

# Bilateral deals destroy global trade

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Over the past five years, the Asia Pacific region has witnessed an upsurge in bilateral trade agreements that bestow preferential trading privileges upon their signatories. These agreements, which could well breach the non-discrimination principle of the World Trade Organisation, are dangerously close to becoming the standard for trade. It is time to wake up to the fact that the proliferation of bilateral agreements carries serious risk. From a business perspective, bilateral trade agreements must be assessed in terms of their impact on the modern global production system.

Manufacturing today is quite different from the past. In the old days, when we talked about manufacturing a product, the idea that immediately sprang to mind was that everything would be done "in-house" – in one factory, under one roof and in one country – before a product was exported and sold in another country. Times have changed and manufacturing carries a completely different meaning today. Increasingly, production is dispersed across different factories in different countries and, indeed, it is becoming globalised.

Our export trading arm, Li & Fung Limited, sources time-sensitive consumer goods on behalf of customers in the world's leading markets. In the past, when we received an order to produce 10,000 shirts from a retailer in the US, our response as a trading company was to look for the best manufacturer available, give it the order and earn some commission in return. Today, because manufacturing is becoming globalised, our model has changed completely. At each stage of production we will consider the best place to produce that particular stage. In the end, the final product that arrives on the retailer's shelf will look exactly the same as if it had come from one single factory, but in fact we have pushed the order back through our network to the best in class for each activity; meaning the use of multiple factories in several different countries. This enables more locations worldwide to contribute according to their skills and capabilities and to develop their own competitive strengths.

In the past, to become active in international trade, a developing country ideally would have had to be able to perform all the activities in the production value chain. Now, because of global production, countries are getting into the game by providing just one or two pieces of the value chain. In this way, the system lowers the barriers to entry for developing countries and especially for small and medium-sized enterprises worldwide. This has obvious implications for employment and economic development.

The global production system, however, is under threat from bilateral agreements. This threat is best understood by business people, who are the first to feel its impact. For example, exporters in countries such as Australia and Malaysia are facing or soon will face the business consequences of new bilateral agreements and, in particular, their rules of origin. According to Professor Ross Garnaut of the Australian National University, because of globalisation of production, there is: "No completely Australian-made fashion clothing any more or Malaysian-made laptop computers. But a lot of fashion clothing is exported from Australia and computers from Malaysia. These exports are competitive because they draw components from the places in the world that can supply them at lowest cost. It is simply not possible for Australian clothing or Malaysian computers to meet the rules-of-origin requirements under different bilateral agreements and to remain internationally competitive at the same time."

Bilateralism distorts flows of goods, throws up barriers, creates friction, reduces flexibility and raises prices. In structuring the supply chain, every country of origin rule and every bilateral deal has to be tacked on as an additional consideration, thus constraining companies in optimising production globally. In each new bilateral agreement, considerations relating to "rules of origin" multiply and become more complex. This phenomenon is what trade experts call "the spaghetti bowl effect". While larger companies have a hard time keeping track, for small groups it is impossible. Bilateral agreements cause the business community to work below its potential. In economic terms, bilateral agreements destroy value. If left unchecked, their continued growth has the potential to hinder the development of the global production system.

Negotiators at the WTO ministerial conference in Hong Kong in December need to understand that they are under very real pressure. If the Doha round is unsuccessful, and the trading system dissolves into bilateral agreements, much of the gain that is possible from the global production system will be lost. It is the multilateral system that enables each location to contribute according to its skills and capabilities and to develop its own competitive advantages. Modern production systems thrive in a multilateral world, not a bilateral one. Multilateralism creates value; bilateralism destroys value. The multilateral trading system democratises the global economy: there is indeed a place for everyone.

The writer is chairman of Li & Fung, Hong Kong's largest export trading company