

Bilateralism versus Multilateralism in International Economic Law: Applying the Principle of Subsidiarity

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1. Introduction

The last few years have seen an outburst of bilateral and regional treaties in the field of international economic law, in general, and in international trade, in particular.¹ In contrast to the new world economic order contemplated by the founders of the Bretton Woods system and the GATT/WTO in the aftermath of World War II, which was to be based on the non-discriminatory and all-encompassing principles of Multilateralism,² we now have a fragmented multitude of bilateral and regional arrangements in most of the important fields of international economic regulation: international trade, international investment and international taxation. Even the United States of America, a former steadfast champion of multilateralism, which only in 1985 signed its first bilateral Free Trade Agreement (with Israel),³ is currently in a “signing spree” of such bilateral agreements, with the count now standing on no less than 37 countries with which the U.S. has either signed or is in the process of negotiating an FTA.⁴ Such agreements have become so widespread that all but one WTO member are now parties to one or more of

¹ Michael J. Trebilcock and Robert Howse, *The Regulation of International Trade* (2005), [----].

² K.W. Dam, *The GATT: Law and International Economic Organization* (1970); A.F. Lowenfeld, *International Economic Law* (2002).

³ Agreement on the Establishment of a Free Trade Area between the Government of Israel and Government of the United States of America, 22 April 1985, reprinted in (1985) 24 *International Legal Materials* 653-87.

⁴ For detailed information on the FTAs concluded and being negotiated by the US, see the website of the United States Trade Representative (USTR):

http://www.ustr.gov/Trade_Agreements/Bilateral/Section_Index.html

them and it is estimated that more than half of world trade is now conducted under bilateral FTAs.⁵

But bilateralism is not confined to trade regulation. In fact, in most other areas of international economic regulation it appears that bilateralism is the rule, and multilateralism the exception. In the field of international investment protection, the attempt by the OECD to create a Multilateral Investment Agreement (MAI) failed in 1998,⁶ and instead we have today some 2,750 Bilateral Investment Treaties (BITs), with the number constantly on the rise.⁷ Likewise, ideas on the creation of a multilateral framework for the coordination of international tax policy have remained mainly a topic of utopian academic dissertations or a limited option for a few regional groupings, while bilateral tax treaties are signed by the dozens each year and are estimated now to amount to some 2,800.⁸ We are also starting to see beginnings of bilateralism in the area of intellectual property regulation⁹ that traditionally was governed almost exclusively by multilateral treaties. The same is true in the field of government procurement where there is only a plurilateral agreement (under the auspices of the WTO) that is very fragmented by bilateral accords and strict reciprocity requirements,¹⁰ and where independent bilateral agreements are now on the rise. This situation has generated a lively debate on the utility

⁵ World Trade Organization, Dec 2004, *The future of the WTO, Addressing institutional challenges in the new millennium- Report by the consultative Board to the Director-General Supachai Panitchpakdi, 19-23 ("The Sutherland Report")*.

⁶ Sol Picciotto, 'Linkages in International Investment Regulation: The Antinomies of the Draft Multilateral Agreement on Investment', 19 *U. Pa. J. Int'l Econ. L.* (1998) 731; http://www.oecd.org/document/35/0,3343,en_2649_201185_1894819_1_1_1_1,00.html

⁷ According to a survey conducted by the UN Commission on Trade and Development (UNCTAD), the number of BITs has grown steadily; they numbered 385 by 1989 and 2,265 in 2003, encompassing 176 countries. See <http://www.unctad.org/Templates/WebFlyer.asp?intItemID=3150&lang=1> . Assuming an average of about 110 new BITs concluded every year (which is the average of the last few years), today (in mid-2008), the accumulative total could stand on 2,750. This number does not include the many FTAs and regional economic arrangements with investment protection chapters.

⁸ According to the UNCTAD survey, *ibid.*, in 2002 the total number of double taxation treaties was 2,256. Here the yearly average is about 75. Thus assuming a similar growth since 2002, the current number should stand around 2,800.

⁹ Current bilateral free trade agreements often include chapters on intellectual property, many of which impose so-called "TRIPs plus" obligations. See for instance the website of the US Trade Representative which lists negotiation of intellectual property chapters in bilateral and regional trade agreements as one of the tools it uses to "promote strong intellectual property laws and effective enforcement worldwide": http://www.ustr.gov/Trade_Sectors/Intellectual_Property/Section_Index.html

¹⁰ See Arie Reich, 'The New GATT Agreement on Government Procurement: The Pitfalls of Plurilateralism and Strict Reciprocity', 31 *Journal of World Trade* (1997) 125-151.

of such bilateral agreements, in particular in the field of international trade, known as the so-called “building blocks or stumbling blocks” debate.¹¹

The conventional methodology utilized in this debate has been the economic cost-benefit analysis. In the trade field this has meant to try to measure trade creation versus trade diversion and estimating their relative costs and benefits. This perspective, first developed by Jacob Viner in 1950,¹² has served ever since as the major framework for the debate on the utility and global welfare effects of bilateral and regional trade regimes, in comparison to the multilateral approach offered by the GATT/WTO system. Based on this approach, most academic scholars are critical of the new bilateralism and regionalism, which often results in only modest reduction of mutual trade barriers, claiming that it often causes more trade diversion than trade creation.¹³

An alternative perspective was offered by Wilfred Ethier in 1998, who argued that the Vinerian perspective is not the most useful means of analyzing the “new regionalism”.¹⁴ Rather, Ethier takes the view that this regionalism should be assessed in terms of assisting economies in transition to join the international trading system, in entrenching commitments to economic reform, and in distinguishing these countries from other candidates for foreign direct investment.

Ethier’s perspective, however, concentrates mainly, as indicated by the title of his paper, on regionalism, and not on bilateral agreements concluded between countries in different geographical regions.¹⁵ In his theory, the success of multilateral liberalization will increase trade between *neighbours*, which in turn will create further incentives to

¹¹ This phrase was first coined by Jagdish Baghwhati in his *The World Trading System at Risk* (Princeton, 1991). For a survey of the debate, see Trebilcock & Howse, *supra* note 1, pp. [_____].

¹² Jacob Viner, *The Customs Union Issue* (New York, 1950).

¹³ See, e.g., J. Baghwhati, "Regionalism vs. Multilateralism", 15 *The World Economy*, No. 5 (September, 1992), 535; A. Panagariya, "East Asia and the New Regionalism", 17 *The World Economy*, No. 6 (November, 1994), 817; and the Sutherland Report, *supra* note 4, p. 22-24. But see also J.A. Frankel, *Regional Trading Blocks* (Institute for International Economics, 1997), 209; who concludes that appropriately designed free trade areas can act as building blocks for global liberalization.

¹⁴ Wilfred J. Ethier, "The New Regionalism", 108 *Economic Journal* 1149 (1998).

¹⁵ *Ibid.*, on p. 1152, Ethier describes one of the characteristics of the “New Regionalism”: “Regional arrangements are regional geographically: The participants are neighbours.”

regional trade pacts. However, one of the characteristics of the more recent surge in trade-bilateralism is that much of it relates to countries separated by great distances. The recent FTAs concluded by the United States with countries such as Australia, Bahrain, Chile, Jordan, Morocco, Singapore, and its declared intention to sign such agreement with Malaysia, South Africa, Thailand and the United Arab Emirates illustrate this trend. Ethier's model is thus less suited to explain this "new bilateralism", as distinct from the more narrow phenomenon of regionalism.

