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Edited by Antoni Esteveordal, Kati Suominen and Robert Teh

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Introduction

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1 Introduction

Regional trade agreements (RTAs) have proliferated around the world in the past decade. Some 200 RTAs currently in force have been notified to the World Trade Organization (WTO) and the number will continue to rise given the many RTAs being proposed and negotiated. It is estimated that, if one takes into account RTAs which are in force but have not been notified, signed but not yet in force, currently being negotiated, and in the proposal stage, close to 400 RTAs are scheduled to be implemented by 2010 (Fiorentino, Verdeja and Toqueboeuf, 2006).

Virtually all countries are member of at least one RTA, with most countries belonging to two or more RTAs at once. The geographic reach of RTAs has also changed over time, making 'regional' somewhat of a misnomer. While most RTAs are still formed among countries inhabiting the same region or continent, they increasingly involve members that are not immediate neighbours and create partnerships spanning oceans. Trans-Atlantic and trans-Pacific RTAs are gaining in number through such agreements as the European Union (EU)–Mexico Economic Partnership Agreement, the EFTA–Chile free trade agreement (FTA) and the recently signed Korea–US FTA.

The economic importance of regional trade agreements has continued to grow. More than half of global merchandise trade flows among countries connected by a common RTA. But RTAs are today increasingly important in areas other than merchandise trade. Indeed, the architecture of RTAs has become both more comprehensive and more complex. Besides trade in goods, many RTAs now regulate such subjects as trade in services, investments, standards, intellectual property

* The views and opinions expressed in this volume are strictly those of the authors and editors alone and do not reflect the views of the IDB, the WTO or any of their Members.

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and competition rules, as well as a host of issues not directly related to trade, such as labour and environment. The body of rules governing international trade has been extended to matters traditionally considered to be within the realm of domestic regulations ('behind-the-border' measures).

These developments suggest that RTAs have become a major and strategic part of commercial policy for many countries. But RTAs also pose important challenges for the multilateral trading system. Indeed, the growing importance of RTAs has directed attention to the potential conflicts as well as complementarities between the rules that are adopted in RTAs ('regional' rules) and the multilateral rules established in such agreements as the General Agreement on Tariffs and Trade (GATT) of 1994, the General Agreement on Trade in Services (GATS) and other WTO Agreements ('global' rules). While the GATT had in the past conducted examinations of RTAs, scrutiny may now become more exacting. The multilateral Doha trade round launched in 2001 included a negotiating mandate aimed at clarifying and improving disciplines and procedures under the existing WTO provisions applying to RTAs – GATT Article XXIV, the Enabling Clause, and GATS Article V. These negotiations have resulted in a new transparency mechanism that was adopted by the WTO's General Council in December 2006. The transparency mechanism obliges Members to notify the WTO of any RTA that Members enter into and to provide information about the agreement. The mechanism also mandates the WTO Secretariat to prepare a report on notified RTAs. While this report on the RTA has to be 'factual' and refrain from any 'value judgment', the increased level of scrutiny can alert the rest of the WTO membership to some of the rules and practices in RTAs that adversely affect non-RTA members. This may induce countries to adopt RTA rules that complement rather than conflict with existing WTO agreements.

The growing policy attention paid to RTAs finds a parallel in the debate in the economic literature on whether RTAs are 'building blocs' or 'stumbling blocs' to multilateral trade liberalization.¹ These concepts refer to the nature of the dynamics or time paths that RTA formation can generate (Bhagwati and Panagariya, 1999). RTAs are building blocs if they accelerate multilateral trade negotiations or progressively enlarge their membership so that they lead to global free trade. RTAs are stumbling blocs if they hamper the attainment of global trade liberalization.

¹ Bhagwati (1991) first coined the terms 'building bloc' and 'stumbling bloc'.

