Changing Faces of International Trade: Multilateralism to Regionalism [1]

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Abstract. Regional trade agreements are an integral part of international trade, they operate alongside global multilateral agreements under the WTO, and they have increased significantly in number and prominence recently. The interface between regionalism and multilateralism is complex and evolving. This paper examines why the countries have preferred regional strategies over the multilateralism and an assessment has been made as to the systemic implications of this new interface. The legal solution for trade regionalism as provided in the law of GATT by virtue of Article XXIV has been dealt with. International trade development in North-South dimensions and the South-South integration has added to this interface. The trade developments in international law over the past half century have left us with the current multilateral status being extremely weak. For some time to come we can expect to see numerous bilateral, regional, and global responses from governments and MNCs.

Keywords: multilateralism, WTO, regional trade, MNCs, regionalism ,GATT, free trade agreements

I. Introduction

The literature on regionalism versus multilateralism is growing as economists and political scientists grapple with the question of whether regional integration arrangements are good or bad for the multilateral system. Are regional integration arrangements building blocks, or stumbling blocks, or stepping stones toward multilateralism? As economists worry about the ability of the World Trade Organization to maintain the GATT's unsteady yet distinct momentum toward liberalism, and as they contemplate the emergence of world-scale regional integration arrangements (the EU, NAFTA, FTAA, APEC, and, possibly, TAFTA), the question has never been more pressing.[2]

The slow progress of World Trade Organisation (WTO) trade negotiations has led to an increase in regional trading agreements (R.T.As) for the purpose of gaining immediate market access. Economic considerations aside, R.T.As are also driven by geo-political and strategic considerations. Crawford and Fiorentino (2005) identified the following trends in the formation of RTAs:

1. The formation of RTAs is a phenomenon observed across countries. In fact, regionalism is, for an increasing number of countries, the main element of their trade policy.
2. Today's RTAs are broader in coverage than in the past. In that sense, they are becoming more complex. They contain provisions applicable to subjects that go beyond those negotiated at the level of the WTO—among them investment, competition, environment, and labour, among other topics.
3. Reciprocal preferential North–South agreements are increasing in number. There is also a significant emergence of South–South partnerships.
4. RTAs are expanding and consolidating across regions and within continents. Most countries today belong to at least one RTA. Indeed, a "spaghetti bowl" of multiple and overlapping RTAs around the globe has emerged.

As far as typology of RTAs is concerned, Free Trade Agreements (FTAs) are the most common type (84 percent at all RTAs in force vs. 8 percent for Custom Unions and 8 percent for Partial Scope Agreements). As for the configuration of RTAs, bilateral agreements account for more than 75 percent of all RTAs notified and in force, and for almost 90 percent of those under negotiation.

Most RTAs are between transition economies (29 percent), followed by North–South agreements (26 percent) and South–South agreements (21 percent). The number of South–South agreements has increased

[1] This article was first published in Kierkegaard, Sylvia, (2008) Business and Law: Theory and Practice. IAITL. pp.390-410

[2] L.Alan Winters, *Regionalism versus Multilateralism*; 'Policy Research Working Paper: The World Bank, International Economics Department, International Trade Division, November, 1996.'

significantly in recent years. Trade within RTAs covered a third of world trade in 2002; however, if MFN rates of zero are excluded, the RTA share declines to 20 percent (World Bank 2005).

2. Why have countries favoured bilateral or regional trade strategies over multilateralism?

Some countries favour bilateral or regional trade strategies over multilateralism There are three major reasons. First, countries may hope to maximize their benefits through so-called first-mover advantages, i.e., they focus on the gains they could obtain from signing an agreement with a large trading partner before competing countries do so. Or they may seek to pre-empt other countries, by denying them first-mover advantages. The validity of this argument will be analyzed in the next section. Second, countries may seek to guarantee permanent access to particular markets. Signing an agreement bilaterally or regionally may be the quickest and easiest way of achieving that goal. Third, a bilateral agreement may be used as leverage to facilitate domestic reforms, particularly in areas that are not dealt with multilaterally, such as investment, competition, and environmental and labour standards.

The agenda of the eleventh Conference of UNCTAD (UNCTAD XI) centred on the coherence between national development strategies and global economic processes to promote economic growth and development, particularly of developing countries. A central aspect of the agenda was international trade and trade negotiations both at the multilateral level under the WTO, and at the regional (including bilateral, subregional and interregional) level. The interface between the two processes has important implications for the trade and development prospects of developing countries. They can be complementary and coherent with the multilateral trading system (MTS), and thus facilitate international trade and enhance development prospects, or they can be divergent and hence undermine the collective and national effort to use international trade as an engine of growth and development[3]. The coherence between multilateralism and regionalism becomes an opportunity and challenge for countries, as well as their regional arrangements and the WTO to manage in the evolving international trading system in order to maximize their potential benefits and minimize their potential adverse effects.

Effectively managing the interface between regional and multilateral initiatives requires greater synergy between national development objectives and external commitments. Central to this challenge facing developing countries is to design and implement an appropriate and strategic pacing and sequencing of national, regional and multilateral liberalization, so as to maximize development gains from these processes of trade liberalization and regulatory commitments, by rendering regional processes and multilateral liberalization mutually supportive and coherent. A challenge is that simultaneous participation by countries in a web of regional trade agreements (RTAs) while also engaging in the evolving MTS, both of which have overlapping agendas, increasingly affects sensitive development policies and overloads the limited negotiating capital of developing countries. Negotiating and benefiting from RTAs requires important human and institutional resources and infrastructures and resolving underlying asymmetries, including with respect to size and economic conditions. This new interface between multilateralism and regionalism in terms of coherence and compatibility deserves special attention by policy makers and requires careful and in-depth study.

3. Why Free trade Agreements?

The obvious answer is that multilateral trade negotiations under the World Trade Organisation (WTO) have been too slow. One recourse is to negotiate bilateral or plurilateral free trade agreements (F.T.As) in order to secure immediate market access.

Ironically, even though some 40% of global trade takes place among developing countries, there have been no serious efforts to negotiate trade liberalisation among the developing countries in a multilateral forum. The only feeble attempt was the General System of Trade Preferences (GSTP), launched under the auspices of the United Nations Conference on Trade and Development (UNTACD), but the offers made were meagre and symbolic. This could be explained by the tradition, rightly or wrongly, among the developing countries that they should not demand and negotiate market access among themselves in order to preserve a semblance of G77 solidarity. One way out is therefore to choose a special trading partner and negotiating a regional trading agreement[4] (R.T.A.) either bilaterally or among a group of developing countries. It is therefore no coincidence that there has been a dramatic rise in the number of R.T.As since the Uruguay Round. As of January 2005, notification of 312 R.T.As has been made to the WTO. They are driven as much by perceived economic benefits of regional integration as by strategic and political calculations, if not more.[5]

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[3] Mina Mashayekhi, Lakshmi Puri and Taisuke Ito, *Multilateralism and Regionalism: The New Interface*, UNCTAD/DITC/TNCD/2004/7.

[4] Types of R.T.As include the Economic Union, Common Market, Customs Union, Free Trade Area, Partial Scope. The most common is the Free Trade Agreement (F.T.A.).

[5] Chak Mun *"FTAs: An Economic Reality for Multilateral Trade"* The Financial Express (June, 22. 2004).

