

INTERNATIONAL BUSINESS TRANSACTIONS

REGIONAL INTEGRATIVE TRENDS IN INTERNATIONAL TRADE RELATIONS – IS THE WTO UNDER THREAT?

OLUSEYE AROWOLO

Seye_arowolo@yahoo.com

Abstract: Regional trading arrangements have been on the increase since the 1990s. However, their implications for the multilateral trade system are uncertain. The collapse of the Cancun Round of trade talks and the threat by developed member countries to resort to regional and or bilateral arrangements as an alternative to the multilateral process has revived the debate over the ‘real’ implications of RTAs for the global trade system. This paper argues that the threat to the multilateral process is not the proliferation of RTAs but political-economic undercurrents provoking their formation. The paper therefore, examines the driving factors in the resurgence of RTAs and the regulatory framework for their formation. The paper also reviews their impact on the multilateral trade system and demonstrates that the way forward in international trade relations is an open and multilateral process. Thereafter, the paper proffers appropriate recommendations to enable the WTO to remain relevant despite divergent aspirations of its members.

List of Abbreviations

AU	African Union
COMESA	Common Market for Eastern and Southern Africa
CARICOM	Caribbean Community and Common Market
ECOWAS	Economic Community of West African States
ICC	International Chamber of Commerce
MERCOSUR	Common Market of the South Americas
MFN	Most-Favoured-Nation
OAU	Organisation of African Unity now AU (African Union)
PTA	Preferential Trading Area
RTA	Regional Trading Area/Arrangements
SADCC	South African Development Coordination Conference
SADC	South African Development Community
SAARC	South Asian Association for Regional Cooperation
SAPTA	South Asian Preferential Trading Arrangement
WTO	World Trade Organisation

1. INTRODUCTION

Regional trading arrangements¹ have exploded in number, and increased in significance since the 1990s.² At the moment, the World Trade Organisation (WTO) has received over 162 notifications of regional trading arrangements (RTAs) in force.³ Between 100 and 200 new regional trade formations are expected by 2005.⁴ Almost every country is a member of one trade bloc or the other. In terms of volume of trade, regional trade blocs are now responsible for at least one-third of the volume of international trade.⁵

Formation of regional trade blocs represents a process of re-alignment of trade interests among nations in which certain trends have become discernible. Firstly, there is an increasing pressure for open regional trading arrangements. Secondly, there is a subtle shift from the form of integration characterised by mere reduction in tariffs and quotas to 'deeper integration'. A third major trend is the emergence of the so-called 'North-South' RTAs in which developed countries and their developing counterparts are becoming equal partners.⁶

The recent momentum in regional trade relations derives from three important developments on the international plane.⁷ On one hand is the dramatic shift in the hitherto hostile disposition of the United States towards regional trade movements.⁸ On the other hand is the collapse of the Soviet hegemony and the consequential impact on the European Union integrative processes. The third is the increased relevance of RTAs as an option for 'South-South' liberalisation. For the US, it is the relative decline in competitiveness in international trade and frustration at the slow

¹ For an overview of the history of regional trading arrangements, see Maurice, Schiff and Alan, Winters: Regional Integration and Development p. 4-6

² See the preamble to Resolution 46/145 adopted by the UN General Assembly at its 76th Plenary Meeting of 17 December 1991 on the need to co-ordinate measures on the international level to guarantee efficient and effective promotion of activities that encourage regional economic integration.

³ International Chamber of Commerce (ICC): Regional Trade Agreements and the Multilateral Trading System <www.iccwbo.org/home/statements> (last visited on 22nd December 2003).

⁴ Ibid, <www.iccwbo.org/home/statements> (last visited on 22nd December 2003).

⁵ Anthony, Venables: Regional Integration and International Trade. <<http://www.econ.ise.ac.uk/staff/agr/regenc2.pdf>> (last visited on 22nd December 2003).

⁶ Maurice Schiff and Alan Winters: Regional Integration and Development p.1-3. <http://www.worldbank.org/publications> (last visited on 22nd December 2003)

⁷ Joan, Spero and Jeffrey, Hart: The Politics of International Economic Relations, 1997, p. 61-69 at p.63-64, 69. See also, Maurice, Schiff and Alan, Winters: *op. cit.* note 6 at p.9-11.

⁸ Robert, Baldwin: *Adapting the GATT To A More Regionalised World* in Regional Integration and the Global Trading System (Kym Anderson and Richard Blackhurst, ed. 1993) p. 388.

pace of the multilateral trade process to reclaim this competitiveness through pursuit of ‘new trade issues’⁹ whilst the collapse of the Soviet Union exerted an exigent pressure on the EU to admit countries from Eastern Europe and the Baltic as members, a process which led to its deepening and expansion.¹⁰ The implications of these developments are further expounded in the body of this paper. In the case of developing countries, the view is that RTAs can deliver improved trade capacity, competitiveness and greater market access thus enhancing their potential for allocative efficiency. In furtherance of this view, RTAs can facilitate greater ‘South-South’ liberalisation thus helping to bridge the extant North-South gap.

