy to get agreement at the multilateral level, or at least as an insurance against a stalled and/or failing multilateral negotiations. When difficulties are too severe, however, members would negotiate bilateral agreements as a strategy to substitute multilateralism or even to create 'counter-multilateralism'. In other words, the greater the difficulties at the multilateral level, the greater the likelihood that bilateral agreements are not going to be integrated within the WTO framework (i.e. multilateralized). On the basis of this analytical understanding, EU bilateralism would be compatible with multilateralism (in the WTO) within a certain context, namely when multilateral negotiations are perceived possible; put differently, they are perceived not to have stalled for the medium or long-term, or to have failed. Table 1 summarizes this analytical insight using the building and stumbling blocks terminology.

Table 1. Relationship between bilateral and multilateral negotiations

Multilateral negotiations	Progress made and/or perceived as possible	Difficulties too severe (stalled or failed)
Incentive for bilateral agreements	Bilaterals act as building blocks for multilateralism (facilitators)	Bilaterals act as stumbling blocks to multilateralism (substitutes)

Source: authors' own.

The impact of the multilateral context on the potential for a bilateral agreement to be compatible with or promote multilateralism is separate from whether a PTA has the technical capacity to do so. Any bilateral agreement, including TTIP, could serve as either a strategy to reach an accord at the multilateral level or a substitute for the multilateral accord, independent of the WTO+ or WTO-X aspects of the agreement. The inclusion of the multilateral context does not predetermine the sign of the technical variable; the results of both variables are not necessarily correlated. The fact that an agreement is WTO+ and/or WTO-X does not preclude a negative multilateral context.

To sum up, the technical compatibility variable upon which the European Commission's hypothesis regarding the compatibility between its bilateral and multilateral approaches is grounded cannot be considered a sufficient condition. To improve the hypothesis other necessary conditions should be taken into account. As the hypothesis already includes a condition regarding the nature of bilateral agreements, we propose to include a condition regarding the nature of the multilateral context, that is, a condition linked to the other side of the coin. This condition is based on a developing body of literature on the nexus between multilateral and bilateral trade negotiations, and leads to the following new hypothesis: *the compatibility of bilateral and multilateral trade approaches depends upon the depth and comprehensiveness of regional/bilateral trade agreements (the more WTO+ and WTO-X the more possibilities) and the severity of the difficulties in multilateral negotiations.*

#### **4. Operationalizing the new necessary condition**

The literature does not provide a definition of what constitute “difficulties which are too severe”, or “stalled” multilateral negotiations, and the answer to this key question is not straight forward because stalemate is not uncommon in multilateral negotiations (Herwig, 2013). Since most GATT rounds tended to be declared “in danger” at different points in time even though they finally led to agreement (Mansfield and Reinhardt, 2003; Cohn, 2002), it is difficult to judge the severity of the challenges facing negotiations on the bases of the number of years without progress. It may be that one year of stalemate in the Uruguay Round (1986-1994) is equivalent to four years in the DDR due to the higher number of participants, the scope of the negotiations, or the impact of external events (the 2008 financial crisis).

Nevertheless, one would expect “difficulties which are too severe” to be apparent to participants and recognized as such by observers, which is to say, they recognize difficulties which prevent any possibility of agreement in the medium or even long-term. In the case of the DDR we can find such a period after agreement was nearly achieved in both July and December 2008 – “the most serious attempt to date to bring the negotiations towards finalization” (Ahnliid and Elgström, 2014: 81). Though the DDR was declared dead at various times by different analysts, such declarations became

*vox populi* after 2008 (Narlikar, 2012; Schwab, 2011). In fact, according to *Bridges Weekly*, January 11<sup>th</sup>, 2012, the WTO Ministerial Conference in December 2011 formally concluded that DDR was in a “stalemate”. Although the financial crisis that broke out in 2008 did not directly challenge the idea that trade should be as free as possible (Subramanian and Kessler, 2013; De Ville and Orbie, 2011), the subsequent difficulty of reaching any plurilateral or multilateral agreements put into question the ability of the WTO to be effective (Azevedo, 2015; Narlikar, 2012; Bhagwati, 2008). The difficulties achieving the mini-package agreement in December 2013 at the Bali Ministerial Conference did little to rebuild the WTO’s image (Herwig, 2013), and even if the Nairobi Ministerial Conference agreement (on agriculture, export subsidies, and issues affecting least developed countries) in December 2015 was a brief period of optimism, the sectoral agreements reached at the WTO Ministerial Conferences confirmed that the principle of a single undertaking (one large multilateral agreement) of the DDR is dead.

