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## *Regionalism versus Multilateralism*

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## Abbreviations

CU	Customs Union
EU	European Union
FTA	Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
MERCOSUR	Southern Common Market
RTA	Regional Trade Agreement
MTA	Multilateral Trade Agreement
SAFTA	South Asian Free Trade Agreement
WTO	World Trade Organization
MFN	Most Favored Nation
NAFTA	North American Free Trade Agreement
ASEAN	Association of Southeast Asian Nations
EFTA	European Free Trade Area
EEA	European Economic Area
CIS	Independent States

## Abstract

The literature on regionalism versus multilateralism is growing as economists and political scientists grapple with the question of whether regional integration arrangements are good or bad for the multilateral system as a whole. The well-known question whether regional trade agreements (RTAs) and the multilateral trading system (MTS) are “strangers, friends, or foes”<sup>1</sup> has gained new importance with the widespread proliferation of RTAs in recent years of economic crisis. Regional trade agreements are cropping up everywhere, with new negotiations being announced almost every day in some part of the world. Are these regional deals undermining the paramount of the World Trade Organization? Are regional integration arrangements “building blocks, or stumbling blocks,” in Jagdish Bhagwati’s phrase, or stepping stones toward multilateralism?

“Regionalism versus multilateralism” switches the focus of research from the immediate consequences of regionalism for the economic welfare of the integrating partners to the question of whether it sets up forces which encourage or discourage evolution towards globally freer trade. This paper tries to give an answer to the debate “multilateralism versus regionalism”. Firstly, I try to give some clear definitions and classifications of the concepts of “regionalism” and “multilateralism”. Moreover, the historical perspectives of these terms should be also discussed. Then, I try to evaluate these trade agreements, regional and multilateral trade agreements, in light of four factors and to explain the meaning of “new regionalism”. The paper continues with the costs and benefits of both regionalism and multilateralism and the reasons of the proliferation of RTAs. Last but not least, I try to give a clear picture of the current crisis and its impact on multilateral trade system through the words of well known persons. The conclusion comes after all these parts and tries to give a clear answer to the debate “multilateralism versus regionalism”.

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1 Bhagwati and Panagariya, 1996

## Introduction

Since World War II, the globalization of the world economy has developed at a rapid pace. This was made possible by the increase in economic activities, in particular, in international trade. The essence of globalization is the creation of a unitary economic and political global space. Regionalization is its integral part and represents regional linking and cooperation, mostly of geographically neighboring countries.<sup>2</sup> In the process of the globalization and general interdependence of the modern world, protectionist measures (tariff and non-tariff barriers) represent an obstacle to the modern development of economy and trade. Hence, the process of the liberalization of the flows of goods, capital, services and people is the only logical path of accelerated development. Seeing the advantages of removing trade barriers, certain countries have established regional organizations, within which they have gradually liberalized their mutual trade. In this way they additionally developed their economies and became an example of successful cooperation. On the other hand, countries that have retained closed economies for fear of being exposed to foreign competition, have lagged further and further behind and, comparatively speaking, have become increasingly impoverished.

Trade is one of the manifestations of globalization, with its positive effects but also its downsides. Free trade advocates face more than just the constant challenge of reminding the public and policymakers of the virtues of open global markets. In recent years the discussion has been over the respective merits of regional free trade agreements such as the North American Free Trade Agreement (NAFTA) and the European Union (EU) on the one hand and the multilateral General Agreement on Tariffs and Trade (GATT), now manifest in the World Trade Organization (WTO), on the other. Today it is clear that the sole work of market forces will not be enough to spread the benefits of globalization to all and that we have to develop instruments to harness globalization, ensuring that both developed and developing countries benefit alike from it and that those in our societies who suffer from the transformations that globalization bring about are adequately taken care of.

One of the tools at our hands to harness globalization is the multilateral trading system. It is intended to rebalance the world trading system in favor of developing countries, through greater market opening and new trade rules adapted to the new changing trading realities of the XXI century. The multilateral trading system has evolved continually since its inception following the Second World War. With successes in lowering barriers to trade, along with advances in technology, the world has witnessed unprecedented economic globalization in recent decades. Countries have

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<sup>2</sup> M. Božić, *Ekonomska politika*, Pravni fakultet u Nišu, Niš, 2006, p. 96.

become more interdependent through the exchange of goods and services and flows of capital, information, and to some extent, labor. Events of the past two decades have generated increasing concern about the direction of the world trading system. With the establishment of GATT after World War II, the multilateral approach was the preferred method of trade liberalization. While the General Agreement on Tariffs and Trade (GATT) helped orchestrate the substantial reduction in tariffs after World War II, as mentioned before, the multilateral approach to trade liberalization has encountered difficulty in stemming the proliferation of non-tariff trade barriers and in extending international rules to new areas of trade. Meanwhile, the appearance of regional trade arrangements in Europe, the Americas, and elsewhere provides an alternative track for expediting trade reform, but also risks deteriorating into exclusionary, trade-diverting blocs that possibly may bring harm to world welfare. The losses of momentum in the multilateral system and the movement toward regional agreements have sparked renewed debate over the relative merits of the two approaches to trade liberalization. In reaction, supporters of the multilateral approach have been reasserting their position.

In the current literature there is a vigorous debate taking place about which way to choose, multilateralism or regionalism. While some researchers claim that regional agreements can be instrumental in attaining global free trade, others fiercely oppose these agreements, since they see them as a potential threat to the multilateral trading system.<sup>3</sup> So, is regionalism a help or a hindrance in the goal of attaining free international trade, in the multilateral trading system?

There has been a creative tension between regional and multilateral approaches which, although often complicated, has generally advanced trade openness and economic integration.

## **A general approach: Free Trade Agreements.**

Free trade agreements are quite current in today's world. It is estimated that just about every country in the world is a member of one or several regional free trade agreements, and there are more than 400 of such agreements in force today. By their very nature, free trade agreements (FTAs) require member countries to grant tariff concessions to each other that they typically do not extend to nonmembers. FTAs are recognized by the WTO in GATT Article 24 and Article 5 of the General Agreement on Trade in Services (GATS) and are exempt from the most favored nation (MFN) rule. MFN is the fundamental principle of non-discrimination of all members. Regional trade agreements

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<sup>3</sup> On one side we have Bhagwati (1995) who argues that, "...further expansion and creation of free trade areas, instead of concentration now on multilateralism at the WTO, is a mistake." Summers (1991) on the other side of the debate argues that, "...holding the degree of multilateral progress constant, the world will be better off with more regional liberalization".

(RTAs) are the collective term used by the WTO to refer to FTAs and other regional preferential trading arrangements such as customs unions.<sup>4</sup> Ever since Jacob Viner's<sup>5</sup> (1950) classic analysis, the static distortions created by such preferential trade liberalization have received significant attention from economists and policy-makers alike. Furthermore, in recent years there has been widespread concern regarding the potential adverse effects of FTAs on the process of multilateral trade liberalization (the *raison d'être* of the World Trade Organization (WTO)).

One well-recognized method for classifying the different types of regional integration is to categorize them by their stage of development, a method which focuses on the degree of integration,<sup>6</sup> which is the one adopted here. From order of looser to stronger integration, there are:

1. FTAs, which remove tariffs and quotas within the group. In a free trade area, tariff and non-tariff barriers to trade between member countries are removed. Trade barriers with the rest of the world differ among members and are determined by each member's policy makers.
2. Customs unions, which establish common tariffs for countries outside the group. In customs unions, trade barriers between members are eliminated and identical barriers to trade with nonmembers are established, typically by common external tariffs.
3. Common markets, which lift restrictions on the movements of factors of production within the region. A common market is a customs union in which the free movement of goods and services, labor, and capital is also permitted among member nations.
4. Economic unions, in which common macroeconomic policies are adopted. An economic union is the most complete form of economic integration. National agricultural, social, taxation, fiscal, and monetary policies are harmonized or unified among member countries, and a common currency may be adopted.

Some examples of FTAs include the Association of Southeast Asian Nations (ASEAN) Free Trade Area, which was established in 1992, and the North American Free Trade Agreement (NAFTA), which came into effect in 1994. The agreement between Japan and Singapore, which was the first RTA to be concluded by Japan, is also a FTA.<sup>7</sup> The European Economic Community (EEC), and the Southern Common Market (MERCOSUR), which comprises four South American countries,

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4 See the WTO website <<http://www.wto.org>> for details of how the WTO handles regional trade agreements.