Furthermore, both Viner's and Ethier's perspectives are confined to regimes of international trade, and do not deal with the wider phenomenon of bilateral and regional agreements on other economic issues.

Finally, and irrespective of any specific theoretical model, the academic community is generally very critical of the new trade bilateralism. It is seen as producing a "spaghetti bowl" of trade arrangements that creates division, lack of uniformity and unpredictability of the trading system and as enabling strong countries to take advantage of the weaker ones.¹⁶ These arguments could to a large extent be applied also to other areas of international economic regulation.

There seems thus to be an ever growing gap between the prescriptions of scholarly writings and the actual reality of international economic regulation. This gap demands the question: If bilateralism is so bad – why is it so widespread? Perhaps bilateralism holds some significant advantages for states that existing theoretical frameworks fail to take account of?

This paper therefore proposes a different perspective on the debate, one that is applicable to all fields of international economic regulation and that can help us to both

¹⁶ J. Baghwati, "U.S. Trade Policy: The Infatuation with Free Trade Areas", in *The Dangerous Drift to Preferential Trade Agreements* (J. Bhagwati & A. Kruger, eds.) (1995). For a compilation of some of the important writings on this subject, see R. Pomfret. *Economic Analysis of Regional Trading Arrangements* (2003).

understand the attractiveness of bilateralism and still provide us with a framework within which we can assess when it should yield to multilateralism.

The perspective that I would like to develop in this paper is modelled after the Subsidiarity Principle. While this principle has mainly been used in the context of allocation of authority between various levels of government in federal or quasi-federal systems of government, in particular within the European Union, this paper proposes to use it in the analysis of the various layers of international law and in relation to the choice of bilateral, regional or plurilateral regimes over multilateral ones. As a result of globalization, increased economic interdependence and the proliferation of all kinds of international regimes, the world scene is becoming more in need of international coordination and the model that is evolving is one of multi-level governance. International law and institutions create the framework and limits for the economic policies of national governments, and much of the decision-making is taking place today on the international level. The proliferation of international adjudication and the rapid growth of international economic law in the last decades reflect the worldwide recognition that the economic efficiency and political legitimacy of economic markets depend on law and institutions limiting market failures as well as political failures. On this background there has also been a growing literature on the need for “multilevel constitutionalism”.¹⁷ This connotes regulation of both vertical and horizontal relationships. While under the former, one would include the relationships between the state and international organizations, and between domestic law and international law, under the latter we refer to the relationship between various international regimes, such as multilateral trade agreements and environmental conventions, or between bilateral,

¹⁷ Ernst-Ulrich Petersmann, *Constitutional Functions and Constitutional Problems of International Economic Law* (1991); Ernst-Ulrich Petersmann, ‘The WTO Constitution and the Millennium Round’, in *New Directions in International Economic Law* (2000) 111; E.U. Petersmann, ‘Multilevel Trade Governance Requires Multilevel Constitutionalism’, in C. Joerges & E.U. Petersmann, (eds), *Constitutionalism, Multilevel Trade Governance and Social Regulation* (2006); John H. Jackson, ‘The WTO “Constitution” and Proposed Reforms: Seven Mantras Revisited’, 4 *J. Int’l Econ. L.*(2001) 67; Robert L. Howse & Kalypso Nicolaidis, ‘Enhancing WTO Legitimacy: Constitutionalization or Global Subsidiarity’, 16 *Governance* (2003) 73; Neil Walker, ‘The EU and the WTO: Constitutionalism in a New Key’, in G. De Burca & J. Scott (eds), *The EU and the WTO: Legal and Constitutional Issues* (2001); J.O. McGinnis & M.L. Movsesian, ‘The World Trade Constitution’, 114 *Harvard L. R.* (2000) 511; Deborah Z. Cass, *The “Constitutionalization” of the World Trade Organization* (2005); Joel P. Trachtman, ‘The Constitutions of the WTO’, 17 *Eur. J. Int’l L.* (2006) 623.

regional and multilateral trade regimes. Thus, the introduction of the concept of Subsidiarity originating from federalist and European Union constitutional discourse could be very appropriate to the realm of international economic law and the various levels on which it is and ought to be regulated.

Such an analysis can provide both a normative criterion as well as an explanatory tool in relation to the reality of booming bilateralism. The objective of the paper is to develop parameters analogous to those used in the federalist discourse but adapted to the subject matter of international economic law. These parameters will incorporate both the efficiency rationales of the Subsidiarity principle, as well as its political and ethical rationales.

One of the advantages of the perspective introduced here is that it allows us to address bilateralism as a general phenomenon in international economic law (and perhaps in other areas too, although this will not be done in this article) and not only in international trade. Indeed, the distinction between trade and other transnational economic activities is often artificial and obsolete. The World *Trade* Organization has since 1995 extended its mandate into both trade in services, technical product standards and regulation of intellectual property rights, and was very close to further extending it to regulation of investment and competition rules during the current Doha Round. Likewise, bilateral and regional free *trade* agreements have also extended themselves into these new areas, as well as into other non-trade issues such as foreign investment protection, protection of labour rights and setting of environmental standards. There is also a strong linkage between regulation of trade and investment flows and international taxation, and there have been calls from academia to enrol the WTO to the task of negotiating a multilateral tax convention.¹⁸ Indeed, much of the more current literature, including Ethier, has suggested to look for the explanations for the “New Regionalism” in areas outside of the traditional trade realm, but even so the subject matter of their theories has

¹⁸ See e.g., ‘Special Survey: Globalization and Tax’, *The Economist*, (Jan. 29, 2000); Reuven S. Avi-Yonah, ‘Globalization, Tax Competition and the Fiscal Crisis of the Welfare State’, 113 *Harv. L.R.* (2000) 1573. Avi-Yonah, however, changed his opinion from the one expressed in an earlier draft, and eventually suggested, due to pragmatic reasons, that the multilateral tax convention be initiated within the OECD.

remained trade. The wider perspective proposed here, encompassing all areas of international economic activity, is thus not only an attempt at a “grand theory”, but also reflects a more realistic and updated approach.

2. The Principle of Subsidiarity

The principle of Subsidiarity is not a new one. Some trace its roots to the Jewish Bible and to Greek philosophy.¹⁹ However, the most explicit formulation of the principle as we know it today was given in a Papal Encyclical of 1931 entitled *Quadragesimo Anno*:

...Just as it is wrong to withdraw from the individual and commit to a group what private enterprise and industry can accomplish, so too it is an injustice, a grave evil and a disturbance of right order, for a higher association to arrogate to itself functions which can be performed efficiently by smaller and lower societies. This is a fundamental principle of social philosophy, unshaken and unchangeable. Of its very nature, the true aim of all societal activity should be to help members of the social body, but never to destroy or absorb them.²⁰

The principle is applicable to various aspects of government, politics, cybernetics and management, but is considered particularly central in federal systems of government. It stands for the idea that a central authority should have a subsidiary function, performing only those tasks which cannot be performed effectively at a more immediate or local level.²¹ As such it can be seen as reflected in many national constitutions, such as the Tenth Amendment of the U.S. Constitution,²² and even more so Article 72 of the Basic Law of Germany.²³

¹⁹ Chava Shachor-Landau, ‘Reflections on the Principle of Subsidiarity in the European Union’, 13 *Bar Ilan Law Studies* (1996) 301, 303-304 (Hebrew), citing the book of Exodus, ch. 18, v. 14 (which deals with the division of jurisdiction between Moses, as the supreme judge, and lower court judges) and Aristotle in *Politics* Book. 1, Part II.