RTAs are one of the most significant exceptions to the MFN rule of non-discrimination under the GATT/WTO. RTAs are by nature preferential and discriminatory. Whilst Article XXIV of the GATT, 1994, the Enabling Clause of the GATT, 1994, and Article V of the GATS 1994, provide the legal basis for this exception in the international trading framework, this paper is concerned with RTAs formed under the provisions of Article XXIV and the Enabling Clause of the GATT, 1994. Most RTAs involving developed countries have been established under the provisions of Article XXIV. Since the Tokyo Round, RTAs between developing countries are set up under the Enabling Clause.¹¹ Also, this paper is concerned with regional trading arrangements involving a group of countries that are geographically contiguous or ‘in [the same] geographically restricted area’ e.g. The NAFTA.¹²

Also, since the framework for the creation of ‘South-South’ RTA is the Enabling Clause, this paper considers the extent to which developing countries have taken advantage of its provisions and its continued prospects for ‘South-South’ trade liberalisation. The paper also posits that the enthusiastic promotion of regional approaches to trade issues by developed countries particularly the US is an attempt to reclaim trade competitiveness (which for instance, for the US, has declined relative to

⁹ *ibid*, p. 398.

¹⁰ *ibid* p. 63.

¹¹ Frieder, Roessler: *The Relationship Between Regional Integration Agreements and the Multilateral Trade Order* in Regional Integration and the Global Trading System (Kym Anderson and Richard Blackhurst, ed. 1993) p. 311.

¹² This paper does not accept the view that the EU-ACP arrangement under the Lome Convention qualifies as a RTA in this context. Cf Robert, Gilpin: The Political Economy of International Relations 1987, p. 263 at 294-295.

Canada, Japan and the EU in recent times). This is reinforced by the express threat by some developed countries to resort to regional and or bilateral trading arrangements after the collapse of the round of negotiations in Cancun, Mexico in 2003 thus exacerbating the debate over the ‘real’ implications of regional integrative processes for the WTO. Hence, the inevitable question, “Is the WTO under threat?”

This is the burden, which this paper seeks to discharge. Towards this end, the paper adopts an analytic approach. The paper will comment briefly on the principles of the multilateral trade system that is, the GATT/WTO, examine the rationale, structure of, and trends in, regional trading arrangements, review the merits of such arrangements, evaluate its relevance to developing countries and the basis for their support by developed countries, review the impact of regional trade blocs on the WTO, and demonstrate that the way forward in international trade relations is an open and multilateral process. Thereafter, the paper will make appropriate recommendations to enable the WTO to remain relevant despite divergent aspirations of its members.

2. REGIONAL ARRANGEMENTS

2.1 RELATIONSHIP WITH THE MULTILATERAL TRADE SYSTEM

The WTO is the primary institutional framework for global trade relations. Trade relations within the WTO follow three fundamental principles namely: (i) non-discrimination through the MFN rule, (ii) free trade through the reduction/elimination of tariff barriers¹³, and (iii) reciprocity.¹⁴ These principles were instituted through the GATT’47 but now apply subject to certain amendments and exceptions, under GATT’94 and the WTO agreements.¹⁵

¹³ The eight multilateral trade rounds conducted under GATT’ 47 achieved substantial success in reducing tariff barriers to very low levels through series of tariff negotiations and bindings.

¹⁴ Robert, Gilpin: *op. cit.* note 12 at p. 191.

¹⁵ The Preamble to the WTO Agreement declared that the WTO was created in order “preserve the basic principles and to further the objectives underlying [the] multilateral trading system”. Also, Art XVI.1 requires the WTO to be guided by the decisions, procedures and customary practices established under GATT’47. See generally the WTO Agreement as adopted and ratified on 1 January 1995

The MFN is the single most important principle of the GATT/WTO. Without this principle, multilateralism becomes impossible.¹⁶ It imputes to the multilateral trade system its non-discriminatory and multilateral character. It applies ‘immediately and unconditionally’ in international trade transactions¹⁷ although this is not the case with RTAs where favourable trading rules are conditional on membership. RTAs are in-built exceptions within the GATT framework and represented a political-economic compromise at the time of negotiation of the GATT.

The recent wave in the proliferation of RTAs is traceable to a series of factors. However, only three are important from the context of this paper. One is the shift in the attitude of the US from active hostility to RTAs to broad enthusiasm. This is quite remarkable given that the US has, since the 1950s, acted to sustain the multilateral process, which it helped to create.¹⁸ Declining productivity and competitiveness in international trade relative to Japan and the EU aggravated the US growing frustration with the slow pace of the multilateral process. Besides, the end of the Cold War era and intense protectionist pressures domestically, eroded incentives for the US to continue sustaining the multilateral trade process.¹⁹

The second factor is the deepening and expansion of the EU as a consequence of the collapse of the Soviet Union. The collapse led to the bid by many Eastern European States to seek admission into the EU. This coincided with the process of completion and adoption of a common internal market in 1992 thus making the EU the world’s largest regional trading bloc.²⁰ In addition, the EU has pursued an active policy of preferential trading arrangements.²¹ Out of 93 RTAs notifications to the WTO, EU is party to 28.²²

¹⁶ P. Van Der Boesche: *Overview of the WTO* in UNCTAD Course on Dispute Settlement p.23 <www.unctad.org> (last visited on 23rd December 2003).

¹⁷ Article I, GATT’94.

¹⁸ This is a major political-economic responsibility borne by the US as the dominant economic and military power at the end of World War II. It is political and economic because of the rise in Marxist-Socialist economic systems. See Joan, Spero and Jeffrey, Hart: *op. cit.* note 7 at p. 63-64. See again, Robert, Baldwin: *op. cit.* note 8 for the history of the multilateral trade system and the role of the US.