4. The evolving multilateral trading system and "new generation" regional trade agreements

The conclusion of the Uruguay Round of multilateral trade negotiations in 1994, and the establishment of the WTO in 1995 to provide the institutional support to the multilateral trade agreements, constituted a significant milestone in the evolution of the multilateral trading system. The principle of "single undertaking" bound all WTO members to all the results of the Uruguay Round negotiations (with the exception of plurilateral agreements), thereby reinforcing the fundamental principle of most-favoured nation (MFN) treatment. With the conclusion of the Uruguay Round and the strengthened MTS, there was an expectation that exceptions to multilateralism, such as regional trade agreements, even though legally covered by the WTO under certain conditions, would either become less of an alternative policy option for countries or will need to be adapted and conducted in such a manner as to become outward-oriented, not inward-looking, and thus constitute building blocks for the new multilateralism ushered in by the WTO. This is apparent from the Doha Declaration[6] where WTO Members stressed their "commitment to the WTO as the unique forum for global trade rulemaking and liberalization, while also recognizing that regional trade agreements can play an important role in promoting the liberalization and expansion of trade and in fostering development".

A notable feature in the recent rise of regionalism is that countries that have traditionally favoured the multilateral approach to trade liberalization, including Australia, New Zealand, Japan, Singapore, India and the Republic of Korea have joined the RTA bandwagon. The United States has also given more attention to concluding RTAs. A different composition of RTAs involving the widening of country coverage beyond the traditional regional zone has emerged. Significantly, RTAs have emerged between countries and entities in different regions/continents (e.g. EU-Mexico, EU-South Africa, US-Israel, Jordan, Morocco, and Chile). In most cases, these agreements are bilateral in membership, concluded by two countries/entities, including the case of free trade agreements negotiated and concluded by the two distinct RTAs (e.g. EU-MERCOSUR under negotiation).

Developing countries are no exception to the process of expansion and reinvigoration of the RTAs.[7] They have actively participated in regional trade agreements among themselves (South-South) and with developed countries (North-South). In Africa, some 14 RTAs are now in force, including UMA in North Africa and CEMAC, COMESA, EAC, IOC, ECCAS, ECOWAS, UEMOA, SACU and SADC in sub-Saharan Africa. These subregional groupings are expected to constitute a continental scale African Common Market under the auspices of the African Union by 2028. In the Asia-Pacific region, some 10 RTAs are currently in force, including ASEAN, SAARC, ECO in continental Asia and MSG, PICTA/PACER in the Pacific. ASEAN is the precursor RTA in the region and has established the ASEAN Free Trade Area (AFTA) with the internal liberalization objective set for achievement in 2020. SAARC has recently agreed upon transforming the entity into the South Asian Free Trade Area (SAFTA), while ECO has established the ECO Trade Agreement (ECOTA). The Bangkok Agreement is a preferential trade agreement that includes India, the Republic of Korea and China. In America, there is MERCOSUR, the Andean Community, CARICOM and CACM. In the Middle East, GCC countries plan to establish an economic union by 2010. Negotiations for the Greater Arab Free Trade Area (GAFTA) were launched with a target date of 2008. Four Mediterranean-Basin countries[8] have signed the Agadir Agreement as a stepping stone towards a Euro-Mediterranean FTA to be established by 2010.

5. Systemic implications of the new interface between multilateralism and regionalism

A. Conventional debate on regionalism versus multilateralism

The debate on the interrelationship between MTS and RTAs is long-standing and well documented.[9] Traditionally, the desirability of RTAs has been discussed against the backdrop of the multilateral trading system based on a simple welfare analysis weighing the "trade creation" and "trade diversion" effect of RTAs with respect to the multilateral trading system. This analytical approach has been strongly criticized by new-generation economists for many reasons, but especially because the scope of its inquiry is too narrow. Nowadays, not only static aspects

[6] Paragraph 4 in the Doha Declaration

[7] United Nations, "*Bilateralism and regionalism in the aftermath of Cancun: Re-establishing the primacy of multilateralism"*, synthesis note based on regional papers prepared by ECA, ECE, ECLAC, ESCAP and ESCWA, for the Round Table of Executive Secretaries of the United Nations: Regional Commissions atUNCTAD XI, Sao Paulo, 15 June 2004.

[8] Egypt, Jordan, Morocco and Tunisia.

[9] For a literature review of the debate, see, for example, Arvind Panagaria, "*The regionalism debate: An Overview"*, The World Economy, vol. 22, no. 4, June, 1999, pp. 477-512.

of economic welfare, but also certain other socio-political concerns associated with RTAs are considered in advocating or rejecting regionalism in international trade. It mainly pertains to the following two broad issues: (i) relative welfare effects of non-preferential across-the-board (MFN) liberalization versus preferential liberalization; and (ii) the political economy implications of RTAs for MTS, as well as those of MTS for RTAs. While the first question asks which approaches to trade liberalization are superior in terms of trade and welfare gains for the members of RTAs, third countries and the world as a whole, the second question seeks to ascertain the systemic implications of RTAs for the MTS in general and multilateral trade negotiations in particular, i.e. whether they represent stumbling blocks or building blocks to accomplishing broader goals of the global trading community such as "raising standards of living" and promoting "sustainable development."[10]

B. RTAs as Stumbling Blocks

The view that RTAs are stumbling blocks is based on the claim that RTAs eventually cause a reduction in aggregate global welfare as they compete not only with non-member states but also with other RTAs to shift the terms of trade in each bloc's favour by raising tariffs against other blocs.[11] Global welfare is diminished, it is argued, because RTA member products are protected irrespective of whether they are of the same quality or their industries are as efficient as those of their non-member counterparts. The stumbling block perspective also focuses on the mercantilist behaviours of trading partners who seek to increase their trade surplus by exporting more and importing less, which amounts to little more than a "beggar-thy-neighbours" policy.[12] Once formed, RTAs follow this path of mercantilism in their interactions with each other. Although this conduct obviously violates the liberal idea of free trade, it nonetheless survives today in the form of policy options reflecting the political reality of protectionism. Mantras such as "national competitiveness" may be understood from this perspective.[13]

RTAs provide abundant opportunities for local interest groups, such as producers of trade-sensitive products, to manipulate both the design and operation of RTAs. The eventual effect of such lobbying efforts is to distort the efficient flow of interstate commerce.[14] In NAFTA, for instance, conventional trade barriers such as quotas in the agricultural sector have been phased out only through a tortuous, highly tedious process.[15] Moreover, complicated "rules of origin" matrices are deliberately designed to safeguard so-called "originating goods" with preferential treatment vis-à-vis non-originating goods, namely, goods imported from non-member countries.[16] Therefore, although preferential rules of origin may help to boost intra-bloc trade (i.e., trade creation) to a certain degree, they generally block global trade flows (i.e., trade diversion) to such an extent that any advantages achieved are offset by corresponding disadvantages.

C. RTAs as Building Blocks

1. *Laboratory Effect.* One of the most powerful arguments for RTAs stems from their experimental or laboratory effect vis-à-vis multilateral trade liberalization. Especially when it comes to new areas in WTO such as services and information technology products, this inefficiency in collective decision-making is compounded by the fact that the WTO has no precedents or acquis to guide these negotiations.

