

Regionalisation within the Context of the WTO
A Case Study of the TTIP: Threat or Stepping Stone?

by

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I would like to thank Professor YOSHIMATSU Hidetaka for his valuable feedback. I have taken his comments into serious consideration and made the necessary changes accordingly.

*First, it is necessary to provide **analytical frameworks**. The current manuscript lacks clear frameworks for an analysis. The student needs to set up several research questions (they are shown in abstract) in Introduction section. The student then needs to provide answers to the questions in conclusion (chapter 7).*

→ I have made a new “4.5. TTIP in the analytical framework” where I explain why the TTIP is a good RTA in light of the WTO system. I have also added some remarks in the Conclusion that address more clearly the research questions

*Second, the author needs to **rationalise why the TTIP was selected** to examine as a representative of RTAs. There are so many RTAs including the recently agreed TPP. The student shows why an analysis of the TTIP is important for achieving the overall objective of the thesis as an independent section as 3.8.*

→ I have added a point “3.8. Why the TTIP” in which I explain my personal and topical reasons for choosing the TTIP as a research subject.

*Third, the student is encouraged to set **up linkages between theories and empirical analyses**. As the student spends several pages on theoretical views on regionalism such as realism and liberalism, it is useful to examine the TTIP’s problems and relevance to the EU from these theoretical standpoints.*

→ I have set up the linkages between the theories and empirical analyses in point 4.5. where I also address the analytical framework.

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Abstract

First, I looked into the legal framework of the exemption clause to the Most-Favoured Nation principle(MFN) provided by article XXIV GATT(General Agreement on Tariffs and Trade) and article V GATS(General Agreement on Trade in services). This forms the objective legal research question of how and why the WTO allows exemptions for RTAs. Secondly, I focused on the potential global influence of the TTIP and place it in the broader context of the the general theoretical framework of regionalisation to see if it

Despite some potential dangers, RTAs are in fact a positive phenomenon for the multilateral trading system. Especially with global trade negotiations stagnating, we need a new dynamic and regionalisation might be it. This being said, I am acutely aware of the negative effects of RTAs and these will be adressed as well.

This is a very hot topic in the world of the WTO and the global multilateral trading negotiations. I feel like we have arrived at a crossroads after the lagging of the Doha Development Agenda. The multilateral trading system failed in conducting efficient negotiations and this lead to an even greater surge in RTAs. The WTO cannot but take a clear stance vis-à-vis RTAs because it is a reality they have to accept and deal with if they want to be taken seriously in the future. A lot of scholars are currently researching this topic which makes it a very relevant research . Researching current RTAs is not a simple task since they come in different formats, scopes, membership et cetera. RTAs are like your children, each one of them is unique in their own special way. Most studies agree this agreement can be a global economic milestone, for better or for worse.

I have chosen to focus on the TTIP because it reflects best the current attitude on RTAs. It is an example of the new regionalism and can form a stepping stone for global liberalisation if it plays its cards right. The TTIP is a form of deep integration and does, therefore, not form a stumbling stone for the WTO.

1. Introduction

Since the mid-1990's Free Trade Agreements (hereinafter FTAs) or Regional Trade Agreements (hereinafter RTAs) have known a significant surge, both in quantity and importance. The increasing economic integration on a regional level leads to benefits as well as complexities. Especially in the World Trade Organization's (hereinafter WTO) multilateral trade system, regionalisation is met with lukewarm and sometimes contradicting feelings. Some authors fear that the increasing regionalisation is eroding the multilateral trading system whilst others think of it as stepping-stones or building blocks. Thus my research question is how and why the WTO allows exemptions for RTAs, and secondly on the potential influences of the TTIP (Transatlantic Trade and Investment Partnership) in the broader context of regionalism. This research is analytical and qualitative by following theoretical views on multilateral approach in trade and regionalism and focusing on the significances and impacts of TTIP.

Due to the rapid evolution in communication and logistics amongst a world of major economic players, globalisation has gained momentum during these last few decades. This makes globalisation a rather new phenomenon compared to regionalisation in the light of history. Regionalisation has been around since the Ancient Egyptians sailed the Mediterranean and the Roman built their empire. This dynamic shows that regionalisation and globalisation are not contradicting, but rather complementing each other throughout history.

There are quite a few definitions of 'regionalism' and 'regionalisation' circulating in the academic world, but for the sake of this thesis we will focus solely on trade regionalisation. In order to convey efficient research it is important to understand what these concepts mean. According to Schulz, Söderbaum & Öjendal (2001) regionalism *sensu latissimo* describes formal processes and projects. *Sensu stricto* regionalism is 'the body of

ideas, values and concrete objectives that try to maintain, create or modify the security, wealth, peace and development within a region." Schulz et al. (2001) state that regionalism means the urge to merge (Schulz, Söderbaum, & Öjendal, 2001).

Regionalisation implies an activist element, as we can derive from the lexical form. According to Schulz et al. (2001) regionalisation is *'the empirical process of change from relative heterogeneity and lack of cooperation towards increased cooperation, integration, convergence, coherence and identity in a variety of fields such as culture, security, economic development, politics etc. within a given geographical space.'*

On the official website of the WTO we can find a definition of 'regionalism' as defined in the Dictionary of Trade Policy Terms: *"actions by governments to liberalize or facilitate trade on a regional basis, sometimes through free-trade areas or customs unions"*. –WTO website

RTAs in the context of the WTO, however, are interpreted more generally and more specifically at the same time compared to this definition. First, they are interpreted in a more general than just 'regional', because often RTAs are concluded between countries that do not belong to the same geographical region. This is the case for the TTIP as it is negotiated between the two transatlantic partners, the US and the EU. Secondly, RTAs in the WTO context are interpreted more specifically through the WTO legal provisions that set out specific conditions for preferential trade liberalisation. (WTO website)

The Transatlantic Trade and Investment Partnership (henceforth TTIP) also known in some countries as Transatlantic Free Trade Area (TAFTA) is a free trade agreement that is being negotiated between the United States of America (USA) and the European Union (EU). The goal of this massive trade agreement is to create economic growth and more jobs for both parties by minimising trade barriers. The substantial lowering of trade barriers would lead, according to the European Commission, to a boost of trade in goods and services, as well as facilitating investment. Officially, negotiations started on the 8th of July 2013 (Delegation of the European Union to United States, 2013) (European Commission, 2013). The idea of such an agreement between Europe and the US is not a new idea. Klaus Kinkel, former minister of foreign affairs from Germany, already proposed this kind of agreement back in 1995 (Leibniz-institut für Wirtschaftsvorschung Center for economic studies,

2013). It is important to follow the negotiations of TTIP because if it does get concluded it will encompass around 40% of the global economic output. This makes it the biggest bilateral trade and investment agreement ever undertaken (European Commission, 2013).

The TTIP should be seen in context of regionalisation in a globalising world. These two processes might seem incompatible at first sight, but a deeper look into the issue will reveal that regionalisation and globalisation are not mutually exclusive. One of the reasons why states still rely on regional trade agreements (RTAs) is the stagnation of the multilateral trading system (Lynch, 2010). RTAs can further liberalise trade despite lagging multilateral negotiations like the fiasco at the Doha Development Round. The Doha Round started in 2001 but so far, no substantial agreements have been made. It has been almost 14 years, which is too long for most countries to wait for further trade liberalisation. Rodrigo de Rato, former managing director of the International Monetary Fund, and Paul Wolfowitz, former president of the World Bank, warned the stagnating Doha Development Agenda will cause a shift to more bilateral or regional free trade agreements that will have significant consequences for the future of the multilateral trade system (De Rato & Wolfowitz, 2006).

The most important benefit in terms of the TTIP would be the insurance and facilitation of investment by setting in place an investor-to-state dispute settlement (ISDS) system. Although both the EU and the USA already have advanced levels of legal remedies, some claim that a unified ISDS mechanism would lead to more investors insurance. There is however the risk of 'regulatory chill', meaning that the adoption of a ISDS mechanism might discourage government from creating legitimate changes in regulations in environment, health and social policies of fear of arbitration. This kind of 'regulatory chill' can be avoided in the TTIP given that the investment protection standards are carefully defined, exception clauses are exhaustively drafted and fair procedural safeguards are put in place (Tietje & Baetens, 2014).

There was a lot of protest against the aforementioned ISDS mechanism in the TTIP. The protesters claimed that the ISDS system will lead to deteriorating labour laws and a decline of social rights juxtaposed with an even stronger position for big companies. The EU negotiators heard the cry of the protesters and decided to give up

the ISDS despite it being one of the initial cornerstones of the draft agreement. It was Jean-Claude Juncker who decided to take out the ISDS once and for all, stating:

I don't understand why great democracies would not have faith in the judiciary. We have courts which are able to deal with cases that are brought to them, and so I'm not really in favour of what one could call "private courts" or arbitration bodies which may sometimes reach good decisions but don't always have to justify their decisions." - Jean-Claude Juncker at the Green Group hearing in July

Nevertheless, Trade Commissioner Karel De Gucht had stated firmly *"there will be no TTIP without an ISDS"* just a mere 24 hours before (McKeagney, 2014). In an open letter to the Financial Times, Bernadette Ségol, General Secretary of the European Trade Union Confederation, supported Juncker's side and wrote that the *'TTIP will not be approved unless ISDS is dropped'* (Ségol, 27/10/2014). This shows that there is disagreement within the EU on a pivotal matter.

2. The WTO and Regionalism

2.1. Initial aversion towards RTAs

RTAs have been shaping world trade long before the creation of the General Agreement on Tariffs and Trade (GATT) in 1947. The GATT has therefore been formed with both acknowledgement and apprehension of RTAs. For the latter half of the 20th century, RTAs contained mainly, or even exclusively, preferential tariff reduction (Narlikar, Daunton, & M. Stern, 2012).

The WTO is the symbol of a globalised economy in a multilateral trading system. Bhagwati defines 'economic globalisation' as *"the integration of national economies into the international economy through trade, direct foreign investment (by corporations and multinationals), short term capital flows, international flows of workers and humanity generally, and flows of technology"* (Bhagwati & Jagdish, 2007).

Even though the GATT of 1947 contained art. XXIV GATT, it seemed like it has been created to control rather than condone the existence and formation of RTAs. The world economy in the 1950's was very different from the global economy now and as it evolved, so did the WTO's stance on the matter. And luckily so for *'il n'y a que les imbéciles qui ne changent pas d'avis.'*¹

As mentioned before, there was a surge of RTAs during the Uruguay round because of lack of trust in the negotiations. A lot of policymakers and scholars predicted that RTAs would naturally decrease if the creation of the WTO system were successful. An important scholar, John Jackson, predicted that *"as the general incidence of all tariff and other trade barriers declined worldwide, assuming the trend of the past twenty years continues, the problem of preferential arrangements may fade away"* (Jackson, 1969). Needless to say, they were wrong. The question then becomes why are RTAs still being formed on a big scale despite the success of the WTO?

¹ French proverb : Only fools never change their mind.

The simultaneous proliferation of RTAs, on the one hand, and the development of the WTO's multilateral trading system, on the other, appear paradoxical at first. The WTO's cornerstone is non-discrimination whilst RTAs are *per se* discriminatory. And yet, the RTAs are allowed to survive by the WTO, given they meet the requirements set out by the WTO's agreements.

2.2. The non-discrimination principle

One of the most important WTO principles is 'non-discrimination'. There are two sides to this principle; on one hand there is the Most Favourite Nation or MFN principle, and on the other hand there is the principle of National treatment.

2.2.1. Most-favoured Nations

The MFN principle is an outing of the non-discrimination principle as described by Art. I of the GATT:

"With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation (...) any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties." – Article I, paragraph 1

GATT

Art XXIV puts forward the requirements that RTAs have to meet in order to be compliant with WTO law. It is the WTO's legitimate concern to keep the reigns on RTAs since a complete *carte blanche* might damage the multilateral trading system.

