Preferential Trade Agreements with Special Reference to Asia

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1. Introduction

Preferential Trade Agreements (PTAs) are agreements among a set of countries involving preferential treatment of bilateral trade between any two parties to the agreement relative to their trade with the rest of the world. Preferences, however, need not extend to all trade between the two, and the coverage could depend on the type of PTAs. Customs unions and the so-called free trade areas are common forms of PTAs. Members of most PTAs belong to a well-defined geographical area, such as for example, the European Union (EU), North American Free Trade Area (NAFTA) and Association of Southeast Asian Nations (ASEAN). For this reason regional PTAs are called Regional Trade Agreements (RTAs). The most common form of RTAs are the euphemistically named Free Trade Areas (FTAs), with few Customs Unions (CU) which require the partners to maintain a common external trade policy, in addition to free trade with each other (WTO, 2001a, p.37).

Historically, barriers to internal trade existed in many countries (and still do in some developing countries such as India) and their abolition is the equivalent of creating a customs union among the constituent units of the country. For example, barriers to internal trade were abolished in France after the revolution; the colonies which became the United States of America did so after they adopted the constitution in 1787 which, through its interstate commerce clause, prohibited such barriers; in the 19th century Russia led the creation of the German Zollverein.

A customs union among Belgium, Netherlands, and Luxemburg (Benelux) was established in 1944. The European Union began as the European Coal and Steel Community in

1952. European Free Trade Association entered into force in May 1960. Latin American Free Trade Area (LAFTA) did so in June 1961. East African Economic Community was established in 1967. WTO (1995) lists 109 regional trade agreements which were notified to the General Agreement on Tariffs and Trade (GATT) since its inception in 1947 and its being subsumed by the World Trade Organization on January 1, 1995. However, as many as 34 of the 109 were notified during 1990-94. Between 1995 and 2000, a further 111 agreements have been notified to the WTO. It is true that not all notified agreements are still in force. Yet the facts that" the trend to the conclusion of RTAs which took off in the 1990s continued to be very strong in 2000" (WTO, 2001a, p.39), and that virtually all members of the WTO are members of at least one RTAs call for an analysis of their costs and benefits and whether the fascination with RTAs is warranted.

2.0 GATT/WTO Provisions and PTAs

Nondiscrimination among trading partners who are contracting parties/members of GATT/WTO is the foundation of GATT/WTO. Article I, on most favoured Nation (MFN) Treatment, requires that members of WTO (Contracting Parties in GATT terminology) shall extend unconditionally to all other members any advantage, favour, privilege or community affecting customs duties, charges, rules and procedures that they give to members. Yet GATT articles permitted exceptions to the MFN treatment for CUs and FTAs. A natural question to ask is why did the founding Contracting Parties (twenty-three in all) include the exceptions? One reason was accommodation to the political reality that CUs predated GATT and had a long history and prohibiting countries from entering into such agreements in the future would have meant that they would not have signed GATT. Another reason was that by permitting

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exceptions to MFN for CUs and FTAs under specific conditions set forth in Article XXIV, the founders sought to avoid ad hoc and partial discrimination practical during the interwar period (WTO, 1995, p.6).

There are basically two routes by which GATT contracting parties could form PTAs.[1] One was by conforming to provisions of Article XXIV, which remained essentially unchanged between the inception of GATT in 1947 and 1994, when The Uruguay Round Agreement (URA) was signed. The URA merely clarified, but did not change, the provisions of Article XXIV. The other route open to PTAs among developing countries is to invoke the authority of The Enabling Clause of the Tokyo Round Agreement. This clause does not refer to Article XXIV, "an omission which has left unclear whether [it] applies in situations where the Article does not, or affects the terms of the Article, or represents, for developing countries, a complete alterative to that Article" (WTO, 1995, p.18). The URA did not address this issue. Be that as it may, out of the 109 RTAs notified to GATT only 11 were under the Enabling Clause.

Article XXIV reflects the positive view of CU's that prevailed in 1947 when the GATT was reached and the charter for the International Trade Organization (ITO) was adopted by the International Conference on Trade and Employment in Havana in 1948. As is well known, the ITO did not come into being, and the GATT, which was to be subsumed under ITO, governed world trade from 1947 until WTO came into existence on January 1, 1995. Basically, two criteria were laid down in Article XXIV for a CU or FTA to be granted waiver from MFN obligations: first, "substantially all trade" among members of a CU or FTA must be free, and second, post-union (or post-FTA) barriers on trade with non-members are not on the whole more restrictive than those that members had prior to their forming a CU or PTA. In his classic

[1] I am ignoring the relatively rarely used route of seeking exemptions from MFN under GATT Article XXV-

work on the charter of the ITO, Wilcox (1949, 70) noted the logical inconsistency between being against any discriminating preferential trading arrangements, even if only partial in coverage of trade, and being in favour of a CU, which is not only such an arrangement, but also one in which the discrimination against non-members is total.

