

# **REGIONAL TRADE INTEGRATION UNDER TRANSFORMATION**

Regional Trade Agreements Section

Trade Policies Review Division

WTO Secretariat

## A. INTRODUCTORY REMARKS

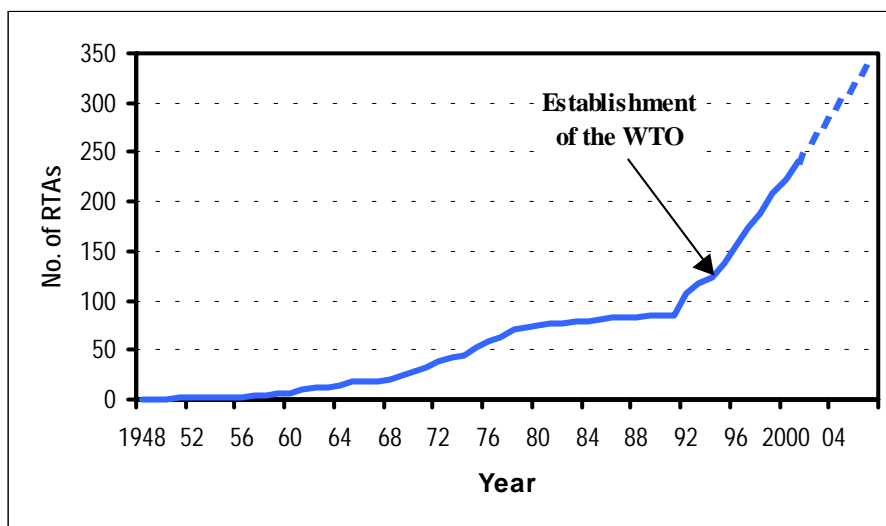
1. The 1990s was a prolific decade for regional trade initiatives. The number of regional trade agreements (RTAs) has increased dramatically and their scope as well as their geographical reach have both broadened and expanded.<sup>1</sup> This trend is likely to intensify further as the few remaining countries traditionally favouring multilateral-only trade liberalization have initiated - or are actively considering - negotiations of several RTAs. The option of regional trade liberalization has become for virtually all countries (whether WTO Members or not) a very attractive tool for managing their trade relations. However, an indiscriminate proliferation of RTAs on a global scale poses systemic risks to the functioning of the multilateral trading system (MTS) and calls into question the viability of current WTO rules governing these agreements. The objective of this paper is to expose some of these risks and provide a factual account of RTAs recent developments. Part B of this paper will look at RTAs' trends and characteristics and their globalizing scope. Parts C and D will consider RTAs' systemic issue and place them within the WTO context.

## B. RTAS IN THE GLOBAL CONTEXT

### (i) Trends and Characteristics

2. The number of RTAs has increased at an unprecedented rate during the last decade and this notwithstanding the successful conclusion of the Uruguay Round. As of June 2002, 254 RTAs<sup>2</sup> had been notified to the GATT/WTO, of which 129 since January 1995 with an annual average rate of notification of 15 RTAs per year compared to the less than three during the four and half decades of the GATT (see **Chart 1**). 172 of the notified RTAs are currently in force and it is estimated that by 2007, a further 87 RTAs<sup>3</sup> may be added, if those currently being planned or under negotiation are concluded.

Chart 1 - RTAs notified to the GATT/WTO (1948-2002), cumulative



<sup>1</sup> RTAs are here defined as trade agreements providing for mutual preferential treatment between the signatory states or territories. Any treatment more advantageous than MFN is understood to be "preferential".

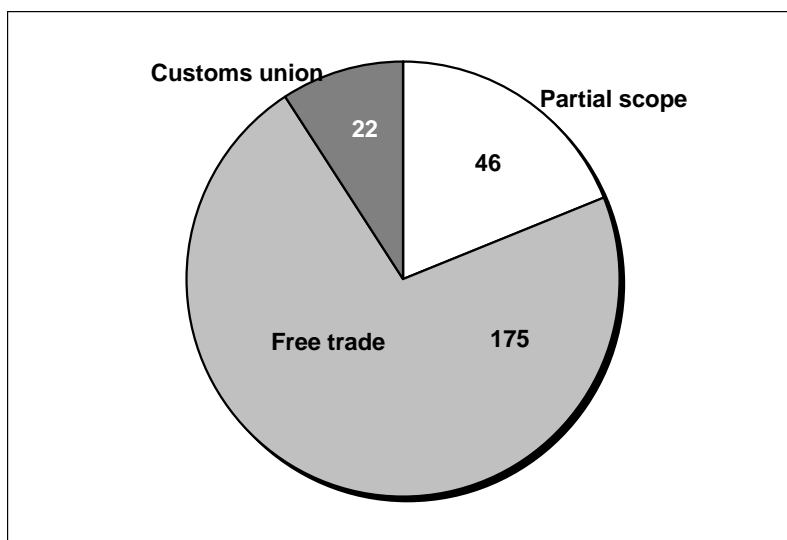
<sup>2</sup> This number corresponds to notifications made under GATT Article XXIV, GATS Article V and the 1979 Decision of the GATT Council on Differential and More Favourable Treatment (Enabling Clause), which include accessions to existing RTAs. It should be noted that RTAs on trade in goods and RTAs on trade in services are notified separately even if the agreement covers both areas

