



Regionalism *A Stumbling Block for Trade Liberalisation?*

The surge in regional agreements has continued unabated since the early 1990s. By May 2003, over 265 agreements had been reported to the World Trade Organisation (WTO) and its predecessor, General Agreements on Tariffs and Trade (GATT). Of these, 138 were notified after the WTO was created in January 1995. At present, some 300 regional trade agreements (RTAs) have been notified to the WTO and some 200 are currently in force. These include South-South, North-North and North-South agreements. They will remain an enduring feature of the international trading system (ITS). The emergence of this new regionalism raises many issues. One of them is its impact on the multilateral trading system (MTS), including whether regional integration is a building or a stumbling block, or a stepping-stone towards multilateralism. One of the most frequently asked and debated questions is whether these regional groups help or hinder the WTO's multilateral trading. This is linked to the element of incompatibility between the RTAs and the MTS, as the former are exceptions to the most-favoured-nation (MFN) principle. The RTAs could weaken the MTS and be detrimental to developing countries. On the other hand, depending on their nature and content, they could contribute to fostering the MTS system and provide important benefits for developing countries. This remains an open question and deserves further analytical work.

*Forum on Multilateralism & Regionalism: The New Interface
UNCTAD, June 8, 2004, Rio de Janeiro*

Introduction

The last decade seen escalation of regional and bilateral trade agreements. Many view regionalism as being a counter to the move to foster rapid multilateralism. However, one could justify this striking proliferation to the reduced momentum of multilateral negotiations. Based on this logic, it makes sense to explore various viewpoints. The contrasting perspectives range from thinking of regionalism as a stumbling block to one that thinks it as being a building block for rapid growth in multilateralism. In the same vein would be the consideration whether regionalism is trade-creating or trade-diverting.

The rapid build-up of the RTAs may have affected the negotiating dynamics of the Doha Round of negotiations under the World Trade Organisation (WTO) and it is unclear whether the increase in bilateral deals is in response to the slow progress of Doha talks. Concerns over the RTA expansion played a role in the launch of the Round, and, after the failure of the Cancun ministerial, it has gathered momentum¹. The divide between the developed and the developing world is being driven by the inability to arrive at a consensus on issues relating to agriculture. The split has been seen in the nature of a North-South polarisation and the characteristic movement of regional and bilateral trading formats is being declared, or announced, virtually on a daily basis.

In this Paper, an attempt is being made to understand the entire gamut of issues connected with regionalism. It will try to look at the issue in the perspective of a rule-based global trading environment. Regionalism will be explained in the context of the legitimacy that the GATT and the WTO provide and whether it has a positive impact on the economy.

What is Multilateralism?

Multilateralism is defined as an approach to foreign policy that seeks durable solutions to major international security problems through co-operation, based on mutual interests, as prescribed by dialogue. This approach stands in contrast with *ad hoc* co-operation, based on coalitions willing to act according to self-prescribed interests of a major power, as defined by its own dictate. This is one way of characterising unilateralism. Three assumptions underlie this concept of multilateralism. First, it is difficult to convince other countries to act for long in ways that are incompatible with their own interests. Secondly, countries ultimately define their interests, based on how their body politics perceive them – not on how an outside power thinks they ought to be. Thirdly, some important problems are amenable to a durable solution only through a mechanism of international co-operation.

By definition, therefore, multilateralism means the imposition of a code of conduct conducive to an accepted norm of behaviour. Extended to the domain of trade, it would essentially mean a rule-based trading environment without hindrances. The fundamental underlying principle would be one of equity and fair play, guaranteed by a robust institutional set-up.

Within the limited context of trade, multilateralism engages the entire membership of the WTO in a sustained process of mutual trade liberalisation. This remains the ultimate goal for trade reforms because no member country is excluded from the process. None of the countries are confronted with discriminatory regional trade preferences and irritants such as domestic agricultural support and export subsidies, as these are then expected to be effectively addressed at a global forum.

While becoming more elusive and gradual, continued progress in multilateral trade negotiations seems critical to the world trading system. As regionalism becomes a larger and more embedded aspect of the international trading system, divergences between the need to sustain multilateralism as a preferred trading arrangement *vis-a-vis* regionalism becomes more stark.

Is Multilateralism beneficial?

The multilateral trading system (MTS) is needed more by the developing countries as a guarantor of fairness and equity in their trade relations. This is because trade is becoming more and more a determinant of their economic growth and development and providing the wherewithal to escape from poverty. So, what the trading system delivers, or does not deliver, can now make a big difference. The MTS affects crucial development policy choices that have to be duly addressed and evaluated.