The thrust of Wilcox's argument in favour of a CU is the belief that any expansion of area within which all trade is free of barriers is desirable in the sense of improving welfare of one or more of its members while hurting no other country, as long as barriers to trade in the countries outside of the area are not raised. Indeed, this is the rationale for the two criteria laid down in Article XXIV for a proposed CU or FTA to be consistent with GATT. Recognizing, on the one hand, that the internal trade barriers will be gradually reduced so as to minimize adjustment costs and, on the other hand, the possibility such gradualism may stop well short of their complete elimination of barriers, Article XXIV also insisted on a plan and schedule for their complete elimination within a reasonable time. Although barriers (tariff and other measures) against non-members after the formation of a CU or FTA in fact meet the requirement that they are "on the whole" no higher or more restrictive than they were in the constituent territories of the CU (or FTA) prior to its formation, it is possible that the common external tariff of a CU could exceed some individual member's previously bound tariffs. For raising its previously bound tariff, such a member was to follow the procedures for withdrawal of any previously negotiated concessions, such as bound tariffs, as set forth in Article XXVIII.

Any proposed CU or FTA agreement was required to be promptly notified to GATT for examination by a working party. As noted earlier in all, 98 agreements were notified under Article XXIV during the life of GATT from 1947 to the end of 1994, including the most enduring of all, namely the European Community (EC) and the European Free Trade Area

(EFTA). A further 11 agreements were notified by developing countries under the 1979 Enabling Clause. Working parties were established to examine virtually all agreements. While 15 working parties had not completed their examinations as of the end of 1994 and five did not report for various reasons, out of the 69 which had submitted their reports, only six explicitly acknowledged conformity with Article XXIV of the Agreement, and this six does not include the European Community (EC) or the European Free Trade Area (EFTA), and only two of the six are still active! (WTO 1995, p.16). The situation has not changed for the better since WTO (2001, p.40) reports "to date, 220 RTAs have been notified to the GATT/WTO, and the Committee on Regional Trade Agreements has proceeded to the examination of notified agreements, with a total 86 RTAs still under examination at the end of 2000".

In fact no agreement was reached on the compatibility of the Treaty of Rome with Article XXIV, and the contracting parties agreed that because "there were a number of important matters on which there was not at this time sufficient information. To complete the examination of the Rome Treaty...this examination and the discussion of the legal questions involved in it could not be usefully pursued at the present time. The examination of the EEC agreement was never taken up again." (WTO 1995, p.11). The main reason for failure to pronounce on compatibility was that required consensus to decide on the issue of compatibility could not be reached, with often-strong opposition against declaring the notified agreements as compatible with Article XXIV.

Whether or not a CU or FTA that is consistent with Article XXIV would have increased global welfare, it is abundantly clear that the procedures laid down for examining such consistency have not worked. WTO (2001a, p.41) frankly admits that the "WTO does not have rules and procedures for examining RTAs that function adequately…the unsatisfactory

experience of the GATT process on examining RTAs continues to be the same in the WTO". There are several reasons for this unsatisfactory experience, apart from the consensus needed in the Working Party for a decision. The most important of these arise from the vagueness of the wording of Article XXIV itself, in particular, the lack of a precise definition of the phrase "substantially all trade" in the requirement for liberalization within a CU or FTA, the lack of a well-specified procedure for determining whether the post-union FTA barriers on trade with non-members are not "on the whole higher or more restrictive" than those that member countries had prior to their forming a CU or FTA, and the absence of any explicit attempt to ensure consistency of the approach to permitted deviations from MFN under Article XXIV, Part IV on Development and the Enabling Clause of the Tokyo Round. Apart from specifying a tariff averaging procedure to enable a comparison of pre- and post-CU or FTA tariff barriers and a period of ten years as a reasonable time span within which internal barriers are eliminated within a CU or FTA, the Understanding reached in the Uruguay Round relating to the interpretation of Article XXIV did not substantially change the situation.