Further evidence of the level of severity of the DDR negotiation in 2009 is provided by the EU’s trade policy. If the difficulties had become too severe, one would expect the EU to have reacted. A lack of change in trade policy could be taken as a sign that the EU did not perceive difficulties as insurmountable, and that an agreement at the multilateral level that would have made possible the multilateralization of its bilateral agreements (at least in the area of market access), reducing potential trade diversion effects and making its bilateral strategy compatible with multilateralism, remained possible. Alternatively, a reaction or change in EU trade policy would have indicated that the difficulties had become too severe. In that scenario, bilateral agreements after 2008 would have been undertaken without any expectation of reaching a multilateral agreement in the medium term. If so, then the EU’s bilateral strategy after 2008 would serve as a substitute for multilateralism.

At first glance, it appears the EU’s most important change occurred with *Global Europe* in 2006 rather than after 2008. From the late 1990s to the mid-2000s, the EU had tried to “manage globalization” by centering its trade policy as never before on the multilateral approach (Meunier, 2007). Then Trade Commissioner Pascal Lamy froze the opening of new bilateral or regional trade negotiations (although it continued with those already initiated and did not close the door on other forms of regionalism; cf. Lamy, 2002; EC, 2002: paragraph 60; EC, 2004: paragraphs 61-62), while focusing on shaping the new multilateral agenda and multilateral rounds of negotiations. This despite both the US and Japan pursuing bilateral agreements at the time. Officially the EU relinquished its moratorium on bilateral agreements in 2006 with its *Global Europe* strategy, which explicitly recognized the need for the EU to sign PTAs with key partners. Since then the EU has continuously emphasized the need for bilateral agreements to serve its trade interests.

However, a deeper analysis indicates that further changes in EU trade policy actually occurred in 2009, with the EU changing its bilateral approach by shifting the focus back to its traditional trade partners (Garcia-Duran *et al.*, 2016). Observers agree that a break

in the structure of multilateral trade governance took place at the WTO Ministerial Conference held in Cancun in 2003, confirming dissatisfaction among certain members that originally emerged at the 1999 Seattle WTO Ministerial Conference (-cf. Evenett, 2003). Despite concessions to developing countries, consensus building in both the GATT and the WTO has largely been determined by the US, in later decades in collaboration with the EU, along with Japan and Canada – the so-called Quad (Ehlermann and Ehring, 2005).<sup>18</sup> The post-World War II structure of international trade was referred to as “the club model” where small numbers of rich-country trade ministers controlled the agenda and made deals because the fundamentals of their policies were cross-nationally consistent (Keohane and Nye, 2001).

In Cancun, India and Brazil led a new coalition called the G20 (it also included China, which became a WTO member in 2001), which rejected the agreement on agriculture proposed by the US and the EU, challenging the classic Western leadership on trade governance (Garcia-Duran *et al.*, 2014; Narlikar, 2011; Blackhurst and Hartridge, 2004). From 2004 onwards, new consensus groups in various formations emerged: the so-called “new Quad” (EU, US, India and Brazil), the G5 (with Australia), G6 (with Japan) or G7 (with China). Analysts speak of a period of “structural power shifts”, as the old Quad hegemonic position dissipated, but without a new power formation able to provide effective leadership on concluding the DDR (Barbé *et al.*, 2016).