5 Viner, J. (1950). *The Customs Union Issue*. Carnegie Endowment for International Peace, New York.

6 See Peter H. Lindert, *International Economics*, 9th edition, (Irwin: Homewood, IL, 1991), Chapter 9, for an example.

7 Partnership Agreement (EPA)." The report of the study group of representatives of Japan's and Singapore's private sector, academia and government, which became the basis of the Japan-Singapore Free Trade Agreement, appears on the websites of the Ministry of Foreign Affairs <[http://mofa.go.jp/region/asia-paci/Singapore/econo\\_b.html](http://mofa.go.jp/region/asia-paci/Singapore/econo_b.html)> and of the Ministry of Economy, Trade and Industry, <<http://meti.go.jp/english/information/data/cJ-SFTA/e.pdf>>.

are examples of customs unions. One main example of economic union is the well known European Union in which 27 members states are part of it. The European Union is the most important and the biggest trade partner of the countries of Southeastern Europe.<sup>8</sup>

## **Definitions and Classifications**

### **Multilateralism**

Multilateralism is represented by the efforts on worldwide liberalization of international relations, which started in the field of trade in goods when General Agreement on Tariffs and Trade (GATT) was signed, and developed into broader fields of trade in services, investment, agricultural products, public procurement, and intellectual property rights with its more sophisticated successor – World Trade Organization (WTO).

A multilateral agreement is defined as a binding agreement between three or more parties concerning the terms of a specific circumstance. Multilateral agreements can occur between three individuals or agencies: however, the most common use of the term refers to multilateral agreements between several countries. Multilateral agreements are often the result of recognition of common ground between the various parties involved concerning the issue at hand. They are usually intended to lower trade barriers between participating countries as mentioned before and, as a consequence, increase the degree of economic integration between the participants. Multilateral trade agreements are considered the most effective way of liberalizing trade in an interdependent global economy. Several countries can enter into a multilateral agreement, which will generally be complex in structure. The General Agreement on Tariffs and Trade, (GATT) now administered by the World Trade Organization, is a treaty in which subscribers commit to individual levels of tariffs for trade with other countries.

Multilateralism, according to Ruggie (1992), can be seen as a deep organizing principle of post-war international life with three defining characteristics:

- Indivisibility of the system is a whole in that the actions of one party affect all parties and each party acknowledges its allegiance to the single whole. It is indivisible in that it permits an extremely dense and far-reaching network of trade links and of intergovernmental contacts and is viewed as

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<sup>8</sup> The observed countries of the region were: Albania, Bosnia and Herzegovina, Bulgaria, FYROM, Croatia, Moldavia, Romania and Serbia (including Kosovo).



having an existence separate from all the individual trade links between participants, and in that its separate existence is seen as valuable.

- Generalized rules of conduct interactions between parties are governed by widely recognized general principles, rather than ad hoc or particularistic interests.
- Diffuse reciprocity of all parties expect to gain from the system, but do not demand precise reciprocity from every separate transaction. Reciprocity is diffuse in that governments do accept individual actions that appear not to be in their immediate interests, but it is generally accepted that, overall, every country has to gain.

Moreover Multilateralism is sometimes referred to as a process whereby countries solve problems in an interactive and cooperative fashion<sup>9</sup>. While such interactions could clearly be affected by regionalism.

## **Regionalism**

Taking into account the definitions of multilateralism, due to Ruggie (1992) (mentioned above), the concept regionalism clearly undermines multilateralism, as it defies MFN. It is also divisive, as it exacerbates tendencies for parties to focus more strongly on some links than others. One defense is that regionalism is subject to generalized rules that all have agreed, and that indivisibility should not preclude having some links stronger than others. The former merely recognizes that the world trading system is imperfectly multilateral, while in practice the latter depends on whether governments shift their focus from general to particular trade relations.

In international trade policy, “regionalism” is used to refer to economic integration between two or more countries based on formal agreements.<sup>10</sup> The most common definition of a regional free trade agreement is an agreement among countries within a specific geographical region. Its objectives are to eliminate barriers to trade and facilitate the cross-border movement of goods and services among the signatories. According to Harvard University, the World Trade Organization requires regional trade agreements to reduce tariffs between countries, but does

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9 Yarbrough and Yarbrough, 1992

10 Siebert 1997 (p.161), Kaiser 2003 (p.25)

not allow these countries to increase tariffs on countries which do not participate. Tariff reductions allow people to purchase goods from other countries at lower prices. The trading partners concerned grant each other conditions that are preferential in comparison with other countries.

The concept “regional” refers to a limited number of countries, as mentioned above, and is used to set it apart from multilateral liberalization, which includes all member states of the WTO. At the same time this also means that non-members of the agreements are placed at a disadvantage with respect to members. Further regionalism does not necessarily refer to unions of countries in specific regions, although this is often the case, but also to trade agreements among countries on different continents.<sup>11</sup> In the economists sense regionalism clearly violates the non-discrimination axiom of multilateralism, but if it moves the world towards freer trade, perhaps it helps in the other dimension. According to the Inter-American Development Bank, Regional trade agreements regulate more than one half of global trade. Some famous regional trade agreements include the European Common Market and the North American Free Trade Agreement. These are only two leading examples, there are hundreds of others, large and small.

## **History elements**

Throughout modern history countries have secured and strengthened their trade relations through various arrangements – from colonial preferences to bilateral commercial treaties to broader regional agreements. These arrangements have also overlapped and interacted, creating a global trade landscape defined by choices between regionalism and multilateralism.

## **Multilateralism perspectives**

When the Bretton Woods institutions were set up, a central policy challenge facing post-war countries was how to prevent a return to protectionism – a policy choice that had led countries into the Great Depression in the 1930s and a decade later into the Second World War. Since those dark days, world trade has increased in such a level which countries have become integrated and interdependent. This aspect, together with currently improved living standards, in many ways is a testament to the many successes achieved by the international trading system.

The foundations of the modern multilateral trading system were laid in the years immediately after the Second World War. This was a period favorable for large advances to be made in

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11 “Multilateralism Or Regionalism?: Trade Policy Options for the European Union” by Guido Glania, Jürgen Matthes, Centre for European Policy Studies, copyright 2005

international trade liberalization and cooperation. The United States had emerged from the war as the unquestioned economic superpower, and it had strong commercial and foreign policy reasons for pushing the international system in the direction of multilateralism. Moreover, the wartime victors, especially Britain and the United States, largely agreed on the root causes of the political and economic chaos of the inter-war period, and wanted to construct an international economic system that would prevent a return to the financial instability and trade bloc rivalry that had led to the outbreak of war.<sup>12</sup>

Multilateralism is represented by the efforts on worldwide liberalization of international relations, which started in the field of trade in goods when General Agreement on Tariffs and Trade (GATT) was signed. For over thirty years the GATT worked tolerably well and, through successive trade negotiations was successful in dismantling tariff and non-tariff barriers. The latest two initiatives being the Tokyo Round (1974-1979) and the subsequent Uruguay Round (1991-1994). The Uruguay Round built on the Tokyo Round achievements but radically re-structured the multilateral trading system. The Tokyo Round was a “milestone” which represented the first serious multilateral attack on non-tariff barriers, which were subjected to new rules and disciplines through a number of special agreements. These “new” special agreements were eventually subsumed into the 1994 WTO Agreement coming out of the Uruguay Round. As of 1994, the WTO had expanded to include more than 120 nations, with formerly planned economies such as China, the Russian Federation and many developing countries eagerly seeking to join. The uncertain status of the GATT was corrected and the WTO itself, as its institutional successor, merged as a true international body with a legal personality, permanent secretariat, complex committee architecture and norm-setting apparatus, and a powerful judicial arm to deal with trade disputes.

After the conclusion of the Uruguay Round in 1994 it looked like the world was embarking on a new era. The birth of the World Trade Organization (WTO), and its achievements brought about further changes. Subsequent change in multilateralism<sup>13</sup> “expanded the scope of WTO” and “deepened its governance”<sup>14</sup> by including the issues of international standards, intellectual property rights

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<sup>12</sup> Brown, 2003: A key figure behind this shift in US trade policy towards greater liberalization and cooperation in trade was Cordell Hull, the US Secretary of State for much of Roosevelt’s presidency, who tirelessly asserted his belief that “wars were often largely caused by economic rivalry conducted unfairly” and that if the world “could get a freer flowing of trade – freer in the sense of fewer discriminations and obstructions” (Irwin et al., 2008).