Article V of GATS, which corresponds in many ways to Article XXIV on goods trade, shares many of the unsolved problems of Article XXIV.

In sum, the WTO articles and procedures as they are now are unlikely to succeed in the future in resolving, any more than GATT articles and procedures did, the tension, if not outright contradiction, between discrimination which is an inherent feature of CU's and FTA's and the fundamental principle of non-discrimination.

This tension was not a serious practical issue, as long as relatively few preferential trading arrangements such as CU, FTA and others were proposed and implemented and fewer still endured. This was indeed the case until the final stages of the Uruguay Round. As noted

earlier, after the Uruguay Round, and particularly 1990s, the process of concluding RTAs has really taken off. As such WTO is justified in concluding that "the relative lack of success in enforcing the rules and procedures for customs unions and free trade areas is a concern, both as regards the specific issues involved and because of the implications it has for the broader credibility of the WTO system and its rules. This is especially true at a time when the number of actual or planned regional integration agreements, and the attention they are getting from third countries, is large. Moreover, even if there is an affirmative answer to the question of whether regional integration agreements have been complementary to the multilateral process, experience cautions against assuming that the post-Uruguay Round rules and procedures will be sufficient to guarantee that this will be the case with future agreements or, for that matter, with the evolution of current agreements." (WTO 1995, p.23).

The conclusion can hardly be overemphasized. However, while credibility of the WTO will be certainly compromised if any of its rules, including those relating to CU's, are not enforced, it should also be noted that whether rules regarding preferential trading arrangements, such as CU's, make sense is also an important issue.

3.0 Recent Trends in Intra-Regional Trade

Table 1 presents data on trends in the share of intraregional trade in total trade of major regions of the world. It would seem that only in Western Europe and North America there is a significant increase, and most of this had occurred by 1973. In Central and Eastern Europe and former USSR, intraregional trade sharply declined in recent years.

To what extent have RTAs contributed to increase in the share of intra-regional trade? Clearly, the EU represents a fully implemented RTA and involves deepest forms of integration. At the other end is APEC which is not a RTA in any traditional sense. Data from WTO (2001b,

Table A4) indicates that in 2000, APEC (21) had the largest share 70.2% intra-regional trade followed by EU (15) at 60.4% and NAFTA (3) at 47.0%. In MERCUSOR (4) the share was 20.7%. The other RTAs namely, ASEAN (10), CETA (6) and ANDEAN (4) had shares between 10% and 12%. The South Asian Preferential Trade Agreement (SAPTA) came into force in 1995. Traditionally South Asian economics, particularly the large ones of India and Pakistan have been inward oriented. Not only South Asian countries did not trade as much as East Asia with the rest of the world, but they did not trade very much among themselves either. Kemal et al (2001, Tables 6.11 and 6.12) report that in 1997, the two largest economies of the region, India and Pakistan, imported from the rest of South Asia only 0.45% and 1.96% respectively of their total imports, and exported to the rest of South Asia only 4.18% and 2.63% respecting of their total exports. The three smaller economies, Bangladesh, Nepal and Sri Lanka imported from rest of South Asia 10% or more of their total imports. Only Nepal exported more than 10% of its total exports to the rest of South Asia, but only in some years.

The above trade shares are based on officially recorded data. Other than Maldives and Sri Lanka, the other countries share long land borders. The sea-lane separating Sri Lanka and India is also sufficiently short for small craft (motor powered or not) to cross easily. As such there is a thriving border trade, often through informal channels, a large part of which may be unrecorded in either country, and some of which is illegal according to laws of one, and often both, countries sharing the border. Also even recorded trade could include illegal trade. However it seems unlikely, though it is impossible to verify, that even if proper adjustments are made to arrive at an all-inclusive estimate of total trade, the proportion of intra-regional trade in total trade will be much higher than that in recorded trade data.

APEC is not an RTA and European Community is unique "in terms of the political commitment to carry integration beyond what has been envisaged in other regional integration agreements" (WTO, 1995, p.84).

The tensions between Argentina and Brazil, the two major countries arising from the possible incompatibility of RTA between the two with very different exchange rate arrangement, suggest caution about the stability of MERCOSUR. WTO (1995, p.84) is certainly right in stating that it is risky to draw a conclusion about conventional CUs on FTAs based on the experience of APEC and EU.