¹⁹ *Ibid.*

²⁰ Joan, Spero and Jeffrey, Hart: *op. cit.* note 7 at p. 61-62. See also Maurice Schiff and Alan Winters: *op. cit.* note 6.

²¹ Lucian Cernat: Assessing South-South Regional Integration – Same Issues and Many Metrics, 2003 p. 3.

²² *Ibid.*

A third factor is the prospect of South-South liberalisation as an option to develop trade capacity, competitiveness and greater market access. This is further dilated on elsewhere in this paper.

2.2.1 Rationale for RTAs

Reasons for participating in RTAs are diverse. They range from economic to non-economic objectives. The common thread is however, the desire to ‘reinforce economic cooperation among the participating countries through equal partnership, mutual respect, common interests and shared responsibility’ with a view to achieving ‘trade and investment liberalization within [a particular] region’.²³ Economic reasons will include the need to lock in unilateral domestic trade reforms, secure access to major markets, improve bargaining power in multilateral trade negotiations²⁴ and exert pressure on government and firms to seek efficiency through larger markets and increased competition due to globalisation.

Participation in RTAs may also be in response to the domino effect i.e. a cost-benefit approach, which weighs the benefits of inclusion in the regional integrative process against the potential costs of exclusion.²⁵ Non-economic reasons for participation will include the need to strengthen political ties among member countries or to assist neighbouring members to achieve stability and prosperity with a view to averting political and economic spillovers.²⁶

2.3 NATURE AND STRUCTURE

Article XXIV, GATT’94 provides the framework for the formation of RTAs under GATT/WTO system. It contemplates two forms of RTAs. These are customs unions (CUs) and free trade areas (FTAs).²⁷ Article XXIV also covers ‘any interim

²³ S. Palaha and H. Sharma: Towards Economic Integration Through Regional Trade Blocs p. 1 <www.iift.edu/publications/paper4> (last visited 23rd December 2003).

²⁴ The European Union is an illustrious example of an RTA that operates in this context. This motive is equally driving regional integrative process in Africa and Latin America. See Bernard Hoekman and Michel Kostecki: The Political Economy of the World Trading System – The WTO and Beyond 2001, p.346 at 365.

²⁵ *Ibid*, p. 349. Also, Maurice Schiff and Alan Winters: *op. cit.* note 6 at p.9-11. See also, S. Palaha and H. Sharma: *op. cit.* note 23 at p. 9.

²⁶ *Ibid*.

²⁷ Richard Snape: The History of the GATT and MFN Treatment in Regional Integration and the Global Trading System (Kym Anderson and Richard Blackhurst, ed) p.280-282 provides insight into the historical antecedents of these two forms of RTAs and their inclusion in the GATT’47 (now GATT’94). See also Article XXIV.8 (a) and (b) for when an RTA qualifies as a CU or a FTA.

agreement leading to the formation of a customs union or a free trade area.’²⁸ A clear distinction between a CU and a FTA is that a CU involves the loss of an autonomous customs territory whereas an FTA does not.²⁹ By Article XXIV, GATT’94 and the related Understanding on the Interpretation of Article XXIV, there are two major requirements in the formation of an RTA whether as CUs or FTAs.³⁰

- *the substantially-all-trade-requirement* – This requirement seeks to reduce opportunities for countries negotiating a RTA with a view to avoiding preferences in sectors in which they propose to increase imports.³¹ Accordingly, duties or other restrictive regulations must apply to substantially all the trade between the parties to the CU or FTA.³²
- *the not higher or more than pre-RTA level requirement* – This requirement seeks to limit trade diversion effect of RTAs. The aim is to ensure that regional trade is not conducted at the expense of non-member countries. Accordingly, duties or other regulations are to be kept at their pre-RTA levels.³³

2.4 MERITS OF RTAs

As part of its positive effects, RTAs enhance capacity for trade creation by facilitating access to major regional markets resulting in significant increase in intra-regional trade for participating countries.³⁴ In consequence of trade expansion, RTAs stimulate economic growth.³⁵ RTAs also create incentives for unilateral trade policy reforms by providing a lock-in mechanism. In this context, RTAs eliminate the threat of contingent protection and minimize the risk of a reversal of unilateral trade reforms.³⁶ RTAs enable small market countries to improve their capacity to trade

²⁸ Article XXIV.5, GATT’94. An example of such interim arrangement will be APEC.

²⁹ Article XXIV.8, GATT’94. See also Richard Snape: *op. cit.* note 27 at p.280.

³⁰ A much detailed analysis of these requirements is provided in chapter 5 of this paper.

³¹ Frieder, Roessler: *op. cit.* p. 314. See also Richard Snape: *op. cit.* note 27 at p.280

³² Article XXIV.8(a)(i) and (b).

³³ Article XXIV.5(a) and (b). See also John McMillan: *Does Regional Integration Foster Open Trade in Regional Integration and the Global Trading System* (Kym Anderson and Richard Blackhurst, ed. 1993) p. 292-307 at 293-297

³⁴ John, Jackson *et al*: *Legal Problems of International Economic Relations – Cases, Materials and Texts* (4th ed), 2002, p. 447. See also Michael Trebilcock and Robert Howse: *Regulation of International Trade* 1995, p. 519-522 at 520

³⁵ Robert, Lawrence: *Emerging Regional Arrangements – Building Blocks or Stumbling Blocks?* in *Legal Problems of International Economic Relations – Cases, Materials and Texts* (John Jackson *et al*, ed) *op. cit.* p. 450 - 52

³⁶ Bernard Hoekman and Michel Kostecki: *op. cit.* note 24 at p. 364. See also Anthony Venables: *op. cit.* note 5.

through pooling of management of economic resources and trade.³⁷ RTAs offer a quicker and flexible means for trade partners to conclude levels of liberalisation or open new areas of trade beyond the multilateral process.³⁸ In this sense, RTAs have proved to be useful laboratories for experimenting new trade ideas for developed countries. The reciprocity requirement in RTAs limits opportunities for free riding, a major concern within the multilateral framework.