²⁰ *Ibid.*, p. 304; *Quadragesimo Anno*, paras. 79 and 80.

²¹ See Oxford English Dictionary, entry: “Subsidiarity”.

²² “The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved for the States respectively, or to the people.”

²³ Article 72(b): “The Federation shall have the right to legislate on these matters [i.e., matters within concurrent legislative powers – A.R.] if and to the extent that the establishment of equal living conditions throughout the federal territory or the maintenance of legal or economic unity renders federal regulation necessary in the national interest.”

Within the EC, the principle first appeared in a 1975 Commission report on Economic Union, which stated that an expansion of Community powers should only occur where the Member States could not effectively accomplish the desired tasks. It became part of official Community law through the Single European Act in 1986, which applied it to legislation relating to the environment:

The Community shall take action relating to the environment to the extent to which the objectives referred to in paragraph 1 can be attained better at Community level than at the level of the individual states.²⁴

As a general principle of Community law, subsidiarity was formally introduced by the Maastricht Treaty on European Union in 1992, as a political compromise between European federalists and anti-federalists without which a consensus on the treaty probably never would have been reached.²⁵ It is referred to in the preamble and in the framework articles of the Treaty on European Union,²⁶ and, finally and most importantly, in Article 5 (ex 3b) of the EC Treaty (2nd paragraph):

In areas which do not fall within its exclusive competence, the Community shall take action in accordance with the principle of subsidiarity, only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community.²⁷

It should be noted, that this provision only applies the principle of subsidiarity to areas which do not fall within the exclusive competence of the Community. The reason is that where exclusive competence exists there is no question of division of power between the Community institutions and its Member States. The states have agreed in the EC Treaty

²⁴ Article 130r(4) of the EC Treaty, as it was then. This provision is now replaced by a reworded Article 174, which does not mention the subsidiarity principle, probably because it now has been adopted as a general principle in Article 5.

²⁵ D.Z. Cass, 'The Word that Saved Maastricht, the Principle of Subsidiarity and the Division of Powers within the European Community', 29 C.M.L.Rev. (1992) 1107.

²⁶ The Treaty of European Union, *Official Journal* C 191, 29 July 1992 11th Preamble and Article B.

²⁷ The Treaty Establishing the European Community (Consolidated text) *Official Journal* C 325 of 24 December 2002.

to transfer all their powers to the Community, and to the extent that the Community has used these powers, only its institutions can act. In areas of concurrent competences, however, where the Treaty has granted non-exclusive powers to the Community, here the question may arise whether the Community should act on behalf of all Member States, or whether each state shall be free to act on its own in regulating this specific area. This is where the Treaty requires to act according to the subsidiarity principle. Nevertheless, as a political norm it would seem that subsidiarity has gained significance that transcends its legal confines. It often features in the political discussions on the proper division of powers within the Community, as a counterweight to excessive centralization. It was also part of the failed Treaty establishing a Constitution for Europe,²⁸ as well as of the Treaty of Lisbon, which, if ratified, will strengthen the principle significantly.²⁹

In order to answer questions about how the principle should be implemented, the 1997 Amsterdam Treaty introduced a protocol annexed to the Treaty. The protocol explains that the Subsidiarity principle is intended to ensure that decisions are taken as closely as possible to the citizen³⁰ and that constant checks are made as to whether action at Community level is justified in the light of the possibilities available at national, regional or local level:

For Community action to be justified, both aspects of the subsidiarity principle shall be met: the objectives of the proposed action cannot be sufficiently achieved by Member States' action in the framework of their

²⁸ Proposal for Treaty establishing a Constitution for Europe, Article 9. By mentioning not only the Member States' level, but also the regional and local level, this proposed formula stresses the idea that it is not only the division of power between the Community and the Member States that is involved, but also between the Community and any other lower level of government, which may be capable to perform the task more efficiently.

²⁹ Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, signed at Lisbon, 13 December 2007, *O.J.* C 306, See in particular the amended Article 3b and Article 8c (to become Article 5 and 12 in the Consolidated Version) of the Treaty on European Union, which adopts the Constitutional Treaty language discussed in the previous footnote, and also empowers national parliaments with the task of ensuring compliance with the principle of subsidiarity. This creates for the first time a kind of political enforcement mechanism of the principle. While its employment is not very easy, it may nevertheless strengthen the deterrence effect against blunt violations of the principle.

³⁰ The 2nd Preamble to the Protocol on the Application of the Principle of Subsidiarity and Proportionality, annexed to the Amsterdam Treaty.

national constitutional system and can therefore be better achieved by action on the part of the Community.³¹

Thus, the Principle of Subsidiarity has been found by the EU and other multi-level systems of governance to be a helpful guide on questions of vertical division of powers, but more as a political, rather than legally enforceable, principle.³² Its ethical rationale is based on the idea that it unjust and wrong to deprive the individual, or a society of individuals from their rights and powers to take care of their own business and organize their lives as they see fit, unless there are solid justifications for allocating the power to a higher instance. The economic rationale of the principle is based on the idea that often decisions taken closer to the people are more attuned to their needs and circumstances, different climate, social, political or economic conditions, and therefore are more likely to achieve efficient outcomes. Only if one can show that there are efficiencies to gain from unity or harmonization, or other economies of scale that can only be attained at a higher, more central level, is action on the more central level economically justified. These rationales would seem to be equally relevant to other types of multi-level governance systems, such as the current system of international organizations and agreements governing global economic relations. This possibility will be explored in the next chapters.

3. Bilateralism versus Multilateralism: Applying the Principle of Subsidiarity

Unlike GATT Art. XXIV, where the point of departure, and the rule, is multilateralism and the exception is bilateralism and regionalism,³³ under the

³¹ *Ibid.*, para. 5. The Protocol also sets out guidelines on how to implement the subsidiarity principle.

³² There are varying views on whether Subsidiarity is a legally enforceable principle, which should be subject to judicial supervision of the Court of Justice. See Shachor-Landau, *supra* note 19, 326-327; A.G. Toth, 'A Legal Analysis of Subsidiarity', in O'Keefe and Twomey (eds), *Legal Issues of the Maastricht Treaty* (1994) 37; Josephine Steiner, "Subsidiarity under Maastricht", *ibid.*, p. 62. While the Court has given some guidance as to how the principle should be interpreted, it has been reluctant to interfere with Community action, and has until now rejected all attempts to challenge the Commission's assertion that Community action is required in a particular area.