Under these circumstances, negotiations among a smaller number of regional participants tend to produce better outcomes in less time.[17] Furthermore, once agreements are adopted and implemented at a regional level, the experience and lessons gained through trial and error will serve as a knowledge base.[18] This knowledge base, in turn, will serve as a valuable foundation on which subsequent multilateral agreements can be built. From an internal point of view, a process such as this often serves to educate government officials (the "demonstration effect"), helping them to adapt to new practices of trade liberalization, and enabling them to move on to a multilaterally binding track. From an external point of view, RTAs can "ratchet up" the multilateral liberalization

[10] WTO Agreement.
[11] Many will recognize this situation as a variant of the "prisoner's dilemma," or "Nash non-cooperative equilibrium" Jeffrey. A. Frankel, *Regional Trading Blocs In The World Economic System* 1 (1997).
[12] Warning against growing "world inequality" resulting from the formation of trade blocs by Zissimos & Vines, Regional Trading Blocs In The World Economic System 1 (1997).
[13] Paul Krugman, *Competitiveness: A Dangerous Obsession*, 73 Foreign Aff. 28 (1994).
[14] Frankel, supra note 10, at p.212; see also Stephen P. Sorensen, *Open Regionalism or Old-Fashioned Protectionism?: A Look at the Performance of Mercosur's Auto Industry*, 30 U. Miami Inter-AM. L. Rev. pp.371, 398 (1998) (demonstrating that "industrial realpolitik" in Argentina and Brazil blocked the introduction of a full-blown market principle in auto industry despite a strong shift to economic liberalization).
[15] David Orden, *Agricultural Interest Group Bargaining over the North American Free Trade Agreement*, in The Political Economy Of Trade Protection (Anne Krueger ed., 1996); Frankel, supra note 10, at p.213.
[16] Anne O. Krueger, *Free Trade Agreements Versus Customs Unions* 13- 14 (Nat'l Bureau of Econ. Research, Working Paper No. 5084, 1995); Frankel, supra note 10, at p.213.
[17] Miles Kahler, *International Institutions And Political Economy of Integration at* p.125-27 (1995); Frankel, supra note 10, at p.218..
[18] See C. Fred Bergsten, *Open Regionalism*, 20 World Econ. at p.545, 548 (1997)

process by creating an incentive for other regions or countries to emulate successful initiatives.[19] In sum, RTAs tend to provide test laboratories for the multilateral trading system.[20]

Empirical studies of the foregoing proposition have reached a variety of conclusions.[21] Some scholars stress that most countries involved in RTAs are also "active and committed" participants in the WTO.[22] Others observe that in the long-term, intra-regional trade becomes relatively less significant vis-à-vis inter-regional trade in terms of average trade flows.[23] Still others offer more detailed evidence regarding the success of regional experiments for global trade liberalization: contributions from NAFTA and the EU to the WTO.[24] These success stories reveal one of the characteristics of convergence, that is, assimilation, of different trading units.

2. Lock-In Effect. Some scholars emphasize that RTAs often "lock-in" previous liberalization records or reforms in a manner that prevents subsequent backsliding.[25] This lock-in effect can be especially attractive to governments of developing countries where reform efforts are often stymied by deeply rooted local powers. These governments may respond to domestic interest groups who vehemently oppose regional trade liberalization and demand that it be stopped by simply saying that their hands are tied.

In this way, RTAs could be halfway houses or building blocks for a more open and liberal MTS. As regards the supremacy of the WTO over RTAs, the constituent treaties of many new-generation RTAs clearly state that these need to be consistent with WTO rules. This indicates that future RTAs would be built on the WTO, seeking to maintain compatibility with its disciplines. This points to a positive, dynamic interface between regional trade liberalization and disciplines on the one hand, and multilateral liberalization and disciplines on the other. Of course, in order for these intentions to become reality, all RTA provisions need to be WTO-compatible.

D. Empirical Debate

Economists have conducted empirical studies on the desirability of trade regionalism. Not surprisingly, these studies yield diverse conclusions according to the particular methodological assumptions and limitations of the economic models they employ.[26] Some characterize RTAs as stumbling blocks[27] while others view them as building blocks.[28]

These empirical findings are broadly consistent with the language of GATT 1994 regarding trade regionalism.[29]

On the other hand, empirical confirmation of the basic objective of the GATT/WTO system with respect to trade regionalism--"complementarity" or "symbiosis"--does not necessarily mean that the GATT/WTO system has always been capable of achieving these objectives. On the contrary, the past record of GATT Article XXIV

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[19] *ibid*

[20] John H. Jackson, *Regional Trade Blocs and the GATT*, 16 World Econ. 121, 130 (1993); Harold Hongju Koh, The *Legal Markets of International Trade: A Perspective on the Proposed United States--Canada Free Trade Agreement*, 12 Yale J. Int'l L. at p.193, 248 (1987).

[21] The laboratory effect described here is analogous to that found in a federal system. Referring to the United States, Barry Friedman points out that "the vast majority of techniques used today to govern were developed at the state and local level." Barry Friedman, *Valuing Federalism*, 82 Minn. L. Rev. 317, 399 (1997).

[22] Gary Sampson, *Regional Integration and the Multilateral Trading System, in Regional Trade Blocks, Multilateralism, And The GATT: Complementary Paths To Free Trade* by Till Geiger & Dennis Kennedy eds., 1996.

[23] For instance, in North America, intra-regional trade accounts for less than 40% of total trade; in ASEAN, trade among members represents only 17% of total trade. Woolcock, *Regional Integration and the Multilateral Trading System, in Regional Trade Blocks, Multilateralism, And The GATT: Complementary Paths To Free Trade* by Till Geiger & Dennis Kennedy eds., 1996 at 118-19. This phenomenon of relative shrinking of intra-bloc commerce becomes even more salient when including inter-regional "investment."

[24] *Ibid.* at p.120-21; C. Fred Bergsten, Globalizing Free Trade: A Vision For the Early 21st Century, 75 Foreign Aff. at p.105, 110 (1996); Gary C. Hufbauer & Jeffrey J. Schott, Toward Free Trade and Investment in the Asia-Pacific, 48 Wash. Q. 37, 37-45 (1995).

[25] Frankel, supra note 10, at p.216; C. Fred Bergsten, *Open Regionalism*, 20 World Econ., at p.548.

[26] Richard Pomfret, *The Economics of Regional Trading Arrangements* (1997), at pp.261-63.

[27] L. Alan Winters, *The EC and Protection: Political Economy*, 38 Eur. Econ. Rev. at pp.596, 601-02 (1994) (arguing that protectionist use of anti-dumping and countervailing duties sheltered the EC industries from the global market).

[28] Riccardo Faini, *Integration or Polarization?: Regionalism in World Trade during the 1980s, in Multilateralism And Regionalism After The Uruguay Round* at p.157 (Riccardo Faini & Enzo Grilli eds., 1997) (arguing that trade between major blocs, such as EU, NAFTA and Asia, and all other regions increased noticeably in the eighties).

[29] "General Agreement on Tariffs and Trade, October 30, 1947, 61 STAT. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194, art. XXIV (5), pmbl. ("Accordingly, the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area; Provided that [the duties and regulations of the CU or FTA are not higher or more restrictive than before the CU's or FTA's formation].").

indicates almost total impotence in this regard. Against this background, the following Part considers the question of how and to what extent the law of GATT Article XXIV has evolved to overcome inherent flaws toward the establishment of a constructive model of trade regionalism under the GATT/WTO system.

6. Legal Solution for Trade Regionalism: Development of GATT Article XXIV

Thus far, the discussion has focused on various aspects of the contemporary discourse regarding the evolution and desirability of trade regionalism. The following section explores how the GATT/WTO system itself has been embracing and addressing trade regionalism from a legal perspective.