<sup>13</sup> These changes started in 1986 by launching the Uruguay Round of the Trade Talks.

<sup>14</sup> Mortensen, 2006, pp. 173-179

and services into the scope of WTO. The old GATT system developed into broader fields of trade in services, investment, agricultural products, public procurement, and intellectual property rights covering internal laws, measures and policies in all sorts of these areas extending far beyond simple matters of the importation or export of goods. These policy changes that took place proved to be nothing less than a revolution in trade policy reform, they led to the further integration of markets and brought forth even greater international investments, trade and application of technology. There were predictions that the World Trade Organization would be “the paramount global institution - a beacon of stability and order”. But, while the GATT system was radically restructured, the building blocks remained in place, with the principle of nondiscrimination remaining as the central pillar supporting the entire WTO edifice. The WTO General Council and its committees, that oversee trade negotiations, seem incapable of moving forward. It was unrealistic to assume that these revolutionary changes would continue to bring about enhanced cooperation among countries, greater stability and prosperity.

Additionally, more sophisticated dispute settlement mechanism increased the influence of WTO on the policy-making in its member states markedly. In opposition to hardly institutionalized GATT, WTO became a firm component of trade governance with a large impact and influence on global, regional and national transactions. Together with this process it however entered into quite a deep crisis, which is more than ever related to the complexity of global governance. Virtually global membership increased the diversity in demands and approaches of WTO members. Together with the consensus system of voting, the diversity and lack of agreement has led towards the current state of affairs in WTO: in July 2006 Pascal Lamy, WTO Director General, suspended the Doha Round, which was not able to overcome differences in approaches towards liberalization of agricultural trade (represented by principal proposals by United States, EU, and most influential developing countries). The WTO was beset with problems.

## **Regionalism perspectives**

In this “multipolar” world of multiple and complex interests, uneven development, unequal trading power and divergent views on the scope of the future negotiating agenda are realities of the multilateral trading system. Imbalances, instability and the need for protecting domestic markets increases as countries deepen their integration. Against this complicated background, regionalism has come to offer Governments, of both developed and developing countries, an attractive strategy to resolve issues that would be more difficult to resolve in the wider multilateral system. In fact, governments across the globe are as active as ever in negotiating regional trade agreements. The lack of progress in multilateral trade negotiations does not imply that global integration is stagnant.

Regionalism in the shape of formal regional trading arrangements has been present in the multilateral trading system since its early days. According to Article XXIV of GATT<sup>15</sup> the objective of promoting regional free trade arrangements (RTAs), such as Benelux and the European Economic Community, was clearly mentioned. Nevertheless, some exception to allow for such arrangements was necessary. However the stipulation in Article XXIV that members of such RTAs could not raise their tariffs above pre-RTA levels ensured that multilateralism could proceed apace.

A very well known example of regional trade agreement was the custom union of the six original EC countries that was completed in 1968 and has been extended to a further six Member States. However, successive rounds of trade negotiations in the GATT have progressively reduced the EC’s average common external tariff to a low level of under 5 per cent. Coupled with the growth of national non-tariff barriers in the turbulent years of the 1970s and early 1980s, this considerably weakened the EC’s regional trade preferences. The decline of regionalism in Western Europe has now been dramatically reversed by the launch of the Single European Market (SEM) programme which aims to eliminate internal market divisions. But European regionalism does not stop at the EC’s frontiers. Tariff-free trade in industrial goods has thereby been secured through the European Free Trade Area (EFTA).

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<sup>15</sup> [http://www.wto.org/english/tratop\\_e/region\\_e/region\\_negoti\\_e.htm](http://www.wto.org/english/tratop_e/region_e/region_negoti_e.htm) ( Original mandate: GATT Article XXIV )

After 1992, trade relations should be further strengthened in the European Economic Area (EEA) (see Lundberg). The EC, and increasingly EFTA, appears to fulfill the conditions put forward by Schott (1991) for a successful regional trade bloc: similarity in per capita incomes, geographical proximity, similar or compatible trade regimes and a commitment to regional organization. EC trade preferences, mostly one way, extend also to the countries of the Southern Mediterranean, to Sub-Saharan Africa and to Central and Eastern Europe.

What we understand is that while the number of regional trade agreements (RTAs) grew only slowly until the beginning of the 1990s, it has remarkably increased since then, especially in the latter stages of the Uruguay Round, following recurring delays in bringing the Round to a successful conclusion. The growth of regional trading blocs has been one of the major developments in international relations in recent years. Regional agreements vary widely, but all have the objective of reducing barriers to trade between member countries and hence, implicitly, of discriminating against trade with other countries. At their simplest they merely remove tariffs on intra-bloc trade in goods, but many go beyond that to cover non-tariff barriers and to extend liberalization to trade investment and other policies.

In the year October 2009, as the global financial crisis raged, 25 new RTAs were notified to the WTO. As of 15 January 2012, some 511 notifications of RTAs (counting goods and services separately) had been received by the GATT/WTO. Of these, 319 were in force.<sup>16</sup> What all RTAs in the WTO have in common is that they are reciprocal trade agreements between two or more partners. Currently, all major trading countries belong to one, or more typically, two or three, RTAs or regional integration arrangements of some kind. Therefore, it would appear that trade on a most-favoured-nation (MFN) basis is more likely to be the exception than the norm.

But not only has the geographic reach of today's RTAs expanded, but also their agenda.<sup>17</sup> Besides mere tariff regulation, many RTAs now include provisions on services, investments, competition rules, as well as a bunch of other issues. According to Bhagwati (1991) this wide proliferation of regionalism relates to

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<sup>16</sup> [http://www.wto.org/english/tratop\\_e/region\\_e/region\\_e.htm](http://www.wto.org/english/tratop_e/region_e/region_e.htm)

<sup>17</sup> Baldwin and Low, 2008

global trade liberalization (RTAs) could be either stumbling or building blocks to global trade liberalization. The questions arise are whether RTAs could contribute to further multilateral liberalization by complementing GATT/WTO or they could impede multilateral trade liberalization. Is there any possibility for Regional Trade Agreements and Multilateral trading system to develop independently from each other or there is a compatibility between regionalism and multilateralism. Let's look at this more closely.

## **Four Evaluative Factors.**

It is useful to evaluate these trade agreements, regional and multilateral trade agreements, in light of four factors: individual liberty, trade effects, the regulatory regime, and the political climate.

### **Individual Liberty:**

Trade liberalization is, first and foremost, the removal of restrictions on the freedom of a country's citizens to dispose of their property as they see fit and to engage in voluntary exchanges with others. Thus, market liberals should establish free trade whenever possible. It is important to put free trade in this context, for the very language used to discuss this issue is misleading. Some speak of countries making trade concessions in negotiations with other countries. From this perspective, a country should remove its trade barriers unilaterally, whether other countries do so or not. If one's standard for judging the merits of a trade policy is whether it increases or decreases the liberty of a country's citizens, then questions of trade creation or diversion would be secondary.

One multi discussed question is if *trade agreements increase economic freedom*? That criterion suggests that the burden of proof rests on those who would advise that an offer from another country to establish free exchange should be turned down. There is no fundamental difference in the case for free exchange between individuals who live in different houses, on different streets, in different towns, in different states of the same country, or in different countries. Market liberals assume that such freedom should be the natural condition, with no special case or justification needed. Thus, the question we must ask is whether there are compelling reasons not to liberalize trade on a regional basis if the opportunity presents itself.

### **Trade Effects:**

Even critics usually concede that, in general, free trade, including multilateral and regional liberalization, improves the welfare of all countries by promoting wealth creation. But they also maintain that under certain circumstances, opening markets with only one or several trading partners

could merely divert trade.<sup>18</sup>

But let us consider the various types of regional trade arrangements in light of the economic freedom rule. To judge the effects of trade arrangements other than the multilateral GATT/WTO approach, it is necessary then to distinguish between two types of regional arrangements: free trade areas (FTAs), such as NAFTA, and customs unions, such as the EU, which maintain common barriers to nonmember countries. The greatest danger for trade distortions and compromises of economic liberty seems to lie in the latter.