³³ As explained in the introduction, the GATT/WTO regime is based on the non-discriminatory and all-encompassing principles of Multilateralism. This is reflected in particular in GATT Article I, which

European Community ("EC") Treaty Art. 5 (at least in areas of concurrent competence) the point of departure and default is that action shall be taken on the regional-Member State level.³⁴ The principle has two prongs: one negative and one positive. The negative prong refers to the ability of the individual Member States to achieve the objectives of the proposed action. Only if they cannot achieve these objectives "sufficiently", the Community may take action. Here, then, the focus is on the lower level, the one closer to the people. We must ask ourselves whether perhaps the objectives of the proposed action are better achieved not on the multilateral, more central, level, but on a lower, more regional level, closer to where the problem lies, by each Member States acting alone as it finds fit. The positive prong is the other side of the coin; it refers to the ability of the EC or any community of states – the level where

requires every WTO member to accord immediately and unconditionally to all other WTO members most favoured nation (MFN) treatment in relation to all its import and export policies. The main exception to this rule is found in GATT Article XXIV which relates to bilateral and regional free trade arrangements (such as free trade areas and customs unions). This provision permits WTO members to conclude such arrangements – even though they depart from the principle of non-discriminatory MFN treatment by granting duty-free access and other benefits to their respective parties but not to other WTO members. However, in order to qualify under Article XXIV, the bilateral free trade arrangement must meet certain conditions, and in particular: (1) that it does not result in higher duties or more restrictive trade barriers towards the other WTO members than existed before the arrangement was concluded; (2) that the free trade arrangement applies "to substantially all the trade" between its parties; and (3) that free trade between its parties is implemented within "a reasonable length of time". While it is true that the Article XXIV exception has been very widely used, especially in the last few years, in order to permit the conclusion of bilateral and regional free trade arrangements, formally the rule is still multilateralism, whereas bilateralism and regionalism is only permitted when these specific conditions are met. The rationale of this exception, as explained in Article XXIV:4, is that the WTO members "recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements." In other words, they recognize that the WTO as a multilateral regime is unable to reach such close integration of economies as can be reached in a free trade arrangement, and they do not want to stand in the way of two or more countries who want to achieve such close integration, even if the price is the departure from, and a certain erosion of, the MFN principle.

³⁴ "...the Community shall take action... only if and insofar etc.". It is of course true that in the EC, the sub-central point of departure applies only in areas which do not fall within the Community's exclusive competence, and that in the many areas in which the Community does have such competence the point of departure (as well as the point of destination...) is Community, i.e., multilateral, action, whereas GATT Art. XXIV does not have such a qualification. However, this reflects a political decision of the EC Member States on how far they want the Principle of Subsidiarity to apply, and not on the Principle itself. This decision may be understood as reflecting an irrebuttable presumption by the Member States that in areas within the Community's exclusive competence, the objectives of a proposed action will always be deemed to be better achieved by the Community than by Member States. Or it may simply reflect the more far-reaching integrationist objective of the EC, in comparison to the GATT/WTO, and the recognition by the EC Member States that in order to achieve this objective, the Principle of Subsidiarity must be limited to areas of concurrent competence only. Be that as it may, our discussion relates to the Principle of Subsidiarity as such, in the abstract, based on its ethical and efficiency rationales as set out in the previous chapter, and its possible positive and normative application to the choice of regime in international economic law.

all the member states act together, multilaterally (and in the case of the EC – supra-nationally) – to better achieve the objectives of the proposed action, by reason of its scale and effects. Here we must focus on the multilateral level, and ask ourselves if there are special reasons which demand and justify common, coordinated action on this level in order to better achieve the task. For Community action to be justified, both aspects of the Subsidiarity principle must be met: the objectives of the proposed action cannot be sufficiently achieved by Member States' action in the framework of their national constitutional system *and* they can be better achieved by Community action.³⁵ The Subsidiarity perspective is thus in effect turning the GATT Art. XXIV perspective on its head, and instead of requiring a special justification for a bilateral agreement,³⁶ it requires justification for an exclusive multilateral approach.

I shall also divide my discussion of bilateralism and multilateralism along these two prongs. First, I shall focus on the regional level, i.e., on bilateralism³⁷, and ask whether the objectives of the proposed international action are perhaps better achieved by a bilateral agreement, or by a series of bilateral agreements, than by one multilateral agreement. Then, I shall proceed to the multilateral level and ask if there are special reasons in connection with the various fields of international economic regulation, which demand and justify common, coordinated action effected by a multilateral agreement.

4. The First Prong: The Advantages of Bilateralism

(A) Enables the Conclusion and Design of Regimes According to the Needs and Interests of the State

Bilateralism allows governments to conclude the types of agreements *they* need and want and to choose their partners to such agreements. It enables them to design such

³⁵ Paragraph (5) of the Subsidiarity Protocol, *supra* note 30.

³⁶ See *supra* note 33.

³⁷ For the sake of brevity I will sometimes use the term "bilateralism" to include any approach that is not multilateral, whether regional or bilateral

arrangements in the way that best suits their needs and interests.³⁸ This is the most essential rationale for the Subsidiarity Principle and for decentralization – taking decisions as close as possible to the people, where actions can be best designed to meet the needs of the constituents of the unit taking the decision. Multilateral agreements, in contrast, will have to target some ambiguous and sometimes elusive common denominator of the many national interests involved. Often, this tends to be the lowest common denominator of all the countries involved as a result of the need to reach a political consensus among the participants. Also, the negotiation and drafting process is usually dominated by the large and powerful countries, whereas the small countries have almost no ability to influence the outcome of multilateral negotiations. At most, they can create groupings in order to represent at least some of their interests, a process that also often involves compromises between themselves, even before the actual process of bargaining and compromising with the larger countries.

Applied to the area of trade liberalization this would mean, that if, for example, two countries with similar levels of economic development and with a neo-liberal economic ideology want to conclude a **Free Trade Agreement** (FTA) that will move them into a system of complete elimination of all trade barriers and deeper integration between their economies, armed with the Subsidiarity perspective, we must ask ourselves why they shouldn't be entitled to do so? Why do they have to be dependent on some elusive consensus of a group of over 150 countries of very different levels of economic development and diverging socio-economic philosophies? Thus, when it was decided to incorporate Article XXIV into the GATT, this can be seen as a recognition of the sovereign rights of two or more countries to conduct the foreign trade policy that is most in line with their own convictions and needs, as long as this is a trade promoting policy that does not cause too much harm to third countries.³⁹ Likewise, developing countries are permitted to conclude preferential bilateral deals

³⁸ However, see argument to the contrary in circumstances of unequal bargaining powers; *infra* paragraph 5(5).

³⁹ For example, one of the conditions of GATT Art. XXIV is that the duties and other trade barriers towards third parties “shall not on the whole be higher or more restrictive” than those that were in place prior to the conclusion of the free trade agreement. See *supra* note 33.

with other countries even if they do not entail complete liberalization of “substantially all trade” and establishment of an FTA.⁴⁰ Indeed, from the perspective of Subsidiarity we need to understand why only certain bilateral trade agreements are allowed and not others. In order to justify such a rule, it has to be shown how the goals of international trade promotion and global welfare will be better served by limiting the “freedom of contract” and sovereignty of nations and embracing multilateralism.⁴¹

Another example is **bilateral tax treaties**. These reflect the nature and interests of the two countries that have signed them, in relation to their own tax systems, and how they foresee the flow of trade, capital, investments and people between their two countries. For instance, a country interested in encouraging its residents to invest abroad, will provide them with a generous exemption for foreign tax income, while a country interested in discouraging such investment, in order to leave more capital at home, will not provide any such exemption, or will grant only a tax deduction, instead of an exemption. Conversely, a country’s willingness to exempt foreign investors from taxes on income derived in their country will depend on the extent of its need and interest in attracting foreign investment. These various needs and interests will be reflected in the different terms of the bilateral tax treaties. Usually, small countries' interest is to exempt foreign investors from taxes in order to attract investment even at the expense of foregone tax revenues.⁴² In big and strong economies, the need to attract foreign investment by using tax incentives may be less acute, and hence the government will prefer not to forego tax revenues generated by such investment. These and other considerations will also determine which "residency" or "source rules" a country will choose. A bilateral approach will allow a country to assess its own needs and interests vis a vis another country with its potential investors, potential investment opportunities and domestic tax regime, and reach a conclusion on whether it would like to sign a tax treaty with this country and,

⁴⁰ Trebilcock & Howse, *supra* note 1, at 471-506

⁴¹ Some of these justifications will be discussed below in Section 5 under "the Advantages of Multilateralism".

