Regional Trade Agreements and its impact on the Multilateral Trading System: Eroding the Preferences of Developing Countries?

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Declaration

I hereby certify that this is an original work done by me for submission in fulfillment of an LLM degree in International Trade and Investment Law and it has not been printed nor submitted elsewhere or for any other purpose.

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Chapter One

1.1 Introduction:
Long before the advent of the World Trade Organisation or even the General Agreement on Tariff and Trade (GATT) its predecessor, trade agreements existed between nations within the same geographical location in the form of Bilateral or Regional agreements\(^1\). With the establishment of the GATT in 1947, attempts were made to preserve the prerogative of governments wishing to continue their regional trade agreements with their neighbors in derogation from the Most Favored Nation principle of the GATT. Non discrimination (as it is expressed in the MFN and National Treatment) is one of the basic principles of the World Trade Organisation and Regional Trade Agreements which are essentially discriminatory agreements are an exception to it. Article XXIV of the GATT lays down the conditions under which regional trade agreements can be allowed. Moreover, developing countries are allowed to notify their preferential agreements to the WTO under the Enabling Clause. Article V of the GATS provides the criteria that agreements relating to trade in services need to comply with. It is estimated that over 43% of the world trade is currently done under regional agreements and this is expected to increase to 55% by 2005 if all the RTAs currently being negotiated are realised.\(^2\)

1.2 Objective of the Study

The purpose of this paper is twofold. First it is to examine the impact that the proliferation of Regional Trade Agreements have had on the Multilateral Trading System and whether by allowing regional trade agreements under the WTO rules, the members of the WTO have not unwittingly weakened the multilateral trading system. Secondly, it is to examine the effect the

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proliferation of Regional trade agreements have had on the special and deferential treatment for developing countries within the system.

1.3 Background

The vast majority of WTO members are party to one or more regional trade agreements indeed, As of February 2005, only one country Mongolia was not a party to any Regional trade agreement. For some of these countries, preferential trade now represents over 90% of their total trade; for others MFN trade relations are limited to a handful of members\(^3\). Since the early 1990s there has been a surge in the creation of RTAs by members of the WTO and this surge has continued unabated till date. Thus far, as of January 2005, some 312 RTAs have been notified to the GATT/WTO, of which 188 were notified after January 1995. Over 170 RTAs are currently in force; an additional 70 are estimated to be operational although not yet notified. By the end of 2005, if RTAs reportedly planned or already under negotiation are concluded, the total number of RTAs in force might well approach 300\(^4\).

One of the major arguments for the justification of the proliferation of RTAs is linked to the fact that the decision making in the WTO is slow as a result of the requirement for consensus. Some developed countries who are eager to see a faster and more encompassing trade liberalisation process are thus left to find regional trading partners with similar trade objectives who they can enter into an agreement with to have their aims achieved. Under the current Doha round for example, developed countries had tried to bring into the agenda for discussions four issues which are known as the ‘Singapore issues’ they are, Trade Facilitation, Government Procurement, Investment and Competition policy. After a lot of negotiation and deadlocks

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at some ministerial conferences, they eventually had to agree to leave out three of these issues and include only trade facilitation in the round.\(^5\) A close look at the RTAs between these developed countries however reveals that these issues are usually covered in the agreements.\(^6\)

Extraneous issues such as human rights, labour standards and environmental concerns which are not included in the multilateral frame work are also usually included in negotiations of RTAs and developing countries which are parties to these agreements are required to comply with rules and conditions related to these.

Although the GATT rules provide for the notification of RTAs there are some RTAs that have not been notified\(^7\) and even among those that have been notified there are some that do not comply with the WTO rules but because of the high level of political commitment to regional and bilateral agreements, there have been few, if any, successful challenges to breaches of GATT/WTO rules\(^8\). The most powerful economic arguments against regional and bilateral trade agreements are that they can cause trade diversion and trade distortions and ultimately undermine the multilateral system because of their discriminatory nature. Developing countries who are not part of these RTAs are unable to take advantage of the terms under these arrangements, which may be more favourable than the terms under the multilateral trading system. Also in Regional Trade Agreements, Developing countries in a bid to get the advantages of market access under the agreement usually take up more onerous burdens than that which they are required to bear under the multilateral trading systems rules on issues such as the TRIPS agreement.

\(^5\) See Paragraph 1:g of the Doha Work Programme ‘Decision adopted by the General Council on 1 August 2004’. WT/L/579
\(^6\) Examples of FTAs between developed and developing countries including all or some of the Singapore include; EC-South Africa, EFTA-Chile, United States-Morocco, United States Jordan, Thailand-Australia.
\(^7\) See the Sutherland Report where it is estimated that there are at least 70 RTAs in operation which are not ye notified to the WTO. An example is the USA initiative under AGOA, a form of preferential trade agreement with African countries
\(^8\) Regional Trade Agreement and the multilateral trade system. A report by commission on trade and Investment Policy. (2002) www.icc.org, as viewed on 11/10/04
Dr. Supachai Panitchpakdi, the present WTO Director General, summarizes the threat posed by the proliferation of RTAs to the WTO mechanism when in a speech he says:

"Regionalism can be a powerful complement to the multilateral system, but it cannot be a substitute. The multilateral trading system was created after the Second World War precisely to prevent the dominance of rival trading blocks. The resurgence of regionalism today risks signaling a failure of global economic cooperation and a weakening of support for multilateralism. It threatens the primacy of the WTO, and foreshadows a world of greater fragmentation, conflict, and marginalization, particularly of the weakest and poorest countries."  

1.4 Scope of Paper

A discussion on Regional Trade Agreements and the multilateral trading system is a very wide and extensive one, which cannot be adequately considered given the limit of this thesis paper. This paper will however consider the impact of Regional Trade Agreements on the multilateral trading system, and whether there is any justification for the argument that RTAs lead to trade distortion and not trade creation. An attempt will also be made to examine how the proliferation of RTAs can lead to the erosion of preferences of Developing Countries, in considering this, a presumption will be made that these preferences confer some benefits on the developing countries. A reference to RTAs in this paper will be taken to include both RTAs notified under Article XXIV of GATT and those notified under the enabling clause.

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9 As quoted in Parthapratim Pal Regional Trade Agreements in a Multilateral Trade Regime: An Overview http://www.networkideas.org
1.5 Research Methodology
The various literature both books and Journals available on the subject will be used to examine the impact of RTAs on the Multilateral trading system. A critical examination will be carried out on the advantages of RTAs vis a vis the perceived negative consequences in eroding the preferential access of developing countries. The Internet will be a major source of information on this topic because most of the current discussions on Regional Trade Agreements are done online.

1.6 Overview of Chapters

Chapter one
This Chapter will be an introduction to the paper. Here, the background, objective, scope and research methodology will be considered.

Chapter Two
In this chapter, a background to the evolution of the Multilateral Trading System, the creation of the WTO and the events that led to the inclusion of Article. XXIV in the GATT will be examined. In addition, we will also consider the evolution of RTAs, Motivations for the creation of RTAs, Types of RTAs, and the disadvantages of RTAs.

Chapter Three
Here the interplay between RTAs and the multilateral trading system, the protection of and rate of compliance with Art. XXIV of the GATT and Article V of the GATS will be examined. The ongoing debate on the systemic issues relating to the provisions of Article XXIV will also be examined.
Chapter Four
In this chapter, the evolution of the debate around special and differential treatment in the GATT/WTO will be examined. The traditional preferences given to developing countries in the multilateral trading system GATT will be examined and what they stand to lose by the proliferation of RTAs in terms of market access and stricter burdens will be considered.

Chapter Five
Will be the conclusion of the paper here, a position will be taken on the topic and recommendations for resolving any area of dispute between the two systems of trade will be made. Recommendation will also be made as to how to preserve the preferences of developing countries.

1.7 KEY WORDS
World Trade Organisation (WTO), Regional Trade Agreements (RTAs), Multilateral Trading System (MTS), Most Favored Nation (MFN), Free Trade Areas (FTA), Customs Union, Regionalism, Developing Countries, Globalisation, Special and Deferential treatment (S&D).
Chapter Two

2.1 Brief History of the GATT

The WTO’s predecessor, the GATT, was established on a provisional basis after the Second World War in the wake of two other new multilateral institutions dedicated to international economic cooperation. The original intention was to create a third institution to handle the trade side of international economic cooperation however for to some political reasons, the ITO charter as it was being called could not be concluded. Over 50 Countries participated in the negotiations to create an International Trade Organisation as a specialised agency of the United Nations but before the talks were concluded, 23 of the 50 participants decided in 1946 to negotiate to reduce and bind customs tariffs. They also agreed that the value of the concessions they had negotiated should be protected by the provisional acceptance of some of the rules in the ITO Charter. The combined package of trade rules and tariff concession became known as the General Agreement on Tariffs and Trade, and the 23 became founding GATT members (known officially as contracting parties). With the death of the ITO Charter in 1950, the GATT even though it was provisional became the only multilateral instrument governing international trade from 1948 until the WTO was established in 1995.

All through the duration of the GATT, further liberalisation was achieved through ‘trade rounds’ and most of the early rounds were devoted to continuing the process of reducing tariffs. It was not until the Tokyo round that there was an attempt to extend and improve the system and a series of agreements on non tariff barriers were negotiated by the 102 countries that participated in the round. These agreements often referred to as ‘codes’

10 Understanding the WTO: Basics, The GATT years from Havana to Marrakesh
http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm
11 The ‘Bretton Woods’ institutions now known as the World Bank and the International Monetary Fund
12 Due mainly to the refusal of the US congress to rectify the Charter.
where however rectified by only a few industrialised country members of the GATT\textsuperscript{13}. By the early 80s, it was clear that the GATT was no longer relevant to the realities of world trade as it had been in the 1940s. For a start, world trade had become far more complex and important than 40 years before. The globalisation of world economy was underway, international investment was exploding and trade in services not covered by the rules of the GATT was of major interest to more and more countries. More so in other areas the GATT was found wanting, for instance with respect to agriculture, loopholes in the multilateral system had been heavily exploited and efforts at liberalising the trade in agriculture met with little success. Even the institutional structure of GATT and its dispute settlement system were a source of concern. With the consensus requirement for any dispute settlement panel report to be adopted it was very difficult to get any dispute resolved as the defaulting country simply blocked consensus.

All these factors together convinced GATT members that a new effort to reinforce and extend the multilateral system should be attempted and that effort resulted in the Uruguay round.