6.1 Overview: *Lack of Legal Discipline Under GATT 1947 Practices*

Under GATT 1947, trade regionalism took the form of FTAs or CUs. Article XXIV was supposed to govern their formation. The legislative background is helpful to clarify the meaning of this provision. In its efforts to establish a post-war international trade order through GATT, the United States sought to construct a strong multilateral trading order, illustrated by the Most Favored Nation (MFN) principle,[30] and by the dismantling of trading preferences, particularly the Commonwealth preferences.[31] At the same time, the United States also acknowledged the necessity of certain exceptions to this MFN principle, such as RTAs, in accordance with its own strategic need to unite Western Europe against the Soviet-led communist bloc.[32] Therefore, the United States exerted its political influence to shape the language of Article XXIV such that exempting RTAs would not result in their misuse. The United States position materialized in various paragraphs of Article XXIV, including those prohibiting any disadvantages to non-member countries as a consequence of forming an RTA (paragraph 4), as well as those regulating the formation process itself (paragraphs 5, 7, and 8).

In a sense, it would be fair to say that a literal reading of the text of Article XXIV is consistent with the so-called building block idea.[33] Paragraph 4 recognizes "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."[34] Yet the same paragraph explicitly stipulates that the purpose of RTAs should not be to "raise barriers to the trade of other contracting parties."[35] In the same vein, in order to prevent the abuse of RTAs for a discriminatory or protectionist purpose, Article XXIV also provides "external" requirements (paragraph 5)[36] as well as "internal" requirements (paragraph 8)[37] to qualify as an RTA. In addition to the aforementioned substantive requirements, Article XXIV also provides a degree of procedural discipline in the form of, *inter alia*, a notification obligation (paragraph 7).[38]

Though the rationale of Article XXIV is quite understandable and idealistic in light of its legislative background, the text itself is so nebulous as to leave many important issues open to wide speculation. Consequently, actual applications of the black letter law were neither clear nor resolute, rendering Article XXIV a virtual dead letter from its inception. Despite the existence of "working parties" whose mission was to examine the compatibility of proposed RTAs with Article XXIV and to forward their findings to the GATT contracting parties,

[30] "General Agreement on Tariffs and Trade, October 30, 1947, 61 STAT. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194, art. I.
[31] John H. Jackson, World Trade And The Law of GATT 576-77 (1969).
[32] *ibid*
[33] See GATT Dispute Panel Report on Turkey--Restrictions on Imports of Textile and Clothing Products, WT/DS34/R (Nov. 19, 1999), http:// www.wto.org/english/tratop_e/dispu_e/1229d.pdf (visited Apr. 22, 2007) [[hereinafter Turkish QRs, Panel Report]. The Panel observed that the relationship between the most-favoured-nation (MFN) principle and Article XXIV of the GATT, which deals with free-trade areas and customs unions, has not always been harmonious. In 1947, their coexistence in the framework of international trade relations had been viewed as ultimately positive, reflecting the perception that genuine customs unions and free-trade areas were congruent with the MFN principle and directed towards the same objective, i.e. multilaterally-agreed trade liberalization. *Ibid*. at ¶ 2.2.
[34] "General Agreement on Tariffs and Trade, October 30, 1947, 61 STAT. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194, art. XXIV (4).
[35] *ibid*
[36] "General Agreement on Tariffs and Trade, October 30, 1947, 61 STAT. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194, art. XXIV (5), pmbl. (Describing the requirements vis-à-vis non-RTA members).
[37] "General Agreement on Tariffs and Trade, October 30, 1947, 61 STAT. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194, art. XXIV (8) (describing the substantive requirements pertaining to RTA members).
[38] "General Agreement on Tariffs and Trade, October 30, 1947, 61 STAT. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194, art. XXIV (7).

these working parties failed to reach firm decisions.[39] Among all the RTAs notified under GATT 1947, only one case received a "clear-cut assessment of full consistency with the rules."[40]

Except for this single case, RTAs have not been formally endorsed by the GATT contracting parties. The GATT contracting parties never took an official position even with respect to the European Economic Community (EEC).[41] What is worse, in many questionable cases, "GATT waivers" (under GATT Article XXV) absolved RTAs of any potential illegality vis-à-vis GATT.[42] John Jackson has noted that "legal arguments have been ignored or [have] resulted in a standoff without resolution." Unfortunately, the history of failure that has plagued GATT working parties on trade regionalism has continued since the launch of the Committee on Regional Trade Agreements (CRTA) on February 6, 1996.[43]

6.2 Dispute Settlement Procedure: Article XXIII

Under GATT 1947 much debate surrounded the question of whether any non-member contracting party could raise the incompatibility of an RTA with Article XXIV in the dispute settlement process provided for in Article XXIII.[44] Since GATT itself was silent on this issue, it would have been possible and even desirable for panels to have adjudicated this issue in specific cases. The lack of due legal consideration in the operation of GATT was most striking on this point. It was only through the launch of the new WTO system that this legal impasse was addressed from a legislative as well as judicial[45] standpoint.

6.3 Records Without Decisions: Working Party Reports[46]

The fact that most working party reports dealing with Article XXIV lacked legal discipline or legal certainty does not necessarily mean that they can now be dismissed. On the contrary, some of the views recorded in the reports still hold referential value in understanding and applying the law of Article XXIV within the new WTO terrain.[47] As a matter of fact, certain critical positions in the working party reports were reflected in the Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994 ("Article XXIV Understanding") as well as in a recent Appellate Body Report. Other portions of the reports may hold historical value in documenting the evolution of GATT 1947 jurisprudence on Article XXIV. The discussion that follows offers a critical analysis of several of the most significant paragraphs of Article XXIV as encountered by GATT working parties.

a. Article XXIV, Paragraph 4

Not to raise barriers to the trade of other contracting parties.[48] The working party that reviewed the accession of Portugal and Spain to the European Communities noted that although some delegations were concerned that Spain

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[39] John H. Jackson Et Al., *Legal Problems of International Economic Relations* at pp.290-91 (3d ed., 1995) at p.471.

[40] This was the CU formed between the Czech Republic and the Slovak Republic. See Working Party on the Customs Union between the Czech Republic and the Slovak Republic: Report of the Working Party adopted on October 4, 1994, GATT L/7501, Oct. 4, 1994; Turkish QRs, Panel Report, supra note 32, ¶ 2.4 n.6.

[41] Supra note 38.

[42] *ibid*

[43] Turkish QRs, Panel Report, supra note 32, ¶ 2.7. See also WTO, Report of The Committee On Regional Trade Agreements To The General Council, Oct. 11, 1999, WT/REG/8http://docsonline.wto.org/GEN_viewerwindow.asp?D:/ DDFDOCUMENTS/T/WT/REG/8.DOC.HTM (visited May 22, 2007) ("The Committee has made substantial headway in the factual examination of a number of RTAs, but has been unable to finalize reports on any of these examinations.").

[44] "General Agreement on Tariffs and Trade, October 30, 1947, 61 STAT. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194, art. XXIII.

[45] In fact, conflict could have occurred with respect to the panel's jurisdiction on legal issues relating to Article XXIV vis-à-vis the mandate of Committee of Regional Trade Agreements (CRTA). Nevertheless, both the panel and the Appellate Body avoided this sensitive issue. See Turkish QRs, Panel Report, supra note 32; Turkey-- Restrictions on Imports of Textile and Clothing Products, Appellate Body Report adopted November 19, 1999, WT/DS34/AB/R, http://www.wto.org/english/tratop_e/dispu_e/34abr_e.pdf (visited Apr. 22, 2007)

[46] Regarding this specific sub-section, see generally 2 WTO, GATT Analytical Index: Guide To GATT Law And Practice, 789-872 (Updated 6th ed. 1995)

[47] The contents of the reports are still significant even though the working parties themselves may not be regarded as WTO-guiding "bodies established in the framework of GATT 1947." "The WTO Agreement includes the 'General Agreement on Tariffs and Trade 1994.' This instrument, known as 'GATT 1994,' is based upon the text of the original [GATT 1947]." WTO, The Legal Texts: The Results of The Uruguay Round of Multilateral Trade Negotiations, preface (1999). GATT 1994 includes GATT 1947 Article XXIV, subject to the Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994. General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, art. XVI (1).