2.5. TRENDS IN RTAs

Certain trends have emerged through increasing recourse to RTAs, whether as an attempt to reclaim trade competitiveness (in the case of developed countries) or to improve trade capacity (in the case of developing countries). Three of these trends are relevant to this paper.

The first major trend is what is called “open regionalism” in international trade parlance. This term has been used in two differing senses. In the first sense, it refers to the lowering by the RTA of external barriers to facilitate trade with non-member countries and minimise trade diversion effects. Secondly, it expresses the possibility of extending ‘membership’ to any country (whether or not it is within the geographical area to which the RTA applies), willing to accept the obligations to which members of the RTA have already committed themselves.³⁹ Whilst open regionalism in the sense of reduction of external trade barriers is understandable, open regionalism in the second sense is not supportable. Although the suggestion that a RTA should be open to any country for membership is designed to aid the ‘global liberalisation’⁴⁰ of RTAs, the risk is the emergence of an alternative multilateral framework to the WTO in international trade relations. Taken to its logical conclusion, such open regionalism has the potential to fragment the trading system leading to waste of human and monetary resources as well as duplication of trade obligations.

³⁷ Maurice Schiff and Alan Winters: *op. cit.* note 6 at p. 10. See also S. Palaha and H. Sharma: *op. cit.* note 23 at p. 9.

³⁸ International Chamber of Commerce: *op. cit.* note 3. See also S. Palaha and H. Sharma: *Ibid.*

³⁹ *Ibid.*, p. 521.

⁴⁰ Cesar, Gaviria: *International Trade and Investment: Regional v. Global Option*, being an address delivered at the Global Forum - Leadership 2000, Washington DC, 1 December 1995. www.sice.oas.org/tunit/speeches/cdt1.29.doc (last visited 23rd December 2003).

The second trend is the move towards ‘deeper integration’. This is an integrative process, which transcends mere reduction or elimination of trade barriers of the FTAs and CUs. Examples of deep integrative forms are common market⁴¹ and economic union^{42, 43}. The EU is a notable example of a RTA that has achieved deeper integration. It established a common internal market in 1992.⁴⁴ Other RTAs such as the ECOWAS are in different stages of deeper integration. For instance, there are plans to translate the NAFTA into a hemispheric FTA comprising all Latin American countries. The impact of this trend is in diversion of focus from the multilateral trade system to regional trade systems as the hub of international trade activities. For instance, the deepening integration within the EU has elicited concerns about market access to a “Fortress Europe”.⁴⁵

The third major trend is the emergence of RTAs involving a developed and developing countries as equal partners for trade purposes, the ‘North-South RTAs’. This form of RTAs enables developing member countries to access technical assistance, foreign technology and capital more easily or readily from their developed partners. Subject to the risk of overwhelming influence in trade management by developed members, this form of RTAs is emerging as a viable option to redress the imbalance in trade competitiveness and trade capacity between developed and developing countries.⁴⁶ A notable example is the extension of the Canada-US Free Trade Area to Mexico to form the NAFTA in 1994.

A relevant issue here however, is that not many developing countries are geographically positioned to leverage on such ‘North-South’ RTAs.⁴⁷ For instance, the developing countries of Africa are far removed geographically from the US, Canada, EU or Japan to participate in a FTA involving them. In this regard, participation in Generalized System of Preferential regimes may be a better idea though may not confer comparable advantages because of strict conditionalities. Or better still, ‘South-South’ liberalisation?

⁴¹ A common market comprises a customs union in which free movement of productive factors are permitted

⁴² An economic union is a common market in which economic policies of member countries have become harmonized.

⁴³ Bernard Hoekman and Michel Kostecki: *op. cit.* note 24 at p. 346

⁴⁴ S. Palaha and H. Sharma: *op. cit.* note 23 at p. 6-7 for an overview of the process of EU integration.

⁴⁵ John, McMillan: *op. cit.* note 33 at p. 301.

⁴⁶ Michael Trebilcock and Robert Howse: *op. cit.* note 34^B at p. 387.

⁴⁷ Diana Tussie and Ngaire Woods: *Trade, Regionalism and the threat to Multilateralism* in The Political Economy of Globalisation (Ngaire Woods, ed) 2000, p. 54 at 68.

The process of achieving enhanced trade capacity, competitiveness and market access for developing countries has diverted trade policy reforms towards regional integration with a view to promoting greater South-South trade. But, can RTAs deliver? This and other issues are considered below.