The seeds of the Uruguay round were sown in November 1982 at a Ministerial meeting of the GATT members in Geneva, nevertheless, it took four more years of exploring and clarifying issues and painstaking consensus building before ministers met again in September 1986, in Punta del Este Uruguay and agreed to launch a new round. In December 1990 at another Ministerial meeting in Brussels, disagreement on the nature of commitments to future agricultural trade reforms led to a decision to extend the round. Finally by 15 December 1993, most issues had been resolved and on 15 the April 1994, the deal was signed by Ministers from most of the 125 participating governments at a meeting in Marrakesh, Morocco. On January 1 1995, the WTO became established.

\textsuperscript{13} ‘The roots of the WTO’ www.econ.iastate.edu/calses/econ355/choi/wtroots.htm
2.2 Evolution of Regional Trade Agreements

Historical Perspectives

A Regional Trade Agreement is an agreement undertaken by countries located within a defined geographic area whereby the participating countries align themselves with each other for the purpose of achieving a predetermined form of economic integration\(^\text{14}\). Long before the establishment of the multilateral trading system typified by the GATT in 1948, countries had always had bilateral and regional trade agreements with one another. In these agreements, some had included the MFN clause to protect their trading partners, but in negotiating the multilateral trade regime, the question was how to apply the MFN on a multilateral basis\(^\text{15}\). As the debate around this was going on, the debate also centred on how to create an exception to the MFN so as to preserve previous trade relations such as customs union between members. As one writer said, ‘For much of the last century, discriminatory preferences between states were the norm for international economic diplomacy. While MFN clauses existed in various bilateral trade agreements, there was no multilateral framework for its application, and the clause when in effect was applied by some only conditionally\(^\text{16}\). As early as 1860, England and France signed the Cobden-Chevalier Treaty with an MFN clause and as every major European country except Russia signed bilateral commercial treaties with France and England and with one another, the MFN clauses in those treaties generalised the tariff concessions, creating a network of agreements that reduced the tariffs structure of Europe generally\(^\text{17}\).

\(^{14}\) http://www.wto.org/english/tratop_e/region_e/region_e.htm
\(^{16}\) For a full account of the history and evolution of the MFN Principle Pre GATT, see Mathis, H.J (2002)
\(^{17}\) Blackhurst, R. ‘The WTO as the Legal Foundation of International Commercial Relations: Current Status and Options for the next Decade’. Pg 196
Britain was interested in the preservation of special economic ties between the members of the British Commonwealth, while America was adversely against the retention of these preferences especially after the Great Depression and non discrimination remained at the centre of its trade policy. During the negotiations for the International Trade Organisation (ITO), the dismantling of the Commonwealth system became a conditional requirement for the US congress to support the process. As it was, Britain did not yield their position and so the US could not give their support to the charter. Since a US and British agreement was essential to forming a post war multilateral trading institution, the rift between them over the status of the Commonwealth preference increasingly undermined their common interest in support of it. In the final analysis the two countries reached a compromise and Britain agreed to dismantle the Preference system, in the negotiations for the MFN clause, it was agreed between them that all future preferences within the annexed system would be subject to the MFN.

The planners of the GATT sought to terminate discriminatory preference by the use of MFN due to a number of political, economic and legal concerns. Their objective was to establish the credibility of the MFN from the onset and to arrange a set of rules to lend support for its coherent application over time. After the introduction of the MFN principle, there was a need to create exceptions to the rule to take into account previous trade relations between parties. One of the country representatives at the committee meeting to review the relationship between the MFN article on one hand and the development and regional preferences on the other while reiterating his country’s support for most favoured nation treatment pointed out that:

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18 The Administration had given a literal guarantee to the Congress that U.S negotiation will deal a ‘fatal blow’ to the commonwealth preference at negotiations in Geneva, and if this blow could not be delivered, there would be no point in supporting the resulting ITOP Charter.
21 Ibid Pg (2002) Pg 13
22 Syrian Representative as quoted in Mathis, H. J (2002) pg 37
‘...exceptions had been admitted which would permit the continuation of existing preferential arrangements representing vested interest. However there were certain countries within the same economic area having traditional relationships which should not be overlooked even though these had not been formalised’

Complete regional formations in the form of custom union had long received exemption from the MFN principle in bilateral arrangements and there was a debate whether or not this exception should be allowed into the GATT. There was also a controversy on whether future preferences should be encouraged or discouraged and if permitted whether they should be subject to voting pre-approval by the organisation. In the final analysis, a case was made for the retention of the exceptions given to customs unions and free trade areas under previous agreements subject to some conditions.

According to Kenneth Dam (1970)\textsuperscript{23}

‘... the principal objective in the drafting of the customs union and free trade area provisions became to tie down in the most precise legal language possible, the conditions that such regional groupings would have to fulfil in order to escape prohibition under the most favoured nation clause as preferential arrangements’

### 2. 3 New Regionalism

Compared to previous decades under the GATT, the proliferation of RTAs after the WTO was established has been on the increase in an unprecedented rate\textsuperscript{24}. As stated earlier, Regional integration agreements have existed in one form or the other for over hundreds of years\textsuperscript{25} as early as 1664, there were proposals for a customs union for the provinces of France and Australia in the course of the eighteenth and nineteenth centuries signed FTAs with five of its neighbours\textsuperscript{26}. After the Second World War, there were many efforts towards regional integration around the world. The creation of the EEC in 1957 led to a spurt of regionalism between

\textsuperscript{23} Kenneth Dam (1970) Quoted in Mathis J
\textsuperscript{24} From recent statistics, there have been twice as many RTA notified to the WTO after its establishment in 1995 than those notified in the 47 years of the GATT
\textsuperscript{26} Ibid
developed countries in the 60s\textsuperscript{27} and developing countries were not left behind. See Figure 1.1\textsuperscript{28}.

Figure I.1 - RTAs notified to the GATT/WTO (1948-2002), cumulative

![Graph showing the increase in the number of RTAs notified to the GATT/WTO from 1948 to 2002.](image)

RTAs have not only increased in number since the 90s but they have also evolved in terms of their scope and geographical reach. In terms of scope, RTAs are going beyond the traditional objective of tariff reduction and even the rules in the WTO in the areas of Services, Trade Facilitation, Competition Policy, Government Procurement, Intellectual Property, Labour and Environmental rights and Contingency provisions\textsuperscript{29}. A study by the WTO Regional Trade Agreement section shows that increasingly, RTAs are also becoming more complex with the overlapping RTAs and network of RTAs spanning within and across continents.\textsuperscript{30}

\textsuperscript{27} Ibid Pg. 348

\textsuperscript{28} Source: ‘Regional Trade Integration under Transformation’ Draft Prepared by the Regional Trade Agreements Section, Trade Policy Review Division, WTO Secretariat for the Seminar on Regionalism and the WTO [www.wto.org](http://www.wto.org) viewed on Feb 5 2005 Pg 4


\textsuperscript{30} ‘Regional Trade Integration under Transformation’ Draft Prepared by the Regional Trade Agreements Section, Trade Policy Review Division, WTO Secretariat for the Seminar on Regionalism and the WTO [www.wto.org](http://www.wto.org) viewed on Feb 5 2005
and New Zealand have entered into integration agreements. Also relevant to this trend is the growing interaction between RTAs where FTAs are concluded between parties where one of the members is an RTA in itself or both parties are distinct FTAs. As was opined by a writer, the term “Regional” may soon become obsolete in describing some of the cross regional agreements that is linking countries around the world.

2.4 Types of RTAs

A method for classifying the different types of regional integration agreement is to focus on the degree of integration. From the looser to the stronger integration, there are:

**Preferential Trade Area** this is an arrangement where members impose lower tariff on goods produced within the union with some flexibility for each member country on the extent of the reduction.

**Free Trade Area** is a preferential trade agreement where parties agree to remove trade barriers between themselves and have no tariff on imports from other members or import quotas.

**Customs Union** here, members remove trade barrier between themselves, have a common external tariff for non members and may cede sovereignty to a single customs administration.

**Common Market** is a customs union that allows a free movement of the factors of production such as capital and labour across national borders within the integration area.

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32 ‘Regional Trade Integration under Transformation’ Draft Prepared by the Regional Trade Agreements Section, Trade Policy Review Division, WTO Secretariat for the Seminar on Regionalism and the WTO www.wto.org viewed on Feb 5 2005
33 Ibid
**Economic Union** is the highest form of integration it is a common market with unified monetary and fiscal policies including a common currency

**2.5 Motivations for the creation of RTAs**

**Political Considerations**

Most RTAs are often driven by foreign policy and national security considerations. They are a means by which a country gains credibility for its policy reforms (both economic and political reforms e.g. Democracy) in so far as it facilitates the monitoring and evaluation of the agreement. An example of this is Mexico in NAFTA. Some Regional integration agreements have supranational enforcement mechanisms and this further reduces the uncertainty regarding implementation. Again, RTAs also help reduce the risk of conflict between nations as increase interdependence among members make conflict costly, and regular political contact among members can build trust and facilitate cooperation. According to a World Bank report, ‘Doubling trade between two countries lowers the risk of conflict between them by about 17%’.

**Trade Creation and Economic benefits**

One of the traditional reasons for the formation of RTAs is the perception that they lead to an increase in trade and so bring economic benefits to the participating countries. Regional trade agreements can increase investment in member countries by reducing distortions, and enlarging markets. Customs unions can encourage foreign investors to engage in tariff jumping by investing in one member country in order to trade freely with all

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36 Ibid Pg 349
37 Crawford, J and Laird, S Regional Trade Agreement and the WTO CREDIT Research Paper http://www.nottingham.ac.uk/economics/credit/research/papers/cp.00.3.pdf viewed on 19/11/04
38 Hoekman, B.M and Kostecki (2001) pg 350
members. Apart from its direct impact on the increased FDIs, this can also promote knowledge and technology transfers thereby raising productivity in member countries. For example, empirical evidence shows that NAFTA substantially increased FDI in Mexico and MERCOSUR did the same in Argentina and Brazil. RTAs also lead to trade creation as removal of trade barriers allows consumers and producers to purchase from the cheapest and most competitive source of supply and this enhances efficiency and increases welfare.