⁴² Tsilly Dagan, 'The Tax Treaties Myth', 32 *NYU J. Int'l L. & Pol'* (2000) 939, 953.

if so, which type of treaty. A multilateral tax treaty, in contrast, with uniform “one-size-fits-all” provisions would be unable to reflect these different needs and interests. As recorded by Rosenbloom & Langbein⁴³: “The early work of the League [of Nations] revealed the justification for bilateral approaches. Multilateral agreement is difficult when countries are in different legal or economic circumstances”.

The same rationale can provide an explanation for the dominance of bilateralism in the area of **foreign investment protection**. Countries are often specific about the countries with which they conclude bilateral investment treaties (BITs). Israel, for instance, will conclude such treaties only with developing countries that are considered as likely host states for Israeli investors, for the purpose of enhancing the protection of such investments. It does not usually sign them with developed countries, which are considered safe enough for Israeli investors on account of their developed economic and legal climate. Unlike many other states, Israel does not see the need to conclude such treaties with developed countries in order to attract investment from them, due to the good reputation of its judiciary and its friendly investment climate. It would seem that a strategic decision has been taken to prevent unnecessary exposure to law-suits from foreign investors, and thus no BITs have been signed with countries that are the source of most of the foreign investment in the Israeli economy (such as the USA and the EU countries⁴⁴). Other countries may have different policies adapted to their specific circumstances, and these will dictate with whom they conclude BITs and what the provisions of those BITs are. The use of BITs allows states to practice such fine-tuned economic policies, whereas a multilateral agreement – such as that proposed in the ill-fated OECD Multilateral Investment Agreement (MAI)⁴⁵ – would have forced them to abide by one uniform formula that ensures the same rights to all the other parties to the agreement.

⁴³ H. David Rosenbloom & Stanley I. Langbein, ‘United States Tax Treaty Policy: An Overview’, 19 *Columbia J. Transnational L.* (1981)359, 366.

⁴⁴ The only exception to this policy may be a BIT from 1976 between Israel and Germany, although the exact status of this BIT, which has not been published in Israel’s official gazette, is not clear. On the website of Israel’s Ministry of Finance, it appeared in the past as a “temporary agreement”.

⁴⁵ See *supra* note 6.

(B) Only Bilateral Agreements Provide Full Reciprocity

When one state negotiates an agreement with another state, it will bargain for whatever advantages it can extract from the other party. It will presumably sign the agreement only after obtaining those advantages that will make its own commitments to that party worthwhile. Such specific reciprocity is possible only in bilateral deals. In multilateral bargaining, as has been noted by Keohane in the international trade context, the reciprocity is more diffuse.⁴⁶ For example, in tariff negotiations within the GATT/WTO, much of the bargaining takes place bilaterally, but the results from the negotiations are extended to all of the other parties pursuant to the general Most Favoured Nation principle. Thus, tariff concessions are in effect given by one state to a multitude of other states but only in return for concessions from the one single state with which it conducted the bilateral negotiations. Under this system (which is not the only bargaining mechanism, but one of the more prevalent) all the other beneficiaries of the concessions are under no obligation to extend any reciprocal concessions. Thus, a country that is keen on opening up a market in a certain foreign country for its exporters, but is unwilling to extend the concessions that will be required from it in return to all the other WTO members, will have no other choice than to enter into a bilateral negotiation with that other country with the aim of concluding a free trade agreement with it, outside the realm of the WTO.

The problem of diffuse reciprocity can be found in other areas of international regulation, as well. A country joining the plurilateral Agreement on Government Procurement, for instance, is often required to extend equal access to its government contracts for suppliers from foreign countries in which its own suppliers may be very unlikely to ever win a contract (e.g., due to the nature of its industry and type of comparative advantage). If only a bilateral option was on the table, it is unlikely that such a country would sign a procurement agreement with these specific partners. However, as part of a multilateral deal, it has no choice but to either accept or reject

⁴⁶ Robert O. Keohane, "Multilateralism: An Agenda for Research" *International Organization* 45(4) (1990).

the entire package of mutual obligations and rights towards all of the parties of the agreement.

(C) Bilateral Agreements are Easier to Conclude

It is also much easier to negotiate and conclude a bilateral agreement with like-minded partners than with 153 WTO members of widely varying levels of development, economic interests and political constraints. Thus, even if we were to assume that the problems raised in the previous sections did not exist, and that a state could realize all its aspirations by the conclusion of a certain multilateral agreement, there would still remain one serious problem: it is extremely difficult to reach the necessary consensus in order to conclude such an agreement, and therefore in many cases it remains a desirable, but unattainable, goal. The problems that the current round of multilateral trade negotiations is facing⁴⁷ is a case at hand, as is the failure of the negotiations toward a multilateral agreement on investments,⁴⁸ the failure of the initiative to reach multilateral agreements on transparency in government procurement and on competition law, as well as the failure of many other multilateral initiatives.⁴⁹

(D) Product cycles get shorter but multilateral negotiating cycles are getting longer

⁴⁷ See the next subsection,

⁴⁸ *Supra* note 6.

⁴⁹ For example, most of the initiatives for harmonization of law in the field of commercial and trade law undertaken by respectable bodies such as the UN Commission on International Trade Law (UNCITRAL) and the International Institute for the Unification of Private Law (UNIDROIT) are acceded to by only a small number of states, much less than required for these initiatives to be successful. Those that are successful are sometimes the result of compromises designed to appease opposition. For example, out of the 10 multilateral conventions concluded under the auspices of UNCITRAL, only two can be considered as successful in terms of the number of their parties: the UN Convention on Contracts for the International Sale of Goods (70) and the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards (142). Five have no or less than ten parties and three have between 19 and 32 parties. For an overview of the status of these multilateral instruments, see these organizations' respective websites: www.uncitral.org and www.unidroit.org.

Multilateral rule-making appears to be unable to respond to the changing needs and problems of the modern international economy.⁵⁰ The first four rounds of GATT negotiations took between a year and two years to conclude, but the two last ones - the Tokyo (1973-1979) and the Uruguay Rounds (1986-1994) - have taken six and eight years respectively, and that doesn't even include the time it took to reach an agreement on launching the rounds. The current Doha round started almost seven years ago (November 2001), and it is still unclear if and when it will come to some conclusion. It has also had to abandon all of the much-needed "new" issues, such as competition, investment and transparency in government procurement. Instead, the whole round seems to be stuck on "yesteryear's" problems of agricultural trade, with its hopelessly embedded protectionism. The problems in this sector, which as a whole represents no more than 3% of total world trade, are preventing agreement on new rules and liberalization measures on the remaining 97% of world trade in manufactured products in sectors such as electronics, software and biotechnology and in service sectors such as financial and telecommunication services. It is therefore no wonder that countries interested in liberalizing these sectors turn to bilateral deals in order to reciprocally liberalize these areas with their likeminded trading partners.

