Title page:

Modern Free Trade Agreements From Law and Development Perspective – A Critical Appraisal

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SHORT BIO: Matjaz Nahtigal received his SJD at Harvard Law School in 2001. His dissertation analyzed large scale institutional and legal reforms in Central and Eastern Europe. He has long interest in the area of institutional reforms, law and development and international economic integration. Currently he teaches European and international economic law at the Faculty of Management, University of Primorska, Slovenia.

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Abstract

The main purpose of this paper is to show that a variety of institutional models of capitalism does not necessarily stand in opposition to improved systems of cooperative economic governance and to the future development of the international trade regime. The goal of deeper integration at the regional level (for example, the European Union), at the transatlantic cooperation level (the most recent Transatlantic Trade and Investment Partnership initiative) and at the global level (the incomplete Doha development round) should not be a simplified process of just removing the remaining trade and non-trade barriers. The goal should be to secure more balanced, inclusive and sustainable development at the regional level, in the context of transatlantic cooperation and especially at the global level. In international trade talks, it is frequently underestimated that any kind of trade agreement, no matter how carefully crafted, creates strong distributional effects. In promoting trade agreements, mainly the positive effects and benefits are highlighted, while the negative effects and losses are mostly overlooked. As witnessed in recent decades, the trade agreements lack sufficient safeguards to compensate the industries, employees and local communities that lose their competitive edge. Subsequently, new rounds of trade talks at the global, transatlantic or regional levels start to lose their appeal in the eyes of large segments of workers, farmers, small entrepreneurs, consumers, environmental non-government organizations and others. The one-sided effects of trade liberalization in recent decades have frequently led to a concentration of economic benefits and technological advancements in the hands of a relatively small number of the most competitive regional areas. Many other regions, localities and large segments of society remain excluded from the benefits of deeper economic and legal integration.

The difference between the post-war development of international legal trade regimes and the context of the most recent free trade initiatives is that the disparate effects of trade liberalization tend to also become more visible in the most advanced economies in the world, in the United States and the European Union. This trend requires rethinking of trade arrangements that would provide adequate instruments, tools and policies when needed for restructuring. Careful calibration of such instruments, tools and policies not to distort, but to strengthen international trade, is something that can be called a “Bretton-Woods compromise” for the 21st century. It could provide an international legal framework conducive to long-term sustainable development and more resilient in different types of international financial crises that may appear in the future. The most important challenge in the process of deepening and widening the economic and legal integration is how to disseminate economic, technological, financial and other benefits to the excluded regions and parts of the population. The prevailing notion that any deepening of economic integration may lead to the "race to the bottom" via undermining the existing economic and social security should be addressed by policymakers. Comprehensive efforts to disseminate the benefits as widely as possible should be applied at the local, national and international levels. In doing so, local communities should be encouraged to launch different development strategies suitable to their comparative advantages, their potential and their needs.

Contents

Introduction

The three most important trade initiatives since the beginning of the new millennium are the Doha development round, the Trans Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP). While the Doha development round has remained incomplete, the fate of the last two initiatives remains uncertain.

The question for the academics, trade experts and policy-makers from around the world should not be a one-dimensional dilemma between trade liberalization and protection. Instead, the debate should focus on the issue of how to secure international trade integration while maintaining room for domestic institutional innovations and for local and regional development strategies.

The post-World War II liberalization of trade undoubtedly opened up immense opportunities for industries from both developed and developing countries to gain benefits.[1] (World Trade Organization, 2015, The WTO at Twenty: Challenges and Achievements)The classical conflict between protectionism (in the form of import substitution strategy mainly in Latin America) and liberalization (in the form of free trade strategy pursued by East Asian countries, while retaining domestic control of strategic companies and industries) turned into apparent success for the latter.

The subsequent rounds of trade negotiations led to an increasingly formalized international trade framework, to expansion of membership in the World Trade Organization (WTO) and to further reduction of tariff and non-tariff trade barriers. In recent years, many difficulties of a conceptual and practical nature started to emerge. One such difficulty stems from outside the relative success of Brazil, Russia, India, China and South Africa (BRICS), not many countries and regions from the developing countries were able to escape from their peripheral economic and social positions. This observation applies to many developing and middle income countries around the world.[2] The pathways from the periphery are always difficult in any given historical and normative context, but the recognition that the current international trade regime is not sufficiently conducive to overall international economic development became most visible with the adoption of the Doha Declaration. The Ministerial Declaration, adopted in 2001, emphasized that the 'World Trade Organization has contributed significantly to economic growth, development and employment throughout the past fifty years…, but at the same time has recognized 'the need for all our peoples to benefit from the increased opportunities and welfare gains that the multilateral trading system generates'.[3]

As is now known, the Doha trade round (a pro-development round) has failed to complete its mission after many rounds and high-level meetings. However, the international economic, political and normative context has changed significantly for both the developing and the developed parts of the world. Therefore, even if any kind of new global, 'development friendly' agreement had been reached in the last decade, many of the original assumptions of the Doha round have changed to such an extent that a new agreement for the first half of the 21st century would have very likely been necessary in any case.