Uncertainty in multilateral trade negotiations
Most analysts opine that frustration with the current pace of negotiations in the multilateral trading system is one of the prime reasons behind the growth of regional trade agreements. There has been a sharp increase in the formation of regional trade agreements after the failure of Seattle Ministerial meeting in 1999. Art. IX of the Marrakech Agreement provides that decision making in the WTO will be by consensus, and given the current number of members of the WTO, reaching a consensus on any issue has been very difficult. Countries keen on liberalizing their trade are turning to RTAs as a means of achieving their goal. Moreover, in negotiating RTAs, countries usually go beyond the current GATT provisions by covering issues that are not yet provided for in the GATT. For example, under the current Doha Agenda, opposition from developing countries have made it impossible to include rules for environmental and labour issues meanwhile, in the recent FTA between US and Jordan, these issues were covered. Again, in the Japan-Singapore FTA, a framework for competition policy is been negotiated. RTAs have thus become a faster way of achieving their trade goals as they are faster to negotiate since they usually involve a fewer number of participating countries. For example, the Uruguay

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41 Op Cit footnote 30 Pg 13
round which was the last round of multilateral trade negotiations under the GATT was initially scheduled to be completed in four years, but it actually took eight years to be completed. Similarly the Doha round which is the current round of negotiations was launched in November 2001 and is still on going with no definite date for its conclusion.

**Regional Trade Agreements as Building Blocks**

Another reason for the proliferation of RTAs is the presumption that liberalisation in RTAs will lead eventually to a liberalisation in the multilateral trade negotiation. They help nations gradually work towards global free trade by allowing countries to increase the level of competition slowly and give domestic industries time to adjust.\(^46\) Since most RTAs typically go beyond the multilateral trade process, there is the assumption that issues that is currently not being entertained in the WTO but in RTAs will eventually cumulate in a multilateral arrangement. One writer describes RTAs as ‘circles of free trade that expand until they finally converge to form expansive multilateral agreements.’\(^47\)

**Enhancing bargaining power**

It can also be argued that by banding together through regional integration agreements, member countries can increase their international economic bargaining power. This is more relevant for developing countries although whether this will work well in practice is left to be seen as these countries still have varying domestic interest.\(^48\) However, it is clear that countries sometimes enter into regional initiatives as a way of strengthening their political and economic influence in the international arena. For instance, CARICOM has attained a degree of visibility that no single member could have hoped to attain individually.\(^49\) As opined by Shujiro Urata,\(^50\) one of the

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\(^46\) ‘Regionalism Summary’ [http://www.cid.harvard.edu.cidtrade/issues/regionalism.html](http://www.cid.harvard.edu.cidtrade/issues/regionalism.html)

\(^47\) Ibid


motivations behind regional integration after World War II was for the European countries to strengthen their economic influence against the US and to reinforce their political and military power against the Communist bloc of the Soviet Union and Eastern Europe.

**Conversion of US trade policy in favour of Multilateralism**

There has been the argument that one of the reasons for the proliferation of RTAs is the conversion of the US from a strong supporter of multilateralism to active participation in regional arrangements. According to Bhagwati\(^{51}\),

> ‘the main driving force for regionalism today is the conversion of the United States, hitherto an abstaining party to [GATT] Article XXIV…the conversion of the United States is of major significance. As the key defender of multilateralism through the post war years, its decision now to travel the regional route tilts the balance of forces at the margin away from multilateralism to regionalism’

If one considers the fact that empirical evidence shows that the greatest concentration of RTAs is in Europe\(^{52}\) and the fact that the US is increasingly getting involved in free trade agreements with other countries, most countries in a bid not to be left out of these markets will also seek to enter into trade agreements with them in order to take advantage of the market access generated thereby. This is the ‘domino theory of regionalism’ postulated by Baldwin where he says that countries in a bid not to be left out of major regional groupings are entering into various integration agreements\(^{53}\).

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\(^{50}\) Urata, S (2002)
\(^{52}\) ‘Regional Trade Integration under Transformation’ Draft Prepared by the Regional Trade Agreements Section, Trade Policy Review Division, WTO Secretariat for the Seminar on Regionalism and the WTO www.wto.org viewed on Feb 5 2005
2.6 Disadvantages of RTAs

Regional trade agreements are an exception to the most favoured nation principle of the WTO and as such are by their nature discriminatory agreements. As early as 1950, Viner in his book ‘the Customs Union Issues’ challenged the view that RTAs lead only to trade creation. He argued that RTAs can lead to trade diversion where as a result of the RTA, members switch imports from low cost producers in non members to higher cost producers in member countries. He says ‘...where the trade diverting effect is predominant, one at least of the member countries is bound to be injured, the two combined will suffer net injury and there will be injury to the outside world and to the world at large.’ According to a recent study by the OECD, RTAs have a potential to have a prejudicial effect on countries outside the regional pact. For example, regional initiatives can and do affect investment patterns because of the perceived growth opportunities in an expanded regional market and through the effects of sector specific rules of origin by inducing firms to shift production into the country imposing barriers on imports.

Moreover, as a result of the multiplicity of RTAs, various regimes of rules of origin are initiated and this create obstacles to trade facilitation by increasing administrative cost of doing business in any one nation as business men may find themselves having to comply with different requirements depending on where they are exporting goods to.

Again the introduction of Free Trade Areas can lead to substantial revenue loss especially for countries for which customs revenue is a major source of income. For example, the World Bank estimates that Zambia and Zimbabwe

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55 Viner, J (1950)
56 Ibid pg 44
58 Ibid pg 4
59 Regional Trade Agreement and the multilateral trade system A report by commission on trade and Investment Policy. (2002) [www.icc.org](http://www.icc.org) as viewed on 11/10/04
could loss half of their customs revenue if free trade is introduced in SADC.$^{60}$

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$^{60}$ Schiff, M. & Winters Alan (2003)’ Regional Integration and Development’. World Bank Report
www.worldbank.org as viewed on 12/12/04
Chapter Three

3.1 RTAs and the Multilateral Trading System

The impact that RTAs have had on the multilateral trading system can be examined from three main angles. One is the extent to which RTAs go beyond the existing trade rules in the WTO, second is the extent to which RTAs diverge from or converge with the WTO and the last is the impact RTAs have on countries outside the agreement and the multilateral trading system generally\(^{61}\).

**Going Beyond the WTO**

As mentioned earlier, modern RTAs are going beyond the trade rules provided for in the multilateral trading system by containing provisions that are more far reaching in sectors covered by the WTO or even dealing with issues for which there are no provision in the MTS. For instance in the area of services, unlike the GATS, many RTAs adopt a negative list approach where everything is liberalised unless otherwise specified\(^{62}\). Though a negative listing can be administratively burdensome, it is more effective and ambitious in producing liberalisation as it ‘avoids backtracking by locking in the regulatory status quo while promoting increased transparency and a commitment to an overreaching set of obligations’.\(^{63}\) Moreover, in the area of temporary movement of service suppliers under mode 4, most RTAs go beyond the WTO rules by providing full national treatment and market access for service suppliers or special market accessory facilitated access for certain group of suppliers.

RTA provisions dealing with government procurement go beyond the provisions of the WTO plurilateral agreement, by enlarging the scope of

\(^{62}\) Ibid
\(^{63}\) Ibid
commitments or by allowing for the provision of additional information. Some have widened the scope by covering more entities while others have reduced the value of threshold of procurement contracts covered. For example, MERCOSUR and the Andean Community Decision 439 of 1998 subjects government procurement to national treatment.

RTA rules on investment go beyond the provisions of the WTO in that they contain provisions on the right to establish a presence in other countries covered by the RTA an obligation that does not exist in any WTO agreement. Again, most RTAs go beyond the question of establishment and free flow of capital by building on the treatment and protection principles of bilateral investment treaties.

In the area of intellectual property, most RTAs have far more reaching provisions than those found in the TRIPS agreement. Most of them have shorter transition and enforcement period and they require adhesion to international accords (such as the Patent Cooperation Treaty). They also contain procedural requirement which are not contained in the TRIPS Agreement. For example the US- Singapore FTA and the FTA between the US and Chile contain provisions which stipulates a 5 years marketing exclusivity rights maximum for parallel imports and makes it impossible for a grantee of a compulsory licence to place generic drugs in the market as such a company is not allowed to register the product. This flies directly in the face of Article XI of the TRIPS Agreement and paragraph 6 of the Doha declaration which seeks to make it possible for governments with severe health problems to use parallel imports and compulsory licences to allow the importation and sale of such medicines. In the current negotiations for a FTA between the US and SACU, one of the major reasons stalling the

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64 Regionalism and the Multilateral Trading System’, Policy Brief OECD August 2003
  www.oecg.org as viewed on 11/10/2004
65 www.ustr.org
negotiations is the desire of the US to include some of these provisions in the agreement.\(^{66}\)

RTA provisions dealing with trade facilitation increasingly acknowledge that technological development may make established procedures obsolete. Hence at the regional level, there are calls for the regular updating of applicable rules to match changed circumstances and for maintaining the efficiency of procedures through the introduction of new technology. For example, most RTAs contain provision for improved technology such as ‘advanced risk management and systemic cargo-profiling techniques that obviate the need for physical examination of shipments; or the use of computers, electronic data interchange and internet technology to provide an environment for paperless trading\(^{67}\).

In the area of contingency protection such as safeguards, antidumping and subsidies, a number of RTAs have gone beyond the WTO disciplines by for example eliminating in internal trade all subsidies affecting trade flows or by adopting disciplines on subsidies that are stronger than those contained in the WTO. Many more contain disciplines limiting the use of quantitative restrictions and subsidies and provide for the use of competition policy instruments in the place of antidumping procedures on trade among the parties.\(^ {68}\)

RTAs are also going beyond the rules of the WTO by containing provisions on the environment and labour requirements for which there is yet no consensus in the WTO.\(^ {69}\) On the environment, RTAs now contain provisions that require parties to prepare periodic reports on the state of the environment and admonish them against relaxing environmental laws for

\(^{66}\) www.tralac.org

\(^{67}\) Ibid

\(^{68}\) Crawford, J and Laird, S Regional Trade Agreement and the WTO CREDIT Research Paper http://www.nottingham.ac.uk/economics/credit/research/papers/cp.00.3.pdf viewed on 19/11/04

the purpose of encouraging trade or FDIs. For example, Article 5 of the Lome Convention and Article 9 of the Cotonou Agreement define their ‘development objective’ in terms of respect for human rights.