Art XXIV wording is not always clear and this leads to disputes about its interpretation. The

Art. I GATT enshrines this concept of Most-Favoured Nation clause and is seen as one of the tools paramount

to liberalise trade. Concerning services, MFN is defined in Art. II GATS and for intellectual property we can find the concept in Art. IV TRIPS. Art. I GATT reads as follows:

“[...]any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.”

Global competitive free trade is seen by most scholars as not being subject to the Pareto theorem. If the market equilibrium is in the Pareto optimum then the welfare of one single player will negatively affect the welfare of the other meaning that the resources are finite. Most recent studies (Bagwell & Steiger, 2002) (Grandmont & McFadden, 1975) however have shown that trade liberalisation is not a zero sum game².

These studies show why MFN is important as a tool to promote trade liberalisation and prevent a Prisoner's Dilemma. Art. I, 1 GATT states that WTO Members have to apply their customs duties in a non-discriminatory way. Concretely, if country A gives a tariff reduction to country B for, for example cars, it must, immediately, do so as well for cars coming from countries C, D,...and Z.

The MFN clause is applicable to both the same and all 'like' products as stated in art. I GATT (Horn & Mavroidis, 2013). Unfortunately, this the term 'like product' is not easily interpreted and the GATT show a vacuum on the interpretation. Jurisprudence has taken this concept under the loop and in the EEC-Animal Feed Proteins³ (L/4599, 1978) it suggest that a narrow interpretation should be given to the concept 'like' since it

² in favour of Pareto optimum: Grandmont, J.-M. & McFadden, D., 'A Technical Note on Classical Gains from Trade', *Journal of International economics*, 1975, 2:109-125

the Pareto optimum is not applicable to global trade: Bagwell, K. & Steiger, R., *The Economics of the World Trading System*, MIT Press, 2002

³ EEC-Measures on Animal Feed Proteins(GATT Doc L/4599, panel report adopted on 14 March 1978)

does not mean 'directly substitutable product' but a more identical product (Matsushita, Schoenbaum, & Mavriodis, 2006).

There are exceptions to MFN, which shows that this principle is not sacrosanct. The exceptions to MFN principle are elaborated under chapter 2.4.

2.2.2. National treatment

The second way the non-discrimination presents itself is by the principle of national treatment. This WTO principle is intimately interlinked with MFN being its national complement. National treatment is stated in Art. III GATT for goods, in Art. XVII GATS for services and in Art. III of the TRIPS for copyrights, patents and trademarks. These articles proscribe that both locally produced goods/patents/services and imported goods/patents/services should be treated equally after the imported goods entered the national market. It is the second non-discrimination clause in the WTO's legal texts and obliges parties to give the same treatment to others as to ones own nationals (WTO-website).

A well-known case for the WTO's Dispute Settlement Body was the *Japan-Alcoholic beverages II* case (DISPUTE-DS8, 1996). In this case, Japan taxed vodka and whiskey seven times higher than their own locally produced 'like' product sake. Japan tried to justify the difference in taxation by claiming that their customers like sake more than the other to and to prove they came up with the statistics of sold bottles per each category. Of course, if one drink is significantly more expensive, it is only natural the customer will take the cheaper 'like' product.

2.3. Changed attitude and the GATT 1994

The second sentence of the 'Understanding of article XXIV of GATT '94' reads as follows: *"Recognizing that customs unions and free trade areas have greatly increased in number and importance since the establishment of GATT 1947 and today cover a significant proportion of world trade;"*

The WTO acknowledges that there has been an evolution in the nature of world trade and RTAs since 1947. It is therefore important that the legal texts are interpreted in the new *Zeitgeist* in order not to become obsolete. We have to interpret the law in light of the *ratio legis* and try to find its teleological explanation. With 142 of its 161 members being part of at least one RTA, the WTO has to acknowledge the fact that RTAs are here to stay.

Article XXIV of the GATT states the exception to MFN for RTAs, or Free trade areas according to the GATT. There has been a lot of criticism concerning the effectiveness and interpretation of this article. The GATT was conceived in the post-war period's economic regime and has been interpreted by the WTO's legal experts in order to fit into today's economic regime. At the time of its creation, the GATT drafters did not expect regions to become such powerful players on the global economic stage. Some scholars proclaim that the discrepancy between law and reality demands for a revision of the GATT article (Kodama, 2000).

From the reading of article XXIV paragraph 4 we can deduct the spirit of the article and consequently the way in which it should be interpreted.

"The contracting parties 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. They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories." – paragraph 4 of article XXIV GATT

The main objective of the article is clear. The GATT wanted to create an exception to MFN and at the same time regulate the complex legal repercussions created by the discriminatory free trade areas. Article XXIV contains a list of requirements the free trade area has to abide by in order to be a legal exception to MFN. These requirements have been subject to a wide range of legal disputes before the WTO's Dispute Settlement Body (DSB). Most of these disputes concern the scope of these requirements, e.g. the scope of 'substantially all trade' in Turkey – Textiles and Canada - Autos on article XXIV paragraph 8. Therefore, it might be desirable to provide a more detailed explanation of the provisions made by the article in order to provide more legal security and less disputes.

The WTO itself admits that RTAs are per se discriminatory because they form a de facto breach of the multilateral trading system's core value, the MFN principle. At the same time, the WTO also admits that RTAs can be a building block and thereby complement the multilateral trading system and strengthen it. The WTO has some reservations concerning the effects of RTAs on global trade liberalisation and also economic growth. This is because the economic impact of RTAs is difficult to estimate beforehand. While the signatory countries will benefit from the provisions in the RTA, there is the fear that these benefits will be less than expected because of trade diversion, distorted resource allocation and investment diversion. The signatory countries need to anticipate these potential threats so that they can be curtailed as much as possible. The WTO does specify that the impact of an RTA depends on its nature. Depending on which parameters the member countries set forth, the RTA can have a different effect on the economy. RTAs that allow deep trade liberalisation and harmonisation, will have a larger economic impact according to the WTO. The WTO also supports the claim that in case simultaneous RTAs are both promoting MFN-based trade liberalisation, whether it be unilateral or multilateral, they can reduce both regional and global trade distortions (WTO).

2.4. Exceptions to the non-discrimination principle

2.4.1. Article XXIV GATT

In order to control RTAs the WTO created article XXIV GATT that is applicable to customs unions and free trade areas (FTAs) for trade in goods. This article serves two major purposes. Firstly, the requirements set forth by article XXIV GATT are designed to limit the negative effects caused by the creation of an RTA to non-parties to that RTA. Secondly, the parties to the RTAs themselves do not discriminate. The WTO allows the creation of FTAs when they facilitate trade among its parties without raising barriers to the trade of other WTO members. The second requirement is that customs duties and other restrictive regulations of trade have to be eliminated vis-à-vis “substantially all trade” between the parties to the FTA. The same goes for customs union, but with one more requirement added; that “*substantially the same duties and other regulations of commerce*” must be applicable to every member of the customs union (Sampson, 2003).

Because of the lack of transparency in the wording of art. XXIV GATT, the lawmakers of the WTO had to come up with the “Understanding on the Interpretation of Article XXIV of the GATT 1994”.

2.4.2. Article V GATS

Art. V GATS on economic integration contains similar yet slightly different requirements as art. XXIV GATS. As opposed to article XXIV GATT the creators of the GATS article did not find it necessary to distinguish between customs unions and FTAs. This article focusses on RTAs that contain services and allows for exceptions to MFN to be made by ‘*integration agreements*’ (*sic*). One of the requirements that is similar to the GATT is that the GATS also requires substantial sectoral coverage without increasing the general level of barriers for third countries.

2.4.3. Enabling Clause

The 'Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries', or in short the 'Enabling Clause'. The Enabling Clause is a 'special and differential treatment provision' consacrated in the GATT 1994. This clause allows for developed countries to lower trade barriers vis-à-vis developing countries without the obligation to lower tarrifs towards other developed countries. For example: If the Netherlands lower the tariff on beans coming from Nigeria it does not have to do so for beans coming from France. Another exception to MFN, and for this paper a more pertinent one, is the exception for free trade areas provided for in art. XXIV GATT and art. V GATS on condition that certain strict requirements are met.

2.4.4. (TOO much) Room for manoeuvre

Except for these three provisions, the WTO leaves us in the dark about which types of commitments in RTAs are WTO compatible. This lack of clarity concerning other regulatory trade issues and trade-related policy areas leaves RTA drafters with ample room for manoeuvre. In case States want to include intellectual property rights and government procurement into their RTA, they will find not even one WTO provision about what measures they can take or not take. If the WTO does not provide any restrictive provision, states are left free to pursue any kind of agenda or regional trade policy they fancy leading to a plethora of distinct RTAs with different levels of integration (Reiter, 2003).

Adding a tad more clarity to the provisions would be better for the WTO since we do not yet know the economic impact of 'deep integration' RTAs. The debate of whether they form stumbling blocs or building blocks is fervently being held without any real conclusive effect (Reiter, 2003). Nevertheless, in this thesis I adhere to the building blocks camp because their cautious calculations and analysis lead to that conclusion. Despite being a supportor of the building block-these, we must not turn a deaf ear to our adversaries and their comments about the potential difficulties arising from deep integration RTAs. As I will discuss later on, RTAs

that pursue 'deep integration', i.e. regulatory integration, will not only have an economic impact; they will also have an impact on the compatibility of different regulatory frameworks. The WTO (1995) refers to this problem as 'institutional complementarity'. The question is whether the regulatory policies created by RTAs will hinder or facilitate the creating of new WTO regulations on that same issue. If RTAs create divergent regulatory provisions concerning policy areas that are untrodden surface for the WTO, it might lead to difficulties when this issue is brought to the multilateral negotiation table. In this scenario, where pre-existing divergent RTA regulations form an obstacle for the succes on the multilateral level, the RTAs can be seen as a stumbling block.

2.5. Principles of the WTO

The WTO is a member-driven global international organisation with legal personality and capacity. On the WTO's website we can see the following disclaimer appear in the bottom left corner:

"The World Trade Organization (WTO) deals with the global rules of trade between nations. Its main function is to ensure that trade flows as smoothly, predictably and freely as possible." - © World Trade Organization 2014

Disclaimer

This is the original purely economic liberalist aim for which the WTO was founded. I do remember however, that some time ago, the disclaimer also mentioned development. The goal of the WTO can be found on the website as well.

"The result is assurance. Consumers and producers know that they can enjoy secure supplies and greater choice of the finished products, components, raw materials and services that they use. Producers and exporters know that foreign markets will remain open to them." -www.wto.org

This is the economic goal and as I mentioned before, a purely economist liberalist view. As we read further we can also find that the WTO is also striving for more development for developing countries as an interlinked

consequence of responsible trade liberalisation. By ensuring a more economically balanced world with a binding dispute settlement system the WTO aims at a more stable political world as well. The former wars have shown us that disputes tend to escalate after severe economic sanctions are imposed unilaterally.

“The result is also a more prosperous, peaceful and accountable economic world. [...]That way, the risk of disputes spilling over into political or military conflict is reduced. By lowering trade barriers, the WTO’s system also breaks down other barriers between peoples and nations.”

The WTO sets forth a few basic principles, which it wants the international community to abide by. If an RTA wants to make sure it does not impede the multilateral trading system then, logically speaking, it must try not to go against these principles directly. We will list the principles and give a short summary how they work and are implemented. These principles form the backbone of the WTO and its philosophy. That is why we need to keep them in mind when studying the TTIP.

2.5.1. The Trading system should be without discrimination

A WTO member should not discriminate against other members or between its own and foreign products, services or nationals. In WTO parlance, the trading partners in the WTO system have to give each other MFN status and national treatment. Even though an RTA is *per se* discriminatory against some of its trading partners, the WTO itself provided an exemption for the RTAs.

2.5.2. A freer market

It is the WTO’s aim to tear down trade barriers by negotiation. The WTO has a very broad understanding of what trade barriers are. They do not only include direct tariffs on import or export, but also indirect trade barriers such as safety or health regulations.