<sup>3</sup> Not every RTA under negotiation will automatically increase the number of RTAs in force, given the fact that some will supersede or expand existing RTAs.

3. Regional trade agreements differ considerably in scope, varying from the exchange of preferences on a limited range of products between two or more countries, to include various trade-related provisions going beyond traditional tariff reduction or elimination. For the most part (though not exclusively), partial scope agreements concern RTAs concluded among developing countries. RTAs among developed countries tend to be more far-reaching reflecting, among other developments, decreasing tariff levels in OECD countries for most non-agricultural goods. The new generation of RTAs, especially those involving developed countries, tend to go far beyond traditional tariff-cutting exercises and even beyond the realm of existing multilateral rules: trade agreements include more and more regional rules on services, investment, competition and standards; in a few cases, they also contain provisions on environment and labour. In these and other ways, many of the new RTAs are paralleling or anticipating the evolution of the multilateral trading system.

4. **Chart 2** shows a typology of all RTAs (whether notified or not to the GATT/WTO) publicly known to be in force as of June 2002. The trend towards the conclusion of FTAs, which require a lesser degree of integration and are faster to conclude than customs unions, has intensified in recent years;<sup>4</sup> today, FTAs are the most common category, accounting for 72 per cent of the total. Twenty of the RTAs identified (19 FTAs and 1 customs union) contain commitments on trade in services in addition to tariff concessions on goods.<sup>5</sup> Furthermore, the new generation of RTAs, especially those involving developed countries, tend to go far beyond traditional tariff-cutting exercises and even beyond the realm of existing multilateral rules to include regional rules on investment, competition and standards, and in some cases provisions on environment and labour.

Chart 2 - RTAs in force, as of June 2002, by type of agreement



5. The configuration of RTAs is diverse and becoming increasingly more complex with overlapping membership and networks of RTAs spanning within and across continents at the regional and sub-regional levels. The simplest configuration is an agreement formed between two parties. Bilateral agreements account for more than half of all RTAs in force and for almost 60 per cent of those under negotiation. More complex are plurilateral RTAs and those agreements in which one of the parties is an RTA itself; the latter account for 25 per cent of the RTAs currently in force. The most noteworthy development expected in the next five years is the emergence of a new category of

<sup>4</sup> Customs unions, which provide for the establishment of a common external tariff and harmonization of trade policy, often take years to negotiate and have (often) long implementation phases.

<sup>5</sup> Countries, to date, have not negotiated separate RTAs for their services trade, but rather include concessions on trade in services as part of RTAs covering trade in goods. Participation in RTAs also covering trade in services is expected to grow over the next few years as the trend towards more comprehensive RTAs is set to intensify.

agreement, namely RTAs where each party is a distinct RTA itself.<sup>6</sup> At present, there are no agreements of this kind in force, but several are currently under negotiation and this tendency looks set to intensify in the near future. This is a new trend which is a reflection of the growing consolidation of established regional trading relationships.

(ii) *Regional and cross-regional developments*

6. As of June 2002, China; Hong Kong, China; Macau, China; and Mongolia, are the only WTO Members yet to notify an RTA. All other Members are parties to at least one RTA, and many to two or more. As indicated below, recent trends point to an intensification of bilateral RTAs, to an increase of cross-regional trade negotiations, and to the development of continent-wide regional initiatives, which in some cases may lead to the consolidation of existing, sub-regional RTAs.

