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BILATERLISM VERSUS MULTILATERALISM IN INTERNATIONAL ECONOMIC LAW: APPLYING THE PRINCIPLE OF SUBSIDIARITY

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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. In contrast to the new world economic order contemplated by the founders of the Bretton-Wood 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, 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. We are also starting to see beginnings of bilateralism in the area of intellectual property regulation that traditionally was governed almost exclusively by multilateral treaties. 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), 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. Such agreements have become so widespread that all but one WTO member are now parties to one or more of them and it is estimated that more than half of world trade is now conducted under bilateral FTAs. Likewise in the field of international investment protection, the attempt by the OECD to create a Multilateral Investment Agreement (MAI) failed in 1998, and instead we have today some 2,400 Bilateral Investment Treaties (BITs). 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 2,500. This situation has given rise to a lively debate on the utility of such bilateral agreements, in particular in the field of international trade, known as the so-called "building blocks or stumbling blocks" debate.[1]

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,[2] 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.

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".[3] 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.

[1] See for instance on the WTO website: www.wto.org
[2] Jacob Viner, *The Customs Union Issue* (New York, 1950).
[3] Wilfred Ethier, "The New Regionalism" in 108 *Economic Journal* 1149 (1998).

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.[4] In his theory, the success of multilateral liberalization will increase trade between neighbours, which in turn will create further incentives to *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,[5] Bahrain,[6] Jordan,[7] Morocco,[8] Singapore,[9] and its declared intention to sign such agreement with Korea[10], Malaysia[11], South Africa and the United Arab Emirates[12] illustrate this trend. 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. There seems thus to be an ever growing gap between the prescriptions of scholarly writings and the actual reality of international economic regulation.

This paper wants to propose a different perspective on the debate, namely that of 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

[4] *Ibid.,* on p. 1152, Ethier describes one of the characteristics of the "New Regionalism": "Regional arrangements are regional geographically: The participants are neighbours."
[5] US-Australia Free Trade Agreement, signed in May 18, 2004; [source]
[6] US-Bahrain Free Trade Agreement, signed in September 14, 2004. [source]
[7] US-Jordan Free Trade Agreement, signed in October 24, 2000. [source]
[8] US-Morocco Free Trade Agreement, signed June 15, 2004 [source].
[9] US-Singapore Free Trade Agreement, signed in May 6, 2003. [source]
[10] Announced in February 2006, see http://www.ustr.gov/Document_Library/Press_Releases/2006/February/United_States,_South_Korea_Announce_Intention_to_Negotiate_Free_Trade_Agreement.html
[11] Announced in March 2006; see http://www.ustr.gov/Document_Library/Press_Releases/2006/March/United_States,_Malaysia_Announce_Intention_to_Negotiate_Free_Trade_Agreement.html
[12] Announced in November 2004; see: http://www.ustr.gov/Trade_Agreements/Bilateral/UAE/Section_Index.html

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".[13] 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 regimes, and between bilateral, 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.

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 will be to try 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 and the political/ethical rationales of the Subsidiarity principle.

One of the advantages of the perspective introduced here is that is 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 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 enroll the WTO to the task of negotiating a multilateral tax convention.[14] Indeed, much of the more current literature, including

[13] 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) at 111; E.U. Petersmann, "Multilevel Trade Governance Requires Multilevel Constitutionalism" in *Constitutionalism, Multilevel Trade Governance and Social Regulation* (C. Joerges & E.U. Petersmann, eds., 2006); John H. Jackson, "The WTO "Constitution" and Proposed Reforms: Seven Mantras Revisited" 4 *J. Int'l Econ. L.* 67 (2001); Robert L. Howse & Kalypso Nicolaides, "Enhancing WTO Legitimacy: Constitutionalization or Global Subsidiarity" 16 *Governance* 73 (2003); Neil Walker, "The EU and the WTO: Constitutionalism in a New Key" in *The EU and the WTO: Legal and Constitutional Issues* (G. De Burca & J. Scott, eds. 2001); J.O. McGinnis & M.L. Movsesian, "The World Trade Constitution", 114 *Harvard L. R.* 511 (2000); 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).

[14] See e.g., "Special Survey: Globalization and Tax", *The Economist*, (Jan. 29, 2000); and Reuven S. Avi-Yonah, "Globalization, Tax Competition and the Fiscal Crisis of the Welfare State", 113 Harv. L.R. (2000) 1573. Avi-Yonah,

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

2. The Principle of Subsidiarity (Chapter to be completed)

a. Its short history

b. Its ethical rationale

c. Its political rationale

d. Its applications in EU Law & German Law

EC Treaty Art. 5 (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."

The subsidiarity principle, as set out in the Subsidiarity Protocol annexed to the Amsterdam Treaty, is intended to ensure that decisions are taken as closely as possible to the citizen[15] 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. Specifically, it is the principle whereby the Union does not take action (except in the areas which fall within its exclusive competence) unless it is more effective than action taken at national, regional or local level.[16]

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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.