4.0 Implications of Existing and Future RTAs Outside Asia for Asia's Trade

President George Bush and 33 other leaders of the Americas met at a summit in Quebec City, Canada in April 2001. They have instructed their ministers to conclude, no later than January 2005, negotiations on a free trade area extending from high artic in the North to Terra de Fuego in the South. The expansion of the EU with the admission of some Central and Eastern European countries is likely to take place in the very near future. WTO (2001, p.37) points out that" virtually all WTO members were partners in two or more…The highest number of agreements concerned the European Union, whose network of preferential trade agreements encompasses Europe, Africa, the Middle East, Asia, and as of 2000 Latin America; cross-regional trade agreements are also increasingly a priority for other WTO members". In such a maze of interlocking PTAs with varying rules of origin, extent of preferences, and so on, it is virtually impossible to make a quantitative assessment of the impact of non-Asian PTAs for Asia's trade. However, some bits and pieces of available evidence are not comforting. Mattoo and Subramaniam (2000) find trade diversion after the conclusion of NAFTA: Mexico, a member of NAFTA has gained greater market share relative to India in the other two member

countries, namely Canada and US in exports of clothing in particular, and manufacturing in general. China, which did better than India in both markets, also experienced a slow-down in the growth of it exports to the two.

5. RTAs in Asia

Other than APEC, which is not an RTA, there are free functioning RTAs, namely, ASEAN, SAPTA and the Indo-Sri Lanka and Indo-Napal Free Trade Agreement. The Indo-Sri Lanka agreement came into force less than two years ago and it is too early to assess its impact. Nepal is landlocked, and most of its trade has to transit through India. Indo-Nepal trade is free and Nepal has much lower tariffs on imports of third country goods than India. Rules of origin are difficult to implement in any case, but the possibilities of corruption of customs officials are significant. In addition there is a thriving informal trade between India and Nepal, some of which avoids going through customs check points altogether. For all these reasons, significant trade deflection i.e. of third country goods are imported into the lower tariff country of Nepal, but intended for, and actually sold, in higher tariff country of India. A survey of 154 traders, half of whom were informal traders, located on both sides of the Indo-Nepal border showed, that most of the respondents trading in goods from India to Nepal procured most of the traded goods within India whereas, nearly half of the respondents trading in goods from Nepal to India claimed that more than 80% of the goods they traded were third country goods (Pohit and Taneja, 2001, p.137).

It was noted earlier that South Asian countries do not trade significantly with each other compared to, say, East Asian countries. As elsewhere in the world, in South Asia also a political forum, the South Asian Association for Regional Cooperation (SAARC) Forum was established in 1985, though it had been proposed five years earlier in 1980. South Asian Association for

Regional Cooperation established an intergovernment group (IGG) on intra-regional trade liberalization in December 1991. The South Asian Preferential Trade Agreement (SAPTA) drafted by IGG was signed in April 1993 and it became operational in December 1995. The governments of South Asia decided in May 1997 to move from preferential trading to free trade at the latest by 2001, thereby transforming SAPTA into the South Asian Free Trade Agreement (SAFTA). In addition to signing SAPTA, India has entered into bilateral free trade agreements with Nepal and Sri Lanka. Unlike other areas of the world, where regional preferential trade agreements have apparently eased political tensions and increased the sense of security among their members, SAPTA has not thus far reduced tension. Indeed the longstanding conflict between the two major powers, India and Pakistan, has come in the way of making the economic cooperation between these two countries meaningful and significant. In fact Pakistan is yet to accord MFN status to India in trade although India has accorded such status to Pakistan. Even if the World Bank is right, and that contemporary PTAs are on the whole beneficial to their members by increasing intra-regional trade of non-member nations, it is unclear that SAPTA would be one such PTA. The experience thus far from its operation since 1995 is not encouraging. It is arguable whether this experience confirms that even in the absence of political impediments, the potential for substantial benefits to the region from SAPTA are larger than the benefits unilateral trade liberalization of all its trade on an MFN basis by each member.

Mukherji (2001) and Kemal et al (2001) analyze issues relating to SAPTA, SAFTA and possibilities for enhancing intra-regional trade cooperation. Mutkherji looks at the nature of trade restrictiveness in South Asia and quantifies the extent of trade liberalization that has been achieved since SAPTA took force in 1995. He also suggests a feasible path for accelerating regional integration. It should surprise no one that the two large countries of the region, India

and Pakistan, are the most restrictive. For countries of the region other than the least developed countries (LDCs) of Banglasdesh, Bhutan, Maldives and Nepal, the preferential tariff as a percentage of MFN tariff, was in the range of 50%-70% in the case of India, 10%-30% with case of Pakistan and less than 15% in the case of others. The number of tariff lines for which preferential rates apply were 1356 in favour of non-LDCs and 1901 in favour of LDCs. In terms of value, the total regional imports of products covered by regional preferences accounted for $480 million in 1998, of which Pakistan accounted for 46%, India 26%, Sri Lanka 16% and Bangladesh 10%.