**Convergence or divergence?**

A former Director General of the WTO Mr. Mike Moore in commenting on the issue of RTAs and convergence with the WTO stated that the current a la carte approach in RTAs especially in the areas of investment and competition is a recipe for confusion. RTAs can have a harmonising role in three ways: ‘by drawing on or replicating underlying WTO approaches; by drawing on other existing international agreements, and in some cases by helping to forge model approaches for possible subsequent adoption in a WTO setting’.

While most RTAs have provisions that goes beyond those founding the WTO, most of them are nevertheless modelled on the WTO rules sometimes using WTO language verbatim. For instance in the area of government procurement, RTAs are broadly speaking modelled on the GPA although sometimes going beyond it. Also, many RTAs generally incorporate the provisions of the TRIMS and TRIPS Agreements either by explicit reference or implicitly by echoing at least some of their content. Again, to the extent that they draw on other international agreements, RTAs also serve to foster moves towards wider harmonisation. For example, in the field of trade facilitation, most RTAs contain provisions which make reference to the World Customs Organisation’s Arusha Declaration on combating corruption in customs systems and to the Kyoto Convention on the simplification and harmonisation of customs procedures. Also, given

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71 Mathis J (2002)
74 Ibid
that the most RTA proliferation is in Europe, model agreements developed by them are replicated in new agreements concluded between them and third countries. This is also similar to what happens in US agreements with third countries, thus creating some sort of harmonised provisions.\textsuperscript{75}

Be that as it may, the proliferation of regional trade agreement can also be a source of divergence. One major source of confusion is the proliferation of different preferential rules of origin contained in different agreements.\textsuperscript{76} A country may have to apply several different sets of rules when determining how to classify the origin of goods being traded, depending on the RTAs to which it belongs. This has the effect of increasing the cost of trade and stifling technological developments networks and joint manufacturing and unduly restricting third country sourcing.\textsuperscript{77} Again in the area of intellectual property rights, while ‘RTAs may increase the degree of harmonisation of approaches to intellectual property rights protection within a regional grouping, the content of such provision may differ between regional trade agreements.’\textsuperscript{78} In another example, regional agreements in the Americas take two distinct approaches to the relationship between competition policy and antidumping action. While in one case there is provision for the ‘reciprocal elimination of anti-dumping actions in return for cooperation in competition policy’\textsuperscript{79}, some other cases, a party’s right to apply antidumping measures is maintained. Thus, the pursuit of strengthened multilateral disciplines on contingency protection is not aided by the plethora of approaches at the regional levels to antidumping measures, countervailing duties and safeguard measures.

It has also been argued that regional initiatives ‘may not lead to so much systemic friction- because there is no direct tension with the WTO rule

\textsuperscript{75} Ibid
\textsuperscript{76} Regional Trade Agreement and the multilateral trade system A report by commission on trade and Investment Policy. (2002) \url{www.icc.org}, as viewed on 11/10/04
\textsuperscript{77} Ibid
\textsuperscript{78} Regionalism and the Multilateral Trading System’, Policy Brief OECD August 2003 \url{www.oecd.org} as viewed on 11/10/2004
\textsuperscript{79} Ibid
making but rather to a systemic overload. An example is in the area of investment where most agreements contain provision for dispute settlement outside the WTO especially at the International Centre for Settlement of Investment Disputes. Given concerns over strains on the existing WTO dispute settlement mechanisms and the increased use of the various existing dispute settlement mechanism for investment, this is an area where considerable work is needed in any eventual investment framework in the WTO.

The question of what impact regional trade agreements have had on non members and on the multilateral trading system is one that is still currently being debated by Economists. Bhagwati in particular raised the question as to whether RTAs pose a treat to the multilateral trading system and this has initiated a rapid growth in the economic literature on the subject. While some hold the view that regionalism acts as a compliment to multilateralism (that is, acts as a building block), others hold the view that RTAs are a “stumbling block” to the multilateral trade negotiations. Bhagwati and Krueger are of the opinion that RTAs divert attention from the multilateral trade system, as they offer an alternative to countries who would otherwise have concentrated on getting the multilateral negotiations moving forward. According to them, ‘increased regionalism is dangerous because it leads to inter block trade wars and domination of small countries by bigger partners in the regional trading blocks’. Some Economists also argue that by pushing aggressive trade treaties on a bilateral basis, developed countries are weakening the bargaining power of developing countries in multilateral trade negotiation. This can be attributed to the fact that developing

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80 Ibid
81 Ibid
82 Bhagwati, J (1992) ‘Regionalism versus Multilateralism’ the World Economy 20,7, 865-888
84 Ibid
85 Notably Bhagwati and Panagariya
86 In most PTAs between a Developed and a Developing country, the developed country always manages to include aggressive tariff cuts, investment protection clauses and other extraneous issues.
countries are forced to agree to issues in the multilateral framework that they have acceded to on a bilateral basis.

However, Baldwin and some other economist do not see regionalism as a threat to the multilateral trading system\textsuperscript{87}. According to Baldwin, ‘because trade is ‘already quite free in major trading nations, few regional liberalisation are capable of creating anti-liberalization forces’\textsuperscript{88}. In his conclusion, he postulates that regional trade agreement will weaken the opponents of trade liberalisation and hence will promote and foster multilateral trade liberalisation. Ethier\textsuperscript{89} argues that ‘The new regionalism is in good part a direct result of the success of multilateral liberalization, as well as being the means by which new countries trying to enter the multilateral system compete among themselves for direct investment’ In his estimation, the current wave of regionalism does not in anyway threaten multilateral liberalism and in fact is a direct consequence of multilateralism. To him countries use regionalism as a stepping stone for entering the multilateral trading system\textsuperscript{90} The International Chamber of Commerce in their report on “Regional Trade Agreements and The Multilateral Trading System”\textsuperscript{91} also opine that RTAs can act as an important building block for future multilateral liberalisation given that ‘they enable parties to conclude levels of liberalisation beyond the multilateral consensus and are able to address specific issues that do not register on the multilateral menu’\textsuperscript{92} The GATT founders and now the WTO also acknowledge that well structured regional initiatives can contribute to the development of the multilateral trading system. However the recent surge in the creation of RTAs in the

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Having abandoned objections about these issues on a bilateral level, the developing country may be unable to resist these issues in a multilateral forum.
\textsuperscript{87} Notably Baldwin, Summers, Krugman, Ethier and Lawrence.
\textsuperscript{91} Regional Trade Agreement and the Multilateral Trade System. A report by commission on trade and Investment Policy. (2002) www.icc.org, as viewed on 11/10/04
\textsuperscript{92} Ibid
\end{flushleft}
past few years is beginning to be a cause for concern. Dr. Supachai Panitchpakdi, the present WTO Director General, summarizes the threat posed by the proliferation of RTAs to the WTO mechanism when in a speech he says:

“Regionalism can be a powerful complement to the multilateral system, but it cannot be a substitute. The multilateral trading system was created after the Second World War precisely to prevent the dominance of rival trading blocks. The resurgence of regionalism today risks signaling a failure of global economic cooperation and a weakening of support for multilateralism. It threatens the primacy of the WTO, and foreshadows a world of greater fragmentation, conflict, and marginalization, particularly of the weakest and poorest countries.”

The WTO annual report in 2003 also expresses deep concerns about this development and comments:

“RTAs can complement the multilateral trading system, help to build and strengthen it. But by their very nature RTAs are discriminatory; they are a departure from the MFN principle, a cornerstone of the multilateral trading system. Their effects on global trade liberalisation and economic growth are not clear given that the regional economic impact of RTAs is ex ante inherently ambiguous.”

### 3.2 RTAs in the Multilateral Framework

The founders of the GATT in a bid to preserve the prerogative of governments wishing to trade with their neighbours allowed for the creation of RTAs as an exception to the most favoured nation principle of the GATT, however, they sought to regulate the conduct of these regional initiative and thus set down guidelines which the agreements must comply with in order to be acceptable to the multilateral trading system. Article XXIV of the GATT deals with agreements on trade in goods while Article V of the GATS deals with agreement on trade in services called Economic integration Agreements.

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93 Parthapratim Pal Regional Trade Agreements in a Multilateral Trade Regime: An Overview http://www.networkideas.org
The criteria laid down in Article XXIV are basically three they are:

(A) The RTA must not “on the whole” raise trade barriers against excluded countries,
(B) Commitment to deep intra-region trade liberalisation as the agreement should cover substantially all trade between the parties and
(C) The Agreement must be notified to the WTO.

The task of verifying compliance of RTAs with these criteria is entrusted to the Committee on Regional Trade Agreements (CRTA) set up by the contracting parties in February 1996. In the past, under the GATT 1947, the Council generally created a working party to examine each RTA, but the GATT experience in testing FTAs and Customs Unions against Article XXIV was very discouraging. According to the Chairman of the working party on the Canada-United States Free Trade Area, commenting on the inability to reach a consensus, he said, ‘Over fifty previous working parties on individual customs union or free trade areas have been unable to reach unanimous conclusions on the compatibility of these agreements with the GATT- on the other hand, no such agreement has been explicitly disapproved.’

In the 46 years of the GATT up to the end of 1994, a total of 98 agreements had been notified under Article XXIV most of which where examined by the individual working parties, but consensus on the conformity of these agreements with the GATT was reached in only the Czech-Slovak customs union. It was in an effort to streamline the examination process that the

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95 ‘Regional Trade Integration under Transformation’ Draft Prepared by the Regional Trade Agreements Section, Trade Policy Review Division, WTO Secretariat for the Seminar on Regionalism and the WTO [www.wto.org] viewed on Feb 5 2005
General Council of the WTO replaced the previous system of separate working parties with the establishment of the CRTA.\(^99\)

The mandate of the CRTA is to carry out the examination of agreements referred to it by the Council for trade in goods (agreements under Article XXIV of the GATT 1994), the Council for Trade in Services (agreements under Article V of the GATS, and the Committee on Trade and Development (agreements between developing countries, established under the Enabling Clause).\(^100\)

The CRTA is also charged to make recommendations on the reporting requirement for each type of agreement, develop procedures to facilitate and improve the examination process and ‘to consider the systemic implications of such agreements and regional initiatives for the multilateral trading system and the relationship between them and make appropriate recommendations to the General Council.\(^101\)

Be that as it may, the CRTA has not had much success either in its task of examining RTAs.\(^102\). This has been due in part to political and legal difficulties. (See Figure I.II)\(^103\)

\(^99\) Crawford, J and Laird, S Regional Trade Agreement and the WTO CREDIT Research Paper

\(^100\) Ibid

\(^101\) ‘Regional Trade Integration under Transformation’ Draft Prepared by the Regional Trade Agreements Section, Trade Policy Review Division, WTO Secretariat for the Seminar on Regionalism and the WTO www.wto.org viewed on Feb 5 2005

\(^102\) As of December 2001, the Committee had 17 RTAs under active consideration (“factual examination”), and 23 in the waiting list Factual examination had been completed for 82 RTAs, whose draft reports where in various stages of consultation.