7. The greatest concentration of RTAs is in **Europe**, particularly in the EC and EFTA countries which have similar networks of RTAs. The central European countries, the Baltic states and Turkey are also engaged in a number of RTAs mainly due to their association agreements with the EC, or customs union in the case of Turkey. The intra-European network of RTAs has recently extended to South-Eastern Europe, in particular the countries of the former Yugoslavia, which are negotiating bilateral RTAs among themselves within the framework of the Stability Pact initiative launched in 1999. Looking ahead to the situation in 2007, there is the foreseen enlargement of the EC.<sup>7</sup> This will on the one hand, decrease EC's participation in RTAs (as its bilaterals with the acceding countries will cease to exist), but, on the other hand, the acceding countries' participation in RTAs will increase (as they will automatically become parties to the EC's existing network of RTAs). Overall, the next wave of accessions should lead to a concentration and consolidation of RTAs in Europe. At the cross-regional level, the EC and EFTA States are engaged in RTA negotiations with partners in the Euro-Mediterranean region,<sup>8</sup> and they are both set to expand their trade ties in the Western Hemisphere, particularly with Latin American countries. With respect to the African continent and the Pacific region, the EC is in the process of renegotiating its trade relations with the African Caribbean and Pacific (ACP) group of countries (*see below*).

8. In the **Western Hemisphere** the process of regional integration has been intensifying rapidly in recent years with networks of bilateral and plurilateral RTAs being established both at the regional and sub-regional level. Canada and the United States are expanding their preferential links with the countries of Central America, while further afield they are engaged in negotiations of several FTAs. Mexico and Chile having already established a dense network of bilateral RTAs in Central and South America, are looking further afield to cross-regional RTAs with Europe and countries in East Asia and Southeast Asia. At the plurilateral level, MERCOSUR (Argentina, Brazil, Paraguay and Uruguay) is engaged in regional trade negotiations with neighbouring countries as well as with the EC, while the North American Free Trade Agreement (NAFTA) between Canada, the United States and Mexico is entering its last stage of implementation. On a continental level, the goal of a Free-Trade Area of the Americas (FTAA), encompassing 34 countries, is in place with firm deadlines for the conclusion of the negotiations set to no later than January 2005.<sup>9</sup>

9. The countries of **North Africa** and the **Middle East**, are developing their intra-regional network of RTAs, as well as strengthening their ties with the EC through the negotiation of second-generation bilateral RTAs based on reciprocal exchange of preferences as part of the "Euro-

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<sup>6</sup> Examples include EC-MERCOSUR, CARICOM-CACM, SACU-SADC, to mention some.

<sup>7</sup> Thirteen applicant countries are currently engaged in the process of eastward enlargement with the EU: Estonia, Latvia, Lithuania, Poland, the Czech Republic, Slovakia, Hungary, Slovenia, Romania, Bulgaria, Malta, Cyprus and Turkey. Negotiations are currently underway with the first twelve.

<sup>8</sup> Turkey is following suit with similar RTA negotiations.

<sup>9</sup> 3<sup>rd</sup> Summit FTAA (Canada, April 2001). Deadlines were also set for market access negotiations: recommendations on methods and modalities are to be completed by 1 April 2002 and tariff negotiations are to be initiated no later than 15 May 2002.

Mediterranean Partnership" which is aimed at establishing a free-trade area by 2010.<sup>10</sup> Similar agreements have been concluded or are being negotiated between these countries and the EFTA States. Other plurilateral trade initiatives encompassing countries both in Africa and the Middle East, are also being explored, such as the recent initiative launched by the Arab League to establish an Arab Free Trade Area by 2007.<sup>11</sup> For their part, members of the Gulf Cooperation Council (GCC) have recently speeded-up the introduction of a common external tariff by reducing the original 2005 target date by two years, and are engaged in trade talks with the EC on the negotiation of a possible FTA.

10. In **Sub-Sahara Africa**, the regional integration process is gaining depth, although progress is uneven and far from certain due to the complex web of overlapping RTAs membership. In western Africa, countries are working at the completion of the West African Economic and Monetary Union (WAEMU)<sup>12</sup> and the Central African Economic and Monetary Community (CEMAC).<sup>13</sup> In eastern and southern Africa, members of the Common Market for Eastern and Southern Africa (COMESA)<sup>14</sup> are advancing in their objective of creating a free-trade area grouping 20 countries, and similarly, the parties to the South African Development Community (SADC) have been working towards their objective of establishing a free-trade area by 2004, despite difficulties mainly due to overlapping membership with other RTAs, in particular the long-standing South African Customs Union (SACU) agreement.<sup>15</sup> In addition to its efforts towards Southern Africa economic integration, South Africa has been active at the cross-regional level, with the conclusion of an FTA with the EC, and by exploring the possibility of similar RTAs with a number of other countries.