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The stumbling bloc camp argues that RTAs undermine countries' incentives to undertake further multilateral liberalization because members are unwilling to dilute the preferential access they have to the markets of RTA partners. Another argument is that RTAs can create incompatible regulatory structures and standards which lock in the members' policies, and increase the adjustment costs associated with multilateral liberalization, thus making it less attractive. The importance of non-economic motives or interests can make RTAs a stumbling bloc to global free trade (Limão, 2007). RTAs can be valuable to a large country because the preferential access to its market allows it to extract co-operation in non-trade matters from smaller partners. Multilateral tariff reductions reduce the value of preferential access to the large market and thus the surplus that can be extracted from potential RTA partners.

Various political-economy models have sought to show that the establishment of an RTA weakens the motivation of the members for reciprocal liberalization with non-members. In Levy (1997), if an RTA produces disproportionately large gains and relatively small losses to the median voter so that his utility is raised above what could be achieved with a multilateral deal, multilateral liberalization will no longer be viable. Krishna (1998) argues that trade-diverting RTAs generate large rents tied to the preferences granted by the agreement for producers. Multilateral trade liberalization threatens those rents. If governments are swayed more by producer interests, then multilateral liberalization will not be pursued. Moreover, the attention that governments invest in RTA negotiations draws away scarce political and human resources from multilateral negotiations.

There are strong arguments for the building bloc story as well. Baldwin (1995) has proposed a domino theory of regionalism where the establishment of an RTA increases the value for non-members of joining the agreement.² The creation of a preferential regional arrangement will reduce the profits of the firms exporting to the region but who are located in a non-member country. They will have a reason to lobby their government to join the bloc. If the regional bloc enlarges as a consequence, the value of membership for outsiders increases since they face a cost disadvantage in an even greater number of markets. This leads to a snowballing of countries which want to join so that the RTA progressively enlarges its membership until global free trade is reached. Another building-bloc

² However, the domino theory does not explain what incentives existing members have to accept new members.

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argument is that preferential trade liberalization will help enlarge the exporting sectors and diminish the import-competing sectors in RTA members. Thus a country which enters into an RTA will expand the economic and political strength of its pro-liberalization constituency ('juggernaut' effect), making it possible for its government to cut a multilateral deal (Baldwin, 2005). There are also those who see RTAs as a stepping stone towards a global free trade policy (Ethier, 1998). RTAs may help a government intent on carrying out economic reforms to mobilize domestic forces in support of opening up to the wider world. By initially entering into a preferential trade arrangement, the reforming country would be able to capture economic benefits, for example through FDI inflows from its RTA partners that tilt the political balance within the country in favour of economic reform and multilateral liberalization.

A more recent vein of research has argued that, as more RTAs are established, the cost to producers of overlapping rules would lead them to pressure governments to harmonize or 'multilateralize' these rules (Baldwin, 2006). As bilateral and regional trade agreements proliferate, a 'spaghetti bowl' of rules of origin will emerge. This, in turn, will run against the increasing fragmentation of production as firms find it more cost-efficient to locate the manufacturing of parts and components in different countries. The requirement to comply with different rules of origin will then raise firms' production costs. Paradoxically, RTA spaghetti bowls can become building blocs to multilateralism as offshoring becomes a force for the multilateralization of existing regional rules. Indeed, there are nascent efforts by some groups of countries in Asia as well as the Americas to examine ways to connect their common RTAs into broader trade areas so as to reduce the complexity of rules facing economic actors in the RTAs and to facilitate more trade and investment.

To be sure, the multilateralization of regional rules may for many still seem to be a long-term aspiration. But what is clear today is that, given that nearly all WTO Members are RTA members and *vice versa*, WTO Members should have an interest in reducing conflicts between regional and multilateral rules and in ensuring compatibilities between them. Yet, despite the growing academic and policy attention to regionalism, the anatomy of RTAs remains poorly understood. Virtually all of the existing mappings that have been undertaken on RTAs focus on a single RTA discipline – rules of origin.³ The lack of a comparative look at

³ A partial list of the literature includes Esteveordal (2000), Suominen (2004), Esteveordal and Suominen (2005) and Cadot *et al.* (2006).