[48] GATT 1947, supra note 46, art. XXIV (4).

and Portugal introduced new quantitative restrictions that were inconsistent with Articles XI, XIII, and XXIV, the EC delegations argued that paragraph 4 of Article XXIV did not outline an obligation but rather an objective.[49] According to the EC, members of an RTA can introduce new trade barriers or extend existing barriers to new members if the net impact of all barriers is less than what had prevailed before the creation of the RTA.[50] Similarly, the working party that reviewed the free trade agreement between Canada and the United States also highlighted the main concern of non-member contracting parties that the agreement would take precedence over GATT, thus opening up the possibility of raising a new trade barrier prescribed by GATT.[51]

In fact, paragraph 4 is the most critical legal text in Article XXIV as it sets forth the objective of trade regionalism in light of the multilateral trading system. Nonetheless, certain trading units, in particular powerful ones like the EC and the United States, often have misinterpreted or understated this paragraph to justify the imposition of new trade barriers as a result of the formation or expansion of RTAs.[52] Eventually this problem, too, was addressed under the new WTO system in legislative as well as judicial terms.

b. Article XXIV, Paragraph 5

Agreements between contracting parties and States or governments other than contracting parties.[53]
During the Havana Conference in 1948, France proposed the formation of a CU with Italy and accepted the negotiation outcome contingent upon the waiver of one of the obligations of paragraph 5, that Italy first become a GATT member.[54] The waiver was eventually granted in March 1948. Later, the working party reports on both the "European Free Trade Association-- Examination of Stockholm Convention" and the "Latin American Free Trade Area-- Examination of Montevideo Treaty" noted differing views as to whether paragraph 5 applied to agreements with non-contracting parties.[55] Certain contracting parties argued for extending Article XXIV to include RTAs involving non-GATT members because they wanted preferential treatment through Article XXIV to be applied selectively to certain non-GATT members free of MFN obligations. Although it ran counter to the plain meaning of paragraph 5, this expansive interpretation seemed to offer a less painful process than making such non-contracting party members enter into GATT prior to joining RTAs. The far-reaching membership of the WTO has effectively marginalized this issue.[56]

c. Article XXIV, Paragraph 8

With respect to substantially all the trade.[57]
According to the Report of the Sub-group of the Committee on the European Economic Community, the EEC-member countries proposed that "a free trade area be considered as having been achieved for substantially all the trade when the volume of liberalized trade reached eighty percent of total trade."[58] However, the report also reveals that many other members of the sub-group argued that it would be inappropriate and unrealistic to fix a general percentage of trade that might be applicable to each different case.[59]

To fix a given figure as a criterion for qualification as a RTA seems problematic for many reasons. First of all, the measurement of "liberalized" trade volume would hardly be accurate in reality because such measurement is generally based on ex ante forecasts of unrealized transactions, such as increased imports resulting from the formation of an RTA.

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[49] Accession of Portugal and Spain to the European Communities: Report of the Working Party adopted on 19-20 October 1988, L/6405, Oct. 19-20, 1988, GATT B.I.S.D. (35th Supp.) ¶¶ 19, 22 (1989) [hereinafter L/6405]; GATT Analytical Index, supra note 45, at p.796-97.
[50] L/6405, ¶¶ 17, 22; GATT Analytical Index, supra note 62, at p.796-97.
[51] Working Party on the Free-Trade Agreement between Canada and the United States: Report of the Working Party adopted on 12 November 1991, L/6927, Nov. 12, 1991, GATT B.I.S.D. (38th Supp.) ¶ 76 (1992); GATT Analytical Index, supra note 45, at p.798.
[52] See, e.g., Free Trade Agreement between Canada and the United States: Report of the Working Party, ¶ 76.
[53] GATT 1947, supra note 46, art. XXIV (5).
[54] GATT Analytical Index, supra note 45, at p.798.
[55] European Free Trade Association: Examination of Stockholm Convention: Report adopted on 4 June 1960, L/1235, June 4, 1960, GATT B.I.S.D. (9th Supp.) ¶ 47-58 (1961) [hereinafter L/1235]; Latin American Free Trade Area: Examination of the Montevideo Treaty: Report adopted on 18 November 1960, L/1364, Nov. 18, 1960, GATT B.I.S.D. (9th Supp.) ¶ 31 (1961); GATT Analytical Index, at p.798.
[56] When Article XXIV was drafted, GATT contracting parties numbered only 23. GATT 1947, supra note 46, pmbl. By contrast, there are currently 151 members of the WTO.
[57] GATT 1947, supra note 46 art. XXIV (8).
[58] The European Economic Community: Reports Adopted on 29 November 1957, L/778, GATT B.I.S.D. (6th Supp.) § D ¶ 30 (1958) [hereinafter L/778]; GATT Analytical Index, supra note 45, at p.824.
[59] L/778, § D ¶ 31; GATT Analytical Index, supra note 45, at p.824.

Ultimately, the substantiality test must be conducted on a case-by-case basis. Considering the inherent textual ambiguity of this test, only jurisprudential development through accumulation of a sufficient body of case law is likely to clarify what is substantial in each case.

7. Dynamism in the Interface between Regionalism and Multilateralism: A Post Cancun Perspective

In the context of the parallel negotiations at multilateral, interregional, regional and subregional levels, the interrelationship between the MTS and RTAs is relevant, especially in the context of the post-Cancun multilateral trade negotiations in the DWP. The setbacks experienced at the Fifth WTO Ministerial Conference have raised concern over the possible shift in emphasis among countries from the multilateral track towards the regional track of liberalization, thereby weakening the impetus for multilateral trade negotiations and eventually the MTS itself.

In concrete terms, the interface between the MTS and RTAs operates at three levels.[60] At the first level are WTO rules governing the operations of RTAs. They define specific conditions under which RTAs are allowed to exist and to operate under the multilateral trading system. WTO rules governing RTAs include GATT Article XXIV on trade in goods, GATS Article V on trade in services, and the Enabling Clause on South-South (preferential) agreements. At the second level, market access commitments, be it goods or services, made on an MFN basis as a result of successive rounds of multilateral trade negotiations determine the degree of preferences available to RTA partners, hence the scope for preferential liberalization among RTA partners. At the third level, multilateral disciplines constitute a "floor", or common minimum denominator, on trade and trade-related policy disciplines covered by the WTO, including non-tariff barriers and behind-the-border regulatory issues. Such disciplines commit all WTO Members and determine the conduct of trade policy that has to be observed, including by the parties of RTAs. However, RTAs may lead to the commitments of a level higher than that statutorily defined under the WTO.[61]

(i) WTO rules on RTAs

RTAs are governed by Article XXIV of GATT 1994, Article V of the GATS and the Enabling Clause. All provisions allow WTO Members to depart from the cornerstone principle of the MFN under certain conditions, and establish the requirements to be fulfilled by members of RTAs to be compatible with the WTO. GATT Article XXIV requirements, which apply to FTAs, CUs and "interim arrangement" leading to either FTAs or CUs, essentially provide that duties and other regulations of commerce should be eliminated for "substantially all the trade" among RTA members, and that the barriers placed in the way of third countries should not be "on the whole higher or more restrictive". These requirements are not applicable under the Enabling Clause. The Enabling Clause provides that the MFN clause of GATT Article I.1 is exempted for a limited number of preferential arrangements, including "regional or global arrangements entered into amongst less-developed countries for the mutual reduction of tariff reduction or elimination of tariffs" (paragraph 2c). Thus, it can be argued that the Enabling Clause sets out less stringent requirements than those contained in GATT Article XXIV. Indeed, a number of South-South RTAs have been notified under the Enabling Clause.[62]

The examination of notified RTAs with regard to their compatibility with WTO rules is conducted by the Committee on Regional Trade Agreements (CRTA).[63] The CRTA has not been able to adopt final reports on its examination to date.