Customs Unions. Consider an example, before Czech Republic and Hungary enter the EU, so before 2004. The Czech Republic wishes to enter the EU. That might mean simply that it removes tariffs and traditional trade barriers to EU member countries while keeping intact barriers to nonmembers. In such a case there is no net loss of freedom for the Czech people. Rather, there is a gain. But such an arrangement could cause some trade distortions. For example, perhaps the Czechs maintain a 5 percent tariff on imported widgets. And under this tariff, Hungarian widgets are more competitive in the Czech Republic against rival German products. Thus, the Czechs purchase most of their widgets from Hungary. But with no tariff on German widgets, the Germans, although less competitive head-to-head with Hungarian suppliers, might dominate the Czech market. That situation is not a problem for the Czechs, nor a reason to remain outside of the EU. The situation would be a windfall for the Germans. They would have no reason to block Czech membership. The competitive status of widget-makers in other EU countries would remain unchanged. Only Hungary would be at a disadvantage. If Hungary has the option to enter the EU, it could eliminate this disadvantage. But Germany might block Hungarian membership to protect its advantage in widgets. So the Czechs, who do not sacrifice freedom with initial EU membership, might be cutting off opportunities for even freer trade in the future. And so might other EU countries that would like, in the future, to purchase less costly Hungarian widgets rather than expensive German ones. To conclude when a country enters a customs union, it does risk gaining a short-term increase in freedom while hampering opportunities for future gains. Of course, that alone, does not seem a sufficient reason for not entering a regional or bilateral trade arrangement.

### **The Regulatory Regime:**

The role of regulation is more important to judging the wisdom of a bilateral or regional trade arrangement than are strict trade effects. One of the greatest dangers to economic revitalization in the Western, industrialized countries, as well as to free trade, and certainly to economic liberty, comes

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<sup>18</sup> Weintraub poor example, that in MERCOSUR, Paraguay and Uruguay could be forced to purchase higher-priced goods from Brazil rather than from less costly suppliers.



from corporate statisticians of both the left and the right who wish to protect an increasingly untenable status quo. The regulatory baggage that a regional FTA might carry can involve a real loss of economic liberty as the price for free trade. In such a case, a potential member must make a pragmatic judgment about whether the benefits in the short and medium term outweigh the drawbacks and whether the prospects in the future are for freedom from regulations or a heavier regulatory burden.

The most blatant example of exporting bad regulations is found in the side agreements to NAFTA. With these agreements, the United States attempted to force Mexico to move closer to American environmental and labor standards. American labor unions, for example, feared that less costly Mexican labor would result in American firms moving jobs south of the border.

### **The Political Climate:**

Domestic political problems are also key factors to consider when judging the wisdom of a trade agreement. Political climate affects decisions on whether or not to join a trade arrangement? For example: How does neoprotectionism affect decisions on whether or not to join a regional trade arrangement? It suggests that if a country can quickly enter good regional trade liberalization agreement without harmful regulatory strings attached, it should do so rather than rely on the longer-term multilateral approach. That is because a Regional Free Trade agreement will give rise in one's country to businesses and other interest groups with a stake in keeping the system opened. Those interests can help counteract the political influence of neoprotectionists.

### **Multilateralism versus regionalism**

Analysis of multilateralism – regionalism relationship done so far has been predominately based upon the “Building Blocks versus Stumbling Stones Argument” introduced by Baghwatti. As a focal point of this argument, multilateralism is a first best option in trade liberalization, which can be eroded or supported by partial solutions of trade liberalization, i.e. by regionalism. Based upon Viner's theories, regionalism constitutes a change in trade flows, which can lead to the trade creation or trade diversion. The first one, trade diversion then affects nonmember countries and decreases overall wealth.<sup>19</sup> Main arguments at the Stumbling Stones side of the debate can be summarized as follows:<sup>20</sup>

- Regionalism may promote costly trade diversion rather than efficient trade creation.

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<sup>19</sup> For a more detailed analysis see Hnát (2006, pp. 89–97) or Hnát, Stuchlíková, Bič (2006, pp.4–8).

<sup>20</sup> IBRD, 2005, p. 133

- Proliferating RTAs absorb scarce negotiating resources (especially in poorer WTO countries) and crowd out policy-makers attention from multilateralism.
- Competing RTAs may lock in incompatible regulatory structures and standards, and may result in inappropriate norms for developing partners.
- By creating alternative legal frameworks and dispute settlement mechanism, RTAs may weaken the discipline and efficiency associated with broadly recognized multilateral framework rules.

Leaving the Building Blocks arguments aside, it is obvious that all arguments stated above put attention to the negative impact of regionalism on multilateralism and this negative side, consequently, makes the concept of regionalism the second best option of global liberalization, which can stumble multilateral efforts. Subsequently, conditions are being stated, which should lead to greater complementarity of regionalism. Greater complementarity means that there is a need for broader scale of RTAs, external openness of regionalism, support of internal reform process and greater geographic diversity of regionalism. Modern analysis of “New Regionalism”<sup>21</sup> generally suggests that these conditions fulfilled by most modern RTAs. Moreover, regionalism is as legitimate tool of states’ economic relations management as multilateralism, and it is used by WTO members ever more, today, leaving WTO no tools of preventing them from doing so. To understand regionalism, I could say “New Regionalism”, better we have to analyze its features in detail.

## **“New regionalism”**

According to the Vinerian paradigm of trade creation versus trade diversion, the “old regionalism” was, to a large extent, motivated by a desire to substitute for insufficient multilateral liberalization. By contrast, “new regionalism” is largely motivated by a desire to facilitate entrance into a much more developed multilateral trading system than ever before. In order one to understand the concept of “developed multilateral trading system”, the main characteristics of “new regionalism” should be mentioned.

According to the concept of “new regionalism”, when a regional trade agreement takes place, typically this arrangement involves one or more small countries linking up with a large country. Taking into account the example of NAFTA, the countries of Mexico and Canada are the small participants, economically, in comparison with the United States which is a large economic power. Similarly some members of the EU like Austria, Finland and why not Greece is tiny relative to the

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21 New Regionalism can be defined, e.g. according to Cihelková (2004, p. 808) it represents a contractual exchange of market access rights among isolated group of partners on the basis of Regional Trade Agreements (RTAs), its most important aspects are revealed from its comparison with previous waves. Most apparently, New Regionalism has an unprecedented scale and dynamics today (i.e. quantitative changes). By a more precise analysis, it can be assumed that its motives, tools and substance has changed as well (qualitative changes), which has additionally led to its new forms and types of RTAs (formal changes).

EU itself. There are many many other examples to mentioned which lead to the same conclusion.

Another characteristic of this new type of regionalism is the fact that typically, the small countries of such regional agreements are making, until today, significant unilateral reforms. The most well known example, concerning our geographically region, is the Europe Agreements, central European participants, who had abandoned communism in favor of regional agreements. Another one is Canada who had turned away from Trudeau-style economic nationalism<sup>22</sup> before negotiating a free trade agreement with the United States, and the Scandinavian applicants to the EU.

Furthermore dramatic moves to free trade between members are not featured. The degree of liberalization is typically modest. Thus the Vinerian paradigm is not a natural starting point. For example, NAFTA actually provides only modest liberalization. Canada and Mexico have done somewhat more, but the most significant measures were unilateral and not part of NAFTA. Also the liberalization achieved is primarily by the small countries, not by the large one. The agreements are one-sided. The liberalization in NAFTA is due to much more “concessions” by Mexico and Canada rather than by the United States. In many past negotiations over EU enlargement, the EU has been flexible on financial responsibilities and periods of adjustments, but has always maintained a “take-it-or-leave-it” attitude regarding the nature and the structure of the EU itself. The Europe Agreements involve no “concessions” by the EU. Indeed the EU instituted antidumping measures against some of its new participants even as the initial agreements were coming into effect. This asymmetry reflects on the changes that the “old regionalism” has brought. Generally, small countries get only small tariff advantages and large countries have small tariffs to begin with. Of course there are exceptions like the case of Mercusor. In this exceptional case Brazil has made concessions at least as large as those of the smaller members.

Very important and understandable characteristic is that regional agreements are regional geographically. That means that the participants of the agreement are neighbors. This is the only characteristics which remains the same taking into account the concept of “old regionalism”.

Last but not least to our list is the fact that “deep integration” is often present to regional arrangements. The participants of such agreements seldom confine themselves to reducing or eliminating trade barriers, and also to adjust diverse assortments of other economic policies. The EU again is a clear example of this characteristic. The three latest GATT rounds of multilateral negotiations tried to broaden the scope of multilateralism, with significant success. But a major attraction of the “new regionalism” is that negotiations with a small number of partners broaden the range of instruments over which negotiation is feasible.