Mukherji's definition of potential trade in any product between two countries (a supplier and its market) as the minimum of the supplier's global exports (i.e. exports to all its trading partners) and the importer's global imports is rather mechanical, since it does not take into consideration of cost, quality and product heterogeneity. He finds that few of the products in which potential trade was substantial with India as the market, and Pakistan as the supplier, were included in the SAPTA concessions. An alternative approach for identifying trade potential is sectoral. It identifies sectors (at a two digit level of classification) which accounted for 5% or more of all bilateral imports as sectors with significant trade intensity. For example, in the case of Bangladesh, sectors identified on this basis accounted for anywhere between 62% and 98% of its imports from the region. However barring very few exceptions, trade intensity did not play a role in the choice of sectors for offering concessions.

Those who believe that regional PTAs, such as SAPTA, are potentially beneficial can take little comfort from Mukherji's findings: the effects of regional trade liberalization under SAPTA have indeed been modest. The steps to transform SAPTA to SAFTA thus far have been

extremely limited. His analysis confirms that South Asia would reap more benefits from unilateral liberalization on an MFN basis

In their detailed analysis of regional trade Kemal et al (2001) begin with an overview of the economies of the region and then discuss liberalization policies and trends in regional trade flows in light of indices of revealed comparative advantage and trade complementarity. Since recent contributions to trade theory have emphasized intra-industry trade based on scale economies and monopolistic competition, the authors look at such trade in the region. Finally they examine factors that have inhibited intra-regional trade with a view to identify measures to strengthen trade and economic relation in the region. They confirm that the share of intra-regional trade in total trade of the region is still low. To adjust for vast differences in GDP of the countries in examining trade share, they define an index of anti-regional bias of a country as the ratio of the share of the country in the total trade (exports or imports) of the region to its share in intra-regional trade, minus one. A positive value for the index would indicate a bias against regional trade and predictably the larger countries, India and Pakistan have an anti-regional bias while the smaller countries do not.

The authors also compute an index of trade balances as the ratio of the share of a country in intra-regional imports to its share in intra-regional exports. A value of unity for this index would indicate that a country's intra-regional trade is in balance, a value higher (lower) than unity, a trade deficit (surplus). There is very little economic significance to this index since what matters is a country's overall trade balance, and not its trade balance with any particular group of its trading partners. However, it has political significance since in political debates, whether a country has a balanced as unbalanced trade with its regional partners matters a lot. Again it is no

surprise that the large countries, India and Pakistan, export more to than they import from the region while the smaller countries do the opposite.

Kemal et al find that South Asian Countries have an almost identical pattern of revealed comparative advantage and low values of trade complementarity indices . Taken literally these findings would explain the low values of intra-regional trade and also indicate that the potential for its expansion is limited. Such a conclusion would be hasty for two reasons. First, the indices reflect in part the barriers that countries have imposed on their trade, which were intended to change the trade pattern away from what would emerge were they to allow their true comparative advantage to dictate their trade. Second these indices are static and do not allow for potential dynamic gains from regional trade.

The analysis of intra-industry trade in the region using the well-known Grubel-Lloyd index shows that such trade is highly erratic, a few products dominate it and its share in total trade is low. The authors correctly suggest that intra-industry trade can play a pivotal role in promoting regional integration. However, to the extent a large part of intra-industry trade in the world is accounted for by intra-firm trade by multinational corporations, the failure of South Asia to attract significant FDI may be part of the explanation for its low share of intra-industry trade in total trade.

In addition to patterns of identical comparative advantage, low trade complementarity, and high trade barriers, the other factors inhibiting intra-regional trade identified by the authors are: lack of communication links, limited capacity to generate exports of a quality and specification that meet regional needs, and above all political problems. It would seem that, if the two large countries, India and Pakistan, were to resolve their conflicts, a favorable environment for growth in intra-regional cooperation will emerge. The other problems, which in

part also reflect the lack of pressure to solve them because intra-regional trade is not important, would be addressed in such an environment. Indeed without such an environment, there is very little chance of adoption of any of the authors' suggested measures for improving economic cooperation in the region, such as broadening the composition of intra-regional trade with a major focus on intra-industry trade, encouraging vertical specialization, joint export marketing, deepening trade liberalization under SAPTA, promoting monetary cooperation and encouraging joint ventures.