3. RTAs AND DEVELOPING COUNTRIES

3.1 GATT PART IV AND THE ENABLING CLAUSE – ANTECEDENTS

The GATT Part IV on Trade and Development and the Enabling Clause provide the primary framework for the establishment of South-South RTAs. The provisions of Part IV and the Enabling Clause are the culminations of over two decades of strident activism by developing countries to obtain special and differential regime in the face of their structural disadvantages within the multilateral trade system.⁴⁸

Relative economic under-development, small markets, monolithic trade capacity undermined any bargaining leverage for developing countries under the GATT. The failure of the GATT'47 to include provisions granting developing countries the right to enforce import substitution or economic planning programmes⁴⁹ as intensely negotiated in the abortive Havana Charter⁵⁰, aggravated the position of developing countries in the GATT system. Again, sectors such as agriculture and textiles in which developing countries had comparative advantage were excluded from GATT's coverage and thus protected.⁵¹

3.2 GATT PART IV PROVISIONS AND THE ENABLING CLAUSE

GATT Part IV comprises the statement of principles and objectives (Article XXXVI), establishes commitment responsibilities for developed countries (Article XXXVII) and provides the support for joint action (Article XXXVIII). Article XXXVI.8 is particularly noteworthy. It incorporates the principle of non-reciprocity in trade

⁴⁸ See generally Joan, Spero and Jeffrey, Hart: *op. cit.* note 7 at p. 149 – 164 for a detailed overview of the events leading up to these two provisions.

⁴⁹ Such as protection of infant industries through trade restrictions like import quotas and permission to stabilize and ensure minimum commodity prices through commodity agreements

⁵⁰ The Havana Charter was to culminate in the establishment of the ITO. However, the failure, in 1947, of the US Congress to ratify the charter scuttled that process and resulted in the provisional application of the GATT'47 for 48 years.

⁵¹ John, Jackson *et al.*: *op. cit.* note 34^A at p. 1171. See also the Haberler Report titled "GATT: Trends in International Trade" of 1958.

negotiations between developed and developing country members. It is however, the Enabling Clause that enables the formation of a developing-countries-only RTA.

The Enabling Clause provides in relevant part that “[such] arrangements shall be designed to facilitate and promote the trade of developing countries and not to raise barriers or create undue difficulties for the trade of any other member and shall not constitute an impediment to the reduction or elimination of tariffs and other restrictions to trade on a MFN basis.” There is no ‘substantially all trade’ requirement under the Enabling Clause provisions. The only requirement is the lowering of external barriers on a MFN basis to limit trade diversion effects of such RTAs by ensuring their openness and increase opportunities for their integration to the multilateral trade system. By WTO rules, RTAs involving developing countries formed before 1979 could be notified to the WTO under the Enabling Clause. Examples of RTAs in this category are the ASEAN, PTN and the Bankgog Agreement.⁵²

3.3. THE ENABLING CLAUSE: IMPACT ON ‘SOUTH-SOUTH’ LIBERALISATION

As at 31 January 2002, nineteen (19) RTAs have been notified and are in force under the GATT/WTO pursuant to the Enabling Clause.⁵³ Ten (10) of these RTAs were notified between 1990 and 2000.⁵⁴ Notable examples of ‘South-South’ RTAs include MERCOSUR, COMESA, ASEAN and SAPTA. A review by Luciern Cernat (2003) indicated significant intra-regional volume of trade within CARICOM, MERCOSUR, COMESA, SADC and ECOWAS. He noted further that there were significant trade creation effects with no trade diversion and moderate trade expansion effects.⁵⁵ Citing the example of COMESA, trade between COMESA members was more than twice the target level and 30% higher in the case of trade with non-member countries.⁵⁶ The immediate impact of this trend is the translation of these regions into big emerging markets and consolidation of the trend towards South-South integration.

⁵² It is noteworthy that the US has resisted attempt by MERCOSUR to bring the RTA under the Enabling Clause. See Financial Times, July 14, 1992, GATT, 1992, p. 20. See also Richard, Snape: *op. cit.* p. 285

⁵³ Committee on Regional Trade Agreements : Summary Statistics in force as at 31 January 2002 www.wto.org/en/english/tratop_e/region_e (last visited on 23rd December 2003).

⁵⁴ *Ibid.*

⁵⁵ The Andean Community and MERCOSUR have not achieved these effects however. They have increasingly become inward-looking. See Lucian Cernat: *op. cit.* note 21 at p. 11.

⁵⁶ p. 10-11

The prospect of South-South integration received a boost with the 10-year waiver granted by the WTO in 1999 for such trading arrangements.⁵⁷

The expectation is that there will be considerable increase in intra-regional trade volumes complemented by moderate increases in trade with non-member countries for existing RTAs whilst there would be increased pressure for new RTAs to emerge.

4. RTAs AND DEVELOPED COUNTRIES

4.1 DEVELOPED COUNTRIES - LOSS OF COMPETITIVENESS

By the end of the 1970s, there was a considerable decline in productivity and relative competitiveness of the US and the EU in the international trade arena. In the same period, there was a rapid rise in trade competitiveness of Japan and the NICs such that there were large competitive shifts, for instance in manufacturing, to Japan and the NICs.⁵⁸ These shifts were due to factor differentials between developed countries and the NICs. There were lags in capital investment and rising labour costs in the developed countries whilst NICs experienced aggressive export oriented policies and relatively low labour costs.

This trend was the result of a process of convergence in the economies of developed countries arising from rapid accumulation of physical and human capital, transfer of technology and the growing similarities in wages. This convergence narrowed differences in factor endowments (which are the basis for comparative advantage) among developed countries⁵⁹; a dimension of trade liberalization never anticipated.

This resulted in the creation of a trading environment in which margins of competitiveness grew thinner and more complex specialisation, greater levels of investment in research and development, and increased managerial effectiveness were required to sustain productivity and competitiveness. The net effect is intense protectionist pressure within national economies of developed countries against

⁵⁷ John, Jackson *et al*: *op. cit.* note 34^A at p.1172.