The alternative to the incomplete Doha round was a subsequent decision to negotiate bilateral and regional trade agreements. Especially, the two leading trading blocs, the European Union and the United States, were active. In addition, the two trading blocs and the large Pacific rim trading bloc (notably with the deliberate exclusion of China[4]) opted for a direction toward regional free trade agreements with a comprehensive regulatory framework. The TPP was even declared as a gold standard for all other future free trade agreements around the world. After years of trade negotiations without sufficient public scrutiny (a pattern that developed in the past), today the NGOs, the international civil society and other social actors have grown more sensitive to the important details of any contemporary trade agreement. Not only the marginal social groups, but also many of the mainstream representatives, experts, social actors and policy-makers started to become critical of many of the agreed clauses, principles and standards included in the trade agreements.[5]

The reasons why the traditional arguments in favor of free trade agreements are being confronted with more critics and unresolved dilemmas than in the past can be summarized in the following three ways. First, the gains from free trade agreements frequently turn out to be smaller than anticipated at the adoption of agreements, whereas certain unanticipated costs may have greater impact on the firms, distribution of incomes and the level of employment. Second, gains from free trade often accrue mainly to the privileged segments of economy. Third, in a period of economic crisis, the entire economy and society can be exposed to the economic hardship.(Summers, 2015, A setback to American leadership on trade)[6]

Good, Bad and Mediocre Free Trade Equilibrium

In modern trade theory, comprehensive modeling based on empirical data has led to the conclusion that there is more than one possible outcome of free trade agreements. William Baumol and Ralph Gomory came to the conclusion that multiple outcomes of free trade agreements with multiple equilibria (good, bad and mediocre) are possible.(Gomory, 2000, Global Trade and Conflicting National Interests)[7] They emphasized that free "trade is not always and automatically benign".[8] To reach a good equilibrium (a situation of mutual gains for the trading partners), many elements need to be carefully calibrated. Among them is the need for an active role of governments in supporting the moves toward the good equilibrium. The gains of trade are not only a matter of individual firms and industries, as they affect entire national incomes in various ways.[9] Moreover, the trading partners should take into account the interests of other partners and not only their own.

The reason why in modern trade theory and practice there is more than one single outcome, but multiple outcomes with multiple possible equilibria, is that unlike in classical trade arrangements run by market forces and the invisible hand, the modern comparative advantages are based on knowledge-based economies and societies. These advantages are not inherited, but they are invented and constructed, often through the partnership between the public and private sectors.[10] (Unger, 2007, Free trade reimagined: the world division of labor and the method of economics)In the words of Baumol and Gomory, high start-up costs and learning may lead to the establishment of the so-called retainable industry: “A retainable industry, because of its high real start-up costs, offers the current established producers a substantial degree of protection from competitive entry, making it easier for them to retain their position… Market forces in retainable industries tend to perpetuate the status-quo.”[11]

The shift from classical to modern trade arrangements indicates the end of classical free trade agreements. The classical free trade agreements should be revised to establish whether they produce outcomes of mutual interest or lead to the zone of conflicts. As emphasized by Baumol and Gomory, in modern trade arrangements “there can be inherent conflicts as well as mutual gain for nations engaged in global trade”.[12] In searching for a better equilibrium, one should move beyond the “mistaken impression that maximizing world output automatically maximizes national prosperity”.[13]

Perhaps in the past, the critical assessment of the underlying assumptions on which the free trade agreements were founded did not receive the necessary scrutiny because they did not significantly affect the advanced sectors of industry in the leading industrial countries. With the emergence of knowledge-based societies, with the increasingly important role of the large emerging countries from BRICS (especially China) and with the growing anxiety of the relatively privileged sectors of economy and society from the leading industrial countries, the opportunity emerges to carefully reassess the achievements and failures of the traditional free trade agreements. The next step should be to start carefully calibrating the future trade agreements with less focus on maximizing world output and with more focus on securing sustainable, balanced and inclusive development at the local, regional and national levels of both the developed and the developing parts of the world. Such an approach might be called a search for the new Bretton Woods compromise for the 21st century.

In the following sections, the missing elements of the failed Doha round to make it truly development friendly are discussed. In the next section, some of the most important implications of the rise of BRICS countries, especially China, are presented. In the subsequent section, the growing anxieties in the leading industrial countries are addressed. Finally, the opportunity to develop a compromise based on mutual interests and positive outcomes for the partners from developing and developed parts of the world are put forward.

Diminishing Expectations from the Doha Development Round: How To Approach Genuine Development Talks Beyond It

In the Doha Ministerial Declaration adopted in November 2001, the words "development" and "developing" were repeated 39 and 24 times, respectively, in 52 paragraphs. In a reference to the Marrakesh Agreement, the commitment that developing and especially, the least-developed countries secure a share in the growth of world trade, was reiterated. Their improved position should be achieved by enhancing market access, by providing balanced rules and by well targeted, sustainably financed technical assistance and capacity-building programmes (paragraph 2).

The recognition of the Doha Ministerial Declaration was that the interests and positions of many parts of the world were not sufficiently taken into account and that the international trade arrangement, as well as international monetary, financial and broad economic framework, led to highly unbalanced and unequal overall development.(Lewis Kolsky, 2011, The Politics and Indirect Effect of Asymmetrical Bargaining Power in Free Trade Agreements;Lewis Kolsky, 2011, The Politics and Indirect Effect of Asymmetrical Bargaining Power in Free Trade Agreements)[14] This recognition did not relate only to the area of agriculture, where the two major trading blocs were able to secure many privileges and exemptions, but to all other areas of economic activities and the principles, rules and mechanisms of international trade law.

Original expectations from the Doha development round were immense. They were supported by some of the early assessments and anticipations about the potential gains from this round of trade talks. However, it soon became clear that the trade talks turned out to be highly complex. The immense complexity of the trade talks with 153 highly diverse countries in terms of size, overall level of development, climate conditions and social inequalities did not necessarily mean that the members of the WTO could reach a new agreement. It should have been taken into account that the developing countries themselves were not a homogeneous block. There are the least developed countries with little to export and the middle-income and fast growing developing countries, determined to fully and completely integrate themselves with the world markets. On top of that, there are growing internal inequalities in countries, such as China and India, and the way these countries continue to integrate with the world markets has a substantial internal distributional impact on their domestic production, on the regions and on the people.