ASEAN was established in August 1967 by Indonesia, Malaysian, the Philippines, Singapore and Thailand for promoting peace, stability and economic growth in the region. Brunei Darwaslan became a member in 1984. A PTA among ASEAN members was signed in 1979 providing preferential tariffs and non-tariff treatment by each member selected exports of other members. WTO (1995, pp. 36-37) reports that "recognizing that these various efforts were having only a negligible effect on trade between ASEAN countries due to their limited product coverage, the ASEAN countries agreed in January 1991 to establish an ASEAN Free Trade Area (AFTA) by the year 2008, a timetable subsequently shortened to 2003. A Framework Agreement sets out the transition towards the AFTA and a Common External Preferential Tariff (CEPT) which came into force in 1994, was accepted as the main formal Tariff-cutting mechanism for achieving the free trade area. The product coverage of the AFTA excludes unprocessed agricultural products, natural resources and services." [more to be added later]

The US-Vietnam trade agreement was only recently approved in the U. S. Congress. It is obviously too soon to assess its effects. However, similar to the US-Jordan free trade agreement, it incorporates provisions on labour standards in the main trade agreement itself, rather than in a side agreement as was the case in NAFTA. Fortunately, labour standards have not entered into

the WTO, and as such, there are no multilateral commitments regarding standards. However the fact that in PTAs with the US, labour standards are becoming integral components, is enough to caution developing Asia in rushing head long into PTAs which include provisions in areas where there are no agreed multilateral disciplines.

Japan-Korea and Japan-Singapore agreements are yet to take their final shape and to be signed.

6.0 Open Regionalism and APEC

In an unpublished paper Srinivasan (1995) I have discussed APEC and open Regionalism in some detail. I will reproduce here a brief version of the discussion.

The United States, under the Clinton Administration, had been actively pursuing the regional route. The Council of Economic Advisers (CEA) to the President in their annual report for the year 1995 claimed that "possibly the most distinctive legacy of this Administration in international trade is the foundation it has laid for the development of open, overlapping plurilateral trade agreements as stepping-stones to global free trade. The Administration's plurilateral initiatives in North America, the rest of the Western Hemisphere, and Asia embody principles of openness and inclusion consistent with the GATT" (CEA 1995, 214-215). I have elsewhere (Srinivasan 1995) critically examined several of the arguments offered by the CEA in favour of plurilateral and found them unpersuasive.

> The CEA also defined the term "Open Regionalism" that had been earlier advocated by the Eminent Persons Group (EPG) of APEC. According to the CEA
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> > "Open regionalism refers to plurilateral agreements that are nonexclusive and open to new members to join. It requires first that plurilateral initiatives be fully consistent with Article XXIV of the GATT, which prohibits an increase in average external barriers. Beyond that, it requires that plurilateral agreements not constrain members from pursuing additional liberalization either with non-members

> on a reciprocal basis or unilaterally. Because member countries are able to choose their external tariffs unilaterally, open agreements are less likely to develop into competing bargaining blocs. Finally, open regionalism implies that plurilateral agreements both allow and encourage non-members to join. This facilitates the beneficial domino effect described above." (CEA 1995, 220].

In assessing these claims, it should be noted that by its very definition any plurilateral free trade agreement provides preferential market access to members and, as such, violates the MFN principle. Even if, in the face of experience to the contrary, such agreements are declared to be in conformity with the updated Article XXIV, any extension of any liberalization among parties to the agreement to others, except on an MFN basis, cannot possibly be viewed as other than conditional and preferential market access. It is available to only those non-members who are willing to meet whatever conditions (e.g., reciprocity) are attached to such an extension. Viewed in such a perspective, Open Regionalism is nothing but an oxymoron.

Although the EPG recommended “unilateral liberalization to the maximum extent possible” and recognized that any individual APEC member can unilaterally extend its APEC liberalization to non-APEC members on an unconditional MFN basis, they did not think that either is likely or even desirable. For example they pointed out that

> "the largest members, including the United States, are unlikely to liberalize unilaterally when they can use the high value of access to their markets to obtain reciprocal liberalization from others. The same view applies in other economies in the region ... we would note ... that the region would give away an enormous amount of leverage ... if its members, especially its largest members, were to liberalize unilaterally to any significant degree" (APEC 1994, 29).