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22 Pierre Elliott Trudeau was a different kind of politician. A figure who swept into power in 1968 on a massive wave of public support (dubbed Trudeaumania), he provided a glittering contrast to the older generation that had ruled Canada for so long. Trudeau believed that Canada's own economic, political and social interests had to come first in relations with the rest of the world: foremost was national unity

## **The debate: regionalism versus multilateralism.**

The architects of the GATT intended to create a world trade system based on non-discrimination in the belief that this gave the best prospects for an equitable and expanding world economy. Regional trade preferences contradict to this philosophy and can be seen as undermining the GATT. Strictly speaking, this is not so since in Article XXIV, the GATT makes explicit provision for the creation of customs unions and free trade areas. In practice, however, the conditions set out are frequently not met either because significant trade flows are excluded from preferential treatment and/or because the length of the transitional period is excessive. Thus supporters of the GATT system have tended to have a negative attitude towards regionalism. But do the supporters of GATT and WTO nowadays still defend their opinion against regionalism or the things due to the concept of “new regionalism” have changed the situation. So as to reach a conclusion, let's examine both the negative and the positive side of regionalism and multilateralism.

## **Advantages of multilateralism.**

Multilateral negotiations are the most effective way of liberalizing trade in an interdependent global economy, because concessions in regional deal may undermine concessions made to another trading partner in an earlier deal. It is also important to mention that under multilateral trade agreements, regional trade arrangements take place and examples of this are the North American Free trade Agreement (NAFTA) and the European Union (EU). The most important organization concerning multilateral negotiations, agreements and contracts is the WTO (mentioned earlier in details). This organization owns a unified package of agreements to which all members are committed and enforces global rules for international trade. The most important requirements are to reduce barriers to trade between nations and to secure that member nations are acting within the predetermined rules. While a system of regional trade agreements creates an extraordinary number of rules, a regimented system of MLTs generates more uniform and more easily identifiable rules.<sup>23</sup>

The General Agreement on Tariffs and Trade (GATT) is the basic multilateral contract between WTO members.<sup>24</sup> A multilateral contract indicates guidelines from which the minimum and maximum purchase price is set, so that importers have an indication of guaranteed purchase quantities and for producing nations to know what guaranteed amounts they will sell to importers. Such contracts deliver advantages through a price-stabilization device, which causes less distortion to

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<sup>23</sup> JOS' E. ALVAREZ, INTERNATIONAL ORGANIZATIONS AS LAW-MAKERS 382 (2005) [hereinafter ALVAREZ, IOS AS LAW-MAKERS].

<sup>24</sup> Farm Foundation, 2002, ITC online 2004, Carbaugh, 2004

the market mechanism and the allocation of resources. This kind of contract does not contain restrictions and includes or improvement of the development of more efficient low-cost producers. A support of limited market stability also leads to the advantage that nations can enter or withdraw relatively easy without various problems.<sup>25</sup>

One of the main advantages of multilateral action is *cost and efficiency*. That has to deal with that different countries have different resources and areas of expertise. Nations working together can pool these resources and achieve more successful outcomes as well as cost savings. Additionally, in a multilateral operation, no one country will have to use all of its available resources on a single operation. In economic and environmental areas, a number of countries acting in concert can achieve greater results than otherwise. One example of this is the Kyoto Protocol,<sup>26</sup> in which a number of countries agreed to simultaneously reduce their greenhouse gas emissions. The effectiveness of the multilateral response is complemented by the efficiency of the process through which equilibrium for cooperation is reached: efficient bargaining is achieved through one multilateral negotiation process.

*Increasing Credibility:* Another reason for countries to join a multilateral trade agreement is to solve time-inconsistency problems. In this case, the source of the problem is a domestic inefficiency, resulting from the interaction between a government and its own private sector. These kinds of problems arise because the decision of the government to implement a certain policy in future may not turn out to be optimal when the time arrives. Therefore, the announcement that a certain policy will be implemented at a later stage is not credible. When a country is a partner of an international trade agreement may help the government to make credible policy commitments that affect the private sector. The commitment to an international agreement will signal to domestic actors that the government will face additional external costs, such as retaliation from a trading partner, if it reneges on its commitment. This external threat makes the policy announcement credible and solves the time-inconsistency problem, thus making trade liberalization viable.

*Diplomatic Respect:* Another advantage of multilateralism, and perhaps the most important one, is that it engenders goodwill and respect from other nations. When a country acts on its own, without regard to the impact on trade, investment and the economy of other nations, it can cause a

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25 Multilateral and bilateral trade negotiations ,Author: Susann Engelmann

26 The Kyoto Protocol is an example of a multilateral agreement designed to promote the environmental interests of the parties in agreement. The basis for the Kyoto Protocol is the attempt to mitigate the effects of climate change by regulating such aspects as carbon dioxide emissions levels. One of the major challenges of a multilateral agreement is ensuring that its terms are followed and/or enforced. In the case of the Kyoto Protocol, most of the world's industrialized nations have signed and ratified the agreement. However, despite having signed the agreement in 1998, the United States had not ratified it as of June 2009, with former President George W. Bush citing adverse effects to the American economy and criticizing that controls would not be equally strict for developing nations like China

chill in diplomatic relations and generally damage a nation's international reputation. This can make it more difficult for that nation to work with other countries in the future on other matters.

## **Disadvantages of multilateralism.**

*Different Priorities:* One disadvantage of multilateral actions is that it can make taking any action more difficult or at least slow things down. It may also mean that a government does not get everything that it wants or does not get what it wants in a timely manner. Different countries and governments will have different priorities and different ideas what actions should be taken, in what order and with what goals. Acting multilaterally can mean compromising on both the timeline and goals of a proposed action.

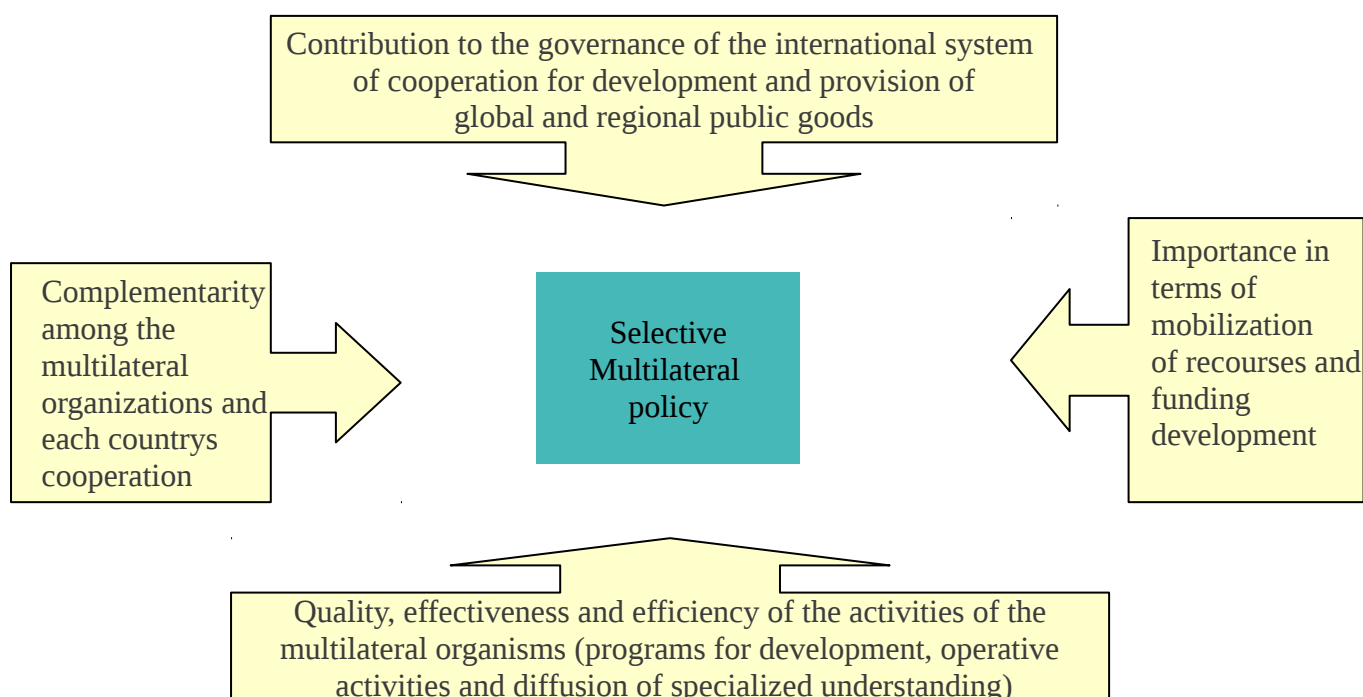
*Organizational Issues:* Another disadvantage of multilateralism is in conducting operations with other countries. While sharing resources can be beneficial to countries, it can also complicate matters. Many countries have strict rules in place for their armed forces, relief agencies and other workers. Different nations have differing ways of doing things and varying chains of command, and some countries do not like their personnel to be under the command of another nation. This can lead to confusion, miscommunication and difficulty in making decisions and getting things done. In order to function in a peacekeeping or military matter, chains of command must be discussed, negotiated and settled between countries. In some cases, one country may have to make a request of another country's forces rather than ordering them. In some situations, such as in the joint occupation of Afghanistan, this situation has been largely resolved by dividing up responsibility geographically, with different countries in charge of different regions.