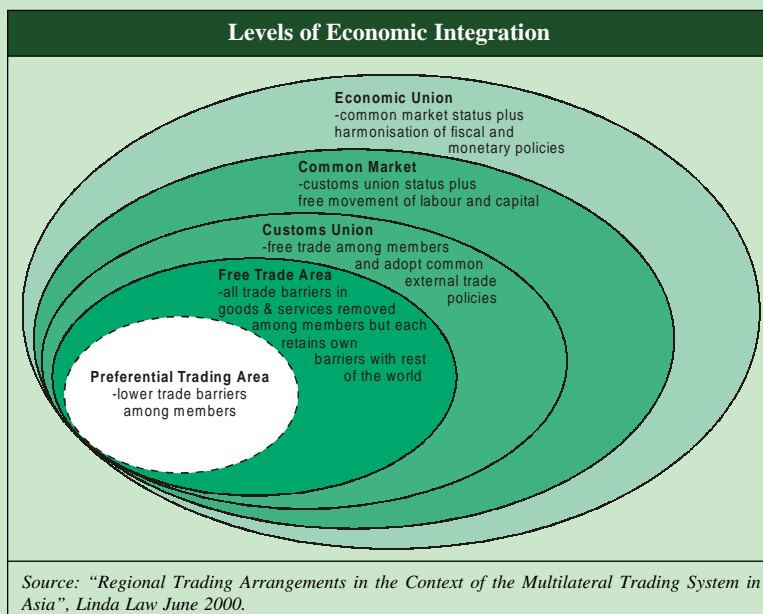
Developed countries need the MTS to engage the developing countries in trade liberalisation and openness, so that they can trade and invest with greater freedom, certainty, predictability and security across borders. The larger countries also use the system as a checks-and-balances mechanism, *vis-à-vis* one another, against those they view as harmful to their trading rights and economic interests.

Despite developed countries' involvement in regional and bilateral trading arrangements, about which so much has been said lately, the multilateral trading system has the utility for them of attracting non-members. It is only in the MTS that industrialised countries could have successfully pursued important negotiating objectives, as Trade Related Intellectual Property Rights (TRIPs), Information Technology Agreement (ITA), basic telecommunications services and financial services. The MTS ultimately delivers more comprehensively, even on the trade agenda of the fully developed countries.

Given the benefits of multilateralism, the question arises whether to pursue this trade strategy alone. The main strength of multilateral reform – its global reach – is also its primary weakness. Multilateralism requires reaching a consensus among a diverse membership that includes countries with different priorities and interests, as well as countries at different stages of development. This diversity of perspective and circumstance is particularly true of the multilateral negotiations on agriculture, and it explains the slow progress of these efforts. For many developing countries, the agricultural sector has a unique social and economic role as an engine for development and a source of income, employment and security for a large number of their population, including their most vulnerable sections.

Why Regionalism?

In an RTA, a relatively small number of countries agree to mutually reduce their barriers on each other's exports. At one time, RTAs were mostly established by geographic neighbours. Today, many RTAs encompass geographically distant countries, such as the US-Jordan and European Union (EU)-Mexico agreements, but the term 'regionalism' is still commonly used. Over the past decade, there has been a rapid increase in the formation of RTAs. As of May 2003, over 180 such agreements were in force worldwide; four times the level a decade earlier, and at least 30 more are planned or under negotiation. Almost every country in the world has joined at least one RTA and some have entered even 20 or more.



Source: "Regional Trading Arrangements in the Context of the Multilateral Trading System in Asia", Linda Law June 2000.

Countries pursue regionalism for a number of reasons. Foremost is that regionalism is a strategy to achieve comprehensive reforms with key trade partners. In the RTAs of the past decade, members have sought to implement deep economic and institutional integration by crafting agreements that address more than tariff reform. Many RTAs now deal with the reform or harmonisation of regulatory practices, investment protection, labour issues, trade dispute resolution and the development of common positions in other trade negotiation platforms. Increasingly, RTAs are also viewed as a way of linking developing and developed countries in a common project of economic development. By encouraging investment and locking in unilateral economic reforms, RTAs can facilitate productivity gains in participating developing countries and accelerate their economic growth.

Many developed countries offer non-reciprocal preferences as another way of fostering exports by developing countries. Non-reciprocal preferences are arrangements between developed and developing countries that reduce tariffs or even allow duty-free access for selected products from developing countries. However, these arrangements often exclude products that are of greatest importance to developing countries. In addition, non-reciprocal preferences do not require participating developing countries to adopt their own market access reforms. For these reasons, non-reciprocal preferences are now viewed by many as a less effective development tool, compared with RTAs.