The EPG candidly admit that

> "We rejected the concept of unconditional MFN treatment of non-members as the sole means of implementing open regionalism for the economic and political reasons...." (APEC 1994, 34)

The main reasons were the familiar free rider problem and the claim that it is rare that benefits of politically negotiated trade liberalization, multilateral or regional, have been extended to non-participants on a non-reciprocal basis.

The 'free rider' argument and the demand for reciprocity reflect a mercantilist view (unfortunately enshrined in GATT and WTO!) of trade liberalization, namely, that a country's offer of liberalized access to its markets is a costly 'concession' for which it has to be compensated by reciprocal liberalization by its trading partners. Except in cases where significantly adverse terms of trade effects are induced by liberalization (an unlikely event certainly for small countries, and most probably even for as large a grouping as APEC), this argument does not carry much weight. One should have thought that if indeed the goal of EPG is globally free and open trade, far from bowing to political expediency, they should have used their prestige to educate the political leaders of APEC that their fears of unconditional MFN extension of their liberalization to non-members are unwarranted.

It is thus difficult to avoid the conclusion that 'Open regionalism', if not an oxymoron, is not a particularly fruitful new concept in the arena of trade liberalization. If the smaller developing countries of APEC, instead of pursuing their unilateral liberalization on an MFN basis, succumb to the 'Open regionalism,' they will be subjecting themselves to what Bhagwati terms "a process by which a hegemonic power [and often manages] to satisfy its multiple trade-unrelated demands on other weaker trading nations more easily than through multilateralism" (Bhagwati 1995, 13-14).

It is unfortunate that the regional route to liberalization and a version of open regionalism had been embraced by Mr. Renato Ruggeiro, the then Director-General of the WTO. He suggested

> "The regional liberalizing impulse is not in itself cause for alarm among the upholders of the multilateral system. Regional initiatives can contribute significantly to the development of multilateral rules and commitments, and in regions such as Sub-Saharan Africa they may be an essential starting-point for integration of least-developed countries into the wider global economy. At the most basic level the real split is between liberalization, at whatever level, and protectionism. Viewed from this perspective regional and multilateral initiatives should be on the same side, mutually supportive and reinforcing." (WTO 1996, 10)

But he added

> "However the sheer size and ambition of recent regional initiatives means we can no longer take this complementarity for granted, if indeed we ever could. We need a clear statement of principles, backed up by firm commitments, to ensure that regional schemes do not act as a centrifugal force, pulling the multilateral system apart.

> The answer is to be found, I suggest, in the principle which some of the newer regional groupings have enunciated -- Open Regionalism." [Ibid, p. 10]

Ruggeiro contrasted two interpretations of Open Regionalism. The first essentially required that any regional preferential trade arrangement be consistent with Article XXIV of GATT 1994 and the understanding on its interpretation incorporated in the UR agreements on Trade in Goods. In the second

> "... the gradual elimination of internal barriers to trade within a regional grouping will be implemented at more or less the same rate and on the same timetable as the lowering of barriers towards non-members. This would mean that regional liberalization would in practice as well as in law be generally consistent with the MFN principle." [Ibid, p. 11]

He concluded

> "The choice between these alternatives is a critical one; they point to very different outcomes. In the first case, the point at which we would arrive in no more than 20 to 25 years would be a division of the trading world into two or three intercontinental preferential areas, each with its own rules and with free trade inside the area, but with external barriers still existing among the blocs." [Ibid, p. 11]

He clearly expressed his preference for the second, arguing, in sharp contrast to the CEA, that it

> "...points towards the gradual **convergence** of regionalism and multilateralism on the basis of shared aims and principles, first and foremost respect of the MFN principle. At the end, we would have one free global market with rules and disciplines internationally agreed and applied to all, with the capacity to invoke the respect of the rights and obligations to which all had freely subscribed. In such a world there could and must be a place for China, Russia and all the other candidates to the WTO." [Ibid, p. 11]

Notwithstanding the former Director Generals' preference for the second interpretation, it seems odd: after all, if regional liberalization is to be extended on the same timetable "in practice and in law" to non-member countries on an MFN basis, it would be multilateral and not regional. If that were the case, why would any group initiate it on a regional basis in the first place?