11. **Africa-wide** integration initiatives remain in place with the African Economic Community (AEC),<sup>16</sup> aiming towards the setting up of an African Economic and Monetary Union by 2028, and the establishment of the African Union, with the ultimate goal of completing the economic integration of Africa, has been recently announced.<sup>17</sup> A further push in consolidating the existing RTAs may come from outside the African continent through the Economic Partnership Agreements (EPAs) between the EC and the ACP countries which are due to be negotiated between September 2002 and January 2008. One of the major objectives of this new strategy (replacing the non-reciprocal relationship under Cotonou) will be to foster regional integration among the partners countries by establishing EPAs with groupings already engaged in a regional integration process.

12. In **Central Asia**, the regional structures pertaining to the Soviet era have been replaced by RTAs among the countries of the former USSR, as well as with their neighbours. In addition to the CIS free trade agreement and a customs union agreement (between the Kyrgyz Republic, the Russian Federation, Belarus, Kazakhstan and Tajikistan), a large number of bilateral agreements have also been concluded. In 2001, Georgia alone notified to the WTO RTAs with Armenia, Azerbaijan, Kazakhstan, Turkmenistan, Ukraine, and the Russian Federation. As shown in Map 2, it is expected that by 2007 there will be some consolidation of the current myriad web of bilateral RTAs.

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<sup>10</sup> Partners to this process are Morocco, Algeria, Tunisia, Egypt, Israel, Jordan, the Palestinian Authority, Lebanon, Syria, plus Turkey, Cyprus and Malta. In addition to the conclusion of Association Agreements between the EU and its Mediterranean partners, this process also aims at fostering South-South integration by encouraging Mediterranean partners to implement free trade among themselves.

<sup>11</sup> Gulf Cooperation Council members (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates) plus Jordan, Tunisia, Egypt, Sudan, Syria, Somalia, Iraq, Palestine, Lebanon, Libya, Morocco, Yemen.

<sup>12</sup> Benin, Burkina Faso, Côte d'Ivoire, Guinea Bissau, Mali, Niger, Senegal, Togo

<sup>13</sup> Cameroon, Central African Republic, Congo, Equatorial Guinea, Gabon, Chad

<sup>14</sup> Angola, Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe.

<sup>15</sup> Members of SACU are Botswana, Lesotho, Namibia (it became a de jure member on July 1990), Swaziland and South Africa.

<sup>16</sup> SADC, COMESA, ECOWAS, CEEAC and the Arab Maghreb Union, have been designated as pillars of the AEC.

<sup>17</sup> 5th Organization of African Unity(OAU) Extraordinary Summit, March, 2001

13. **Asia Pacific**, is a region currently undergoing significant changes with respect to its stance towards preferential regional trade integration. Singapore, Japan and the Republic of Korea appear to have dropped their long-standing policy of MFN- only trade liberalization by negotiating, and conducting feasibility studies for the establishment of several RTAs both among regional partners and cross-regionally. Similarly, New Zealand and Australia are exploring the possibility of several RTAs with regional partners and further afield, in particular with countries of the western hemisphere. At the plurilateral level, the members of the Association of South East Asian Nations (ASEAN)<sup>18</sup> are moving towards the objective of establishing a FTA by 2005, and have recently agreed to initiate RTA negotiations with China. Japan and the Republic of Korea are exploring the possibility of similar negotiations with ASEAN, with the former set to start negotiations in 2003. Clearly, the non-discriminatory "open regionalism" typically associated with the Asia Pacific Economic Cooperation (APEC) appears to be waning against an emerging pattern of bilateral and plurilateral preferential trading arrangements along the lines of the well established discriminatory "new regionalism" in Europe, North America, and South America.

14. If looked at from a **global** perspective, the regional developments mentioned above clearly point to the emergence of a trend towards cross-regional RTAs. Most of the major players at the regional level are increasingly looking beyond their regional borders for partners in selective (often bilateral) preferential trade agreements. The EC and EFTA are leading this trend, however, other regions, in particular countries in North and Latin America are following suit.<sup>19</sup> Similar agreements are in the pipeline for a number of countries. As a corollary to the increased overlapping membership of RTA-families, the coexistence in a single country of different trade rules and provisions, such as preferential rules of origin, is a frequent feature. As discussed below this lack of uniformity can severely hamper trade flows by the sheer fact of the costs involved for traders in meeting multiple sets of trade rules.

(iii) *RTAs' Share of World Trade*

15. As might be expected, the percentage of trade which derives from RTA partners varies considerably from country to country. It is not necessarily the number of RTAs in which a country participates that determines the extent of a country's imports from RTA partners, but, rather, who those partners are. Canada, for example, which participates in only five RTAs, imports nearly 70 per cent of its total imports from RTA partners. In contrast, Chile participates in seven RTAs, but it imports no more than one-third of its imports from RTA partners.