In the area of agriculture, as one main focus of the Doha trade talks, many of the complexities soon became apparent. For example, it became clear that any future liberalization of agriculture will mostly benefit consumers and taxpayers of the developed world. Much less will it benefit the poor agricultural producers in the developing countries, with the exception of the most productive agricultural countries.(Birdsall, 2005, How to Help Poor Countries.)[15] Birdsall highlights only some the complexity of the trade talks and why careful calibration of the rules can have a decisive impact on who may really benefit from a certain arrangement. However in the interim period, the agriculture subsidies and import tariffs by the EU and US remain in place with all of their divergent impacts on the global agriculture.[16]

At the beginning of the trade talks, the estimates of the positive trade gains, especially for the developing countries, were huge; even several hundreds of billions were cited. Gradually, more realistic assessments, based on a more sophisticated model, were made. For example, based on a critical assessment with the help of 'computable general equilibrium' (CGE) trade models, the trade gain estimates from the Doha round became significantly more modest. Not only did the aggregate gains become very small, these gains became particularly small for the developing countries.(Ackermann, 2008, The Shrinking Gains from Global Trade Liberalization in Computable General Equilibrium Models)[17]

With each round of trade talks, the anticipated gains were not only shrinking, but the distributional effect in creating winner and losers of the trade talks became more visible. Sandra Polaski made an important econometric analysis under many plausible scenarios, according to which the Doha round would produce only a modest one-time increase in world income of $40 – $60 billion USD, which represents less than 0.2 percent of global GDP.[18] (Polaski, 2006, Winners and Losers: Impact of the Doha Round on Developing Countries) Adjustment costs for the developing countries need to be taken into account as well. From her econometric model measuring different possible scenarios of the Doha round, one can see that China as the developing country with the largest population, which also has a large pool of very poor people, benefits the most. Many other developing countries may be even worse off because, for example, they may lose unskilled jobs in manufacturing. The most developed countries would also benefit under any of the scenarios. Small gains would come mainly from the liberalization of manufacturing.[19]

Each round of trade talks has strong distributional effects; each round of the Doha trade talks resembled a more regular pattern. The consequence was that only a handful of developing countries were able to escape the peripheral status in the global division of labor. Among the middle income countries, the frequent tendency is that after a period of growth and development, they are confronted with the ‘middle income countries trap.’ In such a situation, the middle income countries cannot move upwards to become internationally fully competitive, whereas the pressure from other developing countries forces them to adjust their relatively high labor costs again downwards.

Regular trade talks without sufficient emphasis on the various needs of the developing countries can contribute only to the maintenance or even widening of the North - South divide, with a few notable and important exceptions in the developing countries. Moreover, the strong distributional impact can lead to the further entrenchment of the rigid global division of labor.

From the enlightened cosmopolitan perspective,(Sutherland, 2005, The Doha Development Round Agenda: Political Challenges to the World Trading System - A Cosmopolitan Perspective)[20] which takes into account the interests and needs of both developing and developed parts of the world, the question should therefore be what a genuine development round of trade talks would really look like. This is the question that was asked by Joseph Stiglitz and Andrew Carlton as well as many other experts from different parts of the world. Stiglitz and Carlton did not take into account only the area of agriculture, which is highly important for many developing countries and rural areas in the leading two major trading blocs, but also the framework to secure gradual advancement in various industries in developing countries.

To move beyond the impasse of the Doha round, the development round would have to more effectively address diverse situations, levels of development, comparative advantages and disadvantages to provide a framework for a more inclusive, balanced and pluralistic arrangement. The major concerns for the developing countries, as identified by Stiglitz and Carlton, are non-tariff barriers, intellectual property, migration, unskilled intensive services, and agriculture.(Stiglitz, ;Stiglitz, 2005, Fair Trade For All)[21] In all these areas of major concern, the founding principles of a fair agreement would be the following: 1) any agreement should be assessed in terms of its impact on development; 2) items with a negative effect of development should not be on the agenda; and 3) any agreement should be arrived at fairly.[22]

If the founding principles and procedures on how to reach a fair agreement would have been observed on commonly agreed values, the talks, negotiations and outcomes of the Doha round would have looked significantly different. At the end, the details of an agreement made a key difference between the development 'friendly' round and the less development 'friendly' round. Many trade experts around the world are of the opinion that such a balanced, fair and genuinely pro-development round would present a 'win-win' situation not only for the developing countries, but also for the developed parts of the world.(Singh, 2005, Special and Differential Treatment: The Multilateral Trading System and Economic Development in the Twenty-first Century)[23]

The area of agriculture is very important for many developing countries. According to the Stiglitz and Carlton analysis, it represents almost 40 percent of their GDP, 35 percent of exports and 70 percent of employment.(Stiglitz, 2005, Fair Trade For All)[24] There have been a number of recommended proposals on how to ensure that the liberalization in agriculture would have the largest positive effect on producers and the smallest negative effect on consumers. For example, this may affect the poor people in the inner cities, as opposed to the poor people in the rural areas, by differentiating among crops and countries. The emphasis should also be on the importance of adjustment assistance, which would need to vary among developing countries, depending on the magnitude of the adverse effects.[25] Another important area is the industrial development in the developing countries. Here, there are many issues that make climbing the ladder of industrial development increasingly difficult. One of the problems is how to overcome the tariff escalation. On average, the tariff rates are at the lowest levels in history. However, often in practice higher tariffs are imposed on the output of manufactured goods than on primary. By applying the effective tariff rate or the tariff peaks, the developing countries are often discouraged to move to the higher value added products. Various categories of non-tariff barriers, such as dumping duties, countervailing duties, safeguards in cases of surge of imports and similar ones, further constrain the possibilities of many of the developing countries to escape from their peripheral status in the world economy and trade.[26]

Most important and difficult, at least from the formal legal perspective, is the need for the developing countries to establish broader policy space and to develop more instruments and policies, in short, how to articulate a qualified principle on special and differential treatment (S&DT). This is difficult to articulate and incorporate in the legal texts, and even more difficult to implement in practice. Originally, GATT Article XVIII on the protection of infant industry was used as a form of broader policy space for the developing countries. The Article was modified in 1954-55 with Section B on quantitative restrictions on imports in case of balance of payments difficulties. In 1965, the concept of non-reciprocity was introduced in GATT. Finally, a framework agreement on S&DT was adopted during the Tokyo round in the 1970s.[27]

However, S&DT provisions pose many difficulties in practical enforcement. Many of the provisions are voluntary and not legally binding; the language of S&DT provisions is imprecise and many regional trade agreements narrow its scope.[28] As a consequence, it is difficult for the developing countries to articulate and implement trade and development policies that would exploit the potential of the S&DT provisions in a way that articulates diverse development strategies, based on their own comparative advantages and tailor-made solutions.