An RTA can lead to a freer market because they liberalise beyond the WTO’s requirements, while at the same

time, not raising barriers to non-members to the RTA in question. The currently applied tariffs between the EU and US are already so minimal that complete tariff eradication will not have a great economic impact. The TTIP's main aim, therefore, is to eradicate the non-trade barriers, more specifically regulatory barriers, between the EU and the US. (Freytag, Draper, & Fricke, 2014). This will allow the markets to open up more to each other by aligning their regulatory policies.

2.5.3. Predictable

The WTO envisions a world where governments, foreign investors and companies should not fear arbitrarily raised trade barriers. The WTO guards over this principle by ensuring that the member states are bound by tariff limitations and committed to opening up their market.

2.5.4. More competition

The WTO directly forbids unfair practices like export subsidies and dumping. This is especially important for developing countries that sometimes get confronted with dumping practices coming from the developed countries. The WTO's anti-dumping regulations form a good safeguard for the developing countries.

2.5.5. Member-driven, one-country-one-vote decisionmaking

Even though *de iure* decisionmaking in the WTO is based on the "one-country, one-vote" principle, *de facto* the members decide by consensus and thus the prime movers, the US and the EU, hold a lot of power. They wield their power in the informal cabinets of the WTO, the so-called Green Room meetings. These informal Green Room meetings are preceded by the Director-General as the chairman and he invites only the members who actively show an interest in a certain trade issue (WTO website). As the two most pro-active members and global economies, the EU and US are always present at these meetings, meaning that they have a great deal of

influence in the policy-making processes and effectively manage the WTO. Another way, in which the EU and US control the multilateral trading system, is via the WTO budget. Decisionmaking by consensus is the *de facto* rule, but every state has its veto and this is how the large countries influence the decisionmaking process. Since the EU and the US contribute respectively 42% and 16% to the WTO's budget annually, they effectively control its the size and composition. The result is that, while the WTO is a 'member-driven organisation', some countries clearly take the driving wheel into their own hands and decide the route. Smaller countries are disadvantaged in case the WTO Secretariat becomes understaffed due to budgetshortages. The EU and US have their own professional staff to handle their trade issues in international trade, but the smaller and poorer states lack the resources to employ these high professionals and are dependent on the quality of the WTO staff, and thus indirectly dependent on the EU and US' contribution to the WTO (Wijkman, 2003).

2.6. How does the TTIP fit into the WTO framework

2.6.1. Open regionalism

Regionalism can be either open or closed. In order to be considered as beneficial for globalisation, liberal economists require the RTA to be 'open' meaning targeted at integrating other participating nonmember states. On the other hand of the spectrum are the 'closed' RTAs that try to curb the effects of globalisation in a way to protect their own economy (Nesadurai, 2002). The first is considered to be a result of the current globalisation process, the latter a response against it. (Dees, di Mauro, & J. McKibbin, 2008)

2.6.2. Deep integration

Deep integration goes beyond mere tariff reduction. The European Union is a good example of deep integration. Deep integration can consist of standard harmonisation, investor protection and regulations and other measures to eliminate non-tariff barriers like the TTIP aims to do. The WTO has thusfar not been able to

do so and its members will likely be opposed to the idea of multilateral deep integration at this point of time because it might endanger their sovereignty. The TTIP integrates on a level that is higher than that of WTO integration and is therefore no impediment or parallel agreement to the WTO rules. Later on under point 3.6 I will go further into the technicalities of the term 'deep integration'.

3. The evolution of Regionalism Chapter

3.1. Different levels of regionalism

Economists differentiate between five different stages or levels of regional integration. These different models do not do justice to the colourful spectrum that is reality, they form a mere guidance to help us understand and classify RTAs. At the least integrated level there is the '*Free Trade Area*' where member states eliminate tariffs and other trade restrictions on substantially all trade between each other, but each member keeps its autonomy regarding trade policies *vis-à-vis* nonmember states. Member states of a *Free Trade Area* do not need to sacrifice their national sovereignty, making it an interesting tool for states with sensitive political ties. The *North American Free Trade Agreement* (NAFTA) is an example of a free trade area. On a second level we find the *Customs Union* (CU), which has the same elements as the free trade area, plus a common external tariff *vis-à-vis* nonmembers. CU members give up part of their sovereignty to institutions that monitor the common tariff. The European Union (EU) is an example of a CU. The third level of integration concerns the creation of a *Common Market*, which has the same principles as the CU, plus free traffic of production factors like labour and capital. The free traffic of labour gives the members an incentive to attune their health, safety and social security standards in order to prevent other memberstates' workers from having a competitive advantage. The EU is currently one of the rare examples of a common market. The fourth level is that of the *Economic Union*, which has all of the characteristics of a common market, but it also harmonises members' industrial, transport, fiscal, regional and monetary policies. The 16 EU members that joined the Economic and Monetary Union (EMU) with the euro as their common currency form an example of an Economic Union. Finally, there is the most integrated level, the *Political union*. A political union is an economic union with harmonised foreign and defence policies for its members (Cohn, 2012).

3.2. Liberalist Point of view

According to Cohn liberal economists regard multilateralism as the *best possible route to freer trade* as it eliminates both regional and national barriers. The liberals do support open RTAs because they consider them to be the *second best route to liberalisation* in case multilateral trade negotiations fail. Closed RTAs that put up more trade barriers and create more trade diversion than trade creation on the other hand, are considered to be a threat to global trade liberalisation by the liberals (Cohn, 2012, p. p. 211). Whether or not RTAs are a stepping-stone for globalisation is a debate mainly amongst liberal economists.

Liberal thinkers prefer multilateralism as the ideal way towards global trade liberalisation. Open regionalism is considered to be the runner-up in achieving this goal as they can lead to what Jacob Viner (Viner 1950) calls trade diversion, i.e. when trade is diverted from more efficient non-member exporters or importers to less efficient RTA-member exporters or importers. Usually an RTA will create some trade diversion, but it has to be less than the trade it creates so the balance will be positive in the end.

The camp of the liberals is divided in this matter; some believe that RTAs form a threat to the multilateral trade regime whilst others think that RTAs can exist alongside multilateralism. Different studies conducted by different institutions came out with different trade effects for the same RTA. This is owing to the usage of different parameters like estimation methods, time periods and databases to measure the effect the RTA has on trade (Cabalu and Alfonso 2007, p.3). It is important to keep in mind which methodology is being used in a certain study. Bhagwati, for instance, uses historical analysis to dissect how the GATT/WTO exceptions for RTAs were created and will come to a different conclusion than someone who conducts a quantitative study of the EU's intra-regional trade effects.

3.3. IPE's Traditional view on RTA

When discussing regionalism and multilateralism it is unthinkable not to mention the work of Jacob Viner. He created the theory on trade creation and trade diversion, the "Vinerian dichotomy" (Viner, 1950). Trade creation means that a more costly source is being substituted by a lower cost source of supply within the area of the importing country. This situation is beneficial to all, both for the member countries and to the world. Trade diversion is the opposite of trade creation (Jinji, Zhang, & Haruna, 2014). In this case a more costly supplier from inside the area is substituted by a cheaper supply source from outside of the area (Lloyd & McLaren, 2004).

Baldwin and Wyplosz (2009) say that the terms of 'trade creation' and 'trade diversion' have become so commonplace, one cannot talk about preferential liberalisation without mentioning them (Baldwin & Wyplosz, *The economics of the European Integration*, Third edition, 2009). Even though there are several shortcomings about these terms, mainly because they are based on a static analysis and only regard the results of tariff reductions, not harmonization of standards. RTAs can induce terms of trade effects provided that the members to the RTA are large countries (Panagariya, 2000) (Baldwin & Venables, 1995). Regional trade liberalisation has competition enhancing effects that are vital for industries exhibiting economies of scale when they are confronted with imperfect competition (Ethier & Horn, 1984). A fair number of authors who are in favour of RTAs, base their arguments on the Vinerian dichotomy. They argue that an RTA that is formed between nations who are already in an important trade relation or 'natural partners', will most likely produce trade creation and not diversion (Saavedra-Rivano, 2001). In case of the TTIP these requirements are fulfilled as the US and EU have been 'natural partners' throughout most of history. Based on this reasoning we can state that the TTIP will be more trade creating than trade diverting.

Bhagwati and Panagariya claim that regionalisation diverts rather than creates trade because it creates preferential treatment for the members of the RTA, thereby leaving the non-members in the cold. They also argue that when countries are actively participating in the RTA they might consider the multilateral

system as redundant (Bhagwati & Panagariya, 1996). On the other side of the argument we find the supporters who claim that RTAs increase global trade liberalisation and thus lead to trade creation instead of trade diversion (Bergsten, 1997). The proponents of RTAs say that the benefits of regionalism can be combined without sacrificing the strengths of the WTO system.

In the field of international political economy the standard analysis of this period is referred to as the “Vinerian analysis”. There are three basic effects that have been theoretically put under this nomenclature since the 1950’s. The first of these effects is known as ‘Smith’s certitude’ that is based on the famous Adam Smith from his work *The Wealth of Nations*. Smith’s certitude goes as follows: “When a nation “exempt[s] the good of one country from duties to which it subjects those of all other ... the merchants and manufacturers of the country whose commerce is so favoured must necessarily derive great advantage.” – Smith’s words (Wealth of Nations, 1776) quoted by Pomfret (1997). The second effect was created by Gottfried Haberler who stated that third nations who are not part of the RTA will face trade losses (Haberler, 1936). This is called the ‘Haberler’s spillover’. These form the traditional view of regionalism (Baldwin, 21st Century Regionalism: Filling the gap between 21st century trade and 20th century trade rules, 2011).

3.4. Realist point of view

Realists see the upcoming of regionalisation as a reaction to changing security and power relationships in the global order. They also believe that the construction of RTAs have important distributional effects whereby some states benefit at the expense of others. The realists say that the larger member of the RTA will not allow smaller members to receive benefits and expects ‘side payments’ from the smaller countries if they want to benefit. These side payments will exceed the expected economic benefit the smaller states would receive from market access and economies of scale however.

This was the case for Canada and Mexico when they wanted to open up trade with the United States in order to gain access to the bigger market of the US. The US in its turn, expected Canada and Mexico to give side

payments in areas like foreign investment and especially energy. This is why realists see RTAs as a representation of the asymmetries in power, wealth and knowledge between states (Cohn 2008, p. 211)

Realists see the formation of the European Union as a consequence of the bipolarity of power shared between the U.S. and the Soviet Union. With the U.S. and the Soviet clashing about global power and security, the European countries sought deeper integration in order to form a counterweight in a bipolar world. The U.S. as the global hegemon used its superior military power to support the GATT negotiations to establish the multilateral trading system. Little by little the hegemony of the U.S. started to decline as its interest in RTAs started to grow. The U.S. felt its declining power and formed RTAs with its allies in order to win back its economic leverage (Cohn 2008, p. 214-215).

3.5. Global Value Chains and 21st Century Regionalism

The rise in RTAs during the early 1990's was mainly due to the fear that the Uruguay Round would be a failure. Many countries thus took precautions by setting up their own bi- or multilateral trading agreements with their economic partners as a 'safety net' should the multilateral trading system collapse. However, the WTO system did not collapse but in spite of this regionalisation continues to thrive. This latest wave of regionalisation is characterised by containing far reaching regulatory clauses such as environment, investment and labour standards and harmonisation. (Zakri, 2003). Twenty-first century regionalism is no longer preference-centric and goes beyond tariff reduction.

The TTIP is an example of this trend as it contains clauses on investment and dispute settlement. It is therefore interesting to study the reasons why countries are choosing this form of deeper integration on a regulatory basis. New regionalism is seen as 'open' regionalism as geographic proximity is no longer a prerequisite for forming an RTA and it can even include several regions (Saavedra-Rivano, 2001). This is why the TTIP is a good example of new regionalism since the EU and the US are geographically speaking far apart and it is an agreement between a country and a region.