\(^103\) Source: ‘Regional Trade Integration under Transformation’ Draft Prepared by the Regional Trade Agreements Section, Trade Policy Review Division, WTO Secretariat for the Seminar on Regionalism and the WTO www.wto.org viewed on Feb 5 2005
On the political side, the problem can be traced again to as far back as the creation of the EEC in 1957. According to Hoekman and Kostecki, a conscious political decision was made by the contracting parties of the GATT in the late 1950s not to scrutinize the formation of the EEC. The reason was that the EEC member states had made it clear that a finding that the Treaty of Rome was inconsistent with Article XXIV would result in their withdrawal from the GATT and so to avoid this the GATT “blinked.”

Given that the EEC probably did not meet all the criteria set down under Article XXIV, this created a precedent that was subsequently followed with other RTAs. The result of this is that most RTAs notified to the GATT contain loopholes and are not necessarily compliant with Article XXIV.

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104 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.
106 Ibid quoting (Finger 1993b)
On substantive issues, there have been disagreements among members on how to interpret the provisions of Article XXIV. On the first requirement that an RTA must not ‘on the whole’ raise trade barriers against excluded countries, (Article XXIV: 5a) there has been the debate on what is considered ‘on the whole’ while some countries adopted the use of arithmetic average as the standard, others canvassed for the use of weighted averages. This dispute has however been resolved through the WTO Understanding on the interpretation of Article XXIV of the GATT 1994, adopted as part of the Final Act of the Uruguay Round, which provides that the evaluation of the general incidence of duties and other regulations of commerce before and after the formation of a customs union shall be based upon an ‘overall assessment of weighted average tariff rates and of customs duties collected, and for the purpose of this calculation, the applied rate and not the bound rates are to be used.\textsuperscript{108} Closely related to this is the interpretation of ‘other regulations of commerce’ (Article XXIV:5 and XXIV:8) to refer to non tariff barriers. According to Crawford and Laird, ‘Regulations of commerce is an expression which as been used in the GATT texts only in connection with RTAs (and) no definition of the term is provided.’\textsuperscript{109} However measures such as anti dumping, preferential rules of origin, technical standards, subsidies and countervailing measures have been identified by some WTO members as falling within the specifications.\textsuperscript{110} The difficulty in interpreting these provisions is recognised in the 1994 Understanding where it states that ‘for the purpose of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows may be required’. In one of the reported case of Turkey – Restrictions on imports of Textile and Clothing Products\textsuperscript{111} the Panel\textsuperscript{112} found that:

\begin{footnotesize}
\begin{enumerate}
\item[\textsuperscript{108}] Understanding on the interpretation of Article XXIV of the GATT 1994
\item[\textsuperscript{109}] Crawford, J and Laird, S Regional Trade Agreement and the WTO CREDIT Research Paper
\item[\textsuperscript{110}] Ibid
\item[\textsuperscript{111}] Report of the Panel, WT/DS34/R
\item[\textsuperscript{112}] Turkey Panel Report, para. 9.120
\end{enumerate}
\end{footnotesize}
More broadly, the ordinary meaning of the terms “other regulation of commerce” could be broadly understood to include any regulation having an impact on trade (such as measures in the fields covered by WTO rules, e.g. sanitary and phytosanitary, customs valuation, anti-dumping, technical barriers to trade: as well as any other trade-related domestic regulation, e.g., environmental standards, export credit schemes). Given the dynamic nature of regional trade agreements, we consider that this is an evolving concept.

It has been argued notably by Krueger that Rules of Origin constitute a significant non-tariff barrier to trade. Countries that are not parties to a regional initiative will prefer restrictive rules of origin to minimize the impact of preferences on their exports, while members of the RTA will prefer restrictive Rules of origin so that the benefit of the agreement does not extend much beyond the borders of the RTA. The impact of rules of origin on the trade regime is that they determine whether or not imported goods are entitled to preferential treatment. The problem that arises is where a finished good has been through several stages of processing in different countries how does one determine if it qualifies for preference under the agreement. A countries rules of origin may be cumulative or non cumulative. A cumulative rule of origin is one where an importing country requires that sufficient processing of the product has taken place in any of the countries with which it has a preferential trade agreement. Thus, it allows an exporting country to cumulate value added in other member countries to that added by itself. For example, if the value added criterion is 40%, and 30% was added in country A while 20% is added in country B, the product would meet the criterion under the cumulative system provided both are parties to the preferential agreement. On the other hand, a non cumulative rule of origin is one which requires that 40% would have to be added in EACH country. This is a much more restrictive rule of origin and the more restrictive a rule of origin is the more it will reduce the extent of liberalisation implied by the RTA. Unfortunately, there is as yet no clear cut rule on preferential rules of

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113 Crawford, J and Laird, S Regional Trade Agreement and the WTO CREDIT Research Paper
origin in the WTO framework.\textsuperscript{114} The International Chamber of Commerce (ICC) has recommended to the WTO that members should seek to ‘develop multilateral disciplines to simplify and harmonise preferential rules of origin including the cumulation of origin’\textsuperscript{115}

The second requirement relates to the fact the regional initiative must cover substantially all trade as between the parties (Article XXIV:8) Again there as been disagreement over the interpretation of the term ‘substantially all trade’ the debate on has centred on two possible explanation. The first is a quantitative approach which favours the use of a statistical benchmark such as the percentage of trade between the parties the EU is one of the major proponents of this view as they hold that the benchmark should be 80% of trade among the parties. The second is a qualitative approach which requires that no major sector should be excluded from the RTA formation\textsuperscript{116}

Another major source of contention between parties is whether a new member of a customs union can apply a quantitative restriction or other measure already being applied by other members consistent with WTO obligations. This came up for decision in the Turkey case\textsuperscript{117}. Turkey argued that Article XXIV:8(a)(ii) requires it as a regional party to impose the same conditions to third countries that are applied by the EC to its external trade. According to Turkey, since it has an obligation to cover substantially all trade in its customs union formation with the EC, to meet this requirement in the area of clothing and textile which represents 40% of their export to the EC, they as members of the customs union must have common tariffs and a common foreign trade regime with third countries in order to comply with paragraph 8(a)ii. India on the other hand submitted that paragraph 8 (a)
merely acts to define the requirements to be fulfilled in order to qualify as a customs union within the meaning of the article. In coming to a decision, the panel found that:

(The) inclusion of a sector within the coverage of a customs union, i.e. the removal of all trade barriers in respect of products of that sector between the constituent members of the customs union does not necessarily imply that those constituent members must apply identical barriers or barriers having similar effect to imports of the same products from third countries.  

The rational for these three criteria has also been the source of major disagreements. For the first requirement, it’s been argued that if restrictions on imports from non-member economies are no higher than before, the extent of trade diversion will be limited. While this may be relevant with respect to members custom unions who are obligated to have a common external tariff, the rule for FTAs is unambiguous. Article XXIV:5b merely provides that duties by each individual countries may not be raised. Bhagwati has suggested that a way of getting around this is to adopt the tariff of the member within the customs union which is the lowest. The rule against increasing protection against non members preserves the sanctity of tariff bindings by ensuring that forming an RTA does not provide a wholesome way of dissolving previous bindings. It also ensures that members of the RTA honours their market access commitment and closes an otherwise available route to protectionism.

On the second condition, there has been the argument that maximum preferential liberalisation is in itself more detrimental to non members than partial liberalisation the requirement for an RTA to cover ‘substantially all trade is thus seen as detrimental to non members. According to James Mathis, ‘as far as economic welfare of the world as a whole was concerned,

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118 Turkey Panel Report, para. 9.149
there was nothing in particular to recommend a complete preferential exchange on a regional level' given that the creation of customs unions lead to both trade creating and trade diverting consequences, there was the fear that if countries were left to chose which sector to give preference to they would most likely choose the trade diverting ones. He quotes Viner in support of this argument who says that:

‘Customs Union if it is complete involves across the board removal of duties between the members of the union; since the removal is non selective by it very nature, the beneficial preferences are established along with the injurious ones, the trade creating ones with the trade diverting ones. Preferential arrangements on the other hand can be and usually are selective, it is possible and in practice probable that the preferences selected will be predominantly of the trade diverting or injurious kind’\(^{122}\)

Some other Economists\(^{123}\) have tried to justify this requirement by saying that the rational for the condition is a ‘public choice one’ ‘it is an attempt to ensure that participants in regional liberalisation efforts go “all the way”. This is to avoid a situation where parties negotiate and cut tariffs on only goods which where previously imported from non members and thus leading to trade diversion. This helps to defend MFN clause by making it subject to an all or nothing exception.

Article XXIV:6 requires that any member of the WTO seeking to increase its bound tariff rate as a result of joining a Customs union to enter into negotiations on compensatory adjustments based on the procedure set forth in Article XXVIII (i.e. the procedure for modification of schedules). In doing this, account is to be taken of the reductions of duties on the same tariff lines made by other members of the custom union. Where this is not sufficient to provide the necessary compensatory adjustment, the Understanding provides that ‘The customs union would offer compensation which may take the form of reduction of duties on other tariff lines’ Where

\(^{122}\) Viner, J (1950) ‘The Customs Union Issue’ Carnegie Endowment, pg 51 as quoted in Mathis J

the compensatory adjustment remains unacceptable, negotiations are to be continued and should there be no agreement with a reasonable period of time in spite of further negotiations, the customs union shall be free to modify or withdraw the concession and the affected members shall then be free to ‘withdraw substantially equivalent concessions in accordance with Article XXVIII’ (That is to retaliate).

In resolving the dispute under paragraph 5(c) of Article XXIV relating to ‘reasonable length of time’ the Understanding established a ten year transition period for the implementation of an agreement. Allowance is however made for exceptional cases where Member parties to an interim agreement believe that ten years would not be sufficient for transition. They are required to provide ‘a full explanation to the Council for Trade in goods of the need for a longer period.’