In the Doha Ministerial Declaration, the importance of the S&DT provisions was not only reiterated in par. 44 of the Declaration, but also the need to strengthen these provisions and "making them more precise, effective and operational" was emphasized. Despite this important recognition, the subsequent theory and practice of international trade regimes do not provide sufficient and necessary policy space, instruments and tools for most of the developing countries to escape from the fate of stagnation and backwardness.

The areas of agriculture, industrial development and broader policy space according to the qualified SD&T principle should all be put on the table for a truly development friendly Doha trade round.

Emergence of BRICS and the Rise Of China

To make the context of international trade and the processes of globalization more complex, one needs to take into account the emergence of the BRICS countries, especially China. The integration of large and historically marginalized third world countries to the international trade, financial and monetary arrangements in many ways redefine the international trade, financial, monetary and other rules. Their integration has an important influence on global labor standards, financial (in)stability, environment, migration flows and exploitation of natural resources, including energy and many other important aspects. The way of how to accommodate large and fast developing countries, such as China, India, Brazil and Russia, in the context of a modern international legal framework will have a profound effect on the future shape of global economy, trade, finance and other aspects.

The attitude toward the fast development of China has changed in recent years. There are several reasons for this shift. One is the fast increase of China's share in world trade. Another is a staggering growth of China's exports to the United States.(Autor, 2013, The China

Syndrome: Local Labor Market Effects of Import Competition in the United States;Autor, 2013, The China Syndrome: Local Labor Market Effects of Import Competition in the United States;Autor, 2013, The China Syndrome: Local Labor Market Effects of Import Competition in the United States;Autor, 2013, The China Syndrome: Local Labor Market Effects of Import Competition in the United States)[29] Even more important is the unexpected fast development of the high-tech and high value industries, which were until recently dominated mainly by the Western companies. One such area is the production of solar panels. German manufacturers and their managers were convinced that the German and other European consumers would not be interested in buying Chinese products that would last more than twenty years.

However, it has turned out that this prediction was wrong. Chinese manufacturers, such as Suntech, JA Solar, Yingli Green and others, outperformed German and other manufacturers. Some of the leading German manufacturers ran into economic difficulties and even insolvency. According to the available data on China's solar-cell progress, the "production rocketed from just 50 megawatts of generation capacity in 2004 to 23,000 megawatts in 2012, by which time it was supplying more than 70 percent of the world market."(Crooks, 2015, Sunshine revolution: the age of solar power)[30] Some analysts are convinced that the success of China's manufacturers of the solar panels can at least be partly attributed to the low costs of labor and to low standards of environmental protection.[31] As a consequence, anti-dumping investigations were launched by the US and EU and duties on Chinese solar imports were imposed. Readiness to reach amicable deals was expressed by the trading partners. In the meantime, new large contracts for solar projects were agreed in Brazil, South Africa and the United Arab Emirates. Moreover, China itself presents a huge market as the world's biggest buyer of solar panels.[32]

This example with the production of solar panels shows how rapidly the shape of the world markets is changing not only in low-skilled and low-wage industries, but also increasingly in high-skilled industries with high added value. This is a new and dynamic equilibrium that requires constant evaluation, assessment and collective ability to reach agreements, policies and directions of development with maximum gains for all the participants.

While embarking on the path of reforms since 1979, China developed many innovative approaches and institutions unfamiliar to the Western world. For example, township-village enterprises developed in rural areas of China and became one of the early and most important vehicles of China's dynamic economic development.(Cui, 1998, Wither China? The Discourse on Property Rights in the Chinese Reform Context)[33] Unlike in Central and Eastern Europe, where mass privatization with the goal of establishing clearly defined property rights was the key strategic tool for international economic integration, in China no similar efforts in mass privatization and establishment of clearly defined property rights were made.

The main innovation of township-village enterprises (TVEs) was that the boundaries between the internal interests of workers with outside members of the community.[34] It created an entrepreneurial environment of flexible specialization that stimulated innovations, improvements in organization of production and adaptation to local needs and circumstances. Moebius-strip organizations, supported by local authorities and financed with the help of local cooperative banks, permitted local populations to gradually abandon farming without leaving the rural areas. Millions of TVEs, cooperating and competing among themselves, were one of the key vehicles of economic transformation of China in its early period of reforms, without implementing the process of mass privatization that took place in Central and Eastern Europe.[35]

Gradual, piecemeal and cumulative transformation that started with land reform, support for entrepreneurial spirit in rural areas of China and high quality of local institutions and education were among the key reasons for the social and economic rise of China, at least in the first two decades since the beginning of reforms. On the other hand, export-led growth, based on the supply of cheap labor and low-skilled assembly of products for the Western markets led to many internal economic and social imbalances, as well as contributing to the global structural imbalances.