Moreover, in negotiating a given agreement, the chance of a Pareto optimal outcome would seem higher when there are fewer bargaining parties, provided other parties are not directly affected by the agreement. The introduction of additional parties to treaty negotiations is hardly ever cost free. It potentially increases barriers to efficient agreements and exacerbates problems of information asymmetry, strategic barriers, psychological barriers, and institutional constraints.<sup>27</sup> The multilateral negotiation process is therefore more efficient than a limited process only if all negotiating participants are indeed relevant and necessary to the regime. If they are not, bargains struck might be shallow—the result of having to disperse benefits across the board—or excessive—due to the participation of parties who would not ultimately share the burden of the costs of compliance.

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<sup>27</sup> On the organizational, psychological, and strategic barriers to favorable negotiated outcomes, see “Barriers to conflict resolution.” (Robert H. Mnookin, Lee Ross & Kenneth J. Arrow eds., 1995).

### Criteria for the selection of multilateral partners.<sup>28</sup>



### **Regionalism: what to expect.**

The rise of the Regional Trade Agreement is an important development in the global economy that has significant implications between and within countries. RTAs are increasing both in number and in scope. A complex, overlapping web of trade agreements stretches around the world. There are now few countries that are not members of at least one RTA.<sup>29</sup> The expansion of these trade arrangements has led many economists to worry that regionalism could be undermining the multilateral trading system. But should we concern about this spread of regionalism or should we move forward to deeper regional integration? In order to reach a conclusion, the reasons that led to the expansion of regionalism should be examined and also the benefits and costs of being part of RTA should be also mentioned.

### **Explaining the expansion of RTAs.**

The socio-economic and political factors that led to the growth of regional trade integration can be divided into “internal factors” (drivers that originate from within a particular region) and

<sup>28</sup> A diagram with a selection of the main criteria which leads to multilateralism.

<sup>29</sup> Only one member of the WTO, Mongolia, is not a member of an RTA

“external factors” (drivers that come from outside a region or nation).

## **Internal factors**

*New markets and trade opportunities:* Regional Trade Agreements promise cheaper imports and more valuable exports by expanding access to foreign markets. RTAs can also help promote foreign direct investment, improve economic growth and open access to new skills and technology and also to other issues that were unknown until then. Taking into account the following example: MERCOSUR<sup>30</sup> is credited with significantly increasing regional trade flows in the decade between 1990 and 2000. Exports between MERCOSUR members rose from US \$4.1 billion to \$17.6 billion while imports grew from \$4.2 billion to \$17.9 billion. Between 1995 and 2000, exports of every MERCOSUR state to other members showed an upward trend.

*Political interests:* While economic self-interest is generally the principal engine of RTA growth, such agreements are also increasingly being guided by political, strategic and security concerns. The fact that the negotiation and commitments of RTAs tends to be less transparent than multilateral trade negotiations makes such an approach easier. There are several examples of South-South RTAs that reflect a combination of economic and security goals that have very little to do with trade. For example: The Association of Southeast Asian Nations (ASEAN) was initially created as response to the perceived spread of communism in the region in the 1960s.

*The growing disappointment of multilateral trade negotiations:* The perception is that negotiating trade agreements within smaller blocs is more flexible and rapid than attempting to bring all the members of the WTO to consensus. In addition, regional trade agreements can be more specific to the needs of a particular region than the “lowest common denominator” solution often offered at WTO negotiations. Especially for smaller countries to be part of a regional trade agreement is for sure much more prominent than being one of the many WTO members.

*Socio-cultural similarities:* Sharing a common language and culture can encourage closer integration. Most of regional trade agreements are among participants/countries which share common culture and social elements which lead to better and deeper regional integration. The most appropriate example in this case is the collapse of the Soviet Union. While the Commonwealth of Independent States (CIS) differing in terms of development and are prone to intra-regional conflicts, was brought together, at least in part, because of socio-cultural similarities.<sup>31</sup>

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30 RTA concluded between the countries of southern Latin America (Members are Argentina, Brazil, Paraguay and Uruguay. Bolivia, Chile and Peru are associate members.)

31 The CIS was created in 1991 and closer economic union was signed in 1993. At present the CIS consists of Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, Uzbekistan and the Ukraine. See <http://www.cisstat.com/eng/cis.htm> (accessed 21st September 2005).



*Counterbalancing the negotiating power of other blocs:* Regional blocs are a powerful tool to negotiate common interests both within and outside the WTO. Increasingly, many developing countries are realizing that their interests may be best served by integration with countries that have similar economies. For many countries to fulfill a goal can be more easily achieved through regional integration. An example, for this case, is the Latin American economies, regional integration has been used to counter the negotiating power of the US while it sought to expand the North American Free Trade Agreement (NAFTA) to the Free Trade Area for the Americas (FTAA). The formation of blocs such as ASEAN, MERCOSUR and the Andean Community of Nations are examples of such bloc building efforts to insulate both against regional and global trading blocs.

*Reducing illegal trade and smuggling:* Regional Trade Agreements can establish the institutions for shared information and action to reduce illegal trade. Furthermore, the setting of common tariffs for trade between members helps to undermine the economic incentive for smuggling. For example the MERCOSUR trade agreement<sup>32</sup> was created with the intention of creating a common market and a common external tariff, but also it is a provider off common security issues such as illegal trade of drugs.

## **External Factors**

*Expanding the concept of regional integration:* EU delegations are encouraged to expand the EU's model of regional integration. This is backed by EU funds that bankroll regional organizations like the African Union and the Pacific Forum. Often this has the explicit rationale of contributing to the prevention, management and resolution of violent conflicts.<sup>33</sup> The same is true of the US. According to Edward Mansfield of the University of Pennsylvania, both the Clinton and Bush Administrations have made spreading regional economic agreements a foreign policy priority.<sup>34</sup> In July 2005 for example, Louis Michel, the EU Commissioner for Development and Humanitarian Aid signed an agreement to provide €30 million to COMESA as part of the EU's five year €223 million Regional Integration Support Programme.<sup>35</sup> This follows a similar payment, of €45 million, to SADC in November 2002.<sup>36</sup>

32 MERCOSUR trade agreement, made up of Argentina, Brazil, Paraguay and Uruguay.

33 Council of the European Union, "Council Common Position concerning conflict prevention, management and resolution in Africa", SN 1010/04, January 2004, p. 3.

34 Edward Mansfield, "Preferential Peace: Why Preferential Trading Arrangements inhibit interstate conflict" University of Pennsylvania, 1999, p.14

35 Europa Press Release, 20 July 2005, (accessed 19th September 2005) The RISP runs between 2002 and 2007  
<http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/05/991&format=HTML&aged=0&language=EN&guiLanguage=en>  
[http://europa-eu-un.org/articles/sk/article\\_4943\\_sk.htm](http://europa-eu-un.org/articles/sk/article_4943_sk.htm).

36 Europa "EU Humanitarian Aid Package to SADC", November 2002 (accessed 19 September 2005)

*Reducing tensions between countries with conflicts:* Such are the perceived benefits of trade to peace-building that external powers have tried to promote trade links between countries with the specific goal of reducing tensions between previous enemies. Regional trading initiatives can help to reintegrate countries into their regions, especially if they have been isolated as a result of conflict.