It can thus be argued that although Article XXIV requirements where economically irrational, perhaps the intent of the drafters was not to provide solely for an economic result. Perhaps they also had a legal and political objective by ‘attempting to affect the course of economic diplomacy by the new obligations contained in the GATT Agreement’. 124

3.3 GATS Article V

The discussion around the provision of the GATS has centred on the interpretation of the terms ‘substantial sectoral coverage’ and ‘substantially all discrimination’125. Article V of the GATS is titled ‘Economic Integration’ and it lays down three conditions any Economic integration agreement has to comply with in order to qualify for exception under the GATS126.

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125 Crawford, J and Laird, S ‘Regional Trade Agreement and the WTO’ CREDIT Research Paper No.00/3
126 At present there are only eleven of such agreements and so the debate on the systemic issues related to trade in good under the GATT is much more advanced.
Firstly, the agreement must have substantial sectoral coverage in terms of the number of defined sectors used in the GATS schedule of commitment, volume of trade affected and the mode of supply. The agreement may not provide for the a priori exclusion of any mode of supply. Secondly, the agreement must provide for the elimination of substantially all measures violating national treatment in sectors where specific commitment were made in the GATS and this must be achieved at the entry into force of the agreement or within a reasonable time soon after. Thirdly, the Agreement may not raise higher barriers against the trade of third countries except those allowed under Article XI, XII, XIV, and XIV bis of the GATS. For the purpose of evaluation, account may be taken of the contribution of such RTA to a wider process of economic integration or trade liberalisation among the members (Article V:2). Article V:3 gives developing countries involved in an RIA the flexibility regarding the realisation of the internal liberalisation requirement and allows them to give more favourable treatment to firms that originate in parties to the agreement.

The substantial sectoral coverage requirement in the GATS is weaker than the ‘substantially all trade requirement’ of Article XXIV, and so is the criterion on the magnitude of liberalisation required and the external policy stance of the RIA. The benchmark is not free trade but the specific commitments made under the GATS by members.

Article V:3 creates some loopholes in the process as it allows for discrimination against firms originating from non members even if such firms are established within the area. Although the objective of these provisions is to attract FDIs, they weaken the scope of the multilateral disciplines and give governments (interest groups) an opportunity to pursue agreements that are more detrimental to non-members.

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Chapter Four

4.1 Special and Differential Treatment

Trade preferences for developing countries have been a feature of industrialised countries commercial policies for nearly 40 years. The evolution of S&D treatment in the current multilateral trading system can be broken into four phases. This is because each phase encompasses significant events and trends in relation to the participation of developing countries in the multilateral trading system. The first phase is from the creation of the GATT in 1948 to the beginning of the Tokyo round in 1973. The second phase is the Tokyo round itself from 1973 to 1979, the third phase is from the end of the Tokyo round to the end of the Uruguay round that is form 1979 to 1995. The fourth phase is from the end of the Uruguay round until the present. In the beginning, the GATT was concerned mainly with issues relating to market access and so the question of S&D related to the conditions of access for developing countries export to the developed countries. At the twelfth session of the GATT ministerial meeting in 1957, contracting parties to the GATT established a panel to examine the impact of the international trading environment of the economies of developing countries. This panel was chaired by Professor Gottfried Haberler and in 1958 the panel came up with a report that the trade barriers of the developed nations was significantly primarily responsible for the inability of developing countries to meet their developmental needs as a result of their low export earnings. Members of GATT then set up three committees to ‘develop a co-ordinated programme of action directed towards the expansion of international trade.’ The third committee had the responsibility

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129 Brown, Kathy- Ann ‘Summary of Paper on the future of preferential trade agreements for developing countries and the current round of WTO negotiations on agriculture’
131 Ibid pg 4
of focussing on barriers to export maintained by developed countries and by 1963, they had drawn up an eight point plan of action which aimed at removing all trade barriers by developed countries to the export of developing countries. However, this plan of action was never really implemented. With the birth of UNCTAD and the creation of independents states developing countries succeeded in placing their issue ‘centre stage’ in the GATT and this led to the inclusion of Part IV in the GATT again this was no more that a set of ‘best endeavour’ clauses with no legal force. However, Article XXXVIII:8 introduced the concept of non reciprocity and this meant that developing countries where not required to reciprocate for preferences given to them by the developing countries.

During the Tokyo Round (second phase), attention shifted from import substitution towards favouring greater export orientation. The inherent limitations and trade distorting effects of excessive reliance on import substitution were becoming better understood and there was a move towards a more neutral stance in respect of trade policy incentives. In these phase, developing countries agreed to limited market access commitments and relatively few tariffs bindings secondly, the ‘code’ approach was adopted in respect of the new non tariff measure agreement, whereby an agreement would only apply to a country if it signed it. Most developing countries simply refrained from signing the various codes. Thirdly, a new framework to define and codify the legal rights and obligations of developing countries was established. The 1979 Decision on Differential and More Favourable Treatment Reciprocity and Fuller Participation of developing countries also known as the “Enabling Clause” provided permanent legal cover for the Generalised System of Preferences.

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132 Provision relating to the grant of S&D treatment for developing countries.
133 Articles XXXVI, XXXVII and XXXVIII
134 Keck and Low (2004) pg 4
135 The codes covered technical barrier to trade, customs valuation, import licensing, subsidies and countervailing measures, anti-dumping and government procurement
(GSP) and also restated the principle of non-reciprocity as provided for in Part IV of the GATT.\textsuperscript{136}

The third phase saw another change in the evolution of the S&D treatment debate. This was the period which led to the conclusion of the Uruguay Round and the establishment of the WTO itself. By the end of this period in 1995, developing countries had assumed higher obligations in the system than ever before. This was mainly because of the single undertaking provision of the round which meant that all WTO members had to accept all agreements as a single undertaking and members were no longer allowed to pick or choose the agreements they wanted to be bound by.\textsuperscript{137} This was in sharp contrast to the previous code system of the Tokyo Round. As a result of this, developing countries were bound by all the agreements forming a part of the Final Act of the Uruguay round including new agreements such as the TRIPS and the GATS.

The fourth phase began at the end of the Uruguay round and developing countries were trying to come to terms with their new obligations in the multilateral trading system. Although in many instances, developing countries where given phase in periods for the assumption of new obligations, the ongoing debate on the future of Special and differential treatment provisions shows that most of them are yet to fully implement their obligations. According to Keck and Low, two distinct elements inform the implementation discussion. One is the difficulty some developing countries are facing as they seek to implement their obligation bearing in mind the cost, administrative and human capital requirement and the other is the substantive provision of some of the agreements themselves. In the first

\textsuperscript{136} The Enabling Clause provides that ‘the developed countries do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to trade of developing countries, i.e., the developed countries do not expect the developing countries in the course of trade negotiation to make contributions which are inconsistent with their development, financial or trade needs. The developed contracting parties shall therefore not seek neither shall less developed contracting parties be required to make concessions that are inconsistent with the latter’s development, financial and trade needs.’

\textsuperscript{137} The Exceptions are the four plurilateral Agreements on government procurement, trade in civil aircraft and dairy and meat products.
instance efforts are being made through technical assistance and capacity building efforts of various organisations\textsuperscript{138} to help developing countries adjust to their responsibilities. In the second instance, developing countries are ‘seeking modifications to some provisions on the grounds that they need to be made more supportive of development and/or less restrictive in relation to the degree of policy flexibility afforded developing counties’\textsuperscript{139}. This is still a part of the current discussion going on in the Doha round. Relevant to this discussion is the call for S&D provisions to be made more effective rather than the “best endeavour” manner in which most of them are couched without any significant legal weight. Ministers at the Doha round have in the Doha Declaration called for a ‘review of all S&D provision with a view to strengthening them and making them more precise, effective and operational’\textsuperscript{140}

4.2 Why S&Ds?

There are a number of factors canvassed as reasons why developing countries need special and deferential treatment but there is an emerging school of thought that S&DT have not always been good for developing countries. Some of the arguments canvassed for them are:

1. It is an acquired political right in this regard some developing countries believe that they have a political right to assume minimum obligations under the multilateral trading system on the basis that their economies are not as strong as those of their developed countries counterparts and for the system to be judged equitable, provision for S&DT must be made. A problem of this type of argument however is that an assumption is being made that the best contribution the WTO can make to development is to ensure that developing countries assume minimum obligations under the system.

\textsuperscript{138} The World Bank, IMF and various UN organisation such as UNCTAD also have programs aimed at capacity building effort for developing countries.  
\textsuperscript{139} Keck and Low (2004) Pg 6  
\textsuperscript{140} Paragraph 44, Doha Declaration.
Some writers\textsuperscript{141} have argued that as long as the developing countries continue to limit their commitment and obligations to the system in this manner, ‘they weaken their negotiating position and lessen the degree to which their development partners are willing to pursue policies that support development. They also weaken the scope for challenging elements in the system which are arguably imbalanced, independent of any consideration of special and differential treatment\textsuperscript{142}.

2. Developing countries should enjoy privileged access to the markets of their trading partners particularly the developed countries: Most developing and least developed countries enjoy preferential market access to the developed countries under the Generalised System of Preferences (GSP) for which a permanent waiver from the non-discrimination requirement was obtained under the enabling clause.\textsuperscript{143} However the benefit from this system is not as substantial as could have been anticipated for a variety of reasons. Real advantages can only be derived if the schemes include products that are subject to significant MFN protection\textsuperscript{144} but in most cases, grantor rather than grantee country interest have determined the product coverage and preference margin in GSP schemes.\textsuperscript{145} In fact as opined by one writer ‘…all areas of potential comparative advantage for developing countries were subject to tight tariff quotas, meagre


\textsuperscript{142} An example of such rules is the differentiated rules on export subsidies in the agriculture and manufacturing sector, the rules on the right to apply export subsidies in agriculture and different manner in which export subsidies are treated depending on whether they are fiscal or financial in nature

\textsuperscript{143} Other schemes limited to a defined set of beneficiaries include for example the AGOA and the EU’s ‘Everything but Arms (EBA) initiative for least developed countries

\textsuperscript{144} AGOA for instance offers zero tariffs and quotas on textiles where MFN tariffs are high and competitors are also subject to quotas.