During the recent period of global financial crisis, in the absence of a global coordinated response, China launched its own stimulus program with the aim to strengthen domestic development in inland China and to raise domestic consumption. The purpose was to become less dependent on exports, to support more balanced internal development and to improve the overall level of domestic wellbeing. However, even after investing heavily in improvements of infrastructure (high-speed railways, highways, airports, inner large cities across China) many imbalances remained. This is despite supporting development of large sprawling centers, such as Chongqing, based on the coexistence of public and private sectors, supporting the combination of urban and rural development and supporting the improvements in environment (for example, by spending $1 billion USD annually to plant new trees). Many imbalances in the areas of social inequality, gaps between rural and urban development, gaps between development levels of various regions and environmental and energy issues remain in place.[36]

Therefore, one of the biggest challenges for the whole world economy is how to accommodate China as a WTO member to these persistent structural imbalances.[37](Ewelukwa, 2011, South-South Trade and Investment: the Good`, the Bad and the Ugly - African Perspectives) To what extent the interests and goals of China are converging with those of the West is one of the key strategic questions for the first half of the 21st century.(Skidelsky, , John Maynard Keynes`, 1883 - 1946: Economist`, Philosopher`, Statesman;Trebilcock, 1995, The Regulation of International Trade;Trebilcock,)[38] One possible approach is the currently questionable approach try to isolate China by excluding it from the TPP. Such an approach inevitably prompts countermeasures and possibly short and long term conflicts in trade relations and multilateral relations in general. Another pathway is to search for converging interests and goals through dialogue and trade negotiations. If the latter path is ultimately chosen (potentially more promising but less likely at the moment), the revival of the Keynes idea of an International Clearing Union in a simplified but potentially very efficient version could be reconsidered.(Unger, 2008, Using the Crisis to Remake the Market)[39]

To restrict large countries from constant surpluses in a neo-mercantilist fashion (one of the biggest concern of Keynes during the Bretton Woods negotiations), there is a requirement to float currencies of the surplus countries within certain relative and absolute criteria. The absolute criteria would depend on the overall impact of a country on the global economy; relative criteria would depend on surpluses and deficits between the major trading partners. In addition, the surplus countries should be supported to turn to development of domestic markets and consumption, whereas the deficit countries should raise private and public savings and channel them into long-term productive investments.[40]

In addressing world structural imbalances[41] with the help of a reconstructed trade framework and an improved monetary and financial framework, a room for international cooperation in energy production and consumption should open. It should include the areas of global environmental protection and social and labor standards in the interests of all the major trading partners. In the context of built-in automatic stabilizers that would largely replace the need for supranational technocracy, a dialogue and negotiations would take place not to the detriment of individual trading partners, but to secure a balanced, inclusive and pluralistic development of all the major trading partners.

The importance of China's rise and its integration with the world economy goes in parallel with the importance of other BRICS countries. Each of them shows its strength, as well as weaknesses and vulnerabilities, after being exposed to the world economy. Brazil is successfully pursuing many important domestic programs, such as focusing on the supply side of the economy by improving quality education and on small businesses with credit, best business practices and access to high technology. The long-term development strategy, based on comprehensive institutional restructuring, is being elaborated by Roberto Unger, Minister of Strategic Affairs and long term professor at Harvard Law School. It departs from the traditional interventionist state, based on vulgar Keynesianism and does not rely primarily on traditional state-owned institutions, such as the state development bank BNDES. Instead, it relies on broad access to knowledge, skills, technologies and all other necessary resources. It relies on new small and medium sized companies, based on cooperative competition and flexible specialization. It will take time, energy, broad strategic alliances and sustained effort to achieve transformation of Brazil in modern, dynamic and inclusive economy and society.(Leahy, 2015, Dilma Rouseff adviser charts a path for Brazil)[42]

Other BRICS countries *mutatis mutandis* face similar challenges and opportunities. An international community and normative framework takes in only to a limited amount the constraints and opportunities of BRICS and other developing countries. A framework of enlightened cosmopolitanism could better understand that a comprehensive and complete integration of BRICS countries does not threaten the interest of the established leading trading blocs, such as the US and EU, but it can also present new opportunities for the main trading blocs in achieving more sustainable and balanced development for all.

Major Trading Blocs and the Future of Free Trade Agreements

After the Doha round reached its partial and weak conclusion with the so-called Bali package, it became clear that it would be very difficult (if not impossible) to achieve a new global trade agreement. Subsequently, the two major trading blocs opted for bilateral agreements with the trading partners around the world and launched the TPP and TTIP free trade negotiations.

On the other hand, many important matters have changed since the beginning of the Doha trade round. The previous sections described that some of the most crucial expectations of the developing countries were not met during the Doha trade round. In the rise of the BRICS countries, especially China, the successful integration of large developing countries is far from certain. In the current state of development, it creates many imbalances as well as opportunities.

The most crucial thing that has changed in the last decade is the attitude and perception of the major trading blocs, the US and EU, with regard to the importance and benefits of the free trade agreements. Until recently, it was taken for granted that any new free trade agreement equals more trade gains and prosperity for all the trading partners. Global and regional disparities were not sufficiently taken into account because the conventional perception was it was only a matter of time until the developing parts of the world would start benefiting from the world trade regime at a greater pace. However after the stalled Doha round, the planned TPP and TTIP caused anxiety and discontent within the many traditionally supportive groups of free trade agreements. The main anxiety was that not only traditionally low-skilled jobs are being relocated from the most developed countries to the developing countries, but recently even some of the high-skilled jobs with high value added jobs are being relocated. The theoretical claim that trade is not about generating jobs but about increasing gains is accurate, but in the context of increasing uncertainties about the jobs, the future prospects of domestic firms and for investments, even in the most advanced countries in the world, become less persuasive. In the context of growing anxieties, the current round of free trade talks received a very mixed public reception on all sides of the trade participants, which should not be surprising. The most difficult question is how to accommodate so many diverse anxieties and uncertainties of so many different groups of employees, firms, consumers and citizens.