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

[16] In the Treaty of Amsterdam, the principle was further elaborated in the so-called Subsidiarity Protocol annexed to the Treaty. Para. (5) provides:

"(5) 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 national constitutional system and can therefore be better achieved by action on the part of the Community.
The following guidelines should be used in examining whether the abovementioned condition is fulfilled:
- the issue under consideration has transnational aspects which cannot be satisfactorily regulated by action by Member States;
- actions by Member States alone or lack of Community action would conflict with the requirements of the Treaty (such as the need to correct distortion of competition or avoid disguised restrictions on trade or strengthen economic and social cohesion) or would otherwise significantly damage Member States' interests;
- action at Community level would produce clear benefits by reason of its scale or effects compared with action at the level of the Member States."

It should be stressed, that while the EC has chosen to apply the principle of Subsidiarity only to areas where there is parallel authority between the Community institutions and the Member States, and not to areas which fall within the exclusive competence of the former, this is a political-constitutional decision that has nothing to do with the principle itself, which expresses a general notion about how authority ought to be allocated in society. In this paper, we will relate to this general notion and not to its particular implementation in the EC system.[17]

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, under the 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 ("…the Community shall take action… only if and insofar etc.").[18] The principle has two prongs: one negative and one positive. The negative prong refers to the ability of the 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 regional level. 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 the 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 Community/community of states – the level where 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

[17] See also note 18 below.

[18] 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 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.

the framework of their national constitutional system *and* they can be better achieved by Community action.[19] 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, it requires justification for an exclusive multilateral approach.

We shall also divide our discussion of bilateralism and multilateralism along these two prongs. First, we shall focus on the regional level, i.e., on bilateralism, and ask ourselves 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, we shall proceed to the multilateral level and ask ourselves 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

(1) 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 arrangements in the way that best suits their needs and interests.[20] 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 bargaining process and compromising with the larger countries.

[19] Paragraph (5) of the Subsidiarity Protocol, *supra* note 15.
[20] However, see argument to the contrary in circumstances of unequal bargaining powers; *infra* paragraph 5(5).

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 shouldn't they be entitled to do so? Why do they have to be dependent on some elusive consensus of a group of 149 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.[21] Likewise, developing countries are permitted to conclude preferential bilateral deals with other countries even if they do not entail complete liberalization of "substantially all trade" and establishment of an FTA.[22] 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.

Another example is **bilateral tax treaties**; These reflects the nature and interests of the two countries that have signed them, in relation to their own tax system, and how they foresee the flow of trade, capital, investments and people between their two countries. For instance, a country interested in encouraging their 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 their need and interest in attracting foreign investment. These various needs and interests will be reflected in the different terms of the different bilateral tax treaties. Usually, small countries have an interest to exempt foreign investors from taxes in order to attract investments even at the expense of foregone tax revenues.[23] In big and strong economies, there may be no such need, and instead the A multilateral

[21] 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.

[22] [Reference to the Enabling Clause].

[23] Tzilly Dagan, "The Tax Treaties Myth", 32 *NYU J. Int'l L. & Pol*. 939 (2000) 953.

tax treaty with uniform "one-size-fits-all" provisions would be unable to reflects these different needs and interests. As recorded by Rosenbloom & Langbein[24]: "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 to 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, but not with developed countries. The latter 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 countries[25]). 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) – would have forced them to abide by one uniform formula that ensures the same rights to all the other parties to the agreement.

(2) 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.[26] For example, in tariff negotiations within the GATT/WTO, much of the bargaining takes place bilaterally, while the results from the

[24] H. David Rosenbloom & Stanley I. Langbein, "United States Treaty Policy: An Overview" 19 *Columbia J. Transnational L.*. 359 (1981) 365-366.
[25] The only exception to this policy may be a BIT 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 Foreign Ministry, it appears as a "temporary agreement". [check]
[26] Robert O. Keohane, "Multilateralism: An Agenda for Research" *International Organization* 45(4) (1990).

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 negotiation. 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 to it any reciprocal benefits. Thus, a country that is keen on opening a certain foreign market for its exporters may 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.

The problem of diffuse reciprocity can be found in other areas of international regulation. A country joining the plurilateral Agreement on Government Procurement, for instance, is often required to extend equal access to its government contracts to suppliers from a foreign country in which its own suppliers are very unlikely to ever win a contract (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 this specific partner. However, as part of a multilateral deal, it has no choice but to either accept or reject the entire package of mutual obligations and rights towards all of the parties of the agreement.

(3) Bilateral Agreements are Easier to Consummate

It is also much easier to negotiate and conclude a bilateral agreement with like-minded partners than with 149 WTO members of widely varying levels of development, economic interests and political constrains. Thus, even if we were to assume that the problem raised in the previous section 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.

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

Multilateral rule-making appears to be unable to respond to the changing needs and problems of the modern international economy.[27] 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 five

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

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.