\textsuperscript{145} For instance until very recently, the EU GSP schemes excluded agricultural products almost completely. The EBA initiative for LDCs will ultimately include all agricultural commodities though for some important products like rice, bananas and sugar after a considerable delay.
preference margins and strict rules of origin. In the current multilateral negotiation where there is a move to zero tariffs on most products the advantages to be gotten under these systems becomes sublimed. Again, because these preferences are unstable and subject to the discretion of the givers, they can be withdrawn at anytime, for instance, in April 1992, the US terminated India’s GSP privileges on $60 million worth of exports of pharmaceuticals and chemicals on the pretext backed by unilateral determination that India did not have adequate intellectual property protection. Moreover, the rules of origin and other requirement under these systems are sometimes difficult and costly to fulfil. Again for example, the US granted GSP preference under the Caribbean Basin Initiative when eligible products had 35% local content. Some corporations then invested in Jamaica and Costa Rica to convert European wine into ethanol so as to reach the 35% local content and export rose, the US then raised the local content required for GSP eligibility to 70% ruling out access to GSP benefits.

3. Developing countries should have the right to restrict imports to a greater degree than the developed countries. This is because it can be argued that they need more policy space to make decisions for developmental purposes. They also have a need to protect infant industries against foreign competition. Most developed countries have applied to the exempted totally from the TRIMs agreement. Moreover, tariffs on import continue to be a major source of revenue

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147 This Example is cited in the ‘Sutherland Report’ Pg 25
148 For instance, the EU schemes require goods to be shipped directly to the EU or else must remain under supervision of customs authorities and this increases the cost of transactions for LDC exporters. Again under the AGOA, beneficiaries have to meet the additional criteria relating to labour standards and workers rights
for most developing countries.\(^{151}\) The protection of infant industries against foreign competition must however be checked so that it does not do more harm than good to the countries industries. Persistent protection may lead to permanent development inhibiting distortions in resource allocation within the developing country.\(^{152}\) If infant industries protection is to be granted on any grounds, a time table for the reduction and eventual elimination of restrictions should be spelt out in advance so as to motivate firms to catch up in terms of productivity and competitiveness. If limits to protection are not clearly specified, ‘rent seeking behaviour will set in with all the associated deadweight cost for the economy in terms of wasted resources, higher prices lower quality and less choice.’\(^{153}\) Some Economist have argued that trade policy as an instrument to promote industrial development is simply outdated in a world where services are increasingly tradable, there are large Foreign direct investment flows and as a result, international production is increasingly becoming fragmented and more and more specialised\(^{154}\). They also observe that an open trade regime provides for ‘important channels of knowledgeable transmission, such as exposure to foreign clients, access to technologically sophisticated imports or knowledgeable competitors’ \(^{155}\).

4. Developing countries should be allowed additional freedom to subsidize exports. A number of developing countries have advanced S&D proposals for full flexibility in applying subsidies.\(^ {156}\) This does not take into account the market distortions caused by subsidies generally and the harm to development that flows there from. The flexibility to subsidize must be carefully designed to avoid wasteful

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\(^{151}\) Schiff, M. & Winters Alan (2003)' Regional Integration and Development'. World Bank Report  
\(^{152}\) Keck and Low (2004) pg 8  
\(^{153}\) Ibid pg 16  
\(^{156}\) Keck & Low (2004) Pg 8
subsidy competition. And where development objectives can be achieved without recourse to subsidies, these alternatives should be implemented. A review\(^{157}\) of cases in Asia and Latin America found that scanty results did not seem to warrant the cost incurred during decades of export subsidization instead it was found that as soon as trade liberalisation and sound macro-economic policies were pursued, good progress on exports was made despite a simultaneous and sharp reduction of export subsidies. Another review\(^{158}\) of some countries found that the diversification of exports towards manufactures occurred when policies of more open import regimes and relative stability in real exchange rates were pursued. In contrast, the provision of export subsidies was not a common element among successful countries, rather, subsidizing countries faced large opportunity cost and an additional waste of resources through rent seeking activities induced in the private sector. A way of dealing with this may be the establishment of Export – Processing Zones (EPZs). Many developing countries have had early success in putting in place an efficient administration and sound infrastructure in a confined space in their territory and many developing countries believe that EPZs have played an important role in their development.\(^ {159}\)

5. Developing countries should be allowed flexibility in respect of the application of certain WTO rules or to postpone the applications of the rules\(^ {160}\). Many developing countries saw a rise in their WTO obligations after the Uruguay round as a result of the single


undertaking provision of the round. However, most of them were not yet prepared institutionally to take on some of these additional responsibilities. In a bid to aid the developing countries, longer time frames were built into the provisions to give them the time to adjust to the new rules. As opined by Keck and Low, some of the WTO agreements require investment in capacity to support their implementation and derive the benefits.\textsuperscript{161} They conclude that ‘flexibility as to when developing countries should assume WTO obligations reflect an appreciation of the adjustment cost of change as well as administrative and infrastructural capacity needs that might be associated with implementation.’\textsuperscript{162} However, such flexibility should also not be a blank cheque and care must also be taken to ensure that S&D provisions are defined to the maximum extent possible in terms of economic needs that automatically identify the beneficiary members.

### 4.3 Preference Erosion

Most developing countries export their products to the developed countries under some sort of GSP schemes or other preferential trade agreement. Where MFN rates are high and other barriers to trade exist, preferential access to a developed country market may confer some benefits to an exporting developing country. Where however MFN rates are low and other trade barriers are non-existent, trade benefits under a preferential agreement becomes minimal. An understanding of this implies that the more trade liberalisation is achieved, the more the traditional preferences given to developing countries become eroded. For example, if the US had an applied tariff rate of 10\% as the MFN rate and grants 2\% under its AGOA scheme to developing countries, developing countries would enjoy better access to the US market for that line item but if the US where to further liberalise it trade

\textsuperscript{161} Some examples are the cost of training and infrastructure to implement commitments under the Agreement on Implementation of Article VII of GATT 1994 (Customs Valuation agreement) and the Agreement on Technical Barriers to Trade.

\textsuperscript{162} Keck and Low (2004) pg 30
and reduce its MFN rate to 5% developing countries may find that their good are no more competitive in the US markets as other developed countries may be able to produce that good more efficiently and thus at a cheaper rate for the US market. Where this occurs, the preference given to the developing countries is said to be eroded. With the current round of negotiation and the further liberalisation of market access for goods in RTAs there is a need to examine the impact this as had on the preferential access given to developing countries in the multilateral trading system. It was in manufactured goods that preference erosion was first noticed since the negotiation of the Multi-Fibre Agreement in 1994, its potential impact on gainers has been known. The effect of the agreement was not fully known as full liberalisation was postponed till 2005. However, calculations of the effect of the agreement suggest that Mauritius, Bangladesh, Sri Lanka and the Maldives were likely to be the most serious losers. A recent IMF report however shows that Malawi, Mauritania, Haiti, Cape Verde and Sao Tome and Principe will also be major losers in the current move for the multilateral tariff reduction. See Figure I.III

<table>
<thead>
<tr>
<th>Least Developed Countries</th>
<th>Other Developing Countries</th>
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<tr>
<td>Malawi</td>
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<td>Cambodia</td>
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<td>Bangladesh</td>
<td>St Kitts &amp;Nevis</td>
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<tr>
<td>Maldives</td>
<td>Guyana</td>
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<td>Haiti</td>
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<tr>
<td>Cape Verde</td>
<td>Dominica</td>
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<td>3.3</td>
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<tr>
<td>Sao Tome and Principe</td>
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<td>Tanzania</td>
<td>St Vincent &amp; the Grenadines</td>
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<td>2.4</td>
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<td>Comores</td>
<td>Jamaica</td>
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Source: IMF, 2004

www.odi.org.uk/publications/brifeing/doha


www.odi.org.uk/publications/brifeing/doha
Another area where developing countries are facing the problem of preference erosion is in the agricultural sector. Typically, the tariffs of most developed countries particularly the EU and the US is highest in agriculture and since most developing countries export their agricultural products to these countries under a GSP scheme, a further liberalisation of trade in this sector will certainly affect the export capacities of these countries. One of the subjects extensively debated during the Uruguay round negotiation was the possible negative impact of the agricultural trade liberalisation on least developed and net food importing countries. Ministers recognised the challenge that was faced by these countries and thus the Marrakesh Ministerial Decision on Measures Concerning the Possible Negative effects of the reform programme on Least Developing and Net Food Importing Developing Countries states that:

‘Ministers recognise that during the reform programme leading to greater liberalisation of trade in agriculture, least developing countries and net food importing countries may experience negative effects in terms of the availability of adequate supplies of basic foodstuffs from external sources on reasonable terms and conditions, including short-term difficulties in financing normal levels of commercial imports of basic foodstuffs’

To deal with the possible negative effects the decision provided for action through some response mechanisms but again the implementation of the decision has remained unsatisfactory.

The proliferation of Regional Trade agreements is also having an effect on the preferences enjoyed by developing countries. Clearly the preferences of ACP countries are being eroded in the EU market. These preferences are eroding because of the continual liberalisation of trade in the MTS, and as a consequence of the Customs Union signed by the EU with Turkey, and the

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166 Towards improving the operational effectiveness of the Marrakesh Decision on Measures concerning the possible negative effects of the reform programme on Least Developed Countries and Net Food Importing Developing Countries. http://www.fao.org/DOCREP/005/Y3733E.htm
167 Contained in the Final Act of the Uruguay Round
FTAs with Mediterranean countries (Euro-Med Agreements), Central and Eastern European Countries (Europe Agreements) South Africa and Mexico, and the one it is negotiating with MERCOSUR and Chile. These agreements give these other countries a tariff regime that is broadly equivalent to the Lome agreement.\textsuperscript{168} And since most of these countries are more efficient producers than the ACP states, the margin of preference enjoyed by the ACP state become eroded. According to EC DG-VIII (1999), by the year 2000, Lome preferences should only be 2.9 percent on the basis of the MFN trade regime and 2 percent on the basis of the GSP regime.\textsuperscript{169}

In January 2005, the World Trade Organisation unveiled a report entitled ‘The Future of the WTO: Addressing Institutional Challenges in the New Millennium’ (the Sutherland Report) which was drawn up by a consultative board chaired by former WTO Director General Peter Sutherland. Chapter two of the report focuses on the erosion of non-discrimination. According to them,

…five decades after the founding of the GATT, MFN is no longer the rule it is almost the exception. Certainly, much trade between the major economies is still conducted on an MFN basis. However, what has been termed the “spaghetti bowl” of customs unions, common markets, regional and bilateral free trade areas, preferences and an endless assortment of miscellaneous trade deals has almost reached the point where MFN treatment is exceptional treatment. Certainly the term might now be better defined as LFN, least favoured nation treatment.’