As RTAs continue to expand amongst more countries, they tend to become supraregional. When a Customs Union or a group of countries, which have a prior RTA amongst themselves, form a new RTA with another Customs Union or group of countries who are joined by a different RTA. The TTIP can be seen as an example of supraregionalism for it is formed, not between two countries, but between a country, the United States, and a Customs Union, the European Union.

Another factor that influenced the 21st century regionalism is the proliferation of global value chains (GVCs) or global production networks. This is what Grossman and Rossi-Hansberg refer to as 'trade in tasks', which is also known as outsourcing, offshoring or production fragmentation (Grossman & Rossi-Hansberg, 2006). As globalisation spreads, so does the production process of the multinational companies. They will split up their production process and relocate different production branches to where they find the best cost-benefit ratio. A company like Apple Inc might design its products in California, USA, but their assembly happens in China where they can find cheaper labour forces. Before the end product ends up in our home, it has been twice around the world already. Since the fragmentation of the production process can lead to ample difficulties and complications, most companies and countries that benefit from this phenomenon are motivated to create RTAs to simplify the cross-border production process and to avoid double tariff levying.

Just from looking at our current world trade, we can see that RTAs have brought their members more economic welfare in most cases. The European Union as the most integrated region in the world is the best example of potential welfare growth by RTAs. NAFTA has been very successful as well because it led to more trade creation than trade diversion. Another region that could gain a great deal of trade benefits is the Asia Pacific region and East Asia. Economic estimates have shown that the intra-regional trade in East Asia would surpass that of NAFTA (*The Economist* 2000). Economic integration is bound to lead to market gains in the region. East Asia therefore has a lot of integration potential in the world trade system (Webber 2001, p.146). The interdependence of production chains in the Asia Pacific region has never been higher. The cross-country value chains allow each country to specialise in the sector in which it has the comparative advantage.

In figure 2 we can see the production chain of hard disk drive in Asia. Without any agreement between these producing countries, the tariffs on each of the hard disk's segments will lead to a situation in which the tariff is higher than the price of the hard disk itself. If that is the case, it is better for the countries to each produce their own hard disk in their national territory. The specialised technology needed for producing high-tech goods makes it difficult and costly to be borne by one state however. Splitting up the production process between countries that can provide high-skilled labourers and those that can provide cheap assembly leads to more profit. In order to eradicate or at least lower the tariffs for this cross-country production process, RTAs should be put in place.

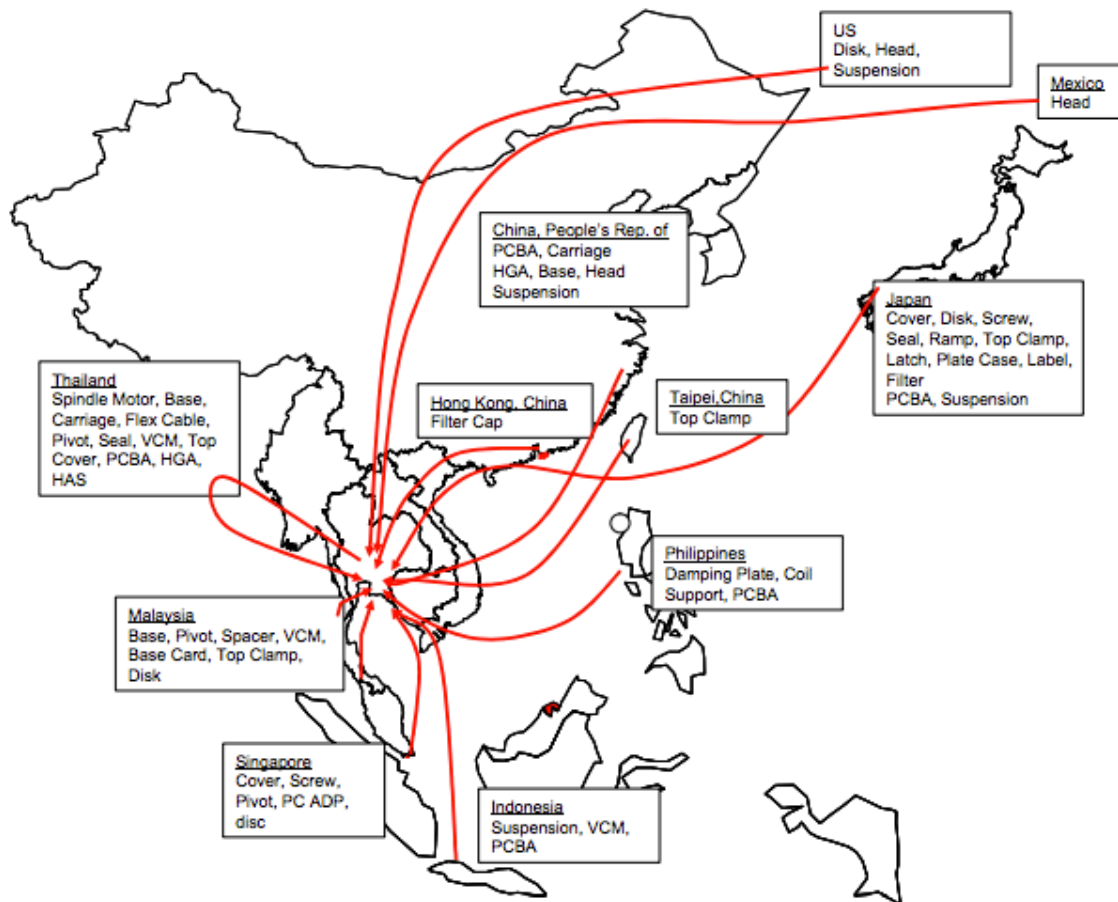


Figure 1: Interdependence of production chains of hard disk driver in Asia Pacific

(Source: Baldwin adapted from Hiratsuka 2005)

3.6. Pros of regionalism

3.6.1. Safeguard against lagging multilateral liberalisation

RTAs can further liberalise trade despite lagging multilateral negotiations like the fiasco at the Doha Development Round. The Doha Round started in 2001 but so far, no substantial agreements have been made. It has been almost 14 years, that is too long for most countries to wait for further trade liberalisation. Rodrigo de Rato, former managing director of the International Monetary Fund, and Paul Wolowitz, former president of the World Bank, warned the stagnating Doha Development Agenda will cause a shift to more bilateral or regional free trade agreements that can undermine the principles of the multilateral trade system

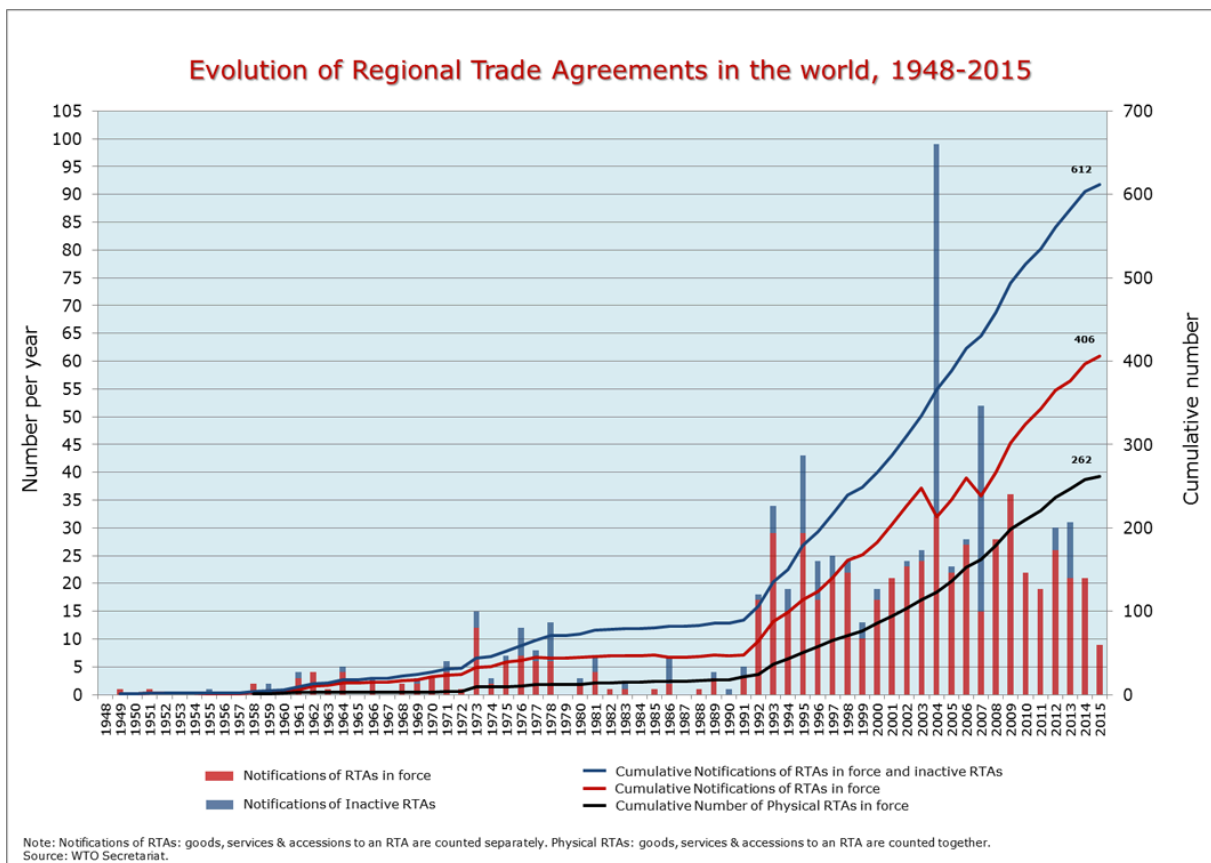


Figure 2: Evolution of Regional Trade Agreements in the World, 1948-2015

Source: www.wto.org

From the figure above we can see the number of RTAs has been increasing with a boom starting in the 1990's. It was around this time that RTAs and multilateral trade liberalisation ceased to be parallel processes. Before

RTAs and the WTO's initiatives would follow each other up close in order to keep up with one another. It was around the end of the Uruguay Round in 1997 that multilateral trade liberalisation slowly began to stagnate, but regional and preferential trade liberalisation thrived. The lagging Doha Round gave RTAs a frontrunner position and the parallelism (Baldwin, 21st Century Regionalism: Filling the gap between 21st century trade and 20th century trade rules, 2011). RTAs can either be an outcome or a reaction to globalisation depending on whether the RTA is accommodating or antagonistic respectively (Nesadurai, 2002). In case of the TTIP we can say that it is an outcome of the global liberalisation process because it is accommodating rather than antagonising liberalisation.

3.6.2. Deep regionalisation goes beyond WTO rules

A number of studies conducted by the WTO, the Organisation for Economic Co-operation and Development (OECD), and the World Bank all concluded that regionalism does not form an impediment to the multilateral trading system, but in fact stimulates it (Secretariat, 1995). The RTAs that were studied differ from the ones that form the 'new regionalism'. The report of the WTO Secretariat was analysed in terms of welfare and net-trade growth as effects of removal of border protection. 'New Regionalism', however, goes far beyond the removal of border protection. It is characterised by a deep liberalisation into the regulatory system of the partnering countries by harmonising their respective regulatory policies (Sampson, 2003). For these reasons we are in need of a new analytical framework to assess the effect of RTAs from the new generation like the TTIP.

As RTAs grow and evolve, the traditional views and analysis that estimated their impact on global trade lose their value. According one of the most important advocates of RTAs, Baldwin claims that the new wave of regionalism is indeed a building block, rather than a stumbling block (Baldwin & Seghezza, Are trade Blocs Building or Stumbling blocks? New Evidence, 2007).

A report by the WTO Secretariat of 1995 (WTO, 1995, p. 62) shows that the members of an RTA often apply the non-tariff barriers that are part of the RTA to imports from third party states as well (Reiter, 2003).