(E) Signaling: Many Bilateral Agreements are Concluded in order to Stick out from the Crowd

Ethier's insight that FTAs are concluded in order to attract foreign investment⁵¹ would seem to work only within a bilateral approach: A country that concludes such an agreement for investment reasons wants to stick out! It wants to distinguish itself from other countries with similar economic endowments, so that investors will choose it over other potential host states.⁵² It does not want a multilateral deal, which will put

⁵⁰ "Regionalism and the Multilateral Trading System: The Role of Regional Trade Agreements" OECD Policy Brief, August 2003.

⁵¹ Ethier, *supra* note 14, p. 1160: "Regionalism is the means by which new countries trying to enter the multilateral system (and small countries already in it) compete among themselves for the direct investment necessary for their successful participation in that system."

⁵² For empirical evidence showing that much of the BIT signing is host-state-driven and that the diffusion of BITs is associated with competitive pressure among developing countries to capture a share of foreign

it in an identical situation with all the other countries. Such a deal will only entail all the costs (for instance, foreign investment protection that limit policy choices and a binding dispute settlement mechanism which may result in high monetary awards for compensation to the foreign investor) without any of the benefits (attracting investment). That is another reason why the Multilateral Agreement on Investment was bound to fail.

(F) Bilateral Agreements are often concluded in order to Promote Political and Strategic Objectives

An examination of the circumstances surrounding the conclusion of several bilateral agreements, in areas such as trade and investment, will reveal that these are often motivated by political and strategic objectives, transcending the immediate subject matter of the agreements in question.⁵³ The first FTA concluded by the US provides a good example. It was proposed by the US to both Israel and Egypt following the Camp David Peace Accord concluded between the two countries through the facilitation of the US. The idea was to reward them for their courage in concluding this ground-breaking peace agreement and to reinforce the relations between them and the US in the wake of the accord and throughout its implementation.⁵⁴ It is also very clear that there are more than pure economic rationales behind the recent FTAs concluded between the US and countries such as Jordan and Bahrain, traditional allies of the US in an otherwise hostile Arab surroundings. Similar motivation can be seen in some of the recent bilateral FTAs in Asia.⁵⁵

investment, see Zachary Elkins, Andrew T. Guzman, and Beth Simmons, "Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960 – 2000", forthcoming: *Illinois Law Review* (Issue 1, 2008).

⁵³ For a general survey, see Raquel Fernandez & Jonathan Portes, 'Return to Regionalism: An Analysis of Nontraditional Gains from Regional Trade Agreements', *The World Bank Economic Review*, Vol. 12, No. 2 (1998) 197-220.

⁵⁴ Israel accepted the proposal, and a bilateral US-Israel FTA was signed in 1985. The Egyptian Government was concerned about the adverse impact an FTA with the US might have on the Egyptian industry and decided to reject the proposal. Arie Reich, 'From Diplomacy to Law: The Juridicization of International Trade Relations', 17 *Nw. J. Int'l L. & Bus* (1996) 775, 817-820; Arie Reich, *International Public Procurement Law :The Evolution of International Regimes on Public Purchasing* (1999) 155-157

⁵⁵ Christopher M. Dent, 'Networking the Region? The Emergence and Impact of Asia-Pacific Bilateral Free Trade Agreement Projects', *The Pacific Review* Vol. 16, No. 1 (2003) p. 1.

Political objectives are of course prevalent and legitimate reasons for government foreign policy. The exercise of such a political function is part of the sovereignty of nations and the attainment of such objectives can only be effected at the bilateral level. A multilateral agreement could never, by definition, serve such an objective of reinforcing bilateral political relations. To insist on the exclusive reign of multilateralism in certain fields would therefore deprive states of their ability to use bilateral agreements in the furtherance of such political objectives. The Subsidiarity Principle would thus provide both an explanation and – at least to a certain extent – a justification for such bilateral action.

5. **The Second Prong: The Advantages of Multilateralism, or When Multilateralism is needed**

Having concluded our analysis of the first prong of the Subsidiarity Principle, we shall now turn to the second prong, where we must ask ourselves if there are special reasons which demand and justify common, coordinated action on the multilateral level, as opposed to the bilateral level, in order to better achieve the task at hand. Here we need to turn our attention to the disadvantages and weaknesses of bilateralism and other fragmented approaches, in relation to multilateral action.

(A) The Classic Vinerian Argument: Bilateral, Preferential Trade Arrangements Cause Inefficient Trade Diversion

The Subsidiarity perspective will also take into account the classic Vinerian argument in favour of multilateral trade agreements, but it will do so along with other relevant arguments, such as those elaborated in the previous section under the first prong, and within a more encompassing framework. Indeed, as shown by Jacob Viner, multilateral, non-discriminatory trade arrangements are more effective in ensuring efficient allocation of manufacturing resources.⁵⁶ By requiring equal treatment to all imports, a multilateral approach such as that espoused by the general Most Favoured

⁵⁶ Viner, *supra* note 12, 53-54.

Nation obligation of GATT Article I, ensures that these resources will be allocated to the most efficient foreign producer. In contrast, preferential arrangements, such as a bilateral FTA, may result in a price advantage for a less-efficient producer established in an FTA country, over a more efficient foreign producer that happens to be established in a country with no FTA with the importing country in question, and thus manufacturing resources will be inefficiently allocated to the former producer (a phenomenon known as "trade diversion"). Hence the advantage of multilateral action in achieving global efficiency and raising worldwide standards of living.

This argument, however, can be met with a contra-argument: "Yes, but discrimination between domestic and foreign products is still permitted under the GATT/WTO multilateral regime (by import tariffs and subsidies, in the case of manufactured products⁵⁷; by quotas and other non-tariff barriers, in addition to tariffs and subsidies, in the case of agricultural products⁵⁸; and by various administrative barriers in the case of services⁵⁹)." This too causes a kind of "trade diversion" (resources are allocated to inefficient domestic producers, away from more efficient foreign producers). Whether multilateralism or bilateralism is preferable as a strategic approach depends on how successful multilateralism is in bringing down such protectionist barriers. If it is relatively unsuccessful and such barriers remain high, thus causing significant "trade diversion" in the form of inefficient import substitution, bilateralism may be preferable. The trade creation a bilateral FTA generates by bringing down protectionist barriers often outweighs the trade diversion it generates. Moreover, as bilateral deals proliferate, trade diversion decreases further, and only the trade creation remains.

⁵⁷ The GATT/WTO regime does not require the abolition of custom duties, only that the parties respect the principle of MFN and do not exceed the levels of duties they have committed to under their respective tariff schedules. Domestic subsidies, i.e., those paid to the domestic industry irrespective of whether they export or not, are also not prohibited per se under the GATT/WTO regime. See J.H. Jackson, *The World Trade Organization : constitution and jurisprudence* (1998) .