## **Benefits and costs of regionalism.**

Despite the presence of multilateral rules and disciplines in the system, it is still the case that most GATT/WTO contracting parties are now parties to at least one regional trade arrangement (as mentioned above). These trade agreements are not only numerous but also vary substantially one from another. The differences between regional trade agreements rely on the fact that different countries have different objectives when they negotiate them. These kinds of differences include the coverage of the agreements, the balance of concessions between the parties to the agreement, and whether the agreement forms part of an ongoing process of wider economic integration.

As a result, the wide range of differences has to be taken into account in analyzing the costs and benefits of such arrangements. On the other hand much of the literature on regionalism implicitly assumes that regional trade agreements are similar. This is partly because in analytical discussion it is common to analyze the symmetric case in which countries are of equal size.<sup>37</sup> If any differentiation is noted, it is usually that some agreements (such as the European Union) are customs unions, while others (such as NAFTA) are free trade areas. Yet some are part of a process headed toward eventual deeper integration (European Community in the 1960s), some are consciously stand alone, more shallow agreements (NAFTA), some are simple in structure while others are more complex. In the following analysis of the pros and cons of regionalism I will try to pay attention to the most important elements and factors that make us to decide whether regionalism help or hinder the multilateral trading system.

When a country decides to become partner of a regional trade agreement, have to think of the cost of its resources. The opportunity cost of negotiating and administering regional trade agreements need to be questioned. Vast amounts of human, financial and political resources have spent on RTAs. Couldn't these resources be put to better use on other issues? Moreover, sometimes countries sign multiple agreements that create obligations that contradict each other, creating uncertainty and confusion among investors, traders and customs officials. The issues, then, that these countries have to deal with are many and very confused. For example, which tariff level applies? Which rules of

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[http://europa-eu-un.org/articles/en/article\\_1759\\_en.htm](http://europa-eu-un.org/articles/en/article_1759_en.htm).

37 Krugman 1991-Haveman 1992- Krugman 1993

origin apply? If special conditions and exclusions are formulated, which RTA's conditions take precedence, and when do these conditions apply? These complexities not only delay private sector decision-making, but they also increase the opaqueness of policies and thereby increase the cost of doing business. Resources are scarce and valuable the more of them are devoted to the negotiation of multiple RTAs, the less they are available for the multilateral trade process. Herein, perhaps, lies one of the most insidious dangers of having a proliferation of RTAs. The spread of these kinds of agreements could slowly but surely undermine the political willingness and administrative capital that developing countries and the developed countries, erstwhile GATT leaders, would be willing to dedicate to the WTO processes, thereby reducing the overall effectiveness and primacy of the multilateral trade process.

Despite the difficulties, countries, especially developing countries, have much to gain from the multilateral process, as embodied in the MFN principle. The MFN principle strengthens the weaker countries by limiting the ability of stronger countries to make deals with each other that exclude the weaker ones. Perhaps more than any force, non-discrimination, as embodied in the rules-based multilateral trading system, has reduced power politics and guaranteed all countries equal rights, irrespective of their size and power.<sup>38</sup> Furthermore, because membership in multiple RTAs requires considerable resources, in the same way that it can distract from the multilateral process, it can also distract from and slow the regional process itself.

One danger of the regional approach, also, is that the major powers seek to use regionalism so as to reinforce their initial positions in future multilateral negotiations. If major players have greater politicoeconomic power within their own regions than in the world in general, it is easy to imagine their building up coalitions for their own policies before taking issues into a multilateral round. Arguably, the United States used approaches by potential partners in the Americas and Asia to broaden the negotiating agenda for its relations with Europe<sup>39</sup> while Europe did the same with the EEA and its Europe Agreements. The time it takes to build regional coalitions can delay multilateral talks.

An argument in favor of regionalism is that the negotiations among a small group of neighboring countries closely associated with each other can make it easier to reach the necessary understanding and compromise. The example of AFTA is often cited as one of the relatively advanced RTAs in the region. AFTA has included, with minimal exceptions, unprocessed agricultural

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<sup>38</sup> Renato Ruggiero, "Regional initiatives, global impact: cooperation and the multilateral system", speech delivered by the former Director-General of the World Trade Organization on 7 November 1997 in Rome at the Third Conference of the Transatlantic Business Dialogue.

<sup>39</sup> Ostry, 1998

products under its liberalization programmes. This arrangement is significant because similar issues that historically have made agriculture the subject of difficult multilateral negotiating positions are being discussed in RTAs as well, and could therefore provide building blocks for multilateral negotiations. Furthermore, ASEAN has included seven priority sectors in its future trade in services liberalization programme. Considerable efforts will need to be exerted to make progress beyond the General Agreement on Trade in Services (GATS).

In some cases, there are multiple country negotiating objectives that lead countries to become partners of Regional Trade Agreements: in other cases, one or two objectives tend to be dominant. It is also the case that objectives frequently reflect only the interests of narrower subgroups within countries, rather than a wider country interest, as with sectoral arrangements in textiles, agriculture, autos, or other areas perceived to be politically sensitive. Nonetheless, once the reasons that countries seek these arrangements are understood, the form that the eventual agreement takes becomes more explicable.

However, some would argue that the cultural and socio-political similarities of a regional trade agreement can provide a more effective route to liberalization in several sensitive service sectors. It should be noted that there is no agreement on what has been the contribution of regional integration arrangements to the multilateral process. Some contend that their role has been less than is sometimes supposed,<sup>40</sup> and that it is by no means obvious that disputes are any easier to resolve in regional forums than in WTO. For example, resolving problems related to implementation of AFTA commitments is not easier than under the WTO framework, in APEC, difficult negotiations on sensitive sectors have been sent for further negotiation under the WTO framework.

Because trade is one of the manifestations of globalization with highly political consequences, some argue that a real benefit of RTAs is that they could serve as a link to band countries together so that they would be able to increase their bargaining power in WTO negotiations. While it is true that RTAs have become more and more important in terms of the political weight they represent in WTO negotiations, as far as developing countries are concerned, there is not much evidence that they have succeeded in negotiating as regional groupings with a common identity.<sup>41</sup> This does not imply that there is no scope for regional action it merely implies that this may be a role that has been underutilized. One of the problems facing neighboring countries is that shared geographical location does not necessarily imply common economic interests. Experience from the Uruguay Round suggests that the most successful negotiating blocs have comprised those countries with a common export (or common interest), whether or not they formed part of a regional grouping. During the

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40 An example of one such argument may be found in *Regional Integration Arrangements* (Washington, DC, World Bank, 2000).

41 The exceptions are customs unions which, by virtue of having a common external tariff, are required to have a single negotiating position.

Uruguay Round (and the Tokyo Round), perhaps the best example of such an influential product-based alliance was the Cairns Group of agricultural exporting countries.<sup>42</sup>

However, for small countries there may be a distinct advantage in combining with other countries. Acting individually, their limited market access invariably places them in a weak position for gaining significant concessions from other more powerful countries. However, by combining with other countries, they are in a position to get noticed, and extract more useful concessions from more powerful players. In this regard, ASEAN, among other RTAs, could play a useful role.

A very noticeable argument in favor of RTAs is that the proliferation of such agreements can create a competition toward trade liberalization that extends far beyond the individual agreements themselves. Many developing nations which are not quite ready to become members of a multilateral agreement, be participants of RTAs make themselves confident for deeper integration in global system. As nations open to the idea of freer trade, regionally at first, they become more amenable to the global approach as well. They warm to the idea of freer trade as they see the benefits from more limited arrangements.

Regional agreements induce growth stimulating changes in developing economies that may in themselves outweigh the costs of trade diversion, or even the benefits of trade creation. In particular, regional agreements encourage private investment into economies that are a party to the agreement. These arrangements are the reason of the macroeconomic policies improvements and also the increased trade that takes place has its positive implications to the investors. The Mexican economy since NAFTA is the perfect example for this case. Mexico is now an investment-grade country, with the growing employment and incomes that entails. NAFTA helped to make Mexico a capital-friendly place, and capital responded. Mexico also demonstrates that global and regional trade agreements often build on each other, rather than excluding each other as some fear. Mexico did not even join GATT until 1986. It joined NAFTA and the OECD in 1994, and is now party to about ten preferential agreements. There is every reason to believe that Mexico will be friendlier toward the Doha round than it would have been if there had never been a NAFTA. Another objective is to use a regional trade agreement to make access to the larger country market in the region more secure for the smaller country.