(5) 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 investment 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. It does not want a multilateral deal, which will put 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 with foreign investors which may result in high monetary awards) without any of the benefits (attracting investment). That is another reason why the MAI was bound to fail.

(6) 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 a 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.[28] 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

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

the accord and throughout its implementation.[29] 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.[30]

Political objectives are of course prevalent and legitimate reasons for government foreign policy. 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 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.

(1) 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 global manufacturing resources. By requiring

[29] 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.
[30] 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.

equal treatment to all imports, a multilateral approach such as that espoused by the General Most Favoured 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. 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 case of manufactured products; by quotas and other NTBs, in addition to tariffs, in case of agricultural products; and by various administrative barriers in the case of services)." This too causes "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.

(2) 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 can explain the existing multilateral regime to 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 not 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 arrangement to fight against money laundering. Indeed, this fight is carried out by a multilateral strategy aimed at all countries, with no exceptions. Under such an arrangement, there is a strong incentive for any country to cheat, in order to attract large sums of capital to their banks, so the arrangement will be in need of a strong enforcement and deterrence mechanism against cheating. [Expand on the FATF project of the OECD].

Another example is the fight against **bribery in international business transactions**. When the US in the late eighties imposed their unilateral law – the Foreign Corrupt Practices Act - on their own businessmen outlawing such bribing activities in foreign countries, 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 where 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.[31] Until today it has 36 signatories, and the OECD attempts 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 lacks the ability to press more countries into joining. The main tool used for this, is by making accession to the Convention a condition of the membership of the OECD, the "club" of the developed countries, which many countries prize. In any case, it is mostly the firms from developed countries that can seriously compete for most of the large foreign government contracts, so if you have them on the boat, you have most of what you need.

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 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 out – a supposedly productive activity that consumes more than it produces – in practice, because of various political market failures, many national governments perceive subsidization of certain sectors and activities as being in their interest (for instance, agriculture). There are some specific sectors where this perception may in fact be true, 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 (for instance, in the civil aircraft sector). Based on that perception – correct or incorrect – such

[31] The Convention was signed in December 1997 and came into force in February 1999. Signatories include all 29 OECD members, plus seven non-Members (Argentina, Brazil, Bulgaria, Chile and the Slovak Republic, ____, _____).

subsidies will also pose a prisoner's dilemma problem. 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. 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 Subsidies is so important, as well as the provisions on subsidies in the WTO Agreement on Agriculture. Unlike some of the other WTO agreements, where we find that many states pursue bilateral agreements as alternatives to the stalled Doha Round, here there can be no real bilateral alternative to an effective multilateral regime.

(3) Economies of Scale

Multilateral agreements offer of course the advantage of lower transaction costs involved in one central negotiation and drafting process resulting in the binding of all the parties to the agreement to mutual obligations to one another. This corresponds to one of the justifications expressly mentioned in EC Treaty Art. 5 for Community/Multilateral action: ("by reason of scale etc."). One such 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 149 members, is equivalent to 11,026 bilateral agreements between all of the members![32] This entails of course a very significant amount of savings in terms of negotiation time and resources, travel expenses, lobbying efforts etc. These costs 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 Convention or the UN Model Conventions. Also Bilateral Investment Treaties tend to adopt similar forms.

(4) The Value of Uniformity

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

[32] (149x148):2 = 11,026

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".

Thus, for instance, high transaction costs may be caused to exporters by the different **rules of origin** that govern the various bilateral FTAs. Exporters are thus faced with a situation where the same product may have to abide by one set of rules when exported to one 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. 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. Indeed, the Uruguay Round package included a special agreement on rules of origin[33] 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, 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 FTAs[34], 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.**

(5) 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

[33] Agreement on Rules of Origin, Annex 1A of the WTO Agreement [reference].
[34] [Qualifications]

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 has 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 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.

6. Conclusions

Unlike the Vinerian perspective, which is generally critical of bilateral trade agreements and provides only a limited justification for them, the Subsidiarity perspective sees them in a more positive light, providing several explanations and justifications for their existence and thus somewhat closing the gap between the reality of booming bilateralism and the rejective scholarship. The Subsidiarity perspective incorporates both ethical and political considerations, in addition to the economic ones, and can be applied to more than just trade agreements. In the text above, we have applied it to numerous fields of international economic regulation, such as tariffs, subsidies, government procurement, foreign investment, money laundering, corrupt practices, labour and environmental standards, and intellectual property. In that, it is also more comprehensive than the Ethier perspective, which only explains the existence of regional trade agreement – not bilateral agreements between non-neighbouring countries, such as those we have seen much of in the last few years, nor bilateral agreements in other economic areas.

Along with the justifications for bilateral action, the Subsidiarity perspective also describes several types of situations where multilateral action is justified, to the exclusion of bilateralism. It develops the contours of the criteria that can be used in order to balance the relative advantages and disadvantages of bilateralism versus multilateralism and come to a conclusion on the preferred venue for different circumstances.