For instance, the EU has its MFN tariff applicable to only nine of its trading partners; all other trading partners are granted concessional market access under Article XXIV, the Enabling Clause, GSP schemes, “Everything but arms” and other relationship.\textsuperscript{170}

Another area where the preferences of developing countries is being eroded is in the practice in modern RTAs which requires them to take on more

\textsuperscript{168} Schiff, M. ‘Regional Integration and Development in Small States’ Development Research Group. The World Bank
\textsuperscript{170} Sutherland Report Pg 19
onercous burdens than that which they are called to bear under the multilateral trading system. As stated earlier, RTAs increasingly are going beyond the multilateral trading systems in terms of sectoral coverage, and requiring developing countries to agree to terms that they are yet to confront in the WTO. More worrisome is the injection of non trade objectives into these agreements. According to the Sutherland report, Apart from comparatively ambitious and one sided provisions on intellectual property rights, there has been an increasing tendency on the part of preference givers to demand significant labour and environmental protection undertakings and even restriction on the use of capital controls-as the price for preferential treatment.\footnote{An Example is the AGOA which "authorizes the President to designate countries as eligible to receive the benefits of AGOA if they are determined to have established, or are making continual progress toward establishing the following: market-based economies; the rule of law and political pluralism; elimination of barriers to U.S. trade and investment; protection of intellectual property; efforts to combat corruption; policies to reduce poverty, increasing availability of health care and educational opportunities; protection of human rights and worker rights; and elimination of certain child labor practices."}

In most RTAs involving a developed and a developing country (North-South Agreement) the developing countries are unable to turn down some of these requirement in a bid to exploit the real and imagined benefit from entering into the agreement (mostly FDIs). Although the basis for most GSP grant was non reciprocity as embodied in the provision of the enabling clause, it would seem that these preferences are no longer unreciprocated as developing countries have to “do” something in exchange if not “give”. This is notwithstanding the fact that even now, there is a move away from the grant of nonreciprocal agreement to one in which the developing country also has to make some concession. For instance the EU/ACP agreement has evolved from one form to another. Under the Cotonou agreement, the ACP states are required to give the EU some more favourable access into their market and come 2008 when the agreement will come to an end, there is already the indication that it will not be renewed and instead, the ACP countries are being asked to form themselves into different regional trading blocks, and the EU would in turn
enter into FTAs with them.\textsuperscript{172} This implies that the ACP countries will enter into new Economic Partnership agreements with the EU either individually or as a regional group.

In a bid to preserve their preferential access to the markets of rich countries, under various GSP and preferential trade agreements, some developing countries have been hesitant to support ambitious objectives on MFN reductions that would erode the value of their preferences under the current Doha round.\textsuperscript{173} There has also been a call for compensation to developing countries for the preference erosion which is as a result of trade liberalisation. Mauritius\textsuperscript{174} the most affected country on both sugar and clothing had suggested a compensatory mechanism in January 2003, and in LDCs and the ACP countries have lent their voice to the appeal, specifying that there should be technical assistance to improve infrastructure, productivity and diversification\textsuperscript{175}. The cotton exporters have also raised the possibility of financial compensation for subsidies;\textsuperscript{176} however there has been no agreement as to who is to implement the compensation. Even in the ‘Marrakech Ministerial Decision on Measures Concerning the Possible Negative effects of the reform programme on Least Developing and Net Food Importing Developing countries’ where financial compensation was implied for countries who are expected to be hurt by a rise in food prices as a consequence of agricultural reforms, in practice no action was taken\textsuperscript{177}.

\textsuperscript{172} Schiff, M. ‘Regional Integration and Development in Small States’ Development Research Group, The World Bank  
\textsuperscript{173} Sutherland Report ibid Paragraph 85  
\textsuperscript{175} Ibid  
\textsuperscript{176} Ibid  
Chapter Five

5.1 Conclusions and Recommendations

From the foregoing, it is apparent that regional trade agreements have become the priority for some governments as a way of achieving their trade policy objectives rather than the multilateral trading system. Evidence of this is the statement credited to a negotiator in Geneva who said ‘if we do not get what we want in the negotiating agenda, why should we worry? We have our own RTA, that’s where the action is.’\textsuperscript{178} There is no doubt that this kind of sentiment represents the interest driving the current wave of regionalism and it is trite to say that this is an unhealthy sentiment.

As established in the recent study carried out by the OECD the major consideration for most countries in entering into regional trade agreements is political and not economic. According to the OECD study, ‘…all RTAs are driven in large measure by geo-political considerations. Their role in the trading system, though crucial for trade policy, will always be seen by the participating governments in the broader context of the political and strategic objectives that the agreements seek to serve.’\textsuperscript{179} Most of the preferential agreements involving developed/developing countries are for the most part an avenue for the developed countries to achieve their political policy objectives since this agreements are not reciprocal and no economic benefit accrues to the developed country.

As noted earlier in the introduction, 43% of world trade is currently been done under regional trade agreements and this is expected to rise to 55% by the end of 2005. This gives credence to the continuous dependence of

\textsuperscript{178} Crawford, J and Laird, S ‘Regional Trade Agreement and the WTO’ CREDIT Research Paper No.00/3

countries on regionalism. Countries such as Chile, Mexico and Singapore seem to have a policy of ‘addictive regionalism’ as they have formed preferential relations with all their major trading partners. If the explosive growth of regionalism continues, then it is bound to have a detrimental impact on the WTO regime. If a very high proportion of global trade gets diverted through the regional route, WTO is bound to loose some of its relevance in the global trading system.

In terms of economic cost the full impact of the proliferation of RTAs is still not known. After over 50 years, the debate of whether regional trade agreements lead to trade creation or trade diversion is still ongoing and there seems to be no consensus among leading economist. As noted above, the MFN rate of the EU is currently applicable to only nine of its trading partners and though this includes its largest trading partners the US and Japan, the effect of this diversion of trade is still rippling on the MTS.

Differing Rules of Origin among RTAs are likely to have negative effects on trade. Complex and varying methods of calculating regional content impose a significant burden on industry and this problem is magnified by the overlap of RTAs. The problem of ‘spaghetti bowls’ of regional trade agreements is a reality that the multilateral trading system has to address within the current negotiating round.

The maintenance of a dual system (of antidumping duties for third parties and competition or anti-trust policy among RTA parties) can create distortions where different criteria and conditions apply to the invocation of such measures and thus have the potential for discrimination against third countries. This also adds to the complication of the trading arena and defeats the goal of creating a transparent world trading system.

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On the debate around the systemic issues of the compliance of RTAs to the provisions of Article XXIV, this is currently a part of the agenda on the table in the Doha Development round and it is clear that the members of the WTO would need to give careful attention to the issues so as to come out with a workable recommendation on how to interpret the concepts. This disagreement certainly does the system little credit, but it is also a consequence of the fundamental consensus process of the WTO. It is frustrating to all WTO Members, participants or not in an RTA, and has effectively given carte blanche to participants to operate a range of discriminatory schemes. Given the divergences of view in the CRTA and the strength of entrenched positions, it is difficult to see any major breakthroughs in this area\textsuperscript{181}.

An alternative may be to leave the issue of verifying compliance of an RTA to the WTO Dispute Settlement body (DSB), but the downside to this is that it means that as long as no member challenges the constitution of the RTA, it would remain in force even if it is having a negative impact on the trade of another member. And given the fact that the process of bringing a dispute before the DSB is expensive and out of the reach of many developing country members of the WTO who would most likely be the ones to feel more direct the negative impact of the RTA, it means that they may be unable to have the agreement set aside and would have to bear their losses.

Be that as it may, it must also be appreciated that regional trade agreements do have a complimentary role to play in the trading system. Few willing countries may decide to develop trade relationships that are both broader and deeper than is easily achievable on a global scale, and these agreements can act as spurs to the more hesitant development of the multilateral system. The reality of the benefits some traders in the

\textsuperscript{181} Crawford, J and Laird, S ‘Regional Trade Agreement and the WTO’ CREDIT Research Paper No.00/3
developing countries derive from the various GSP schemes is very tangible for these small scale traders who would otherwise have not been able to compete with the more efficient producers in the developed world. Theoretically speaking, trade liberalization through regionalism does not offer the best solution. However, in the current state of distorted multilateralism, regionalism has turned out to be one of the more viable alternatives for countries to expand their market access. In the final analysis, it is clear that Regional trade agreements can complement, but cannot substitute for, coherent multilateral rules and progressive multilateral liberalisation.

On the question of the erosion of the preferences of developing countries, a case has been made to show that with further liberalisation in the multilateral trading system, the preferences given to developing countries are being eroded however, this is further compounded by the proliferation of RTAs as the developed countries which usually gave them this preferences are giving the same advantages to more and more countries in free trade areas and customs unions. Secondly, the problems associated with unequal power structure and exploitation of smaller members by a bigger economic power can be more acute in a regional trade block. Also, it is always possible that if the world is divided in a few mega trade blocks, then the weakest countries will be marginalized.

By demanding developing countries to take up more burdens than those which they have to cope with in the multilateral trading system before they can benefit from a preferential trade agreement, their preferences are also being eroded indirectly. Like the Sutherland report\textsuperscript{182} argues, the inclusion of non trade requirement such as labour and human rights as conditions for receiving preferences by developed countries in their trade agreements is an indirect way of introducing into the multilateral trading system issues

which cannot be justified within it. According to them, ‘... if such requirements cannot be justified at the front door of the WTO they probably should not be encouraged to enter through the side door.’¹⁸³

While little or nothing can be done to prevent the further spread of regional trade agreements, one cannot but agree with the members of the consultative board in the Sutherland report when they conclude that:

‘(W)e would like to think that governments will take into account the damage being done to the multilateral trading system before they embark on new discriminatory initiatives. If the motivation is to promote non-trade agendas or simply an instinctive desire to “catch up” with others or follow suit, they should at least show some restraints. At the very least we need to be clear that future initiatives are taken above all other considerations genuinely to improve trading and development prospects of beneficiaries or (the RTA) members.’¹⁸⁴

Finally, in addition to some of the recommendations made above one would recommend that in cases where regional agreements increase protection against non-parties, compensation must be paid in accordance with Article XXIV.6, and in cases where regional agreements do not meet GATT criteria for customs unions and free trade agreements, the parties should at least respect the Most Favoured Nation (MFN) principle and lower trade barriers on an MFN basis.

¹⁸³ The Sutherland Report Pg 23
¹⁸⁴ Ibid Pg 26
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