16. Looking at the global picture, if unabated, intra-RTAs' share of world trade is certain to soon surpass MFN trade, making the latter the exception rather than the rule in the conduct of global trade relations.<sup>20</sup> The addition of RTAs such as the FTAA, the potential expansion of RTAs in Asia to include China, and the enlargement of the EC to new countries will have a significant impact on that share. Given that preferential treatment under RTAs represents by the far the greatest exception to the WTO's principle of non-discrimination, the ongoing increase in trade conducted under RTAs points to a continuing erosion of trade conducted under MFN rules.

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<sup>18</sup> Brunei Darussalam (1987), Cambodia (1999), Indonesia, Laos (1997), Malaysia, Myanmar (1997), The Philippines, Singapore, Thailand, Vietnam (1995)

<sup>19</sup> One example is Mexico: being part of NAFTA, it has recently concluded an RTA with the EC.

<sup>20</sup> The WTO Secretariat recently estimated intra-RTAs' share of world trade at 43%, in *Overview of Developments in the International Trading Environment*, Annual Report by the Director-General (2001), WT/TPR/OV/7. It is however important to recall that only a part of intra-RTA trade flows involve preferential treatment – the essence of an RTA – since (i) many tariffs are MFN-bound at zero (among the Quad countries, for example, the share of imports entering under bound MFN zero rates ranges from about 25% for Japan to somewhat over 40% for the EU); (ii) most RTAs exclude certain sectors, for example, agriculture; (iii) in some instances importers forgo free-trade treatment because the MFN duty is less than the cost of complying with rules of origin and other requirements; and (iv) most RTAs include a transition period, generally up to ten years, for the phasing in of tariff reductions on their most sensitive products.

(iv) *The Development Dimension of RTAs*

17. Developing countries participation in RTAs, accounts between 30-40 per cent of all agreements estimated to be currently in force. The path to regionalism differs considerably from region to region. For instance the ambitious regional initiatives typical of the African continent are in stark contrast to the limited objectives set forth by the countries of East and Southeast Asia.<sup>21</sup> In spite of these differences, recent developments indicate a general shift from partial scope agreements, which have been recurrent among developing countries, to more comprehensive agreements involving firmer political commitments to trade liberalization. Likewise, in the case of some non-reciprocal preferential arrangements between developed and developing countries, there are clear signs of a shift towards the conclusion of reciprocal RTAs. This is already the case for the Euro-Mediterranean agreements, which replace the less ambitious arrangements signed in the 1970s; it may also be the case in the new wave of post-Cotonou EC-ACP agreements.

C. SPILLOVER EFFECTS OF RTAS

18. It can be concluded from the previous section that the trend towards the negotiation of RTAs by WTO Members, which took off in the 1990s, is enduring. Prospects for the near future signal an expansion of the geographical reach of RTAs and a broadening of their scope with the inclusion of trade policy mechanisms in addition to tariff preferences. The contour of a multi-tiered global trading system, with a variety of less than global trade initiatives pursued in parallel to MFN efforts, is clearly in the making, without clear and agreed rules determining the interplay between these levels. No WTO Member is set to gain from such a development since by definition all are a third party to a growing number of RTAs. Thus, the common interest should be in promoting regional initiatives which bolster multilateral trade liberalization efforts. The reality of today's regional landscape, however, does not appear to be listening to this common logic.

(i) *Depth of Integration through RTAs*

19. As mentioned before, the spectrum of RTAs varies widely. A recent study by the WTO Secretariat<sup>22</sup> indicates that RTAs, while effective in reducing and, in most cases, eliminating existing tariffs on industrial imports,<sup>23</sup> has rarely done the same for agricultural imports, which most often remain subject to restraints also under such régimes.<sup>24</sup> Average agricultural RTA tariffs remain high and concessions on agricultural products granted by RTA partners tend to be parsimonious in nature. Nor have RTAs, for the most part, served to remove existing tariff peaks in the trade of agricultural products. The widespread use of the positive list approach in the granting of concessions on agricultural products in the majority of RTAs<sup>25</sup> serves to limit the scope of potential concessions. The failure to use the selective (and hence "less risky") environment of an RTA to confront long-standing sectoral distortions may serve to cement domestic constituencies resistant to change and undermine the willingness to deal with such issues on a multilateral basis. This is truly a lost opportunity.

(ii) *Rules of Origin Régimes*

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<sup>21</sup> Most of the regional initiatives among African countries aim to the establishment of customs unions or common markets, grouping a large number of countries and over long transition periods, often 20-30 years. Countries in East and Southeast Asia have instead opted for speedy and loser forms of integration like FTAs.