⁵⁸ *Ibid.* See also Robert Gilpin: *op. cit.* p. 204.

⁵⁹ Joan, Spero and Jeffrey, Hart: *op. cit.* note 7 at p.61-62 See also Jagdish, Bhagwati: *The Global Age - From A Sceptical South To A Fearful North* in International Economic Regulation (Jane Kelsey, ed) p. 27.

foreign competition. In the US, intense protectionist lobby by special interest group domestically, forced a re-evaluation of its support for multilateralism, which had influenced its development of an economic recovery package for the war torn countries of Europe and Japan after World War II.⁶⁰

There was increased usage of non-tariff barriers, subsidies, voluntary export restraints and in some cases, high tariffs by developed countries. For instance, nearly one-third of US and EU manufactured goods were covered by NTBs in the 1980s.⁶¹ Price support programmes for agriculture were introduced in the US and EU. Voluntary export restraints mechanisms were also adopted against manufactured goods particularly from Japan and the NICs. There was also government intervention in such sectors as textiles, steel, footwear, automobiles, consumer electronics and machine tools in which the NICs had achieved critical comparative advantage. At the multilateral level, definitive understanding or agreement on new issues involving intellectual property, environment and labour were sought whilst recourse to regionalism (as a disguised form of protectionism) was the fall back strategy.

4.2. EMERGENCE OF THE NEW PROTECTIONISM

The US, supported by Japan⁶², pushed for the launch of a new trade negotiation round. This was the Uruguay Round launched in 1986. At this Round, new agreements on intellectual property, removal of agricultural export subsidies, government investment policies, market access for services and environment were sought by the US.⁶³ It is noteworthy that the service and high-technology sectors for which new agreements were sought were primary growth sectors in the developed countries. Although the Uruguay Round somewhat re-charged the flagging multilateral trade system, the TRIPS and TRIMS foisted on the trade system were designed to safeguard the competitiveness of developed countries in the areas of trade covered under those

⁶⁰ Robert, Baldwin: *op. cit.* note 8 at p. 391-392.

⁶¹ Robert, Gilpin: *op. cit.* note 12 at p. 204, 207.

⁶² Japan is until recently a multilateral-trade-only developed country. It is currently exploring regional integrative possibilities with ASEAN.

⁶³ It is noteworthy that the US earlier proposals on the new trade subjects were rejected at the Ministerial Meeting of the GATT in 1982, a development that solidified the US view that the multilateral process under the GATT had become too cumbersome. See Robert Baldwin: *op. cit.* p. 398.

agreements.⁶⁴ It is instructive that environment and labour practices issues, which floundered at the WTO, were top priority consideration for the extension of the Canada-US Free Trade Area to Mexico in 1994 to form the NAFTA.

This is the face of the ‘new protectionism’ the major purpose of which is to create comparative advantage and internationally competitive industries “especially the high value added end of the industrial spectrum”. This paper submits that the regionalism of the developed countries is a ‘spoke’ of this ‘hub’.⁶⁵ This view is particularly underscored by the express threat by some developed member countries to resort to regional and or bilateral trading arrangements after the collapse of the round of negotiations in Cancun, Mexico in September 2003. It would be recalled that the Cancun Round of negotiations collapsed when Japan and South Korea with the tacit support of the EU and the US were prevented by around 100 developing and least developed countries from introducing into the WTO ‘new issues including investment rules and competition policy’ at the wake of bitter discussions on the new WTO work programme on Agriculture which was perceived by developing countries to be heavily in favour of developed countries.⁶⁶

5. RTAs – IMPACT ON THE MULTILATERAL TRADE SYSTEM

5.1 RTAs – THE ISSUE AT STAKE AND EFFECTS

In his essay titled “*International Trade and Regional Economic Integration*”, Anthony Venables framed the issue thus:

“Is the growth of regionalism part of a process towards global free trade or is it a substitute for it, damaging to multilateral negotiations and likely to lead to a situation of protected trading blocks?”⁶⁷

⁶⁴ Martin Khor: *Rethinking Liberalisation and Reforming the WTO* in International Economic Regulation (Jane Kelsey, ed) *op. cit.* p. 257 – 262. See also, John, Jackson *et al.*: *op. cit.* p.1186.

⁶⁵ Robert, Gilpin: *op. cit.* p.211. See Joan, Spero and Jeffrey, Hart: *op. cit.* p. 64.

⁶⁶ K., Sudhaman: *WTO talks collapse after developing nations block EU agenda*, being news item posted on www.rediff.com/money/2003/sep/15wto1.htm/ (last visited 23rd December 2003).

⁶⁷ Anthony, Venables: *op. cit.* note 5. See also The 1995 Report of the WTO Secretariat on RTAs where it was stated that RTAs and the multilateral process are complements rather than alternatives. Is this position still true?

In addressing this issue, this paper recognizes the potential for some gains that may accrue to members from participating in RTAs. However, this paper x-rays and projects forcefully, certain negative effects of RTAs as evidence of its preference for a rule-based multilateral trade system which limits the concentration of power in developed member countries and enables weak members to subject more powerful members to the disciplines of the trade system.