Simple rhetorical claims about the common benefits and gains are not sufficient anymore. For example, the North American Free Trade Agreement (NAFTA) was declared an important boost for the US economy and a major boost for the Mexican economy. However after twenty years in place, NAFTA can be called a rather mediocre equilibrium. Mexico's exports to the US increased substantially as well as its foreign direct investments, but the

Mexican economy did not experience an overall economic transformation. The Mexican economy grew slowly in comparison with other fast growing developing countries. There was a net loss of employment for Mexico. It had limited job creation in manufacturing but substantial job losses in agriculture due to imports of cheap corn and other agricultural products. Despite the inclusion of ILO core labor standards in the NAFTA agreement and despite the stated goal of promoting an upward convergence of labor standards in North America, the wage gap of nearly six times between the US and Mexico has even widened. Almost half of Mexico's population cannot find formal employment.(Pardee, 2009, The Future of North American Trade Policy: Lessons from NAFTA)[43]

On the other hand from the US perspective, one of the often stated goals was to address the migration issue with Mexico by exporting goods and not people. The migration flows after NAFTA only grew further until the adoption of all possible measures on the border between the US and Mexico to limit the migration flows.[44]

One of the most important developments since the establishment of the free North American trade area was in job manufacturing. Since 2000, North America lost about one quarter of its jobs in manufacturing, which expresses the loss of competitiveness in the entire free trade economy. It requires a new regional strategy to compete effectively with other manufacturing exporters, particularly China. Most significantly, the impact of NAFTA was that in place of convergence, it accentuated the economic and regulatory asymmetries that had existed among the three countries.[45]

The lessons and experience with the NAFTA require deep rethinking about the free trade agreement. The emphasis should be on tailor-made strategies suitable for each of the trading partners to improve competitiveness, supporting activities to address the asymmetries among trading partners and recognizing that free trade agreements are not a substitute for coherent national development strategies. Different developing countries, such as Brazil or Mexico, should be allowed to opt for different trade strategies, to realize their economic and social potential. International trade, economic and financial rules can be more or less hospitable to such a goal for the developing countries.[46] This latter observation should be taken into account both by the developing countries and developed countries.(Grewal, 2006, Is Globalization Working?)[47]

Large parts of the populations are being negatively affected by the deepening of international economic and financial integration, even in the most developed countries in the world. These social groups associate the international economic, trade and financial framework with the stagnation of their incomes and increased uncertainties relating to job precariousness. Without addressing their anxieties and providing support in the form of adequate training, reskilling and support for new entrepreneurs and start-up companies with access to all necessary resources, it is not likely to expect that the excluded large parts of population would be willing to support new round of free trade agreements such as TPP and TTIP.[48]

The recent financial crisis exposed the vulnerabilities of the leading industrial and financial countries in the world. The response to the crisis was in the form of US fiscal stimulus, Eurozone austerity measures, China's stimulus to strengthen its inner development and various activities of the central banks (mainly in the form of quantitative easing). However, according to many experts and observers, these were not sufficient measures to return the international economy to the path of more balanced and sustainable development in the future.[49] The attempts of the G20 meetings until now did not succeed in reaching a new global framework for monetary, financial and trade integration. In the absence of any global agreement that would accommodate the interests and expectations of all the major global actors, the two major trading blocs, the US and EU, opted for the new round of trade agreements.

The template for these trade agreements largely follows the NAFTA. Neither the TPP nor the TTIP took sufficiently into account the lessons from the existing free trade agreements.

The main goal of both agreements is not merely to further dismantle the remaining tariff and non-tariff barriers between the trading partners; it is to achieve a common level of regulatory harmonization.[50] In itself, this can be a valuable goal provided that all of the trading partners aim at achieving higher environmental standards, labor and social protection standards as well as standards of consumer protection. From a practical perspective, one can see how difficult it is to first reach an agreement about the highest possible common denominators in certain areas of environmental, health, labor and consumer standards. Second, even if such agreements can be reached, it is known from practical experience how difficult it is to supervise the implementation of such agreed standards.

Even deeper is the problem of negotiating common standards that are derived from arm's length regulation. The rules and standards may appear to be neutral, but they may serve interests and protection of the established industries. As such, the allegedly neutral standards may lead to the hierarchical segmentation of markets in which new entrants have difficulties in competing with established industries on an equal footing. This is the case of new member states in the European Union, where despite the creation of the common European market, new member states and their firms are only exceptionally able to capture higher value added segments of the common market.[51] Without supportive measures to increase the productivity of labor and total factor productivity, these new member states and their firms are being essentially excluded from the benefits and gains of the common market. A similar process appears to affect not only the member states on the common market as many European regions and even the long term members of the European Union are stagnating. Instead of a framework of equalizing and enhancing opportunities for all, new divisions and fault lines can emerge in the common market. Stagnating regions and the member states should be allowed room for maneuver to articulate and implement their own development strategies, based on tailor-made solutions that would develop comparative advantages of these regions and the member states.

Even in the framework of relatively homogenous trading partners, a variety of outcomes of the free trade agreement can develop. The introductory chapter noted that different free trade regimes can lead to substantially different equilibria for the trading partners, from desirable to mediocre and ultimately to the non-desirable. To avoid the undesirable outcomes of free trade regimes, certain accommodations to the distributional impact are necessary, but more importantly, instruments, policies and institutional innovation should be allowed to the deprived regions and segments of industry and employees. Policy space, tools and instruments for the stagnating regions to improve their levels of competitiveness should be allowed under the improved free trade regime. As seen during the period of economic and financial crisis, sometimes even the most developed countries require a certain breathing space to restructure their firms and industries. By extension, even more important would be for the stagnating countries and regions to receive sufficient policy space to restructure and improve competitiveness. Similar difficulties can be seen in the European neighborhood (Caruso et al).[52] For a shift in the direction toward an improved, qualified version of free trade agreements, the major trading blocs in the world would have to recognize that they themselves frequently resort to the modern sophisticated versions of industrial and development policies. Sometimes they are necessary to counteract an economic crisis; at other times, they are necessary to sustain and improve the modern knowledge-based economy and society.

Toward A "Bretton-Woods Compromise" for the 21st Century?