The improvement and the clarification of the WTO disciplines affecting RTAs are critical in disciplining RTAs in a manner supportive of the MTS – one which minimizes the harmful effects of RTAs on third countries and the MTS. In this respect, multilateral negotiations have been launched as provided for in the Doha Ministerial

[60] Luis Abugattas Majluf, "*Swimming in the Spaghetti Bowl: Challenges for Developing Countries under the New Regionalism*, Policy Issues in International Trade and Commodities Study Series No. 27; UNCTAD (2004).

[61] Some perceive this differently; for example, the EC takes the view in the CRTA minutes that internally restrictive measures between RTA members are legal modifications (Vienna Convention on Law of Treaties, Article 41) and are permitted until third party rights are violated. The argument is that parties can freely modify WTO with internally restrictive measures in an RTA.

[62] South-South RTAs notified under the Enabling Clause include the India-Sri Lanka FTA, EAC, CEMAC, SAPTA, AFTA, CAN, COMESA, ECO, MERCOSUR, the Trade Agreement among the Melanesian Spearhead Group Countries, the Lao People's Democratic Republic-Thailand, GCC, LAIA, the Bangkok Agreement, PTN (Protocol Relating to Trade Negotiations among Developing Countries), GSTP, TRIPARTITE Agreement, and UEMOA. http://www.wto.org/english/tratop_e/region_e/provision_e.xls Caribbean Community and Common Market (CARICOM) were notified under GATT Article XXIV on 14 October 1974 most likely due to the nonexistence of the Enabling Clause at the time. It has been reported that the SADC Trade Protocol would be notified under GATT Article XXIV despite the fact that its membership contains developing countries only.

[63] MERCOSUR was notified under the Enabling Clause but is being examined in the CRTA under both the Enabling Clause and GATT Article XXIV, which is a unique situation that has not been applied to any other notified developing country grouping since 1979.

Declaration on WTO rules (paragraph 29) applying to regional trade agreements aimed at "clarifying and improving disciplines and procedures", while taking into account their "developmental aspects".

(ii) RTAs and negotiations on agriculture and NAMA

The core market access negotiating agenda under the DWP concerns agriculture, NAMA and services. As regards trade in goods, since the principal aim of RTAs is to achieve the elimination of tariff and non-tariff barriers among RTA partners on a reciprocal basis, RTAs have direct relevance to the ongoing DWP negotiations on agriculture and NAMA.

Developing countries engaged in RTAs need to take into account the implication of MFN liberalization and the appropriate level of preference for their RTA partners, while the supremacy of the multilateral trading system requires that such preferential treatment does not hinder multilateral efforts for across-the-board MFN tariff reductions. As exporters, they have to ascertain which forums, multilateral or regional, are the most suited for seeking increased market access in a given market or building one for coherence, and to get the best trade deals and opportunities for their exports. Erosion of preferential margins is the major issue for LDCs and those low-income countries that have enjoyed substantial preferential margins either under RTAs or unilateral preferences provided by major developed countries. Some compensatory or adjustment mechanism and trade solutions may need to be devised under WTO or otherwise so as to address serious adverse effects on the development prospects of these countries.

While some trade-distorting measures such as agricultural subsidies may be better addressed in the WTO (e.g. FTAA subsidy debate), certain market access barriers in sensitive sectors such as agriculture might be better addressed in the limited scope of the regional context. In this respect, it can be noted that protection prevalent on an MFN basis tends to persist under RTAs (e.g. agriculture, textiles).[64] While RTAs may be better suited for addressing specific highly protected sectors on a limited basis, the weaker bargaining position of developing countries in North-South agreements may not allow them to successfully address such barriers against powerful developed country partners.

(iii) RTAs and negotiations on services

The Uruguay Round negotiations on services have resulted in the establishment of GATS as a multilateral framework of principles and rules for trade in services with a view to the expansion of such trade under conditions of transparency and progressive liberalization and as a means of promoting the economic growth of all trading partners and the development of developing countries. GATS provides for a positive list approach to liberalization of services.

"Positive list" refers to a liberalization mechanism that separates general obligations that apply to all countries (such as MFN treatment), from the negotiated specific commitments of market access and national treatment in respect of specific service sectors and activities, which can be subject to limitations and conditions.[65] The commitments undertaken during the Uruguay Round negotiations have largely reflected *status quo* except in respect of financial and telecommunication services sectors resulting in deeper commitments.

Thus, the Doha negotiations on services achieved progressive and more substantial liberalization. Deeper liberalization has taken place in the regional context, where a number of RTAs including developing countries have embarked on preferential services liberalization based on "GATS-plus" commitments, some under a negative list approach to provide preferential treatment to their RTA partners. Liberalization of services in the regional context may be beneficial in improving the cost efficiency of national economies as services account for a significant share of GDP for most developing countries and constitute major inputs to production of goods and services. Under GATS Article V, "flexibility" is allowed for developing countries forming regional integration agreements (RIAs), and additional flexibility is available for those RIAs formed among developing countries only.

It should be noted that Article IV and XIX.2 of the GATS allows for a measure of flexibility for developing countries in respect of liberalization commitments and a commitment by developed countries to give priority attention to sectors and modes of interest to developing countries.

[64] WTO, "Coverage, liberalization process and transitional provisions in regional trade agreements", background survey by the Secretariat (WT/REG/W/46), April 5, 2002.

[65] The positive list approach would allow for each country to strategically select the individual services sector or transaction that would be liberalized. See Mina Mashayekhi, "GATS 2000 negotiations: Options for developing countries", *Trade-Related Agenda, Development and Equity* (T.R.A.D.E) Working Papers 9, South Centre, December 2000.

(iv) RTAs and regulatory measures and standards

In the area of the trade-related regulatory dimension, RTAs increasingly assume prominence as they embark on new trade-related behind-the-border regulatory measures. Multilateral rules in these areas are currently underdeveloped. Of particular relevance to developing countries are those areas where no multilateral rules exist. Some RTAs have given precedence, by way of "WTO-plus" agreements, to the multilateral rules, as was the case with investment under NAFTA, or competition policy and other economic policies under the EU. Some have seen this as evidence to support the "building block" thesis of the interrelationship between the MTS and RTAs, as RTAs serve as a platform for a new rule-making exercise. Others see such developments representing the potential risk of increased fragmentation of trade rules at regional levels, making it difficult to agree multilaterally on new issues.