<sup>22</sup> *Coverage, Liberalization and Transitional Provisions in RTAs*, WT/REG/W/46

<sup>23</sup> Bearing in mind that MFN tariffs on such products, especially as applied by industrialized countries, are already at low levels.

<sup>24</sup> Broad duty-free product coverage in RTAs tends to be the exception rather than the rule, since the domestic forces that resist trade liberalization at the multilateral level are just as likely to resist it at the regional level.

<sup>25</sup> Contrary to the practice generally adopted vis-à-vis tariffs on industrial goods, where a negative list approach is the norm.

20. Preferential origin regulations are an essential element of all RTAs except fully implemented customs unions.<sup>26</sup> Since the WTO Agreements contain no provision on preferential rules of origin,<sup>27</sup> origin régimes tend to differ widely among RTAs.<sup>28</sup> As a corollary to the increased overlapping membership of RTAs or RTA-families, the coexistence of different origin rules in a single country is a frequent feature. The vast majority of RTAs presently in force, as well as those currently under negotiation, include origin requirements where product-specific rules of origin are often supplemented by other provisions which can either add to or diminish their flexibility.

21. Preferential origin regulations are usually more stringent than MFN rules of origin, and the more so for products for which the margin of preference between the MFN and the preferential tariff is larger. This may alter substantially the level and effective structure of the preferences established, and result in an inefficient allocation of resources among the preference-receiving trading partners. For instance, the elimination of trade-restrictive measures (such as tariffs and QRs) could be counteracted by rules of origin so stringent that the costs incurred for the final product to be granted originating status would not be compensated by the benefits derived from the use of the preference. In such case, there would be a *de facto* nullification of the trade liberalization provided under an RTA. Last but not least, rules of origin may also increase the possibility of trade (or investment) diversion.<sup>29</sup>

(iii) *Effects of Overlapping*

22. The proliferation of RTAs is closely connected with the phenomenon of overlapping regional trade agreements, also known as the *spaghetti bowl* effect. Overlapping increases the cost of administering such agreements and may eventually frustrate its trade liberalization objectives. Firstly, as seen before, differing rules of origin create a maze of (sometimes conflicting) criteria for the granting of origin. Secondly, membership in a number of different RTAs for a given country can result in the duplication and maintenance of tariff schedules for each preferential partner with different phase-out periods. Thirdly, the dedication of resources to the negotiation and maintenance of agreements at the regional level may divert attention from negotiations at the multilateral level. Participation in plurilateral RTAs, or in RTAs in which one party is an RTA itself, adds to the complexity of administering, and complying with, multi-column tariffs systems and different origin regulations, especially where each country maintains a distinct preferential régime with each partner.<sup>30</sup>

(iv) *Multilateral vs. Regional Trade Rules*

23. The indiscriminate proliferation of RTAs, especially as their scope broadens to include policy areas not clearly regulated multilaterally, also increases the risks of inconsistencies in the rules and procedures among RTAs and between RTAs and the multilateral framework. This is likely to give

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<sup>26</sup> Whenever parties grant each other preferential market access but have not (yet) harmonized their treatment for goods imported from third countries, determination of the origin of an imported good is needed to ascertain whether such a good is eligible for preferential treatment in the importing country. Origin rules may also be justified to prevent products from non-parties to an RTA gaining preferential access to the market through the party which maintains the lowest external import restriction (i.e. to avoid "trade deflection").

<sup>27</sup> With the exception of a "Common Declaration with Regard to Preferential Rules of Origin" in Annex II to the Agreement on Rules of Origin.

<sup>28</sup> The lack of uniformity among preferential rules of origin regimes is demonstrated in a recent study by the Secretariat. See, *Rules of Origin Regimes in Regional Trade Agreements*, WT/REG/W/45.

<sup>29</sup> The increasing importance of rules of origin may eventually lead producers to consider them as a factor of production *per se* that would be analyzed in the same manner as the availability and cost of inputs, labour costs, infrastructure, etc. In that sense, rules of origin can influence investment decisions, both with respect to sourcing of various inputs and location of production and result in producers increasing both inputs and processing within a preferential area at the expense of third parties that would otherwise have a comparative advantage.