The idea to rethink the Bretton-Woods compromise and to frame it for the 21st century is not entirely new. It was first proposed and articulated by Roberto Unger two decades ago;[53] more recently, it was contemplated by Nicholas Crafts in the context of the Eurozone crisis.[54] The points of departure for the new Bretton-Woods compromise are that 1) the current international framework does not sufficiently accommodate the needs and interests of many developing countries in the first place; 2) it may contribute to the internally uneven developments of the fast developing countries, such as BRICS countries; and 3) it does not provide sufficient breathing space for the developed countries when certain economic restructuring is necessary in periods of slumps or economic crisis. More recently, Joseph Stiglitz with a group of financial experts prepared a report for the United Nations about the necessary reforms of the international financial and economic architecture.[55]

Some additional important factors in the last two decades contribute to the call for rethinking and searching for a Bretton-Woods compromise for the 21st Century. First, the rise of China not only as a country of assembly factories and sweatshops for the whole world, but its rise as an increasingly important, innovative and competitive manufacturer in high value added and high quality products. To a lesser extent, two similar observations apply to some other fast developing countries: the exposure of vulnerability of the Western countries in periods of protracted financial and economic crisis; and the emergence of knowledge-based societies and economies that significantly rewrite the traditional concepts of development and comparative advantages.

The main constraint of the current international legal and economic framework is that large parts of populations in the developing countries and increasing populations in the developed countries do not benefit from the current path of international economic, trade and financial integration. In this context, the leading trading blocs opted for the new round of free trade agreements in the frameworks of TPP and TTIP without substantially rethinking of the free trade agreements. Such an approach left out China and other large developing countries on one hand and was met with the growing anxieties of many social groups in their own countries. The impression is that both trading blocs are trying to consolidate their own positions before redefining how to approach the next round of trade talks with China and other large developing countries. This approach may be plausible, but it does not address many of the cumulated world structural imbalances previously described.

The alternative approach could lead to rethinking the Bretton-Woods compromise and adjusting it to the international needs of the first half of the 21st century. The main goal is to elaborate a framework that would be more conducive in achieving more balanced, inclusive and diverse development at the global level. Another important goal is to articulate such a framework that would simultaneously address the legitimate needs of the developing countries and the fast developing large countries of the BRICS, as well as the legitimate needs and interests of the most developed countries in the world. The international integration can be further strengthened while the existing structural imbalances that are not sustainable are appropriately addressed.

The proposal of a simplified version of the International Clearing Union has a goal to build automatic stabilizers to prevent central banks entering the currency wars, to neutralize the role of international speculators and to avoid excessively rigid conditional requirements by the International Monetary Fund. The main advantage of automatic stabilizers is that the major economic powers of the world, from developing or developed parts, would assume their own responsibilities for the maintenance of international economic and financial stability. The system would directly address the issue of persistent trade surpluses and deficits and the pattern of neo-mercantilism, to which more and more economies currently aspire to the detriment of an open world economy. Finally, the imposition of structural adjustments would be replaced by allowing countries to develop and implement their own strategies of development, based on tailor-made solutions to improve competitiveness.

The world trade regime should become capable of addressing three major concerns of the existing structural imbalances: 1) to incorporate the development friendly framework by enhanced rules of the SD&T and other development friendly clauses into the world trade regime; 2) to explicitly recognize that the fast developing countries are allowed to develop their own institutions and measures, even if unorthodox, and to develop their own economies and societies in more sustainable and inclusive ways; and 3) to explicitly recognize the legitimate need of the most developed countries to receive breathing space to restructure their industries in cases of protracting economic crisis or in cases of high levels of unemployment. The new Bretton-Woods compromise would create more maneuvering room for restructuring, while at the international level prevent the individual countries to resort to "beggar thy neighbor" activities. The built-in mechanisms as well as the commonly agreed rules should also raise the global environmental, labor and social standards in the future. The developing countries with a proven record of improved labor rights and standards, as well as environmental standards, should enjoy better access to the most developed markets of the world.

The most promising period in international economic integration was the early period of the Bretton-Woods and GATT regimes. It was a period of high rates of growth and high rates of employment with the steady increase in the incomes of labor, while the international disparities between developed and developing parts of the world were gradually reducing. On the other hand, the Bretton-Woods regime had certain in-built flaws that led to its ultimate collapse in the early 1970s.

It is neither possible nor desirable to return to the regime that was developed after World War II. New global challenges, such as environmental issues and growing social disparities in the developed and developing parts of the world are some of the reasons why it is not possible to simply review the post-war trade, financial and monetary international arrangement. While it is not possible or desirable to return to the past, it is possible to apply and adjust some of the premises and principles that proved successful in the past. For example, more flexibility and broader maneuvering room for the members of the GATT regime was allowed in the early post-war period.[56]

One of the measures of modern industrial policy, the rules on state subsidies in cases of restructuring and selective turnaround of industries, should again become less restrictive. These are the measures that were abundantly used by the developed countries in the past before they were reaching competitive edges in various industries. On the basis of establishing stronger cooperation between the public and private sectors of the national economy, Roberto Unger suggested there should be a "heavy presumption against outlawing a practice on the ground that it represents a subsidy".[57] Only in cases of direct interventions for changing the cost structure of export products could the negotiated compensatory measures be contemplated.[58]

The idea of flexibility received a qualified proposal in the form of temporary opt-outs from the international trade regime. The proposal was to allow countries to temporarily opt-out from the trade in the period of comprehensive restructuring of their economies. Such opt-outs should be negotiated multilaterally and with the following price: "a county will lose access to other countries' markets to the extent it closes its own market."[59] Despite this price, Roberto Unger is convinced that explicit opt-outs are more transparent and more in favor of economic, political and social pluralism than the currently existing partial opt-outs in the areas of entrenched agricultural protection for the rich countries(Unger, 2007, Free trade reimagined: the world division of labor and the method of economics).[60]

To achieve the "possibility of coexistence among different development strategies, institutional systems, and forms of social life… the room for national and regional diversity, deviation [and] heresy" must be created. For Roberto Unger, a reconciliation between global openness and coexistence of variety of institutional models are more important goals than merely maximizing free trade.[61] The idea of "one institutional size fits all" underlies the current international trade, economic and financial framework. The underlying assumptions of the Bretton-Woods compromise are tailor-made solutions, institutional innovations and decentralized development based on public–private cooperation.