Even where multilateral rules exist, negotiations for "WTO-plus" RTAs can transform themselves into standard-setting negotiations, thereby entailing the risk of upward harmonization of regulatory standards in developing countries. A case in point is intellectual property protection.[66] While minimum statutory standards are provided in the multilateral rules, namely the TRIPS Agreement, in the absence of provisions equivalent to GATT Article XXIV or GATS V (or because it does not entail market access elements and preferential treatment may not in itself be desirable economically or practicable), IPR standards negotiated regionally are automatically multilateralized. It can be noted that, under the TRIPS Agreement, the only exception permitted to the MFN principle is "grandfathering" of preferential IPR protection under plurilateral treaties predating to the WTO.[67]

The implication of the regulatory standard-setting nature of RTAs is particularly significant in the North-South context, as developing countries would be under pressure to adopt higher standards, such as patent protection in terms of coverage, level of protection or enforcement, with a consequent restriction of the scope of policy flexibility available under multilateral rules, including for the purpose of ensuring access to essential medicines for all. New issues are often negotiated and included in the North-South agreements, including investment, competition policy, government procurement, environment and labour standards. In this sense, RTAs may serve to bypass, dilute and override SDT for developing countries available under WTO rules and create new obligations in areas not covered by WTO, which would be higher than would have been agreed at the multilateral level.

8. Resolving Underlying Assymetries:Development Dimension in North-South Agreements

A major innovation in the formation of RTAs is that developed country and developing country RTAs are also emerging. Traditionally governed by various unilateral preferences schemes, a number of agreements under negotiation are aimed at transforming the trade and economic relations that developing countries enjoyed with their previously preference granting developed countries into reciprocal free trade areas, such as the pan-American negotiations for the FTAA, or wider partnership accords as is the case with the ACP-EU negotiations for the Economic Partnership Agreement under the Cotonou Agreement. Under the US African Growth and Opportunity Act, the possibility exists for the conclusion of FTAs with sub-Saharan African beneficiary countries. The Pacific Agreement on Closer Economic Relation (PACER) envisages launching FTA negotiations among the Pacific Island countries on the one hand, and Australia and New Zealand on the other, once the Pacific Island countries have launched FTA negotiations with any other developed countries such as with the EU. As noted, a variety of bilateral initiatives have been launched in the North-South context, most recently by the United States.[68] Another example is the Euro-Mediterranean agreements are aimed at establishing free trade between the EU and Mediterranean basin countries.

The underlying asymmetry between the two partners in size, conditions and capacity requires that corresponding asymmetry in obligations and commitments be embedded in the agreement so as to ensure equal treatment among "unequal" partners. In practical terms, this translates into ensuring market access and entry for exports of developing countries, while at the same time defining more carefully and clearly the coverage of the

[66] For a discussion of the role of RTAs in setting "WTO-plus" standards in the intellectual property protection regime, see, for example, David Vivas-Eugui, *"Regional and bilateral agreements and a TRIPS-plus world: The Free Trade Area of the Americas (FTAA)"*, TRIPS Issues Paper 1, QUNO/QIAP/ICTSD, Geneva, 2003; MSF, "Access to medicines at risk across the globe: What to watch out for in Free Trade Agreements with the United States", *MSF Briefing Note*, May 2004.

[67] Article 4 (d) of TRIPS Agreement provides that MFN obligation is exempted for any advantage, favour, privilege or immunity "deriving from international agreements related to the protection of intellectual property which entered into force prior to the entry into force of the WTO Agreements".

[68] Such US bilateral initiatives include: FTAs concluded with Australia (May 2004), Morocco (March 2004), Central American countries (CAFTA) (December 2003), Chile (June 2003) and Singapore (May 2003). Negotiations were launched with Bahrain (August 2003), SACU (June 2003), Bolivia, Columbia, Ecuador, Peru (May 2004) and Panama (April 2004).

agreements and securing SDT under the agreement to address adjustment and social costs, including resource transfer through development assistance. There is also a preliminary asymmetry issue that would need to be taken into account, namely the capacity to choose a partner may often reside with the larger country. North-North regional integration arrangements, such as the EU enlargement, would also have implications for developing countries.

On the export side, since developing countries have enjoyed quite liberal market access conditions on preferential terms in developed country markets, it is not easy to ascertain the areas where those countries could gain from future agreements. This is particularly so as preference margins decrease as MFN and other tariff reduction progress. One obvious area where developing countries could expect gains is the residual market access barriers in sectors of export interest to them, most notably agriculture and labour-intensive manufactures. These remain important areas as some low-income, small and vulnerable developing countries still rely heavily on preferential access to developed country markets for their exports of a limited number of commodities.

Other possible areas of expected gains include market entry barriers, most notably technical, sanitary and environmental regulations, as well as rules of origin. Another area is the liberalization of trade in services, in particular a temporary movement of natural persons in Mode 4 of the GATS and recognition of qualification of services professionals.

Indeed, North-South Agreements are often promoted on the basis of their expected effect on FDI flows, the benefits of extended IPR protection, and the impact of these agreements on the predictability of the rules of the game and on institution building and governance.

On the import side, the costs of liberalization under North-South agreements are likely to be substantial for developing countries. Reciprocity under RTAs requires mutuality in opening of markets and other commitments between RTA partners, and this applies also to North-South Agreements.

In this respect, WTO disciplines may limit the scope of such flexibility by the requirement of reciprocity under GATT Article XXIV, and to a lesser extent under GATS Article V.[69] Furthermore, the lack of corresponding provisions in TRIPS or the lack of multilateral rules at all in new areas of investment, competition policy or government procurement may lead to a higher level of commitments than would have been agreed upon at the multilateral level, thereby limiting policy space for developing countries.

9. South-South Integration and Coperation: New Trade Geography

South-South trade and integration have formidable potential for boosting intraregional trade for greater integration of developing countries into international trade and the world economy.

Over the past two decades or so, the importance of South-South trade in world trade nearly doubled, and the interdependence among developing countries for their exports increased significantly. It can be noted that such trade still concentrates on a limited number of developing countries most notably in East and South-East Asia, and there is need for greater participation of a broader range of developing countries in South-South trade integration.[70] Developing country exports increasingly cover new and dynamic sectors, including IT-enabled services (e.g. outsourcing).[71] Interregional South-South trade cooperation through the Global System of Trade Preferences among Developing Countries (GSTP) provides an important complementary avenue for developing countries to increase and expand their market access opportunities.

As regards the net welfare effects of South-South agreements, it has been argued that RTAs among developing countries may generate potential adverse effects on trade patterns among RTA members and between them and third countries. World Bank research has concluded that South-South regional blocs are problematic in several respects. Apart from small non economic benefits, South-South RTAs between two or more poor countries are very likely to generate trade diversion, especially when external tariffs are high.[72] Similarly, another study, based on data from sub-Saharan Africa, concluded that, judged by the variance in their trade patterns from what current comparative advantage would predict, intraregional trade has potential adverse effects on non-RTA

[69] "Flexibility" is provided under GATS Article V; thus there is scope for more favourable treatment for developing country Members of regional integration agreements in trade in services. See also the ACP proposal on GATT XXIV, op. cit.

[70] The 12 leading exporters among developing countries accounted for some 73 per cent of the total developing country exports of goods (2002) and 71 per cent of their total exports in services (2003). The leading exporters include China, Hong Kong (China), Republic of Korea, Mexico and Taiwan Province of China. UNCTAD, "Trade in services and development implications" (TD/B/COM.1/71), 20 January 2005.

[71] The product composition of developing country exports has evolved so that they have become major players in markets for many "dynamic sectors". Developing countries account for 30 percent of world exports of the 20 most dynamic products. UNCTAD, "Strengthening participation of developing countries in dynamic and new sectors of world trade: Trends, issues and policies", background note by the UNCTAD secretariat (TD/396), 17 May 2004. See also UNCTAD, "Trade and development aspects of professional services and regulatory frameworks" (TD/B/COM.1/EM.25/2), 25 November 2004.