Opponents of regionalism are concerned that bilateral Free Trade Agreements (FTAs) like the TTIP will complicate the international trading system and reduce interest in the WTO. This depends on whether the FTA in question is offensive or defensive. In an offensive FTA one country will use its bargaining leverage in order to extract a preferential margin for its goods in the market of the other party to the FTA. This is the case for the EU which figurates as an important hotspot for FTAs with the Eastern European and with the Mediterranean countries. These bilateral FTAs are politically motivated because of the prosperity and stability it might bring to the two parties.

Defensive FTAs on the other hand, are created to protect market shares as a reaction to another FTA concluded by an important competitor in a key market. Even though most countries agree that the best way to reduce preferential margins is through GATT negotiations, because then all tariff reductions are multilateralised to all WTO members according to the MFN principle instead of through defensive FTAs, there are cases where countries opt for the latter. For instance, the EU negotiated its own FTA with Mexico to oppose NAFTA by negotiating tariff reductions that only benefit the EU. Following this logict, analysts also claim that if the APEC countries form an FTA with the USA like partly did with the TPP, the EU will be inclined to also negotiate with APEC to protect its market shares. (Wijkman, 2003). Now that the TPP is formed and the TTIP is on the way to being formed, we might expect a new attempt of the EU to negotiate an FTA with the Asia-pacific countries.

The result of this process is that overlapping networks of bilateral FTAs emerge which raises the transaction costs for companies' foreign trade. These extra costs are due to the adjustments the companies must make in order to be compliant with all the different FTAs. This mainly harms small and medium sized businesses because of the costs they incur by adjusting their products to the different technical legalities that apply to a country in specific. One of the main arguments contra regionalism is that the bilateral FTAs and RTAs will form trading blocs that will undermine the WTO system. However, the world economy has not been divided after the emergence of trading blocs. This is due to the fact that each trading bloc needs the others and this forms a strong incentive to keep their economies open. Lawrence (2000) claims that: "In sum, the importance of extra-

regional trade to nations all over the world means that no region is in a position to sever, or even significantly curtail, its trade ties with the rest of the world by forming closed blocks.” He supports his claim by referring to EU, Japan and the USA who are all global traders that may all benefit from RTAs but they cannot survive in an isolated RTA between themselves. They need the rest of the world too much to only rely on themselves (Lawrence, Frieden, & Lake, 2000). RTAs and multilateral liberalisation, together have worked as a “double-header” and benefitted the smaller countries in the multilateral trading system.

3.6.3. Stepping stone towards multilateralism

As mentioned before, the best way towards an open trading system is via non-discriminatory global multilateralism. Especially price-taking countries, usually the developing countries, benefits most from multilateralism because they lack the leverage ability in regional trade negotiations. That being said, the increasing globalisation of markets also triggered a process of ‘mega-regionalism’ with RTAs like APEC, TTP and the TTIP. This shows that more countries want to integrate more deeply than what the WTO agreements allow at the moment. Developed countries are using regionalisation to increase their leverage in a world of scale economies where there is no more hegemon that can unilaterally decide the course of the economy. Countries still rely on regionalisation for development and competitiveness of their economy and group together to maintain their economic position and adjust to the dynamic economic forces faster than multilateral agreements. Even though global liberalisation is the ultimate goal, countries will often take the route of regionalisation in order to form broader markets and to increase their competitive advantage. (Gonzalez-Vigil, 2001).

I believe that the most convincing argument why RTAs can be beneficial for global trade liberalisation is the stepping stone argument. Allowing deeper regional integration might pave the way for more complex multilateral negotiations. A good example of this is NAFTA. NAFTA liberalised trade in services before the WTO (at that time still called GATT) did (Cabalu and Alfonso 2009). Then there is the issue of trade diversion versus

trade creation. Some RTAs lead to an amount of trade diversion, but there are RTAs who lead to more trade creation. For example, NAFTA is an RTA that led to more trade creation than trade diversion (Hufbauer & Schott 2005).

By now we can safely assume that globalisation and regional integration are complementary processes even though they seem contradictory at first glance. Regionalisation should be seen as an intermediary step towards ultimate global trade liberalisation as most of the economic motives behind the creation of RTAs are the same ones used for globalisation. This theory clearly states that RTAs like the TTIP form a building block in the process of liberalising the world trade (Saavedra-Rivano, 2001).

3.6.4. Efficiency

Another important argument in favour of economic integration is the efficiency that is reached. This is what the standard neo-classical economic theorems all agree on, bar none, that the free flow of goods and services between two nations will increase their welfare (Saavedra-Rivano, 2001). Unilateral policymaking in countries that are interdependent will most likely result in inefficient policies (Horn & Mavroidis, 2013). That is why it is important for interdependent economies to work together to form efficient policies. This is why the TTIP is such a good policy to take for the EU and US market since the trade flow between the two entities is already massive, there are a lot of efficiency gains to be made. Some countries can liberalise faster on a regional level.

The Doha Round has painfully exposed the WTO's weakness of needing a consensus from all 161 members, each wanting to put forward their own interest. RTAs on the other hand, are negotiated between a small number of parties who, on top of that, are usually more like-minded. RTAs can thereby help reduce the complexity of the WTO negotiations by first working out the disagreements within their region before joining the negotiating table with the rest of the world.

3.6.5. Economies of scale

One of the most straightforward and economically logical reasons why RTAs are beneficial for trade is that they contribute to economies of scale. Countries in Eastern Europe are trying very hard to become a member of the EU in order to gain a huge market with low tariffs for their products. They also answer to the needs of comparative advantage by allowing the smooth division of labour within the region like the European Union did by allowing free traffic of labour. The TTIP will be the biggest RTA ever concluded with both of its members being economies of scale by themselves already. The economic size of the market created by the TTIP will create a bigger product differentiation because of the broad market. Its large size will make it possible to develop more creatively as certain projects that would have seemed unreachable for either, might now seem feasible in a common economic space (Saavedra-Rivano, 2001).

3.6.6. Spillover effects

Border countries to the US and the EU might prospect from the creation of the TTIP since they might become more central to the newly created economic system. (Saavedra-Rivano, 2001). These are the so-called 'spillovers' that might take place after the installation of the TTIP. Another study has also shown that RTAs can lead to trade creation amongst their members due to technology spillovers (Xu & Wang, 1999) (Acharya & Keller, 2009). Later on we will also look briefly into the objectives of the TTIP regarding political spillovers.

3.7. Cons of regionalism

3.7.1. Spaghetti-bowl syndrome

RTAs can also bring about negative effects in certain situations. It is therefore important that we understand these downfalls and use that knowledge to prevent it from happening in the future. One of the potential

problems caused by the increase in RTA combined with concluding bilateral FTAs, is the occurrence of overlapping membership. This overlap happens because every RTA develops its own 'mini-trade regime' and countries that are member of more than one RTA will have to comply with different coexisting trade rules (WTO). Instead of smoothing out trade rules, the consequence is that trade flows are obstructed because the companies incur increasing costs by having to comply with different sets of trade rules for the same product or service. The proliferation of RTAs during these last few decades has created inconsistencies in the regulations and procedures amongst RTAs. As the scope of RTAs enlarges, they risk creating regulatory confusion, distortion of regional markets and implementation problems. The WTO is also concerned about the inconsistencies that can arise between RTAs and the multilateral trading system now that RTAs are including policy areas that are not yet regulated by the multilateral framework.

The most known adversary of RTAs is Jagdish Bhagwati, calling RTAs 'termites eating away at the multilateral trading system' (Bhagwati 2008, p. XII). He also prefers the name 'Preferential Trade Agreement' to Free trade agreement as it underlines the discriminatory effect and nature of these agreements. Another reason why Bhagwati uses the term PTA is that the RTA is usually not only concluded between geographically close states, but also with states who are physically distant from the other member states.

Bhagwati refers to the phenomenon of overlapping trade rules of various RTAs as a 'spaghetti bowl' (Bhagwati 2008, p. 18). The increasing amount of bilateral Free trade agreements (FTAs) are creating a web of overlapping rules that might jeopardise the *transparency and predictability in international trade relations* (Crawford & Fiorentino 2005, p. 1). This is one of my concerns as well. The overlapping of bilateral trade rules has become a complex phenomenon in regions like Asia and Europe. Equivalent to Bhagwati's 'spaghetti bowl', Baldwin refers to the Asian situation as the 'noodle-bowl syndrome' (Baldwin 2007).

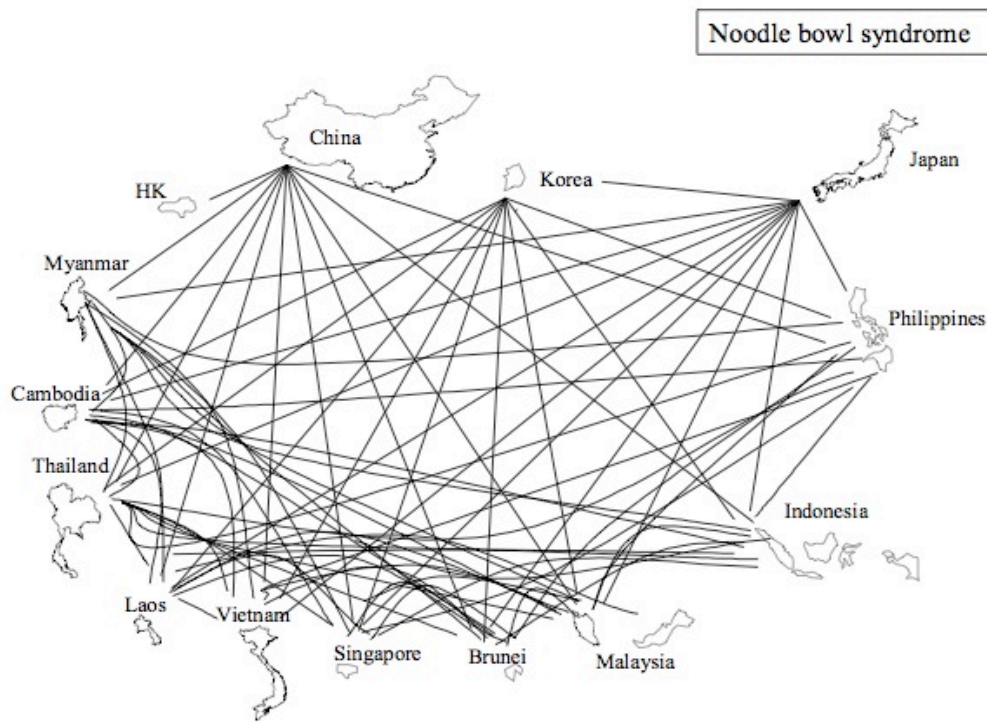


Figure 3: the Noodle Bowl Syndrome

Source: Baldwin 2007, p.5

The Noodle Bowl Syndrome poses a complex problem as it defeats the initial goal of RTAs. States establish an RTA to make trade transactions go more smoothly, but the overlapping rules trigger lengthy legal discussions between different parties. Integrating the different rules into one or more bigger RTAs can nevertheless solve this problem. The states can also sit together to find the most occurring rules and try to persuade the other countries to harmonise them.

3.7.2. Discriminatory RTAs

Bhagwati (Fast track to nowhere, 1997) and others claim that RTAs are discriminatory by nature and therefore incompatible with MFN treatment. Bhagwati claims that because RTAs and PTAs are *per se* discriminatory, they are not free trade. Since the WTO explicitly allows the creation of RTAs and PTAs and their coexistence with the

WTO rules, the WTO indirectly acknowledges that, in some cases, free trade needs to be put on the back burner in favour of development through RTAs. The fact that the WTO allows RTAs also means that free trade is not the WTO's top priority in the global economy (Gonzalez-Vigil, 2001).

There is some truth to the claim that RTAs can be discriminatory, but nevertheless, the GATT/WTO has provided exceptions to MFN in the Enabling clause⁴ and in article XXIV GATT. The Least Developed Countries (LDCs) can make exceptions to MFN via the Enabling Clause allowing them to discriminate against their trading partners, which goes against the WTO's principles. LDCs and developed countries also establish many bilateral RTAs together. The danger here is that the rich countries will use their political and economic power to force concessions from the LDCs (Abbott 2007).