It was in this new challenging environment that EU bilateralism was revived. The EU’s first reaction to Cancun was to consider whether to end its moratorium on PTAs. In an early 2004 publication, Lamy argued that a new strategy was needed for “harnessing globalization” because “Cancun was not just an accidental collision” and Europe had become part of a “cosmopolitical world” (Lamy, 2004: 19-20). In November 2003, in a communication on the EU perspective on reviving the DDR, the European Commission pondered ending the moratorium by asking member states “about the extent to which more emphasis should be given in the future to bilateral and regional trade negotiations” (COM(2003) 734 final: 3). In its 2004 report to the WTO on its Trade Policy, the then European Communities (EC; today EU) declared:

In addition to its support for the multilateral trading system the EC is engaged in developing trade relations with other trade partners in the world through a number of preferential trade arrangements, including bi-regional and bilateral free-trade areas, and bilateral agreements aiming at facilitating cross border trade with the EC’s closest neighbours (EC, 2004: paragraph 61)

After officially ending its moratorium on bilateral agreements in 2006 the EU first focused on the emerging economies (cf. EU, 2007: paragraph 28), but after the 2008 failure to reach an agreement in the DDR the EU shifted the focal point back to the members of the old trade “club” that had controlled the governance of the trade

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<sup>18</sup> On the formation of the Quad see Cohn (2002).

multilateral system up until Cancun (cf. EU, 2011: paragraph 59). In order to better to serve the EU's main trade interests, *Global Europe* (2006) identified so-called "future major trading partners" in Asia and America as key partners; the EU started negotiations with India, Association of East Asian Nations (ASEAN), and South Korea, and tried to revitalize its negotiations with MERCOSUR.<sup>19</sup> In *Trade, Growth and World Affairs* the EU maintained the need for bilateral agreements to serve EU trade interests but changed the target of the agreements. Since 2010 it has focused on reaching agreements with the Old Quad members: Canada, Japan, and most importantly the USA through the TTIP negotiations. *Trade for All* (2015) reemphasized their importance.<sup>20</sup>

This new focus of EU bilateralism is less conducive to multilateralism (WTO wide agreements). While bilateral agreements with emerging economies could not offer an alternative to a DDR agreement since the value added of PTAs with emerging economies was relatively small, PTAs with old Quad members affect much larger markets, and could thus make the EU less dependent on multilateral agreements (Garcia-Duran *et al.*, 2016). To put it in negotiation terms, emerging market economies do not offer the EU a BATNA, that is, a best alternative to a negotiated (multilateral) agreement, contrary to agreements with Canada, the US, and Japan.<sup>21</sup> Agreements among the latter can set precedence, establishing rules and norms that become globally applicable, something bilateral agreements with emerging powers cannot accomplish. In fact, emerging countries do not want to reach agreements on the areas of focus to as the opposition to most of the "Singapore issues" (investment, competition policy, government procurement, and trade facilitation, Woolcock, 2013).

Developed members seek agreements on these advanced issues. When investor protection was proposed for TTIP, and notwithstanding the long established and prevalent practice of including of investor to state dispute settlement systems (ISDS) in EU member states' Bilateral Investments Agreements (BITs), opposition mounted from hundreds of non-governmental organizations and unions across Europe against its inclusion in TTIP (and by extension to CETA). This became one of the largest obstacles to completing the agreements, causing an 18 month pause on negotiating the investment chapter in TTIP in 2014-15 and contributing to a freeze in negotiations declared in November 2016 (Eliasson, 2016; Garcia-Duran and Eliasson, 2017). The EU responded by proposing to include in all their ongoing bilateral negotiations a new way to solve disputes between companies and states, by proposing significant alterations to filing procedures, transparency, government rights, mediation, as well as a permanent

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<sup>19</sup> China was to receive special attention: relations should be enhanced but no FTA was considered.

<sup>20</sup> The 2009 Lisbon Treaty also awarded the EU (Commission) responsibility for FDI, but without clarifying how such competence should be administered. A 2012 Directive clarified that all agreements affecting investments signed after December 1, 2009 would be subject to approval by the Commission, while all existing investment agreements remained in effect and responsibility of the signatory Member State(s) until they were found incompatible with EU law or replaced by EU treaties with the involved countries (EU, 2012). Thus investor protection was part of the Singapore, Vietnam, and Canada agreement, and proposed for TTIP.