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other RTA rules severely limits our understanding of the effects of RTAs and provides little foundation for recommending measures to further compatibilities between regional and global rules. We therefore take up Richard Baldwin's recommendation in this volume to move the economic profession's discussion from high theory to one which is more empirically grounded and policy-relevant.

2 Objectives and analytical approach

The main objective of this volume is to begin filling the gaps in our knowledge of RTA rules and their relationship to multilateral trade rules. The ultimate goal of our endeavour is to provide a firmer basis for informed policy debate and policy-making on RTAs. We seek to accomplish these objectives by developing detailed analytical mappings of regional rules in six key areas – market access, trade remedies, technical barriers to trade, services, investment, and competition policy – across dozens of the main RTAs around the world.

The choice of rules to include in the mapping exercise has been dictated by a number of considerations. Our primary focus was regional rules for which there are corresponding global rules or for which a global rule is under negotiation in the Doha Round. However, we also allowed for the inclusion of regional rules that are applied in a substantial number of RTAs even though they have no multilateral counterpart (which is the case for competition policy). We feel that the choice of these six areas also strikes the right balance between the 'traditional' areas covered in trade agreements, such as market access and trade remedies, and the new but growing areas such as TBTs, services, investment and competition.

Beyond addressing the lacuna in our knowledge of RTAs, we seek to meet three other objectives with this book. First, we hope to inspire and inform further work on disaggregating RTAs into their component parts, a task that is absolutely crucial for understanding the implications of the rising tide of regionalism on the global economic system. Secondly, by developing methodologies for dissecting RTAs, we hope to establish a rigorous starting point for further studies, as well as to provoke debate on the best prisms to examine RTAs. Thirdly, by virtue of containing detailed data on RTAs around the world, the chapters here hope to serve as inputs for fresh empirical work on the economic effects of RTAs.

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3 Organization and main findings

The second chapter of this volume, by Richard Baldwin, provides an analytic framework for examining the building bloc–stumbling bloc debate. The chapter discusses various economic mechanisms (Smith's certitude, Haberler's spillover and Viner's ambiguity) that help determine whether preferential trade arrangements help or hinder multilateral trade liberalization. Baldwin critically reviews the long line of literature on both sides of the debate and identifies four distinct types of stumbling blocs in the literature – preference-erosion, goodies-bag, cherry-picking and the bargaining-model stumbling blocs. The building-bloc effects include the juggernaut effect, the Kemp–Wan effect, and the veto-avoidance mechanism. He then details the economic arguments that underlie these various effects. Baldwin's main conclusion is that, while many of the models provide helpful theoretical frameworks for assessing the potential effects of RTAs on the global trading system, it is now time to move the literature's focus from high theory to empirically grounded research which will have more policy relevance.

The third chapter begins the mapping exercise. The focus of Antoni Esteveadeordal, Matthew Shearer and Kati Suominen is on market access disciplines in RTAs – both tariff liberalization and a number of other disciplines that can qualify the extent of market access in RTAs, including non-tariff measures, special regimes, rules of origin, and customs procedures and trade facilitation. The study goes to the heart of GATT Article XXIV, which sets out the conditions under which the main types of RTAs – free trade agreements (FTAs) and customs unions (CUs) – are viewed as consistent with multilateral trade rules. The Article has been a source of extensive debate and interpretations. Some of the most disputed issues centre on the Article's stipulation that RTAs are to eliminate tariffs on 'substantially all trade' (SAT) between the parties, and to do so within a 'reasonable length of time'. Another key line of debate involves the meaning of the Article's requirement that, besides tariffs, RTAs eliminate 'other restrictive regulations of commerce' on substantially all trade.

Employing both tariff-line-level and aggregate data, the authors strive to capture the extent to which RTAs meet the Article XXIV benchmarks. There are three main findings. First, most RTAs attain a common interpretation of SAT and 'reasonable length of time' – liberalization of 90 per cent of tariff lines by year 10 of the agreement. Trade-weighted measures of the depth of liberalization yield similar results.