Because of the dangers of discrimination and welfare loss due to RTAs, some authors warn the WTO not to be too lenient in allowing disproportionate MFN exceptions. One of the solutions to preventing discriminatory RTAs that cause welfare losses is to create stricter requirements that RTAs have to meet to form a legal exception to MFN. An example of a stricter requirement could be to only exempt RTAs if they promise trade creation and not trade diversion, that they are not too discriminatory and that they include deep levels of integration. Deep levels of integration can be shown by the RTA if its goal is to form a single economic entity like a customs union (Gonzalez-Vigil, 2001). I do not agree with all of these proposed requirements. Especially the requirement of 'promising to have a single economic entity as its goal' seems rather difficult to prove. When the foundations of the current EU were laid out at first, there was no certainty that it would evolve into the customs union with a single currency.

⁴ GATT Council adopted the Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries (the "Enabling Clause") to waive [Article I of the GATT](#) for certain arrangements, with respect to, *inter alia*, "[r]egional or global arrangements entered into amongst less-developed contracting parties for the mutual reduction or elimination of tariffs".-www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_09_e.htm

Not all RTAs between rich and poor countries are purely to take advantage. RTAs can make foreign direct investment in LDCs easier by lowering tariffs and by negotiating an investment arbitration clause to make the investors feel more at ease. In LDCs the judicial system is often lacking and the establishment of an investors arbitration court will gain more trust from foreign investors should a dispute arise. Furthermore, the WTO was not established in order to help LDCs. It is not a development NGO supporting only third world countries and therefore RTAs cannot be considered harmful in this aspect. The WTO's goal is stated clearly on their main page:

"The World Trade Organization (WTO) deals with the global rules of trade between nations. Its main function is to ensure that trade flows as smoothly, predictably and freely as possible."-@World Trade Organization 2015
Disclaimer (<https://www.wto.org/>)

Sometimes RTAs are created as a reaction to the threats of globalisation in which case they can be seen as stumbling blocks (Bhagwati J. , The World Trading system at Risk, 1991). Developed and developing countries have different priorities and will, therefore, react differently to globalisation making custom-sized RTAs for their respective problems. Saavedra-Rivano referred to this problem as "a regionalisation of globalisation" (Saavedra-Rivano, 2001).

3.8. Why the TTIP?

3.8.1. Personal Reasons

The reason why I chose the TTIP is twofold, personal and topical. My personal reason for choosing the TTIP is that I am European. I have studied European law in my undergraduate degree and am therefore much more knowledgeable when it comes to European trade policy issues and the EU's competence in negotiating international treaties. This prior knowledge and understanding of EU law and international trade law allows me to follow the rationale of certain clauses of the TTIP better than those of other RTAs. Certain aspects of the TTIP cannot be understood unless one is familiar with European law tradition and *ratio legis*.

3.8.2. Topical Reasons

The second reason is topical, meaning that the TTIP is a good contemporary example of new regionalism because of its immediate relevance to the topic. As elaborated above, new regionalism constitutes far reaching regulatory clauses such as environment, investment and labour standards and harmonisation. It is no longer preference-centric and wants to go far beyond mere tariff reduction. It is also an example of mega-regionalism because of its vast size and economic scale, which may function as a benchmark for other RTAs in future. This way the TTIP personifies all the attributes of 21st or new regionalism.

Another good example of new regionalism is the Trans-Pacific Partnership (TPP). I lack, however, deep knowledge of American trade law and the trade law of Asian countries. That is why I thought it be more opportune to stick to what I am familiar with, meaning European policy.

4. The TTIP

4.1. History

The idea of a Transatlantic RTA is not a new one. As mentioned in the introduction, Klaus Kinkel, former minister of foreign affairs from Germany, already proposed this kind of agreement back in 1995 (Leibniz-institut für Wirtschaftsvorschung Center for economic studies, 2013). The roots of the TTIP were thus formed in the 1990s when a series of agreements was made, but eventually lost their purpose over time (Siebert, 2013). The idea for the TTIP saw the light of day again when Germany was in charge of the EU-presidency in 2007 when the German Chancellor Angela Merkel set up the Transatlantic Economic Council. The members of this council are government agencies like the US Chamber of Commerce but also private pressure groups like BusinessEurope and also the Bertelsmann Foundation. The Transatlantic Economic Council has done most of the preparatory work before the joint High Level Working Group took over (Commission, 2013) (Choblet & Hager, 2015).

4.2. Gross gains

The study carried out by the Centre for Economic Policy Research (hereinafter CEPR) is globally positive about the effects of the TTIP (Centre for Economic Policy Research). It uses a computable general equilibrium (CGE) to make a simulation of the impact of the TTIP. This study was funded by the European Commission, but the CEPR emphasises that it is an independent pan-European economic research organisation. Therefore, its analysis and conclusion are reached independently by their researchers. Although this might be true, I thought it would be good to also include another study by an organisation not (directly) sponsored by the EU. For that purpose, I read the study carried out by the Konrad-Adenauer Stiftung, which was funded only by the German government (Konrad-Adenauer Stiftung).

In the following, I will summarise both organisations' findings and how they support my hypothesis that the TTIP can be economically efficient. According to the research of the Konrad-Adenauer Stiftung, the main

effects of the TTIP will be determined by three characteristics possessed by the EU and the US: the huge scale of both economies, the already extensive intra-firm trade between them and the high levels of intra-industry trade. The EU and the US have, due to the mutual intensive trade and investment, the world's largest bilateral economic relationship (Erixon and Bauer, 2010)². Together, these two economies represents more than 40% of the world GDP. This leads us easily to believe that the impact of eliminating trade barriers will have a global effect on third countries to, willy nilly.

By gross gains I mean the absolute gains in GDP, export/import and per household income. These numbers give a good image of what gains the TTIP will bring to the economy. However, these numbers must be seen in light of the overall picture illustrated by the effects on third countries, job market, consumer etcetera. Later on I will expand on these issues, but for now I will share some interesting numbers of the latest studies. According to CEPR's study the economic gains for the EU by the TTIP could amount up to €120 billion and for the US €95 billion, representing an increase of GDP of 0.5% for the EU and of 0.3% for the US. These gains would occur by 2027 after full implementation of the agreement and given that the economies have gotten some time to adjust to the new regime.

4.3. Substantive provisions

4.3.1. Definition

Substantive provisions or commitments deepen the existing obligation under the WTO agreements by eg providing for mutual recognition, policy approximation, harmonisation

Substantive provisions have the tendency to be more progressive and therefore WTO-plus material. They also create more market opening than procedural provisions and has a greater effect on institutional complementarity between the RTA and the multilateral level. Problems of institutional complementarity will arise when there are substantial differences between the regulatory regimes of major trading parties, on one

hand, and of the WTO, on the other hand, regarding a certain policy area (Reiter, 2003).

4.3.2. Minimising regulatory barriers

Both the US and the EU have a relatively similar cost and production structure and a rather low barrier to trade. In light of these circumstances we can deduct that the main impacts introduced by the TTIP will come from lowering regulatory barriers. The reason for this is that most companies are operating in Global Value Chains(GVC) or in global production networks and being globally interlinked, are more affected by international regulations. The TTIP will go a lot deeper in trade liberation than the WTO and its world trading rules by setting standards and regulations, investment regulation and protection (Freytag, Draper, & Fricke, 2014).

According to Freytag *et al* (Freytag, Draper, & Fricke, 2014), referring to a study by Felbermayr and Larch(2013) , mainly major corporations that already export to the US will benefit from tariff elimination and the consequential decreasing consumer prices. This reasoning counts *mutatis mutandis* for the US market. The elimination of non-tariff barriers on the other hand, will mainly benefit small and medium-sized enterprises. High gains are expected from the elimination of non-tariff barriers and also from the harmonisation of other standards that have the same effect as trade barriers. According to a study conveyed by ECORYS (Berden, Francois, Thelle, Wymenga, & Tamminen, 2009) the reduction of non-tariff measures can produce modest improvements in national income and household income for both the EU and the US. In the most positive scenario where the parties could manage to eliminate 50% of non-tariff barriers and regulatory divergences, the real income could increase by 0.7 % for the EU and by 0.3% for the US. Another study conveyed by Fontagne, Gourdon and Jean(2013) which uses a different CGE model finds that a 25% reduction of non-tariff measures together with a 100% reduction in tariff duties produces a 0.3% increase in the GDP of both the EU and the US in the long term.

The TTIP's main aim is to reduce regulatory barriers to approximate the markets in the US and the EU.

According to the analytical framework for the qualitative assessment of RTAs designed by Woolcock (2003),

substantive provisions that contain approximation will reduce costs and make the markets of the member states more compatible (Woolcock, 2003). When national standards differ, suppliers need to adjust their product to each different national standard if they wish to import their products. Approximation will reduce the costs and enable conformance assessment as we have seen happening in the past with the harmonisation of standards by the OECD countries to wipe out national regulatory barriers. These regional norms might go further than international norms and standards making them a WTO-plus RTA.

Another frame of substantive provisions is the mutual recognition or equivalence of certificates or tests. Suppliers from third-countries, however, will not be able to benefit from this mutual recognition. The harmonisation will promote market access by cutting the costs for suppliers by approximating national and European standards, regulations and conformance assessment provisions. The impact of this harmonisation will depend on how much farther it goes than the WTO's or other international standardisation bodies standards. If the standards of the TTIP differ too much from international standards it could lead to regional preference. Regional standards can become a form of preference when they differ from the standards that are applicable in the domestic market of the supplier (Woolcock, 2003).

Another potential consequence of regional harmonisation, especially in case of the TTIP, is that other countries might feel obligated to comply with the regional standard of the dominant markets. This has happened before in case of the EU and non-EU members who oblige EU standards without any legal obligation. Access to the EU market can only be granted to products that comply with the EU *acquis communautaire*, regardless of whether or not the country of origin is negotiating access to the EU or not (Woolcock, 2003).

4.3.3. Mutual recognition of standards

The TTIP will make it possible for bureaus or centres of the EU and US to mutually recognise each other's performance standards or certificates. This is another frame of the substantive provisions in the TTIP.

Recognition means that the performance standards of the exporting state are regarded equivalent to those of

the country of import. For example; once a product gets approval in the US, it can enter the EU without a second test or check by a laboratory in the EU and mutatis mutandis. Mutual recognition opens up the market and reduces the costs since there is no need for secondary testing. However, if the the concern that third parties will not be able to meet the requirements set forth by the mutual recognition agreement. If this is the case, it leads to regional preference. Another form of regional preference would occur if third parties meet all the conditions for equivalence of tests but are not allowed to enter into the mutual recognition agreement (Woolcock, 2003).

4.4. Procedural commitments

4.4.1. definition

Procedural commitments can take various forms, for example; measures to increase transparency, promoting cooperation, reviewing existing agreements with the purpose of strengthening them, bilateral dispute settlement mechanism

4.4.2. ISDS Investment dispute

An important part of the TTIP will be the ISDS mechanism. The ISDS would fall under the division 'implementation and enforcement' in Woolcock's framework (Woolcock, 2003). In order to effectively implement and enforce the ISDS, the TTIP would contain remedies and judicial instruments. This allows the TTIP to make effective reviews and apply remedies to these disputes. This will implement more liberalisation and non-discriminatory measures between the two parties. A downfall of this mechanism is that it does not extend to to third parties (Woolcock, 2003). NAFTA also offers investor-state dispute settlement clauses in addition to national law. If third states are not granted equal rights into the remedies it forms a regional preference. The TTIP can be regarded at WTO-plus in this area for it provides a review mechanism and an ultimate remedy for

its market participants concerning the application of regulations in the area of investments.