<sup>21</sup> One could argue that this is not the case with China, but the EU did not contemplate an FTA with China.

international court to ultimately solve disputes between investors and states. In short, through its bilateral agreements with its traditional trade partners the EU can propose an alternative to achieving multilateralism on investment protection the WTO way; a form of counter-multilateralism.<sup>22</sup>

One could therefore surmise that while the bilateral negotiations the EU began in the mid-2000s were not intended to substitute for a multilateral agreement, the new-generation FTAs the EU has sought to establish with non-European developed countries since 2008, including TTIP, and in a context of stalled multilateralism, could be attempts to substitute rather than promote multilateralism (or, in the case of the TTIP, to create counter-multilateralism). While the EU was convinced that a DDR agreement was possible (up until 2008), it focused its efforts on accommodating emerging economies. Once the prospect of a DDR agreement receded, the EU shifted the focus of its efforts to partners that could offer key market access and regulatory convergence, that is, to a second best solution. Thus, the technical potential to multilateralize from bilateral agreements is insufficient to ensure that its bilateral approach complements WTO multilateralism (let alone promote it).

## 5. Conclusion

The European Commission has repeatedly argued since the mid-2000s that bilateralism and (WTO type) multilateralism need not be mutually exclusive, and that the key condition for compatibility is whether preferential agreements have the technical capacity to bolster or undermine the WTO. As new EU bilateral agreements allow for greater trade liberalization than existing multilateral accords, they may serve as a form of enhanced cooperation which could later be multilateralized. This paper has not disputed this possibility or scenario. On the contrary, it has recognized that it is based on a solid body of research, and that the nature of any agreement (WTO+ and WTO-X) should be taken into account when assessing the compatibility between bilateral and multilateral trade approaches.

This paper however has challenged the comprehensiveness of the European Commission's argument. It has argued that the potential for multilateralization of PTAs is not a sufficient condition for compatibility with its (WTO based) multilateral strategy and proposed a new independent variable to complete the analytical equation: level of severity in multilateral negotiations. The inclusion of this new variable is justified by a body of literature that indicates that there is a link between multilateral negotiations difficulties and bilateral agreements objective. This literature indicates both that difficulties in multilateral negotiations lead toward new bilateral agreements and that when these difficulties become too severe bilateral agreements become substitutes for a multilateral agreement (or even counter-multilateralist).

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<sup>22</sup> This did not satisfy opponents and some academics also called for all forms of ISDS to be dropped from TTIP, and thus accept existing BITs with ISDS (Kleinheisterkamp, 2014; Koskenniemi, 2014; interview Commission adviser, May 2016).

To establish whether the stalemate of the DDR from 2008 to at least 2015 can be considered to represent a period of “difficulties which are too severe” from the perspective of the EU, we have used a proxy. We have looked at whether the EU has changed its trade policy from that moment. Since 2006, the EU reaction to difficulties in the DDR seems to have been the same: bilateral agreements. Yet, from 2006 until 2009 the EU sought bilateral partners among new important trade players (India, ASEAN and South Korea), while since then the EU has focused on reaching agreements with the old Quad members (Canada, Japan and the USA) which are even more important trade partners. Following the analytical logic of this paper, this change indicates that EU bilateral agreements initiated in the twenty-first century can be justified from the perspective of the WTO multilateral system until 2008. However, EU bilateral agreements or negotiations since then should be seen as substitutes for a multilateral strategy (or in the case of TTIP, counter-multilateralist).

These results help explain the language in *Trade for All*, specifically the need to pursue bilateral and regional agreements in a manner that supports returning the WTO to the center of global trade negotiations. They are also in line with the conclusions reached by some authors (Siles-Brügge, 2014; De Ville and Orbie, 2011) that policy-makers in DG Trade at a time of economic crisis are being more sympathetic to the arguments of exporters than import-competitors. They are also in alignment with recent research on how the reciprocity agenda of the EU varies depending on the degree of economic development of the partner. Following Woolcock (2014), market access interests play less of a role the less developed the partner is that the EU deals with, and vice-versa. Finally, as trade and globalization became “dirty words” in the 2016 and 2017 elections in the US and Europe, the guardians of the international trading system, more research on the issue of when and how bilateralism is compatible with multilateralism, how the former can promote the latter, and their general interrelationship should be welcomed. This paper is one contribution to this debate.

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