[72] World Bank, *Trade Blocs*, New York: Oxford University Press, 2000.

members.[73] By contrast, some recent studies have demonstrated that South-South RTAs — particularly African RTAs — are net trade creating, in many cases more than doubling the trade among South-South RTA members.[74] Increased trade with both regional partners and third countries in the case of South-South RTAs might be explained by the removal of a variety of tariff and non-tariff barriers and as a result of trade facilitation measures implemented upon the establishment of RTAs. Such increased intraregional trade appears to have been offset by a decrease in exports to non-RTA partners.

The product composition of intraregional trade tends to differ substantially from that of interregional trade with the rest of the world. In most cases intraregional trade is mainly composed of manufactured goods with higher value added in contrast with trade with the rest of the world, which is dominated by one or two basic commodities. Thus, the importance of the share of intraregional trade aside, the significance of South-South RTAs lies in their potential for the diversification of exports towards higher-value-added products. While the degree of intraregional trade share is in no way the sole measure of success of regional integration, the generally low degree of intraregional trade indicates that many South-South RTAs are yet to exploit their full potential.

Significant trade barriers to regional trade, includes residual duties, quantitative restrictions, other non-tariff measures such as rules of origin, and other market entry barriers such as technical, sanitary and environmental standards, as well as market structure and infrastructure networks.

At the interregional level, the GSTP provides enhanced prospects for South-South cooperation. The GSTP was established in 1988 at a Ministerial Meeting of the Group of 77 held in Belgrade as a framework for the exchange of trade preferences among developing countries to promote trade among themselves.[75] The agreement includes results of the first round of negotiations conducted between 1986-1988, and entered into force in 1989 after 44 countries ratified the agreement.

10. The Challenge of the Future

When one examines the investment-protection mechanisms that international law developed in the last half-century, they should be impressed by their three ingenious innovations. The first innovation was to employ bilateral agreements and multilateral investment protection institutions. A BIT is useful but regional and multilateral devices have proven to be more effective because they replace one-on-one obligations with a multinational constraints agenda that is broader than trade. The second innovation was to give injured member states direct rights of action against other member states themselves by enforcement through a multilateral investment mechanism. However, the problem with the current multilateral status is that it is extremely weak. The third innovation was the shrewdest of them all. It was to engraft the first two innovations into "trade" groups whose agenda includes not only free trade issues but also investment protection.

The ingenuity of the third innovation builds on the difference in the empathy that human beings have for organizations as compared with agreements. Agreements are regarded as a rather abstract expression of rights and obligations, but an organization is a bundle of living relationships. Signing an agreement, a nation is merely a party; joining an organization, it becomes a member of the club. Building on that stronger empathy, modern regional trade agreements bind trade group members in more rigors and detail than do corresponding provisions of the BITs or TRIMs.

For some time to come we can expect to see numerous bilateral, regional, and global responses from governments and MNCs.[76] Raymond Vernon's statement, "the challenge that governments face is to preserve the advantages that openness has brought while mitigating the tensions that it generates" characterizes what is to come as the world continues to globalize.[77]

What is clear from the foregoing analysis is that we are likely to see the evolution of regional trade areas on a two-fold scale. First, we will see the evolution of the trading areas within which trade and investment, and the

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[73] Alexander J. Yeats, "What can be expected from African regional trade arrangements? Some empirical evidence", *World Bank Working Paper* No. 2004, Washington DC, World Bank, 1998.

[74] See, for example, Lucian Cernat, "Assessing Regional Trade Arrangements: Are South–South RTAs More Trade Diverting?" *UNCTAD Policy Issues in International Trade and Commodities Study Series* No. 16, United Nations: New York and Geneva, 2003.

[75] The GSTP is based upon the following principles and features: (i) the GSTP is reserved for the exclusive participation of members of the Group of 77 and China; (ii) the GSTP must be based and applied on the principle of mutuality of advantages in such a way as to benefit equitably all participants, taking into account their respective levels of economic development and trade needs; (iii) the GSTP recognizes the special needs of the LDCs and envisages concrete preferential measures in their favour; (iv) tariff preferences are bound and form part of the Agreement; (v) the GSTP is negotiated step-by-step and improved and extended in successive stages, with periodic reviews; and (vi) the GSTP must supplement and reinforce present and future subregional, regional and interregional economic groupings of developing countries.

[76] Raymond Vernon, *In The Hurricane's Eye: The Troubled Prospects of Multinational Enterprises* at p.37 (Cambridge, Mass, Harv. Univ. Press, 1998).

[77] *Ibid* at p.55.

rules governing such intra-regional transactions, will likely become more integrative. Second, inter-regional expansion through the "regionalization" theory is likely to increase the number of countries involved in regional investment regimes and thus increase the spread of common investment rules. Efforts will continue in finding ways to widen the circle of liberalization.

11. Conclusion

Regional trade agreements have proliferated in number, expanded their membership, and deepened their integration since the creation of WTO, and in particular since the launch of the Doha Work Programme. Both developing and developed countries have been actively participating in these processes by establishing and reinvigorating North- South and South-South agreements, often on an inter-regional basis.[78]

As regards North-South agreements, the development dimension needs to be taken into account in respect of both market access and entry opportunities and domestic policy space. North-South RTAs may address market entry barriers, most notably rules of origin. They can also result in deeper Mode 4 commitments and facilitated recognition of qualification. Adjustment costs may be significant for developing countries, and this requires meaningful special and differential treatment, including resource transfer for development purposes, to be incorporated in the agreements.

As regards South-South agreements, the potential for trade expansion is significant, while a number of South-South integration groupings have yet to exploit their full potential for export expansion and diversification. Deep integration would prove to be beneficial under South-South agreements.

Effectively managing the interface between RTAs and the MTS requires, at the national level, comprehensive development-oriented trade policies and a clear assessment and awareness of the impact of the norms and disciplines being entered into at the different levels of trade integration. Clarity of policies addressing the development, trade and financial needs of developing countries is necessary in order to mould RTAs into effective instruments for development. Development objectives deserve priority attention in RTAs and in the WTO, including in the context of questions touching upon special and differential treatment issues. At the regional level, ensuring additional policy space and flexibility available for promoting development in the context of RTAs is necessary. The emergence of issues related to “WTO plus” and “WTO-minus” demands comprehensive analysis of the different regulatory developments in the multilateral and regional contexts, and identifying additional policy space available for action at the regional level. At the multilateral level, it is important to strengthen the rules affecting RTAs in order to guarantee that RTAs are indeed instruments for promoting trade liberalization globally, while at the same time the rules needed to allow for special and differential treatment for developing countries to make use of flexibility available to them.

We find that regional trade agreements are building blocs to trade liberalization in Latin America. This result is in strong contrast to much of the theoretical literature and to recent work by Nuno Limao on the United States and the European Union. Trade agreements in developing countries may be more likely to create incentives for trade liberalization for a number of reasons.[79] One possibility is that, since the multilateral system has not enforced much tariff reduction on developing countries, regional agreements may offer an enforcement mechanism for a broader reform package.

Alternatively, regionalism may set the stage for competitive liberalization. If countries in a South-South agreement have incentives to liberalize because the costs of trade diversion are large, a competitive liberalization could result. As one partner lowers external tariffs, the preferences the other country faces decline, encouraging a reciprocation of the reduction in preferences. Alternatively, considering that agreements must be self-enforcing, the tariff reduction by one member would lead to a decline in the gain from the agreement to the partner. Lowering external tariffs would increase the gain and make the agreement self-enforcing. Thus, the new equilibrium would be one with lower tariffs.

[78] Supra note 2 at p.21.

[79] Antoni Estevadeordal, *Caroline Freund and Emanuel Ornelas, “Does Regionalism Help or Hinder Multilateralism? An Empirical Evaluation.”*