4.4.3. Anti- competitive practices

the regional agreement can open up the market by making sure that anti-competitive practices do not limit trade. When public regulatory barriers of a segment of the market are removed, it will lead to the creation of private barriers that are often less transparant. Sectors that were publicly regulated before, might behave differently than expected because there is no knowledge of the economic behaviour of that sector after deregulation and opening up to competition. Providers with a monopoly in one country might try to enter the foreign market, which are liberalised, and will cause competitive distortions. This behaviour has been seen before regarding the telecom-sector or energy sector. The GATS art. VIII:2 was created to deal with these potentially compitetive distortions (Woolcock, 2003)

4.5. TTIP in the analytical framework

4.5.1. Open regionalism

Even though the negotiations only involve the EU and the USA for now, we cannot say with complete certainty that the TTIP will be a closed RTA. From EU side it is not closed since there still exists the possibility of other countries to enter to the EU. By entering to the EU the new member states automatically become a member of all international agreements that bind the EU. Article 216 of the Treaty on the Functioning of the EU.

Another aspect of open regionalism is that the TTIP can function as a benchmark for other RTAs or for the WTO system. If the TTIP turns out to be a succes, it can use its good practices and share them with the rest of the world. The good practices of TTIP could be extended to other countries and/or regions. This potential shows

that the TTIP will not affect the WTO system in a negative way, but might form a catalyst for the multinational trading system.

4.5.2. More trade creation than trade diversion

According to most of the studies conducted by diversified agencies and working groups, the TTIP will create a great deal of economic gains between the U.S. and the EU. Regarding the effects on third parties the opinions differ, but overall, good spillover effects are expected to come from the TTIP. This is due to the expectation that the TTIP will set forth a global standard that other third party countries will try to implement as well. Several studies have shown the potential consequences of the TTIP for the economy (see *supra* Chapter 4). Even though some studies are rather sceptical, the overall tendency is optimistic amongst economists.

4.5.3. WTO compatible

According to the information provided by the WTO and the EU Commission, the TTIP is compatible with the MFN-exceptions as provided by Art. XXIV GATT and Art. V GATS. As explained above, in order to be compatible with the articles XXIV GATT and V GATS, the agreement has to cover “substantially all trade”. The vast size of the TTIP will ensure that this requirement is fulfilled. The second requirement is that the TTIP must not raise the average level of MFN. This requirement is also fulfilled since the TTIP concerns harmonisation of standards and other procedural and substantive provisions that are WTO+.

4.5.4. No overlap with existing agreements (no spaghetti-bowl syndrome)

The TTIP covers much more than the existing trade agreement that the U.S. and the EU have made with other parties who will not be part of the TTIP. Since the TTIP’s main focus is on harmonisation and minimising regulatory barriers, it goes beyond most bilateral tariff reduction agreements. This means that the risk of the spaghetti-bowl syndrome is minimal for the TTIP. This shows that the consequences of the TTIP will not affect

the multinational trading system negatively in this aspect. It might even help to harmonise all other RTAs along the way.

4.5.5. Deep regionalisation

Another reason why the TTIP will not damage the WTO system is that its main goal is harmonisation of standards. Contrary to the WTO, who focuses on global tariff reduction, the TTIP's aim goes above and beyond that by its deep regionalisation. It not only contains substantive provisions concerning minimising regulatory obstacles, but also procedural commitments to facilitate the jurisprudence between the two entities.

5. Problems regarding the TTIP

5.1. Waves of protest

As the negotiations continued, the protest began to grow bigger. What began as sceptical murmurs ended up in a protest mars of hundreds of thousands. There are a number of reasons that have caused this public outcry are ample. Even though the European Commission has calculated that the TTIP will provide revenue of 545 euro per households, some economists say that it is not certain this extra money will end up at the households, but instead stick to the hands of the big companies. More than 3 million people in Europe have signed a petition against the TTIP (Campaign Office of the European Citizen's Initiative "Stop TTIP").

These protest make it clear that, at least for the European side, money is not everything. Most Europeans seem to be concerned about how this transatlantic deal will affect their public sector such as healthcare, pensions, education etcetera. Their fear is legitimate in the sense that the approach to the public sector is very different in the US and the EU. Europeans fear that the entrance of the US into the market will lead to more privatisation and higher costs in the long run.

5.2. Secrecy

Although it is not unusual for international trade talks to be kept under the wraps, protestors are infuriated that big companies do get some access whilst the public does not. This injustice sets more bad blood amongst the public because they believe that major companies can influence the trade talks to shape it to their needs. This goes against the principles of a democratic society.

Wikileaks has offered a reward of 100,000 euro for TTIP documents on its website (Wikileaks website)

5.3. Undemocratic

Many a people fear that the TTIP will give more power to companies, thus taking away power from the electorate and the democratic system. Especially European labour organisations and other pressure groups claim that the TTIP will render American companies too powerful. The protestors believe that the TTIP will contain dispute settlement regulations via which the corporations can easily sue governments over laws that could potentially hurt their business. Sceptici in Europe fear that American companies will use the dispute settlement mechanism provided in the TTIP as a leeway around the traditional court system. They fear that the EU's high environmental and health standards will be attacked and judged by an obscure arbritation system that is not legally obliged to make its judgement public.

The protestors give the example of *British American Tobacco Australasia Limited v The Commonwealth*. This case concerns Philip Morris' lawsuit against the Australian government's rule on plain packaging laws for cigarettes '*Tobacco Plain Packaging Act 2011*' (High Court of Australia, S389/2011, 2012). Another example is the case of Vattenfal, a Swedish energy company, against the German government concerning Germany's decision to abolish nuclear power brought before the International Centre for the Settlement of Investment Disputes (ICSID). Vattenfall challenged the German government and its environmental, energy and safety policy and demanded an enormous compensation claim to be paid from Germany's state treasury. As it was brought before an arbitrary tribunal, there was no access for the public whatsoever and no disclosure of the documents. This lack of transparency in a case where the state's public financial resources and thus the taxpayers' money is concerned, should raise serious questions about the democratic deficit in international arbitration. In cases of investment arbitration there needs to be a certain amount of transparency in order to inform the public. There should be enough access to the documents of the arbitrary proceedings to check if the facts are corrects and if the laws are applied correctly. This guarantees the ability to balance the public interests and the state's regulatory autonomy against private corporate interests (Bernasconi-Osterwalder & Brauch, 2014).

Not all European politicians want the agreement to implement this international tribunal system, but there are

also strong supporters of the ISDS mechanism. The US is in any case a big proponent of the tribunal for investment disputes.

5.4. Difference in protection of consumer health and environment

One of the biggest obstacles for the TTIP is the precautionary principle of EU legislation. In the EU, legislators will prohibit those products of which science is not able to outrule that there is not even the smallest risk for the health of people, animals and plants. Article 191 of the Treaty on the Functioning of the European Union contains the precautionary principle as enabling *rapid response in the face of a possible danger to human, animal or plant health, or to protect the environment. In particular, where scientific data do not permit a complete evaluation of the risk, recourse to this principle may, for example, be used to stop distribution or order withdrawal from the market of products likely to be hazardous*⁵. In the USA, the opposite is the rule: unless science can unequivocally prove that the product is dangerous, it can enter the market. Sort of a 'not dangerous until proven', whereas in the EU it is 'suspected dangerous until proven not'. The USA want the EU to acknowledge the standards set by the American scientist.⁶ (Add [Grant E. ISAAC's essay views](#))

5.5. The scope of the TTIP

The TTIP is being negotiated multilaterally since the EU is made up of 28 countries. If successfully negotiated, the TTIP will comprise around 40% of the world's gross domestic product (GDP) and 30% of the world trade. Due to its size and ratio of GDP the TTIP is considered as a mega-regional agreement (Freytag, Draper, & Fricke, 2014). The sheer size of the TTIP is both a blessing and a curse. A blessing because it will undoubtedly have a large impact on the rest of the world. If the USA and EU work together to set up high standards for health and

⁵ (http://europa.eu/legislation_summaries/consumers/consumer_safety/l32042_en.htm)

⁶ (Kopinga, 2015)

environment regulations then the rest of the world might be more compelled to raise their standards as well in order to become a trade partner as well. But the downside of its huge size is that many developing countries and growing economies fear that they will lose out once this deal is been made.

The TTIP will encompass a free trade area that represents almost 50% of the world's trade, but only 11,8% of the world's population (Leibniz-institut für Wirtschaftsvorschung Center for economic studies, 2013). This illustrates almost painfully how inbalanced the concentration of world trade is geographically situated and how much power these two trading blocks can yield. Since it is a bilateral agreement, it will mainly create benefits for EU and USA but as I mentioned above, third countries who are not member to the TTIP might undergo the negative consequences. Scholars fear that the extra job creation in the USA and the EU will be at the cost of loss of jobs in non-member states. (Unmüßig & Falk, 2014). Unlike most other RTAs where parties of both the periphery and the center are found, the TTIP is a center-center agreement. As the TTIP would be an agreement between the world's biggest economies, there is no doubt it will have a serious economic impact worldwide (Freytag, Draper, & Fricke, 2014).

6. The TTIP in the scheme of European integration

6.1. A brief history

The first major integration act of what would become the future European Union was formed shortly after World War II. In order to preserve peace and to end inflation wars the European Coal and Steel Community was established in 1952 by six countries Belgium, France, Germany, Italy, Luxembourg and the Netherlands. Its founding fathers included Jean Monnet, Robert Schuman, Paul-Henri Spaak and Alcide De Gasperi. The goal of this community was to strengthen and unify the ties between the countries economically and politically. In 1957, after lengthy negotiations, the Treaties of Rome were signed establishing the European Economic Community (EEC) and the European Atomic Energy Community (EURATOM). These 3 communities existid independently until the Merger Treaty was signed in Brussels and came into force on the 1st of July 1967 thereby creating the European Communities. The European Union as a genuine political entity, was created by the Maastrich Treaty signed on 7th of February 1992. The further integration of the European Union took place on 1 January 1994 by pushing forward the Economic and Monetary Union by establishing the European Monetary Institute and the development of the Euro as a single currency. The euro was launched in 1999 and the European Central Bank was established as well. The euro became the official single currency from the 1st of January thereby replacing all other old national currencies.

In the beginning of this process, the founding fathers had a dream of an integrated Europe. However, I doubt they could have predicted that the European integration process would go this far. The EU is the most integrated area in the world as a political union with a single market and single currency. Thusfar, the EU has been a success story and has been used as a global example for other regions who are trying to integrate.

6.2. TTIP as a geo-political tool

The TTIP can also be seen as more than just a trade agreement since it can also be seen as a way to influence geopolitics. Some analysts claim that the TTIP also means to create political spillover of Western civilisation. By 'Western civilisation' the analysts mainly refer to the dominance of deregulated trade, private investments and their guaranteed protection, property rights rather than social rights and stated intervention. If the EU and the US combine their huge consumer markets then there is a big chance producers from other countries worldwide will start to gravitate towards the standards set up between the EU-US in order to be guaranteed market access. In this case the TTIP's harmonised product standards will be used as a regulatory blueprint worldwide for trade deals (Choblet & Hager, 2015). Because there are so many countries dependent on the EU and US market, they are likely to adopt the TTIP standards in order to keep market access guaranteed (Bertelsmann Stiftung, 2013). This might trigger a new wave of bilateral trade agreements by these countries in order not to be excluded from the market.

6.3. EU and US: the trade-related issues crusaders

Even though there are significant differences in the two transatlantic economic policies, there is enough common ground to form a stabile bond between the two mastodons. Even in dealing with nontrade issues, both the US and the EU tried to improve labour and environmental standards in other countries via trade policy measures. This way of doing business was one of the reasons why the Seattle WTO ministerial meeting of 1999 collapsed. Especially in the US, activism in trade areas has risen due to the influence of NGO's and interest groups in the decisionmaking process the open system of governance. These groups want to pursue their own non-trade objectives through the US' trade policy by calling them 'trade-related issues'. Especially in the field of labour and environmental standards, this is a powerful tool to force these non-trade issues onto foreign countries. When confronted with the possibility of losing market access to a country like the US or EU the foreign firms will almost certainly comply with the non-trade issues as well in order to make their products conform (Wijkman, 2003).