<sup>30</sup> For example, the RTAs signed between the EFTA countries and the countries of central Europe require that each central European country negotiate preferences with each EFTA country (counting Switzerland and Liechtenstein as one) individually and vice-versa.



rise to regulatory confusion, distortion of regional markets, severe implementation problems, especially where there are overlapping RTAs, and to greatly complicate future efforts to develop a consistent set of multilateral rules and procedures governing the trade-related policies of WTO Members. One example in this respect is overlaps of judicial jurisdiction between the dispute settlement mechanisms of the WTO and those of RTAs, and the apparent absence, in the current state of international law, of rules capable to provide effective answers to resolve conflicts of jurisdiction between these mechanisms.<sup>31</sup>

24. These potential adverse effects do not appear, however, to deter countries from negotiating an increasing number of RTAs. A mixture of political and economic considerations may better explain the appeal to regional trade integration. Thus, for instance, such agreements are deemed to accelerate and deepen trade liberalization on a bilateral or plurilateral basis, and to offer prospects for increased market access for exports and greater flows of foreign direct investment. There is also a general feeling that complex policy issues of commercial significance (such as services regulations, foreign investment rules, intellectual property protection, competition policy, technical standards and government procurement) can better be managed amongst a limited circle of countries sharing some kind of common aspirations.

25. Additional considerations, however, are at play. Looking at the maze of RTAs world-wide, it becomes apparent that preferential RTA régimes are being employed by some governments as defensive tools to maintain access to major markets or, conversely, to forge strategic regulatory relationships throughout the planet. The strategic use of RTAs resembles a *regionalism à la carte*, based on the selective choice of trading partners and sectors to be liberalized in a preferential way, to the detriment of third countries trade and to the clarity and uniformity of global trade rules. The domino effect of RTAs reinforces the development of such relationships by making them a necessity as insurance policies to counteract protectionist pressures. Put another way, with virtually all WTO Members party to one or more RTAs, countries come under increasing pressure to play down MFN and negotiate RTAs to prevent their trade being discriminated against, and excluded from preferential market access. Middle and lower income developing economies are particularly vulnerable to this pressure because of their relatively small domestic market and the need for market access to larger markets. At the same time their limited administrative capacities severely constraints their ability to administer a multi-tiered trade régime as well as placing them at a considerable disadvantage when negotiating the terms of an RTA with a powerful "hub". Economic and political bargaining power, and the negotiating resources and capabilities are, other than rules, certain to dominate the process of drafting the agreement.

#### D. RTAS AND THE WTO

26. Although economic theory has been able to produce almost no unambiguous results on the costs and benefits of RTAs,<sup>32</sup> GATT's founders were of the advise that well-structured regional trading initiatives can contribute to the development of the MTS. Indeed, while RTAs are *ex ante* inherently ambiguous with regard to their *economic* benefits, they can always be designed to benefit economically both the members and the world at large.<sup>33</sup> If trade diversion is a problem, it can be mitigated by reducing trade barriers on imports from third countries, either unilaterally by members of

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<sup>31</sup> See, K. Kwak and G. Marceau, *Overlaps and Conflicts of Jurisdiction between the WTO and RTAs*, paper prepared for the Seminar "Regionalism and the WTO", Geneva 26 April 2002. Paper available at [http://www.wto.org/english/tratop\\_e/region\\_e/sem\\_april02\\_e/sem\\_april02\\_e.htm](http://www.wto.org/english/tratop_e/region_e/sem_april02_e/sem_april02_e.htm).

<sup>32</sup> Due to the intrinsic discriminatory nature of RTAs to the trade of non-parties, economists generally recognize that RTAs are a second-best option to MFN trade liberalization. See OECD (2001) *Regional Integration: Observed Trade and Other Economic Effects*, Working Party of the Trade Committee, TD/TC/WP(2001)19/Rev.1, for an extensive up-to-date summary of the empirical evidence on the trade effects of RTAs. The empirical evidence also suggests that the impact on economic growth is quite small.

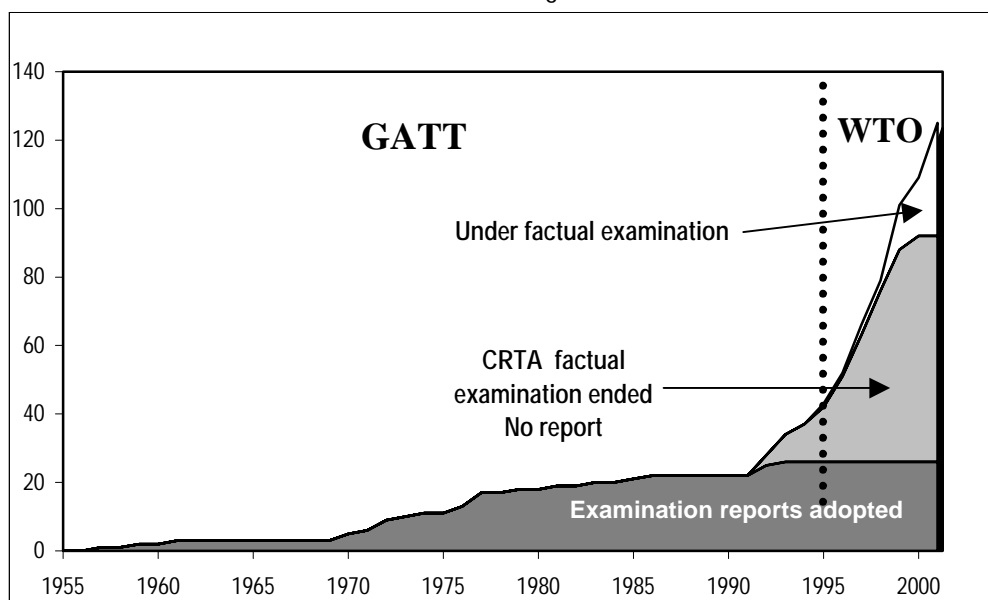
<sup>33</sup> See M. Kemp and H. Wan (1976) "Elementary proposition concerning the formation of Customs Unions", *Journal of International Economics*, Vol. 6, February, pp. 95-98.