Moreover regional trade agreements include processes to settle trade disputes. Countries come into conflict with one another over agricultural subsidies, dumping products at low prices, and currency manipulation. These

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<sup>42</sup> The Cairns Group is a coalition of 19 agricultural exporting countries, which account for over 25 percent of the world's agricultural exports. The group consists of Argentina, Australia, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Guatemala, Indonesia, Malaysia, New Zealand, Pakistan, Paraguay, Peru, the Philippines, South Africa, Thailand, and Uruguay. It aims to push for the liberalization of trade in agricultural exports during the current WTO Doha Round of negotiations.

kinds of trade agreements include standardized arbitration rules and ensure that trade disputes are resolved according to consistent rules. Regional trade agreements often specify the forum in which trade disputes are resolved, reducing disputes about which organization has jurisdiction over the trade dispute.

It should also be mentioned that regional trade agreements provide “dispute remedies”. That means with simple words that a country which uses trade practices that harm a trading partner can be legally punished according to the rules of a trade agreement. For example Brazil received authorization from the World Trade Organization to increase tariffs on U.S. cars and drugs, as well as reducing intellectual property protection for works created in the United States, because the United States provided subsidies, or export credits, to cotton producers, according to the U.S. Treasury. When the United States provides a subsidy to its cotton producers, this harms Brazilian cotton producers since the American cotton producers can charge lower prices on the cotton they sell in Brazil and still receive a profit. The WTO ruled that the export credit guarantees and payments to cotton producers which the United States government provided violate the terms of the trade agreement between the United States and Brazil.

The view that trade creation dominates trade diversion does not imply that regional trade agreements are necessarily welcome. Some commentators argue that the reason multilateral negotiations at the WTO are stuck is because RTAs are spreading. One concern is that RTAs may create interest groups that block further liberalization initiatives. There are also arguments indicating that the opposite may be true ( as mentioned above). A simple argument is that negotiating RTAs helps officials develop the expertise to implement international trade agreements, which could be useful at subsequent WTO negotiations. Moreover, RTAs also destroy rents in parts of the economy.

If the rent-holders who lose with RTAs were the ones slowing down multilateral talks, then RTAs can actually provide a boost to multilateral negotiations. As Baldwin (1994) puts it, liberalization (regional or multilateral) begets more liberalization.

The logic of Article XXIV must lie in the international political economy of trade liberalization. As the theory tells us<sup>43</sup> it is not possible to argue that limited free trade is better than no trade though both are inferior to multilateral free

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43 See, for example, Lipsey and Lancaster (1956-57), Lipsey (1957), Meade (1955)

trade. In other words, the case for Article XXIV must rest on the ground that a series of regional movements may pave the way for multilateral free trade. More importantly, for many countries regional trade arrangements are a method of locking in free trade policy reforms which are difficult to sell politically at the multilateral level. To that extent, it can be argued that regionalism helps multilateralism rather than act as a stumbling block. But how the current situation formulates the debate “regionalism versus multilateralism?”

**Table 1: Sample of prominent RTAs<sup>44</sup>**

<b>ASEAN</b>	Association of Southeast Asian Nations
<b>CAN</b>	Andean Community
<b>CEFTA</b>	Central European Free Trade Agreement
<b>EFTA</b>	European Free Trade Association
<b>GCC</b>	Gulf Cooperation Council
<b>LAIA</b>	Latin American Integration Association
<b>MERCOSUR</b>	Southern Common Market
<b>MSG</b>	Melanesian Spearhead Group
<b>NAFTA</b>	North American Free Trade Agreement
<b>OCT</b>	Overseas Countries and Territories
<b>PTN</b>	Protocol relating to Trade Negotiations among Developing Countries
<b>SADC</b>	Southern African Development Community
<b>SAPTA</b>	South Asian Preferential Trading Arrangement
<b>SPARTECA</b>	South Pacific Regional Trade and Economic Co-operation Agreement
<b>UEMOA-WAEMU</b>	West African Economic and Monetary Union
<b>ECO</b>	Economic Cooperation Organization
<b>EAEC</b>	Eurasian Economic Community
<b>EAC</b>	East African Community
<b>COMESA</b>	Common Market for Eastern and Southern Africa
<b>CIS</b>	Commonwealth of Independent States
<b>CEMAC</b>	Economic and Monetary Community of Central Africa
<b>CACM</b>	Central American Common Market
<b>CARICOM</b>	Caribbean Community and Common Market

<sup>44</sup> This table shows the most prominent regional trade agreements all over the world.

## **The impact of current crisis.**

The challenges facing the WTO today are numerous, this crisis poses a particular challenge to the WTO because it reveals that its rules are not equipped to contain the current meltdown. Director-General Pascal Lamy, in a speech at the Humboldt-Viadrina School of Governance in Berlin on 26 June 2012, said that “multilateralism is at a crossroads. Either it advances in the spirit of shared values and enhanced co-operation, or we will face a retreat from multilateralism, at our own peril. Without global cooperation on finance, security, trade, the environment and poverty reduction, the risks of division, strife and war will remain dangerously real.”<sup>45</sup>

The impact of the current crisis, which started in 2008-2009, still remains very fragile. So as to understand the ongoing challenges of the crisis, we have to look more carefully the EU and its troubles of the multilateral system, since Europe remains a microcosm of the cosmos. Within the eurozone, countries have to face a huge recession and the same can be also said for the World growth which remains below its potential. “WTO projections indicate that trade growth will further decelerate this year to 3.7 per cent, down from 5 per cent in 2011. Moreover, WTO economists believe that downside risks to an even sharper slowdown in trade growth remain high. Unemployment remains unacceptably high in many of our societies. Many of the achievements in poverty reduction over the past decade run the risk of unraveling.”<sup>46</sup>

The former president of the Swiss Confederation, Ms Micheline Calmy-Rey said that “multilateralism is failing on many fronts and is clearly unable to deliver in these very difficult times we are witnessing across the globe.” As an example she said “the excellent work done by WTO to monitor protectionist pressures”, adding that the multilateral trading system “can help (WTO members) contain extreme protectionist measures.” In the same discussion, according to Mrs Lamy words multilateralism is not in good shape because of its 20 years outdated. With all the challenges in the world and the globalization, the current system shows it cannot adjust to it and the present economic crisis does not help, he said.

## **Concluding remarks.**

Basically, the WTO is no longer “the boss”, I could say, of the world, if it ever was. There is a marked drift towards regional trade agreements (RTAs) as countries grow cynical of the capacity of the multilateral system to deliver progress on trade liberalization. RTAs are becoming more complex,

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<sup>45</sup> WTO NEWS: SPEECHES — DG PASCAL LAMY, 26 June 2012, Lamy: “Multilateralism is at a crossroads”

<sup>46</sup> WTO NEWS: SPEECHES — DG PASCAL LAMY, 26 June 2012, Lamy: “Multilateralism is at a crossroads”



in many cases establishing “WTO-plus” regulatory regimes that go beyond those of the multilateral agreements. In sum, RTAs have become defining features of the modern economy and a powerful force for globalization. “Unlike multilateral negotiations—which often fall under the uncomfortable scrutiny of the world’s press and within earshot of anti-globalization protestors, regional trade negotiations are typically held behind closed doors and tend to slip unnoticed beneath the radar of international attention.”

Since regionalism has become, and will probably remain, the preferred form of reciprocal liberalization for most countries – no matter what we economists say – we should therefore focus on ways to integrate regionalism with multilateralism more effectively. The real-world issue facing policy makers is how to increase the likelihood that these RTAs help the world trade system and reduce the likelihood that they hurt it. Thinking up ways of making regionalism fit in better with multilateralism will require highly detailed knowledge of matters such as rules of origin, and RTAs’ treatment of non-tariff barriers. The fact that that most GATT-WTO members are now members of at least one regional arrangement also suggests that governments clearly regard regional and multilateral approaches as complementary. So we should stop thinking of these as mutually exclusive choices.

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**Video:** “Is multilateralism in crisis?” (2012) Anabel González (Costa Rica's Minister of Foreign Trade), and Eduardo Pérez Motta (Chairman of Mexico's Federal Commission on Competition), discuss this topic with Keith Rockwell, WTO Spokesperson.

(Available at: [http://www.wto.org/english/forums\\_e/debates\\_e/debate45\\_e.htm](http://www.wto.org/english/forums_e/debates_e/debate45_e.htm))

<http://www.voxeu.org>

<http://www.wto.org>

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