The policy of enforcing trade-related issues via RTAs is met with contradicting reactions. The NGOs in developed countries are big supporters of this indirect enforcement of non-trade issues, but developing countries claim that rich countries try to blackmail them by forcing them to comply with the labour or environmental standards by threatening the developing countries with loss of market acces. For developing countries an RTA or FTA containing these kinds of trade-related issues, is like a Trojan horse because it comes under the guise of good intentions, but actually contains bigger commitments.

The WTO agrees with the opinion of the developing countries and wants to ban developing countries from imposing these kinds of standards on foreign producers who wish to import their goods. A good example of the WTO's stance is given in the prejudicial panel report on the 'tuna-dolphin' case between Mexico and the US (WTO panel report, 1991). Mexico argued that the US had illegally put an embargo on imported tuna from Mexico because it was caught using purse seine nets. These kinds of nets form a danger for dolphins who get stuck in them and die. The Marine Mammal Protection Act of 1972 forbids purse seine nets because of the danger they form to dolphins. The US wanted to enforce this environmental standard indirectly through trade policy, but their plan backfired when the WTO's panel report spoke in favour of Mexico. The panel report stated that the US is not allowed to enforce US legislation in Mexico because this is a form of extraterritoriality and thus forms a violation of Mexico's sovereignty. Even though the developed country's intentions are good, such as preventing child labour or protecting the environment, they are not allowed to justify trade restrictions. (Wijkman, 2003)

6.4. EU's integration process and US trade policy

From the EU's integration process we learn that deep integration, i.e. regulatory integration and harmonisation up to a customs union, is not harmful to global liberalisation. In fact, the regional RTAs that were formed between the industrialised countries in the 1960s and 1970s moved at a faster pace than the multilateral trading system (Wijkman, 2003). This is due to the fact that regionalism forms a path with intermediate organisation and structure that the international trading system can make use of. Herbert Simon wrote that "the international economy is overwhelmingly vast, and the number of nations is correspondingly large. This

system has become too large to deal with on an undifferentiated basis. There is a need to ‘decompose’ the system in order to manage it effectively, and regionalism presents a kind of ‘part-within-parts’ decomposition which is recommended by analysts who study complex systems.” (Simon, 1962)

The US trade policy has changed its course drastically since the 1980s Reagan administration by going from a multilateral to a bilateral approach. Over the years, the US has signed more bilateral agreements with important partners. Some authors call this a ‘competition in liberalisation’ and it is mainly happening between industrialised countries like the US and the EU-members. A lot of the parties to these RTAs have a set of shared values, history, culture and needs which makes it far easier to come to an agreement compared to the multilateral negotiation table (Wijkman, 2003).

In light of the consecutive EU enlargements, the US urged the GATT to create more rounds to lower the common external tariff of the EU. Via the GATT rounds, the EU and the US negotiated tariff reductions that were automatically extended to all the members of the WTO through the MFN-principle. In other words, the recent global liberalisation is a result of the close exchange between regional and multilateral policies (Wijkman, 2003).

The TTIP can be seen as an expression of US-EU approximation, which has increased after the EU surpassed the US as the Nr.1 commercial power. No longer being the incontestable economic hegemon, the US feels the need to partner up with its powerful ally in trade, the EU. The US pursues a multilateral approach because it is the best way towards trade liberalisation. Still, the US is cautious not to jeopardise its sovereignty in favour of the multilateral trading system. In order to protect their sovereignty, the US prefers multilateral trade agreements that are limited in scope such as agreements on market access, trade rules and procedures, in other words ‘shallow integration’. The EU’s trade policy, on the other hand, is driven by deep integration in becoming a customs union and the most integrated trade and political area in the world. These different attitudes towards the level of integration are also expressed in the US and EU’s vision of the TTIP. Whereas the EU is hammering for environmental and labour regulations (deep regulatory integration), the US is very much concerned about the ISDS mechanism since it does not want EU law to be applied on their companies. Still, there are signs that

its transatlantic partner's competition policy is increasingly affecting the US. Especially in the area of mergers and acquisitions the US is taking over the European rules due to the lack of multilateral agreements in this area. In general and in particular with the TTIP it is beneficial for companies and consumers to adopt a harmonised set of rules and procedures (Wijkman, 2003).

6.5. EU and NAFTA approach.

Even though there are differences in the approaches between EU and NAFTA, examples have shown that there can be compatibility between the two dominant players on the international forum. E.g. the EU-Mexico free trade agreement where the EU had to navigate its way around the existing regulations on services and public procurement formed by NAFTA. NAFTA was formed before the GATS and thus contains divergent regulations regarding services. In general differences in regulatory approaches increase the transaction costs of trade negotiations. Even though there were substantial differences between NAFTA and EU approach, these transpacific and cross-regional differences were not impossible to overcome. In case of the NAFTA and EU, the similarities appear to be bigger than the differences. That is why a consensual approach can be found to consolidate the divergent approaches. The EU and NAFTA have made decisions about new trade policies that are only partly, or not at all covered by WTO law. The question is what kind of effect these pre-existing decisions will have when the multilateral negotiations start on these trade policies (Reiter, 2003).

Compared the EU, the USA has signed fewer RTAs over the last few decades because of its trade policy. The USA has been trying to initiate global liberalisation via the GATT instead of going through the intermediate step of RTAs. This policy is referred to as "*regionalism with a global goal*" by the United States' Trade Representative Robert Zoellick (Zoellick, 2015). Even though the US has shown a greater interest in RTAs during recent years, policy analysts predict that the US will not give in to temptation to create more bilateral FTAs. Since the US is a global trader, it benefits more from global than preferential liberalisation. This is why the analysts predict that the FTAs made by the US are "*part of a double header, rather than an exit from the multilateral trading system*" (Wijkman, 2003).

6.6. The Euro-Mediterranean Agreements

One of the important examples of European regulatory approach is the European-Mediterranean Association Agreements⁷ (hereinafter EMAs) established in 1995. During the so-called “Barcelona-process” the then European Economic Community and its Mediterranean Partner Countries (MPCs)⁸ negotiated to change the pre-existant individual cooperation agreements, which provided mainly asymmetrical duty-free access of non-agricultural goods to the European single market, into a more harmonised unit of agreements (Baert, 2003). Some authors want to know if the EMAs are a form of imperial or hegemonic harmonisation formed by the EU (Baldwin, *Regulatory Protectionism, Developing Nations and a Two-Tier World Trade System*, 2000) (Lawrence R. Z., 1995). Hegemonic harmonisation, as defined by Baldwin (1995), means that the EU approach is to transpose the basic set of EU rules and definitions. There is a de facto approximation by the MPCs trade policies to the EU’s. The MPCs know they are the ones that have to change, because the EU will not. (Baert, 2003).

Baldwin suggests that according to his domino theory, meaning that a change in the preferential status of country A will change the position of all the other countries in the hierarchic pyramid. This change of position will in its turn lead the affected countries to ask for deeper integration and expanding the preferential status (Baldwin, *A Domino Theory of Regionalism*, 1995). The EMAs are a good examole of North-South integration. It might seem like a good opportunity for the EU to follow its approach of exporting its own regulatory model since there is no other strong regulatory framework. When the Southern countries are economically dependent on their Northern allies, the former often align their rules and policies with those of the North even when they are not obliged to (Baert, 2003).

⁷ The EMA consists of the EU and seven other members: Lebanon, Egypt, Israel, Tunisia, Jordan, Morocco and Algeria

⁸ The current European Mediterranean Partnership: EU, Lebanon, Egypt, Israel, Morocco, Tunesia, Jordan, Turkey, Palestine, Libya, Syria and Algeria. Currently the partnership with Libya and Syria is suspended.

The Europe Agreements that the EU has with the Central and East European neighbours fall under a different approach. Since complying with the *acquis communautaire* is a *conditio sine qua non* for accession to the EU, the agreements with the Central and East European countries contain much more WTO-plus provisions. In this case it is clear that the EU exports its own regulatory model onto those countries. The cooperation between the EU and the MPCs strives to improve the institutional infrastructure to make the region more competitive and make it more attractive for FDI. Through this mechanism RTAs can encourage national regulatory reform in order to gain more competitiveness (Baert, 2003).

There is evidence of potential economic welfare gains in this North-South venture through deep integration. This kind of deeper integration surpasses that Vinerian gains that come from 'shallow' integration and usually contain nothing more but tariff regulations. The establishment of the EU-Mexico agreement, NAFTA and the EU membership of Southern European countries like Portugal, Spain and Greece all point in the direction that regional integration will increase competition, investment and efficiency (Baert, 2003).

6.7. EU approach on Food safety and eco-labelling

The EU approach concerning food safety and eco-labelling is very distinct from its transatlantic counterpart. Concerning genetically modified (GM) crops, the EU took a deliberate stance that differed from the existing approach most developed countries were following. Environmental pressure groups are advocating an EU bio-label for fruits and vegetables grown organically in the EU to make the customer aware of what he or she is buying (Isaac, 2003). The EU and US both have strict and severe food safety measures, but their philosophy behind it is quite different. Let us look at the case of chlorinated chickens for example; in the US dead chickens are washed in chlorine to kill all bacteria, whilst in Europe this technique is forbidden because the chlorine can affect human health negatively. Both entities have the same goal, but use different measures that are not exempted on the other side of the Atlantic.

7. Conclusion

Scholars of international political economy and practitioners in international trade remain divided on the issue of regionalism versus multilateralism notwithstanding a vast amount of empirical studies. Even within the smaller circle of liberal economists, opposing views concerning the effect of RTAs *vis-à-vis* the global trade regime remain afoot. As elaborated above, different studies conducted by different institutions came out with different trade effects for the same RTA due to the usage of different parameters like estimation methods, time periods and databases to measure the effect the RTA has on trade. It is important to keep in mind which methodology is being used in a certain study in order to interpret the conclusion in a critical way.

RTAs might create trade diversion if they increase external trade barriers to protect national inefficient industries, but when thought through well, they can lead to trade creation. Especially when the RTA members are already major trading partners, the RTA will most likely lead to trade creation. The WTO's DSB should therefore keep up its binding dispute settlement mechanism. A revision or at least a clear listing of the requirement of article XXIV GATT by jurisprudence would increase legal security and lessen disputes regarding the scope of the requirements.

Despite its potential harmful consequences, regionalism might be the only way forward when multilateral negotiations are lagging. Most economic studies show that much can be gained from economic integration such as market access and elimination of tariffs. Especially East Asia and Asia Pacific are the two regions that show a lot of growing potential if they should form RTAs. The WTO does not need to be an outsider in all of this for it possesses the infrastructure needed to curtail potential external negative effects of RTAs; it has a binding dispute mechanism, international agreements, a platform for multilateral discussions *etc.* With all of these safeguards in place, I believe that RTAs can form building blocks for the multilateral trading order. And the bigger the blocks, the easier it is to build towards a harmonised union of trade rules.

What is clear that in all of this, is that the TTIP will undoubtedly have beneficial effects for the EU and the US. Since the TTIP is a form of the new regionalism, it has deep integration as its objective. That is why it will not go

against the WTO's principles of MFN. Thus, in relation with the pros and cons theories on regionalism, TTIP could function as a stepping stone or building bloc for a wider liberalization of trade and investment not only in terms of traditional tariff rates reduction but also in areas of harmonization of standards and rule makings.

After comparing the TTIP to the theoretical framework, it is almost certain that the TTIP will not form an obstacle for the WTO. It focuses on deep integration, a stage that the WTO is not yet ready for with all of its members. However, advanced economies like those of the US and the EU can liberalise further while multilateral trade talks have stagnated. The TTIP might also create political and technological spillovers for other countries, which will benefit competition. If the TTIP works out well, it can form a potential future blueprint for other agreements or for the multilateral trading system. Not all parts of the TTIP have been agreed upon by both parties and there is still some resistance from the public, so we will have to sit and wait for the final result of the negotiations. The TTIP can eliminate the last barriers that stand between the already massive trade flow between the EU and the US.

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