7. Harmonization of Policies

In a collection of essays by economists, political scientists and legal scholars edited by Bhagwati and Hudec (1996), harmonization issues were analyzed from an economic (Volume 1) and a legal (Volume 2) perspectives. In his contribution to the first volume, Bhagwati poses the question as follows: Does free trade require harmonization of domestic institutions (e.g. retail distribution system), policies (labour and environment of standards competition policies)? Those who think it does, have demanded that such domestic diversity among nations that seek freer trade among themselves be reduced or even eliminated.

Bhagwati identifies the philosophical, economic and political arguments behind this demand. The philosophical arguments include: (i) the notion that those interested in higher labour on environmental standards or more generally human rights have the moral obligation to sustain these rights, if necessary using trade sanctions as means to coerce those nations to which do not respect them to do so (ii) trade with countries with abundant unskilled labour and lower standards will produce paupers at home and (iii) forms in higher standard countries incur higher costs than those in lower standard countries and as such free trade results in unfairness in competition between them.

The economic arguments arise principally from two questions: Instead of mutual gains from trade, could predation against a nation be the the result of diversity in standard persist

under free trade? Even if predation is not the result, does diversity reduce one's absolute and relative gains from trade? The political arguments against diversity arise from protection seeking: protectionist demands are more effective it can be claimed those who export to the home economy enjoy 'unfair' cost advantage because of lower standards in their countries. Also in the context of regional political integration, demands are made for common social standards, not because they are essential for economic reasons but because it is felt that a key ingredient of political integration must be that each state should at least have a minimum set of standards, as in a social charter, in common among themselves.

Harmonization demands are often called "deep integration." Bhagwati rightly cautions that the combination of two pleasurable words, "deep" and "integration," should not lull into thinking that the demands are legitimate. Indeed his thorough analysis of the philosophical, economic and political arguments for the demand for harmonization suggest that they are not well founded.

Economic analyses of the harmonization are available with respect to environmental standards (Bhagwati and Srinivasan, 1996) and human rights (Srinivasan, 1998). The first finds as long as the environmental problems are purely domestic diversity in standards is legitimate and consistant with free trade. When the problems are global (e.g. global warming) and a cooperative solution is sought through multilateral agreement, issues of the legitimacy of the agreement, non-compliance by some of its signatories and free riding by non-signatories arise. However in many contexts it might be possible to devise a efficient market solutions involving trading of pollution permits and transfers among traders to ensure that the efficiency gains from the market solution are equitably shared can be devised. The second argues that once again there is room for diversity even with respect to some rights and what is more, trade policy

instruments such as trade sanctions are rarely the most effective instruments for promoting human rights.

The available analyses of harmonization demands suggest that there are few, if any, examples of the demands being founded on solid economic grounds. Despite this, the fact PTAs seem to be a vehicle through which harmonization is sought to be imposed is unfortunate.

8. PTAs, GATS and Services

GATS is different from GATT in that the deviations from non-discrimination (MFN and National Treatment) are integral parts of the agreement itself! Article II, paragraph 1, requires MFN, but the very next paragraph, allows members to maintain a measure inconsistent with paragraph 1 provided it is listed in and meets the conditions of, the Annex on Article II exemptions. Similar deviations from national treatment are also allowed. As already noted, GATS Article V is the analogue of Article XXIV of GATT on PTAs and suffers from the same infirmities.

Hoekman (2001) notes that the scope for gains from services liberalization are large and that recent studies suggest real income gains of 5 to 10% of GDP are attainable. He emphasizes the need for regulation to ensure social objectives such as universal service are met. While the absence of pro-competitive regulatory policies may substantially reduce the social pay-off to privatization of publicly owned service providers by transferring rents to private owners, the establishment of regulatory disciplines and institutions may involve substantial start-up and running costs. PTAs could enable such costs to be recovered through regional cooperation. On the other hand, since the social benefits of well designed regulatory system are likely to be substantial, its initial start-up costs could be financed by borrowing and external assistance. It is

not obvious that gains of cost recovery through PTAs offset the losses from their trade distorting features.

Table 1

Share of Intra-Regional Trade in Total Trade

	1948	1973	1993	2000
Western Europe	41.8	67.7	69.9	67.8
Central and Eastern Europe	46.4	58.8	19.7	26.6
North America	27.1	35.1	33.0	39.8
Latin America	20.0	27.9	19.4	17.3
Asia	45.5	41.6	49.7	48.9
Africa	8.4	7.6	8.4	7.6
Middle East	5.0	6.1	9.4	6.5

Sources: WTO (1995, Table 3), WTO (2001b, Table A4)