the RTA or in multilateral trade negotiations. More generally, the balance between trade creation and trade diversion often depends on the details of the agreement, including provisions on external trade barriers, rules of origin, and sectoral coverage. By choosing these parameters carefully, the risk of trade diversion can be mitigated, if not eliminated altogether.

27. In line with such thinking, the GATT, and now the WTO, has allowed Members to further the market access they have bound in the GATT/WTO by concluding RTAs, albeit subject to a certain number of criteria.<sup>34</sup> The criteria are fundamentally three: (a) transparency, (b) commitment to deep intra-region trade liberalization, and (c) neutrality *vis-à-vis* non-parties' trade. The task of verifying the compliance of the RTAs notified by Members with these provisions is entrusted to the Committee on Regional Trade Agreement (CRTA).<sup>35</sup> The CRTA, however, has enjoyed no success so far in assessing the consistency of the more than 100 RTAs notified to the WTO,<sup>36</sup> due to various political and legal difficulties, most of which inherited from the GATT years (see **Chart 3**).

Chart 3 - Status *vis-à-vis* the examination process of  
RTAs notified to the GATT/WTO under GATT Art. XXIV  
and in force on 31 January 2002<sup>37</sup>

Cumulative figures



28. One problem derives from the possible links between any CRTA consistency judgement and the dispute settlement process. Also, there are long-standing controversies about the interpretation of the WTO provisions against which RTAs are assessed, and institutional problems arising from either the absence of WTO rules (e.g., on preferential rules of origin), or from troublesome discrepancies between existing WTO rules and those contained in some RTAs.

<sup>34</sup> These criteria are contained in GATT Article XXIV, for agreements in trade in goods, and in GATS Article V, for agreements in the area of trade in services. The Enabling Clause governs the conclusion of preferential arrangements among developing countries (trade in goods only).

<sup>35</sup> The CRTA was established in 1996, in particular (a) to oversee, under a single framework, all regional trade agreements, and (b) to consider the implications of such agreements and regional initiatives for the multilateral trading system and the relationship between them.

<sup>36</sup> As of June 2002, the Committee had 22 RTAs under active consideration ("factual examination"), and 27 in the waiting list. "Factual examination" had been completed for 106 RTAs, whose draft examination reports were in various stages of consultation and finalization.

<sup>37</sup> For clarity reasons, the chart is based only on a subset of all RTAs notified to the GATT/WTO: those RTAs notified under GATT Article XXIV and known to be still in force on 31 January 2002.

29. This situation has highlighted several areas requiring action. The conformity of regional trade initiatives with the basic message of deeper liberalization underlying the relevant WTO provisions is consistently put into question. The rising number of RTAs is also increasing the risk of incoherent trade policy regulations being implemented through these special regimes. And, lastly, detailed WTO rules and procedures applicable to RTAs are often considered inadequate to steer RTAs concluded by Members and, *a fortiori*, those announced for the coming years.

30. Against this background, WTO Members, meeting at the Fourth Ministerial Conference in Doha, while recognizing that RTAs can play an important role in promoting trade liberalization and in fostering economic development, also stressed the need for a harmonious relationship between the multilateral and regional processes. On these basis, Ministers agreed to launch negotiations aimed at clarifying and improving the disciplines and procedures under the existing WTO provisions applying to RTAs, by taking due account of the developmental aspects of these agreements. Whether these negotiations will amount to a redrafting of the RTA-WTO relationship or to a piecemeal re-interpretation and clarification of existing rules is premature to say. What is certain, however, is that any meaningful effort aimed at redrawing the balance between regionalism and multilateralism will require stronger WTO rules capable of monitoring and discipline the operations of RTAs.

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