An immediate negative effect of RTAs is the potential for trade diversion.⁶⁸ In practical sense, RTAs are preferential trade systems in which policies and rules likely to result in trade diversion are adopted. Trade diversion implies a shift in trade from efficient suppliers outside the RTA to inefficient suppliers within. The approach favoured by Article XXIV is to keep the external tariff of the RTAs at pre-integration level. There is however a risk. A RTA may be consistent with Article XXIV in not raising average external tariffs and still create a trade diversion effect, damaging the welfare of the world.⁶⁹ Article XXIV does not specify how the general incidence of a set of tariffs is to be measured or to determine in net terms whether the RTA has increased barriers to external trade.

RTAs particularly FTAs, require the application of rules of origin to ensure that external imports do not come into the region through the member with the lowest external tariff. These rules are often complex and as a result, reinforce the trade diversion effects of the RTA. According to the ICC, preferential rules of origin stifle technological developments, networks, joint manufacturing and unduly restrict third-country sourcing. The rules also create obstacles to trade facilitation through border red tape, duplication of customs procedures and differing national product standards. For instance, the cost of border formalities on Intra-EU trade in the early 1990s has been estimated to be more than one percent of the gross volume of internal trade.⁷⁰

RTAs undermine the basic aim of the multilateral trade system not only by granting preferential market access but also by eliminating market access rights and other

⁶⁸ The potential for trade diversion may be reduced where the RTA involves original trading partners, which implies that they are the lowest cost source of supply. See *Ibid.*

⁶⁹ John, McMillan: *op. cit.* note 33 at p. 295.

⁷⁰ David Palmeter: *Rules of Origin in Customs Union and Free Trade Areas in Regional Integration and the Global Trading System (Kym Anderson and Richard Blackhurst, ed.) 1993 p. 326 –343 at 337.* See also Anthony, Venables: *op. cit.*

rights guaranteed under the GATT/WTO. For instance, the parties to the RTA may agree to oust certain GATT rights in their relations with one another.⁷¹

RTAs promote the proliferation of institutions and trade-related dispute settlement procedures. This trend is a menace for clarity and certainty of trade rules. Where the RTA provides for alternative dispute settlement procedures, the potential for *forum shopping* is enhanced. This implies that each party can adopt the procedure that serves its interest best. Such a provision exists in the CUSFTA.⁷² ‘Such a behaviour erodes the rule of law in international trade, [by] suggesting different laws for different states according to their region and their power to influence regional fora’.⁷³ There is equally an increase in the regulatory burden of participating

The lowering of external tariff barriers of RTAs on MFN basis on the pretext of ‘open regionalism’ is capable of reducing the need for multilateral disciplines and hence, the multilateral trade system. Indeed, it can erode commitment to the global trade system and perpetuate a ‘partial and unequal form’ of liberalisation.⁷⁴

5.2 THE MULTILATERAL ‘HIGHWAY’

There is a convergence in international trade literature on the need for a multilateral trade system. There is a forceful contention that the current wave of proliferation in RTAs should not divert attention from multilateral liberalisation and the ultimate goal of a free global market.⁷⁵ The reality of the global economy makes this imperative. And that reality is interdependence. ‘No country has a clear-cut choice between regional and international trade. All regions depend heavily on other markets.’⁷⁶ A case in point is the EU. Despite that it is the largest trade bloc, the EU relies heavily on North American markets and so does Japan. NAFTA offers too small an arena of

⁷¹ Frieder, Roessler: *op. cit.* note 11 at p. 317.

⁷² Alice, Enders: *Dispute Settlement in Regional and Multilateral Trade Agreements in Regional Integration and the Global Trading System* (Kym Anderson and Richard Blackhurst, ed.) 1993 p. 344 – 357 at 345. See also Frieder, Roessler: *op. cit.* p. 318, 320

⁷³ Diana, Tussie and Ngaire, Woods: *op. cit.* note 47 at p. 70.

⁷⁴ *Ibid*, p. 69

⁷⁵ S. Palaha and H. Sharma: *op. cit.* note 23 at p. 5.

⁷⁶ *Ibid*, p. 70.

trade to the US.⁷⁷ To the ICC, multilateral agreements remain the preferred instruments of liberalizing international trade.⁷⁸

The present multilateral framework rose from the ashes of pre-world war II protectionism and has continued to evolve guaranteeing more liberalized trade today than in the 1950s. There has been greater integration and commitment to make trade liberalisation work on the basis of strengthening domestic institutions in various economies. The costs of these processes cannot be lightly discounted in favour of newly emerging protected/open regional trade blocs.

The multilateral trade system is rule-based and as such, limits the concentration of power in developed member countries and enables weak members to subject more powerful members to the disciplines of the trade system. The requirement of consensus in decision-making process at the WTO ensures that all countries contribute to the trade management process. It also provides a point of equality amongst states and opportunity for expression of interests regardless of development. This balance is absent in RTAs.⁷⁹

The multilateral trade system also improves the bargaining power of small countries as resources could be pooled. Similarly, developed countries have opportunity to negotiate across board with their trading partners at once thus avoiding the convoluted processes of separate bilateral arrangements.

The multilateral trade system as it exists under the WTO has a constructive process for management of dispute. The GATT/WTO has mechanisms such as good offices, conciliation and mediation as well as the influence of the Council to promote dispute settlement.⁸⁰ Enders considered this a powerful counter-argument to the view that RTAs are alternative to the multilateral process.⁸¹

⁷⁷ It is noteworthy that market access was a major rationale in the US' push for the Uruguay Round in the 1980s.

⁷⁸ ICC: *op. cit.*

⁷⁹ The process of Mexico's accession to the CUSFTA to form the NAFTA illustrates this.