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However, and secondly, there are a number of outlier RTA parties (in general, developing countries) and product categories (particularly sensitive sectors – agriculture, textile and apparel, and footwear) that do not attain the benchmark. Many an RTA also contains provisions that could potentially be classified as ‘other restrictive regulations of commerce’, such as tariff rate quotas, special safeguards, and demanding rules of origin.

Thirdly, in terms of the aggregate provisions, many RTAs are also ‘WTO-plus’, in terms of incorporating a larger number and/or more specific provisions than are currently in force at the multilateral level. One key example is customs procedures and trade facilitation where US agreements in particular establish quite comprehensive and specific commitments.

Overall, the findings are encouraging as to the extent of liberalization provided in RTAs and the potential for RTAs to serve as testing grounds for new, more comprehensive trade rules than have thus far been crafted at the multilateral level. The results could also provide insights and guidance for any future efforts to define ‘substantially all trade’ and ‘reasonable length of time’ in a more precise fashion at the multilateral level – as well as for negotiators of new RTAs to meet and go beyond the liberalization attained in past agreements. To be sure, the discriminatory potential of the RTAs remains, and must be attenuated with simultaneous unilateral and multilateral liberalization.

In chapter four, Robert Teh, Thomas Prusa and Michele Budetta examine provisions on trade remedies – anti-dumping, countervailing and safeguard measures – in RTAs. Their main concern is with the possible increase in discrimination against non-members that come from regional rules on trade remedies. The elastic and selective nature of trade remedies may lead to more discrimination against non-members through greater frequency of trade remedy actions against them. The adoption of RTA-specific trade remedy rules can increase this risk of discrimination, with trade remedies against RTA members being abolished outright or being subjected to greater discipline. Given the second-best nature of preferential liberalization, any increase in intra-regional trade that this brings about may simply be substituting for cheaper sources of imports from non-members.

They find that about one-sixth of the RTAs surveyed have dispensed with at least one type of trade remedy. In addition, a number of RTAs have adopted RTA-specific rules that tightened discipline on the application of these remedies against RTA members. In the case of

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anti-dumping for example, some specific provisions have increased *de minimis* volume and dumping margin requirements, adopted a lesser duty rule and shortened the duration for applying anti-dumping duties. They have also pointed to the role of regional bodies with the authority to review or remand determinations made by national authorities in possibly reducing anti-dumping action against RTA partners.

In the case of safeguards, they have expressed some concern about the exclusion of RTA partners in safeguard actions triggered by GATT Article XIX and the Agreement on Safeguards. This puts RTA rules on safeguards in conflict with the non-discriminatory principle that underlies multilateral rules on safeguard action and squarely raises the problem of trade diversion. Although WTO panels have ruled against such exclusions so far, it is not clear that future panels will do so consistently given the particular ground of parallelism on which previous decisions have been made. There appears to be less of a problem with countervailing duty (CVD) provisions in RTAs: no major changes have been made to CVD rules in the RTAs included in their survey. They suspect that a major reason for this is the absence of agreements in RTAs on meaningful or significant curbs on subsidies or state aid.

Chapter five, by Roberta Piermartini and Michele Budetta, analyzes the variety of approaches that have been adopted at the regional level to remove technical barriers to trade (TBTs). The chapter attempts to answer whether RTA provisions have gone deeper than the Agreement on Technical Barriers to Trade (TBT Agreement) of the WTO in liberalizing TBTs and what factors determine the design of TBT rules at the regional level. The chapter develops a template that follows the structure of the WTO TBT Agreement to map rules on technical barriers to trade in regional trade agreements.

The authors find that provisions on standards, technical regulations and conformity assessment procedures are widespread across RTAs. Overall, regional agreements tend to favour harmonization over mutual recognition of product standards, while equivalence and mutual recognition appear to be the preferred options to deal with TBTs arising from testing and certification.