⁵⁸Michael J. Trebilcock & Robert Howse, *The Regulation of International Trade* (2005- 3rd Edition) 321-348

⁵⁹ *Ibid* p. 439-470

(B) Prisoner's Dilemma Situations: Some Problems Require Fully Coordinated Solutions with No Defections

Another category of circumstances which may require multilateral action are those that involve Prisoner's Dilemma situations. Some problems require fully coordinated solutions, with no defection by any party. One example of such circumstances is the fight against international **money laundering**. If only one or more countries – but not all – impose anti-laundering regulations on their banks, the money launderers will move their activity to banks with no such regulations. Thus, the countries that imposed these regulations would be hurting their own banking industry, by taking away from them a considerable amount of business, but without really solving the global problem of money laundering. The money laundering would continue through banks in other countries, and the criminal activities which the anti-laundering regulations were meant to combat and choke will continue uninterruptedly. Assuming that there are no costs to the hosting country from the laundering itself (for instance in the form of other “spillover” criminal activities that because of the laundering activity will also take place within its territory), but only gains, you would therefore not expect to find a bilateral or even plurilateral agreement against money laundering. Indeed, reality shows that this fight is carried out by a multilateral strategy aimed at all countries, with no exceptions. It is done through a multilateral body named the Financial Action Task Force (FATF)⁶⁰ which was founded in 1989 by the G7.⁶¹ Since, as explained, there is a strong incentive for any country to cheat on the rules of such a regime in order to attract large sums of capital to their banks, the regime needs a strong enforcement and deterrence mechanism against cheating. The FATF has managed to establish such a mechanism through the use of blacklisting of non-

⁶⁰ The purpose of the FATF is to develop policies to combat money laundering and terrorist financing. The FATF Secretariat is housed at the headquarters of the OECD in Paris. Since its creation the FATF has spearheaded the efforts to adopt and implement measures designed to counter the use of the financial system by criminals. It established a series of Recommendations in 1990 and revised them in 1996 and in 2003 in order to ensure that they remain up to date and relevant to the evolving threat of money laundering. The recommendations set out the basic framework for anti-money laundering efforts and are intended to be of universal application, not just to the members of the Task Force.

⁶¹ G7 is short for "the Group of 7" (today known as G8) and is an international forum for the large economies of the world, which at the time included the states: Canada, France, Germany, Italy, Japan, the United Kingdom and the United States; For more on the FATF project of the OECD see: www.fatf-gafi.org.

cooperative countries, which results in significant financial pressure on them and a *de facto* boycott of banks and financial institutions located in such countries. Thus, the success of this international initiative was due to its ability to establish an effective multilateral regime, which no state could afford to violate.⁶²

Another example is the fight against **bribery in international business transactions**. In the late eighties the US enacted the Foreign Corrupt Practices Act,⁶³ thus unilaterally imposing on their own businessmen a prohibition against such bribing activities in foreign countries. In doing so it also hurt its industry significantly, by placing it in disadvantage with competing industry from other countries, where no such restrictions applied. These competing industries could thus win foreign government contracts by bribing the foreign officials in charge, while US industries were enjoined from similar tactics. To solve this problem, the US initiated a multilateral treaty in 1997, namely the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.⁶⁴ Until today it has 37 signatories, and the OECD makes efforts to enforce it by conducting and publishing individual country monitoring and follow-up. The effectiveness of the convention could of course benefit from getting more countries to join its ranks, but the OECD – as an organization of mainly developed states - lacks the ability to press more countries into joining. Therefore, this important task of combating corruption has lately been taken up by the United Nations itself, which in 2003 launched the United Nations Convention Against Corruption (UNCAC).⁶⁵

To a certain extent, the problem of **trade-distorting subsidies**, in particular export subsidies, could also be seen as involving a prisoner's dilemma situation, and

⁶² Guy Stessens, *Money Laundering: A New International Law Enforcement Model (2000) part IV*

⁶³ Pub. L. 105-366 (November 10, 1998); 15 U.S.C. §78dd-3.

⁶⁴ The Convention was signed in December 1997 and came into force in February 1999. Signatories include all 30 OECD members, plus seven non-Members (Argentina, Brazil, Bulgaria, Chile, Estonia, Slovenia and South-Africa). The text of the Convention is available at: <http://www.oecd.org/dataoecd/4/18/38028044.pdf>

⁶⁵ United Nations Convention against Corruption, adopted by the General Assembly by its resolution 58/4 of 31 October 2003; available at:

http://www.unodc.org/pdf/crime/convention_corruption/signing/Convention-e.pdf;

Ben W. Heineman, Jr and Fritz Heiman, 'The Long War Against Corruption', *foreign affairs* (May/June 2006)

therefore require a multilateral regime. While from a purely economic perspective, the granting of subsidies is usually bad for the granting state's economy, causing inefficient allocation of its own resources, and creating – as Adam Smith pointed out⁶⁶ – a supposedly productive activity that consumes more than it produces – in practice, because of various political market failures, many national governments believe that subsidization of certain sectors and activities is in their interest (for instance, agriculture). There are some specific sectors where this may in fact be true. For instance, if subsidization can be used in a strategic manner in order to eliminate competitors, who because of high entry barriers will be precluded from re-entry, it may capture an industry niche and thus benefit the subsidizer's economy.⁶⁷ Based on such a strategy, these subsidies will also pose a prisoner's dilemma. Take for instance the case of export subsidies, where the industries of several countries compete for the same export markets. Each country would be best off, according to its own perception, if the other countries all eliminated export subsidies, except for itself. If everybody continues to subsidize, they are all worse off than if they didn't, because they spend money but don't gain more markets than what they would have if everybody stopped subsidizing, or brought down subsidies to the same levels.⁶⁸ Thus, here too we are unlikely to see bilateral regimes. For an international regime to be effective, it would have to be multilateral. This is why the WTO Agreement on Subsidies⁶⁹ is so important, as well as the provisions on subsidies in the WTO Agreement on Agriculture.⁷⁰ Unlike the subject matter of some of the other WTO agreements, where we find that many states pursue bilateral agreements as

⁶⁶ Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (London: George Routledge and Sons, Ltd., 1890), p. 386 (Book IV, Ch. V).

⁶⁷ One of the sectors where this is said to have had success is the civil aircraft sector. See e.g., J.A. Brander & B.J. Spencer, 'Export Subsidies and International Market Share Rivalry', 16 *J. Int'l Econ.* (1985) 83; P.R. Krugman & M. Obstfeld, *International Economics: Theory and Policy* (2nd ed., 1991) 269.

⁶⁸ This assumes inelastic demand. However, even under an assumption of increase in demand as a result of lower prices in a heavily subsidized market, this increase can never fully compensate exporting states for the costs of the higher subsidies.

⁶⁹ Agreement on Subsidies and Countervailing Measures, Annex 1A.12 of the Marrakesh Agreement Establishing the World Trade Organization; in *The Results of the Uruguay Round of the Multilateral Trade Negotiations: The Legal Texts* (WTO, 1995) 264.

⁷⁰ Agreement on Agriculture, Annex 1A.2 of the Marrakesh Agreement Establishing the World Trade Organization, *ibid.*, 39.

alternatives to the stalled Doha Round,⁷¹ here there can be no real bilateral alternative to an effective multilateral regime.

(C) *Economies of Scale*

Multilateral agreements offer of course the advantage of lower transaction costs involved in one central negotiation and drafting process that results in the binding of all the parties to mutual obligations to one another.⁷² This corresponds to one of the justifications expressly mentioned in EC Treaty Art. 5 for Community/Multilateral action: (“by reason of scale”).⁷³ One multilateral agreement is equivalent to a number of bilateral agreements that equals the number of partners to the multilateral agreement multiplied by the same number minus one, and divided by two. One WTO agreement, for instance, between its current 153 members, is equivalent to 11,628 bilateral agreements between all of the members!⁷⁴ This entails of course a very significant amount of savings in terms of negotiation time and resources, travel expenses, lobbying efforts etc. Of course, the significant costs connected with a system where only bilateral agreements are used can be reduced somewhat by the parties subscribing to a standard template agreement, thus saving themselves the need to negotiate and draft each and every provision. Indeed, this appears to be the case with bilateral tax treaties, which tend to adopt the OECD Model Tax Convention⁷⁵ or the UN Model Conventions.⁷⁶ Also Bilateral Investment Treaties tend to adopt similar forms.