Stumbling vs. Building Block

Whether regional agreements are stumbling or building blocks to multilateral trade, the terms Bhagwati (1991) coined remains the primary question. According to stumbling block advocates:

- RTAs promote costly trade diversion when sizeable Most-Favoured-Nation (MFN) tariffs exist to maintain preferential margins in 'their' markets.
- RTAs absorb scarce negotiating resources and crowd out policy makers' attention.
- North-South combinations leading to competing RTAs create incompatible regulatory structures and standards and may be inappropriate for developing-country partners.
- RTAs weaken the discipline and efficiency associated with a broadly recognised framework of rules.

Building block proponents emphasise that:

- regional or bilateral agreements sensitise the domestic constituencies regarding liberalisation and help incremental progress on trade.
- expanding the number of RTAs can reduce the opposition to trade, as each RTA reduces the margin of preference.
- RTAs are more often geo-political alliances than trade alliances, and, hence, are not in competition with global trade.
- regional agreements help developing-country firms to learn and internalise the competitive requirements of global trade.
- for issues like regulatory co-operation, RTAs may be a more preferred choice.

Other findings indicate the following divergent views:

- Developing countries with preferential agreements may have a vested interest in perpetuating the tariff barriers that keep out competing countries.
- Mansfield and Reinhardt (2003) found that an increase in RTA activity might be associated with multilateral trade negotiations.
- Others argue that the RTAs are a mechanism of enhancing the pressure to move on to the multilateral front. Schott (2004) indicates that the US has, in the past decade, utilised the RTA approach to coax and cajole its partners to progress towards a multilateral format of trading.

All of the above are indicative of limited evidence and an inconclusive premise whether regionalism is trade-creating or trade-diverting in nature. However, it does indicate the tactical approach and benefits that regionalism can provide to a trading system.

Do GATT/WTO Legitimise RTAs?

While Free Trade Agreements (FTAs) are designed to permit the achievement of greater economic integration, they involve a major exception to the fundamental principle of MFN treatment. To address this concern and ensure that the trading interests of third (non-member) countries are respected and that such agreements are compatible with the rules-based and open MTS, the GATT/WTO establishes a number of conditions that must be satisfied by FTAs.

The primary disciplines are laid out in Article XXIV of GATT 1994. They permit RTAs if:

- external trade barriers do not rise (Article XXIV:5);
- all tariffs and other regulations of commerce are removed on substantially all exchanges of goods between the partner countries within a reasonable length of time (Article XXIV:8); and
- notification is made to the WTO General Council.

The fundamental building block of the multilateral system is the principle of non-discrimination enshrined in Article I of the GATT, signed in 1947. But, as pointed out above, there are exceptions. In addition to the primary disciplines, there are:

- rules that cover preferential agreements and deal with trade in services, as set out in Article V of the General Agreement on Trade in Services (GATS); and
- developing countries may invoke the provisions of the 1979 Decision on Differential and More Favourable Treatment,

Reciprocity and Fuller Participation of Developing Countries, also known as the Enabling Clause.

Unlike Article XXIV, the Enabling Clause does not require that internal barriers be removed on “substantially all” trade among all participants in those arrangements. The Common Market for Southern Cone (MERCOSUR) was notified to GATT under this provision and not Article XXIV. The Enabling Clause also legitimises non-reciprocal programmes such as the Generalised System of Trade Preferences (GSTP).

The task of verifying the WTO compliance of RTAs is entrusted to the Committee on Regional Trade Agreements (CRTA) to oversee all RTAs under a single framework and consider the implications of such initiatives for the multilateral trading system.