⁸⁰ Alice, Enders: *op. cit.* note 72 at p. 352.

⁸¹ *Ibid*, p. 355.

This paper plainly recognizes the special challenge that regional integrative processes hold for the multilateral trade system and this spurs the need to put the relevant issues in perspective. At this juncture, the analysis turns on the locus of the threat to the WTO and what the WTO must do to remain credible and relevant in the global trade system.

6. CONCLUSIONS - WHAT THE WTO MUST DO

“In a world where regional trade arrangements have become so widespread, it is hard to characterize them as ‘exceptions’”⁸²

The above comment by Lucian Cernat suggests that the potential threat of RTAs to the WTO is in their proliferation such that they represent ‘the norm’. This paper is unable to agree. The real threat to the WTO is located in the political and economic undercurrents provoking the formation of the RTAs or better still, PTAs. Hence, this paper disagrees with the view expressed by Robert Lawrence that “the forces initiating these developments [i.e. regional integration] are the very opposite of protectionism [or that] they represent positive integrative responses to the pressures exerted by globalisation”⁸³. The recoil into ‘new protectionism’ is an admission that a ‘big-bang’ trade liberalisation can create a vicious cycle of financial instability, debts and recession.⁸⁴ An extension of the new protectionism is ‘open regionalism’ the implication of which has been described previously.

It is needful to stress that this paper is not against RTAs. It only seeks to unveil the political-economic calculations driving their formation particularly since the 1990s. The paper concedes the following points:

- The structure of the GATT/WTO rules that would determine whether an RTA would enhance or reduce the credibility of the multilateral rules and disciplines.⁸⁵
- Trade liberalisation will produce negative results if it is imposed upon countries that are not ready for or able to cope with it.⁸⁶

⁸² Lucian Cernat: *op. cit.* note 21 at p. 6.

⁸³ Robert, Lawrence: *op. cit.* note 35.

⁸⁴ Martin Khor: *op. cit.* note 54 at p. 257.

⁸⁵ Frieder, Roessler: *op. cit.* note 11 at p. 318.

Accordingly, the recommendations to the WTO will be two-fold. The first set of recommendations concerns the regulatory framework for the creation of RTAs/PTAs. The second set of recommendations focuses on the trade liberalisation process and the divergent aspirations of developed and developing countries.

6.1 REGULATORY⁸⁷

(a) Review of Article XXIV

Article XXIV should be revised to require compliance not in terms of tariff level but in terms of trade volumes as a consequence of trade barriers including non-tariff barriers.⁸⁸ In addition, the requirements need to be more forcefully and stringently interpreted and applied.⁸⁹

(b) *Multilateral Surveillance*

The enforcement mechanism should be strengthened. The Committee on Regional Trade Agreement should conduct assessments of RTAs with a view to determining their compatibility with GATT/WTO rules. There is also a need to establish compliance mechanisms to ensure that compatibility is sustained. Of all the RTAs notified to the WTO, only the Czee-Slovak FTA is officially compliant with GATT/WTO rules. For some of the others, their legal status has remained undetermined. If the CRTA would be hampered, it is suggested that RTAs could be brought within the purview of the Trade Policy Review Mechanism.⁹⁰

(c) *Requirement of GATT Acquis Clause*

WTO rules should require the introduction of a GATT *Acquis* Clause. Such a clause ensures that rights guaranteed under the GATT/WTO rules are not eliminated in the RTA. It also ensures that the GATT/WTO dispute settlement process applies to disputes between members of the RTA.⁹¹

(d) *Rules of Origin*

⁸⁶ Martin Khor: *op. cit.* note 54 at p. 257.

⁸⁷ John, McMillan: *op. cit.* note 33 at p. 306. According to McMillan, the concern here is designing international laws that ensure a structure for the RTAs to promote global free trade through trade expansion with non-member countries.

⁸⁸ John, McMillan: *op. cit.* note 33 at p. 300–301.

⁸⁹ Michael Trebilcock and Robert, Howse: *op. cit.* note 34^B at p. 521.

⁹⁰ Bernard, Hoekman and Michel, Kostecki: *op. cit.* note 24 at p. 365. See also Frieder, Roessler: *op. cit.* note 11 at p. 323.

⁹¹ Frieder, Roessler: *Ibid*, p. 320.

The WTO should develop multilateral disciplines to simplify rules of origin and thus limit the hassles those rules impose on trade relations.

6.2. TRADE LIBERALIZATION

(a) New Trade Issues

The WTO should be more concerned about the ‘quality, timing sequencing and scope of liberalisation’. There is therefore a need for the WTO to review the liberalisation process and adopt a realistic approach. The eagerness to pursue new areas of trade by developed member countries should be contained whilst other members notably developing countries are battling with implementation difficulties.

(b) Commitment to Trade Rules

The WTO should highlight areas of non-compliance with trade rules by developed member countries. This will enhance the credibility of the trade system and improve on multilateral disciplines.

(c) Development objective

As established in the Doha Agenda, the WTO should follow through on the economic development as primary objective. It is the level of development that determines productivity and consequently trade capacity.

(d) Implementation of Existing Agreements

The WTO should develop mechanisms for the review of the problems dogging the implementation of many of its agreements.

(e) Balance

The WTO should work to achieve balance in the divergent aspirations of its members. The requirement of consensus in decision-making is designed to guarantee members a say in the trade management process and not as a weapon for stand-off.

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