(D) *The Value of Uniformity*

⁷¹ Such bilateral free trade agreements deal primarily with mutual elimination of custom duties and other bilateral concessions where benefits can be reserved to the industries of the respective parties.

⁷² R. Keohane, *After Hegemony: Harmony and Discourse in International Economic Relations* (1984).

⁷³ See *supra* text attached to note 26

⁷⁴ $(153 \times 152) : 2 = 11,628$.

⁷⁵ Articles of the Model Convention with Respect to Taxes on Income and on Capital, available at: <http://www.oecd.org/dataoecd/50/49/35363840.pdf>

⁷⁶ The United Nations Model Double Taxation Convention between Developed and Developing Countries, available at <http://daccessdds.un.org/doc/UNDOC/GEN/N00/676/65/PDF/N0067665.pdf?OpenElement>. Both the OECD and the UN Model Conventions are periodically revised and updated to respond to changing needs and conditions.

Another advantage and possible justification for multilateral action is when uniformity between the manifold bilateral sets of rules is required or is very valuable. This would correspond to the idea expressed in EC Treaty Art. 5 by the words: “by reason of the ...effects of the proposed action, [can] be better achieved by the Community”.⁷⁷

Thus, for instance, exporters may suffer high transaction costs as a result of the different **rules of origin** that govern the various bilateral FTAs.⁷⁸ They are often faced with a situation where the same product may have to abide by one set of rules when exported to a certain country, and another set of rules when exported to another country. It may require them to change their production process or sourcing requirements according to the target market, or to inefficiently match their sourcing and production policies to the requirements of the most stringent of the FTAs in this regard. This happens because the rules of origins of an FTA are often a reflection of the domestic political economy and of protectionist lobbying efforts by industries in the two parties to the FTA.⁷⁹ The negotiations are therefore bound to result in different sets of rules for each FTA. Only within a multilateral trade agreement can the parties arrive at one common set of rules. There have been three notable attempts at multilateral harmonization of rules of origin,⁸⁰ but unfortunately none of them has been very successful. The 1995 Uruguay Round package included a special agreement on rules of origin⁸¹ that was meant to achieve, if not uniformity, at least harmonization of the rules of origin that govern the trading-rights under the WTO agreements (but not under the bilateral trade agreements, which are not part of the WTO). It seems, however, that the working programme set up by the agreement has not been able to produce an agreement on such harmonized rules,

⁷⁷ See *supra* text attached to note 26 .

⁷⁸ For a discussion of this problem, see Bernard Hoekman, ‘Rules of Origin for Goods and Services: Conceptual Issues and Economic Considerations’ 27 *Journal of World Trade* (1993) 81; Trebilcock & Howse, *supra* note 1, 189-190.

⁷⁹ Moshe Hirsch, ‘International Trade Law, Political Economy and Rules of Origin: A Plea for Reform of the WTO Regime on Rules of Origin’ 36 *Journal of World Trade* (2002) 171 .

⁸⁰ The first was in 1953, when GATT Contracting Parties considered adopting uniform rules of origin, but could not agree on a draft text defining origin. Then in 1974, the Custom Cooperation Custom Council adopted the International Convention on the Simplification and Harmonization of Customs Procedures (the Kyoto Convention), which provided guidelines for rules of origin, but not actual rules. The third attempt is the Agreement on Rules of Origin, adopted in 1995 as part of the WTO agreement, discussed in the text above.

⁸¹ Agreement on Rules of Origin, Annex 1A of the WTO Agreement [reference].

until the agreed deadline, or even until the extended deadline of the end of 2001. Until today no compromise has been reached. It seems therefore that the serious coordination problems of the multilateral rules-making process that we discussed above have again frustrated the ability to produce the necessary rules for the multilateral society. If a multilateral regime is not attainable even for the limited purpose of the WTO's own agreements, then countries have no choice but to again resort to bilateral or regional venues. Thus, the large players, such as the US and the EU, have managed to more or less harmonize the rules of origin that they apply towards all of their smaller trade partners within the bilateral FTAs⁸², but any of these partners that have agreements with more than one such player, have no choice but to accept different rules for different countries.

A similar pattern can be found with regards to **product standards**.

(E) *Unequal Bargaining Power*

A final reason to prefer multilateral action is in circumstances where bilateral action will give unfair advantages to the stronger party to the negotiations, and lead to suboptimal outcomes either from a distributive justice or efficiency perspective. In such situations, multilateral negotiations that allow weaker countries – such as developing and least developed countries – the possibility to coordinate their positions and bargain collectively with the stronger countries may lead to better results.

Such circumstances seem to exist currently in the areas such as intellectual property regulation, foreign investment protection and labour and environment standards. When the US found itself unable to promote its objectives in these areas within the multilateral negotiations of the Doha Round, because of the collective objection of developing countries, it turned its efforts in this regard to the bilateral level where it has already achieved some success. Several bilateral FTAs concluded lately with developing countries include so-called “TRIPs plus” provisions, provisions on investment protection, and side-agreements on labour and environmental standards – all of which have hitherto

⁸² Antoni Esteveadoral & Kati Suominen, ‘Rules of Origin: A World Map and Trade Effects’, mimeo IDB, Washington, D.C. (2004)

been rejected within the Doha Round negotiations. The US “divide and conquer” approach in this regard has been severely criticized by many trade scholars and NGOs.⁸³

6. Conclusions

As we have seen, the subsidiarity principle provides a more balanced and comprehensive perspective on the problems associated with the 'spaghetti bowl' of bilateral and regional economic agreements, that many see as threatening to unravel the gains of the post-World War II multilateral trading system. Subsidiarity as an organizing principle could be more effective than the current regime – GATT Article XXIV – in regulating the relationship between the WTO and regional trade agreements, because it would optimize the advantages of both regionalism and multilateralism. Bilateral and regional agreements have many advantages that are foregone within the multilateral system: They are more sensitive to the particular needs and interests of states and allow decisions to be taken on a level closer to the people, they enable full reciprocity without 'free-riding', they are easier to negotiate and consummate, they can address technological change and shorter product cycles faster than the WTO, they provide efficient signaling to other participants in the multilateral system and to investors, and they are convenient platforms for political agreements. Multilateralism, on the other hand, is needed for other, complementary reasons that are not necessarily contradictory: It prevents trade diversion, overcomes cooperation problems, optimizes global economies of scale, provide uniform standards and 'language', and balances asymmetrical bargaining power. The subsidiarity approach would turn GATT Article XXIV on its head, by making bilateral arrangements the default, with multilateralism being engaged only where the goals could not be attained on a regional or bilateral basis. However, the Subsidiarity perspective can be applied to more than just agreements on lowering of tariffs. In the text above, we have applied it to several other fields of international economic regulation, such as subsidies, government procurement, foreign investment, money laundering, corrupt practices, labour and environmental standards, and intellectual property. In that, it is also more comprehensive

⁸³ [References]

than the Ethier perspective, which only explains the existence of regional trade agreement – not bilateral agreements between non-neighbouring countries, such as those that we have seen much of in the last few years, nor bilateral agreements in other economic areas.