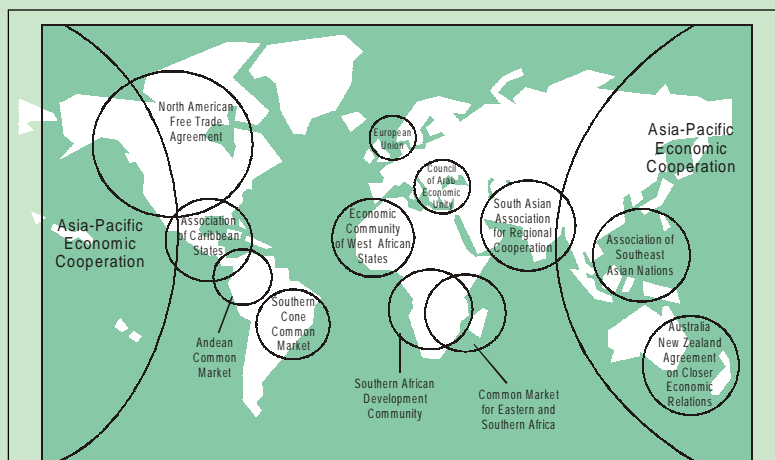
As was the case under the GATT, the CRTA has been unable to carry out its function effectively, essentially because of the fear of setting a precedent and opening up agreements to dispute settlement proceedings. The CRTA has, thus, been unable to conclude the examination of any of the 110 RTAs currently under scrutiny. Most observers would agree that the existing WTO disciplines and enforcement mechanism have no teeth and are not particularly effective at controlling, limiting or shaping the growth and coverage of the RTAs.²

From Regionalism to Open Regionalism

The call for stringent application of WTO rules seems a non-starter in today’s times, where RTAs seem to be proliferating at a hectic pace. The area where a sufficient amount of knowledge has accumulated is Rules of Origin (RoO). It is clear that complex and stringent RoOs limit the success of RTAs for developing-country partners. Differing RoOs across the world complicate matters and an agreement that promotes simple, common and less stringent rules would be advantageous. The Uruguay Round (UR) has not been so successful, in terms of achieving the objectives on non-preferential RoO.

The success of an open trading system will depend upon the transparency of rules and benefits to stakeholders and a common acceptability of policy implementation and formulation.

Developed countries may need to pursue such agreements in the hope of reducing environmental externalities, addressing non-trade issues such as labour migration or national security. But, if there are delays in the process of multilateral openness, then this would defeat the purpose. The Doha Development Agenda (DDA) would be guaranteed only if the benefits are protected and the interests of the world trading system are



Source: *Regional Trading Arrangements among Developing Countries: The ASEAN Example by Dean A. DeRosa 1995, IFPRI.*

safeguarded. The need to lower external barriers would be supportive of open trade, ensure efficient development and reduce the adverse impact of the RTAs. Integrating agriculture with the RTAs would help smaller countries integrate with the larger. Liberal accumulation of RoOs will erode the preferences of North-South RTAs. Putting the interests of partner countries before domestic industry interests would help foster openness in the global system. Abolishing anti-dumping, as a means of protectionism, would help in this drive too. Development assistance can build the institutional capacity for increased trade and access to markets.

Developing countries should unilaterally lower external barriers to trade in relation to other partners, in addition to those within the regional agreement, and this will help foster the multilateral trading system. Delaying measures to liberalise trade and reforms seem to delay the process of integration with the global system.

Conclusions

In multilateralism, the entire membership of the WTO engages in a sustained process, with mutual trade liberalisation as the primary goal. This is because no member country is excluded from the process, or faced with discriminatory regional trade preferences and policies such as domestic agricultural support and export subsidies can be better addressed in a global forum. On the other hand as regionalism achieves a greater

following and more natural aspect of the international trading system, a sustained commitment to multilateralism can help.

What Kobrin says seems quite appropriate in today's times. Kobrin (1995) argues that the comparison of "regionalism vs multilateralism" is wrong because "it assumes that global integration is a political process and that it depends on the effectiveness of multilateral negotiations". The future of closed regionalism is unlikely, as even the largest economic regions are too small to be viable economically, and there is no reason to believe that regional borders will be any more meaningful than national in the face of an electronically networked world economy. Regions writ large at a time when geography, as a basis for the organisation of economic activity, is in question. In his view, RTAs are not the solution because economic and technical systems are inherently global.

The emergence of new regionalism brings new challenges and opportunities for participating developing countries. These RTAs are likely to be trade-creating because of existing complementarities, and regionalism is used as a means of expanding the trade agenda beyond what is currently possible in the MTS.

As regionalism becomes a larger and more embedded aspect of the international trading system, a sustained commitment to multilateralism can help contain the potential divisiveness of regionalism, while harnessing its energy for deeper and more rapid reforms³.

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Endnotes

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- 2 op cit.
- 3 Multilateralism and Regionalism: Dual Strategies for Trade Reform, Burfisher, Mary E & Zahniser, Steven on www.usda.gov, Amberwaves September 2003, Features.

An earlier version of this paper was presented at a seminar on Economic Cooperation in South Asia, which was held in Colombo (Sri Lanka) in May 2005 and organised by CUTS-CITEE, India and India Office of Friedrich Ebert Stiftung, Germany.

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