Their analysis seems to confirm theoretical predictions that similarity in the levels of development affects the likelihood of introducing provisions for mutual recognition of product standards and technical regulations, but there does not appear to be a link between the requirement to harmonize standards and the level of development. In general, regional rules on TBTs develop according to a hub-and-spoke

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structure. In particular, the family of RTAs which involves the EU tends to promote the use of European standards. A common feature of RTAs signed by the US is the inclusion of provisions for the establishment of institutions to deal with the administration of the TBT chapter of the agreement, the resolution of disputes on TBT matters and encouragement of mutual recognition. One important question that the authors raise is whether, because of a 'cloning' tendency on the part of the hubs, standards become a barrier to trade between major regional groupings. To the extent that TBT provisions in RTAs succeed in locking in a country to 'regional' standards, RTAs act as a stumbling bloc in the process of multilateral liberalization.

Trade in services makes up a substantial proportion of world trade. In 2006, commercial services exports grew by 12 per cent in nominal terms to US\$2.76 trillion – accentuating the salience of both RTA and GATS services rules.⁴ Chapter six, by Martin Roy, Juan Marchetti and Aik Hoe Lim, analyzes services liberalization commitments in RTAs, and compares them to prevailing GATS commitments and Doha Round offers.

Focusing on market access achieved in both bilateral and multilateral negotiations thus far, their main finding is that services commitments in RTAs tend to go significantly beyond GATS schedules and even Doha Round offers. These advances take the form of a high proportion of new bindings in sectors that had remained uncommitted in the GATS and improved bindings in sectors that were already committed in the GATS schedules/offers. The authors reach a number of further conclusions about the pattern of services liberalization in RTAs.

First, countries that have used negative-list approaches have bound at least the existing level of openness for the large majority of sectors. This instils predictability in the bilateral relationship and spurs cross-border investment and trade. The authors also highlight that a number of agreements have led to 'real' liberalization on the ground. Secondly, a number of the larger developed countries tend not to go as far beyond GATS as many of the smaller developing economies. The authors argue that this might be explained by an imbalance between negotiating partners and by the fact that at least some of the larger developed countries have less room to improve their already extensive GATS schedule and offers. Thirdly, as a result, the most protected services activities in larger developed countries remain largely unaffected by RTAs, for example audiovisual for EFTA and the EC, maritime transport

⁴ WTO (2007).

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and certain professional services for the US, cross-border trade in a number of financial services for a variety of countries, and education services where there has been no significant improvement for the US, EC and EFTA Member States.

Preferential trade in services has its benefits and costs. On the one hand, preferential access in services may be less costly than in merchandise goods. One reason the authors provide is that barriers to trade in services are usually embedded in regulations and it may be difficult for governments to devise and enforce one set of regulations for some service suppliers and another set of regulations for a different group. But preferential access can also engender important costs: non-parties may suffer because preferences may provide lasting advantages to first movers that might be hard to reverse through subsequent extension of access to other countries; while parties to the agreement may also suffer if they are stuck with relatively less efficient suppliers. Additionally, from a political economy perspective, bilateral negotiations may have a deleterious impact on multilateral talks. For one, bilateral and regional initiatives divert important resources from multilateral negotiations. Moreover, the proliferation of RTA negotiations may well have led some WTO Members to make minimal WTO services offers in the Doha Round so as to have 'negotiating chips' to trade in RTA negotiations.

The authors suggest two ways in which multilateral initiatives can overcome these drawbacks and help harness regionalism to reinforce multilateralism. First, countries involved in RTAs could conditionally offer a level of services commitments in the WTO closer to the one they agreed to in RTAs. Those WTO Members that have not been involved so far in RTAs could use the GATS-plus commitments in RTAs as a kind of target they could aim for in the Doha Round. Secondly, the authors propose better multilateral surveillance of the implementation of the services commitments in RTAs. They envision this surveillance to be modelled along the lines of China's transitional review mechanism in the WTO, according to which China has an obligation to provide information on policies affecting trade in services (e.g. changes to laws and regulations, state of play of licensing applications), information which is subsequently reviewed by Members in the specialized WTO bodies overseeing the issues at hand. The same obligation could be imposed on WTO Members having signed RTAs including services obligations and commitments.

A substantial body of academic literature agrees that trade policy and investment tend to influence each other: high tariff walls may encourage