The varieties of institutional models, suitable to the potential and comparative advantages of different regions and countries around the world, can offer more balanced, inclusive and sustainable development in the future. It can address the problem of persistent structural imbalances of the world economy. Global markets do not presuppose identical institutional and policy arrangements in all the diverse member states and their regions around the world. Different institutional arrangements stem from different traditions and decision-making processes. The world trade regime should not stall further development of various institutional arrangements. The international regulatory framework is not necessarily incompatible with the diverse institutional structures of the member states.

Comparative institutional analysis shows that despite a widespread assumption that the processes of globalization would inevitably lead to institutional convergence of different national socio-economic models, in practice the continuation of a variety of market economies can be traced. The study of comparative institutional development, at least in the process of Europeanization, concluded that the member states used different strategies to retain, adjust or when it suited their comparative advantages, changing institutional and domestic regulatory regimes when seeking compromises in the context of multilateral cooperation. In so doing, institutional convergence was not a prerequisite for the successful development of any kind of international integration.[62] It is equally plausible to assume that institutional diversity and coexistence within any kind of multilateral organizations should not be hindered but rather supported when establishing the common framework.

Free trade is not a goal in itself. Maximizing the volume of trade and investments around the world does not automatically translate into higher growth and employment rates. It does not also automatically lead to more inclusive, balanced and diverse development.

Conclusion

The suggested model, based on the variety of institutional solutions, should support decentralized, cooperative, participatory and diverse development. More sustainable and socially inclusive development should become the main goal of global, regional and transatlantic cooperation. New development alliances can offer new development alternatives.[63] Economic integration, if legal rules are calibrated accordingly, can become a process of improved social, labor and environmental standards. The experience of the original Bretton-Woods and General Agreement on Tariffs and Trade (GATT) regimes can still be a useful guide for a Bretton-Woods type compromise for the 21st century.

The method of the proposed research will be a comparative institutional analysis. The analysis will be devoted to the regions and countries that successfully maintain high levels of international competitiveness and social cohesion. The study on comparative institutional development may show that different countries use various strategies to retain, adjust or if it suits their comparative advantages, change institutional and domestic regulatory regimes when seeking compromises in multilateral cooperation. In the context of the variety of institutional models suitable to different comparative advantages, institutional convergence should not be viewed as a prerequisite for the successful development of any kind of international integration. Hence in the proposal for institutional diversity and coexistence within any kind of multilateral organization, it should not be hindered but rather supported when establishing the common framework.

Notes

[1] An overview of successes and failures of the WTO arrangement: The WTO at Twenty: Challenges and Achievements. pt. 83 (2015)
[2] About the challenges and difficulties of finding the pathways from the periphery, see Haggard, *Pathways from the Periphery*; Amsden, *The Rise of "The Rest"* and Rodrik, *One Economics, Many Recipes*.
[3] Ministerial declaration 2001.
[4] Pilling, "The anyone but China club" and Yoon, "US to co-operate with China."
[5] Maupin, "Transparency in International Investment Law."
[6] See more in Summers, "A Setback to American Leadership on Trade."
[7] Baumol and Gomory, *Global Trade*, 20-22.
[8] Ibid., 72.
[9] Ibid., 62-63.
[10] Unger, *Free Trade Reimagined*, 36.
[11] Baumol and Gomory, *Global Trade,*, 17.
[12] Ibid., 73.
[13] Ibid., 40.

[14] Lewis Kolsky, "Asymmetrical Bargaining Power."
[15] Birdsall et al., "How to Help Poor Countries."
[16] Ibid.
[17] Ackermann and Gallagher, "The Shrinking Gains from Global Trade."
[18] Polaski, "Winners and Loosers."
[19] Ibid.
[20] Sutherland, "The Doha Development Round."
[21] Stiglitz and Carlton, *Fair Trade*, ch. 7.
[22] Ibid.
[23] See, for example, Singh, "Special and Differential Treatment."
[24] Stiglitz and Carlton, *Fair Trade*, ch. 8.
[25] Ibid.
[26] Ibid.
[27] Singh, "Special and Differential Treatment", 239.
[28] Ibid.
[29] Autor, "The China Syndrome."
[30] Crooks and Hornby, "The Sunshine Revolution."
[31] Ibid.
[32] Ibid.
[33] Cui, "Property Rights in China."
[34] Ibid.
[35] Ibid.
[36] Cui, "Chinese Socialist Market Economy".
[37] Ewelukwa, "South-South Trade and Investment".
[38] Skidelsky, *John Maynard Keynes*, 674-678 .
[39] Unger, proposal on the improved version of International Clearing Union presented in "Using the crisis".

[41] Eichengreen, "*Global Imbalances*"
[42] Leahy, "A path for Brazil".
[43] A Report, "Lessons from Nafta".
[44] Ibid.
[45] Ibid.
[46] Santos, "Carving Out Policy Autonomy for Developing Countries".
[47] Grewal, "Is Globalization Working? "
[48] Summers, "A trade deal must work for America's middle class".
[49] Chang, "Bad Samaritans".
[50] Wagner, "Regulatory Space in International Trade Law".
[51] Kukovec, " Law and Periphery".
[52] Caruso et al., "Trade and History".
[53] Unger, "The Really New Bretton Woods".
[54] Crafts, "The Future of the Eurozone".
[55] Stiglitz Report, "Reforming the International Monetary and Financial System".
[56] Broude, "International Governance in the WTO".
[57] Unger, *Free Trade Reimagined*, 189.
[58] Ibid.
[59] Unger, *Free Trade Reimagined*, 181.
[60] Ibid.
[61] Ibid., 180.
[62] Fioretos, "The Domestic Sources of Multilateral Preferences", 242-243.
[63] Banks et al., " New development alternatives".

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