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REGIONAL TRADE AGREEMENTS AND THE WORLD TRADE ORGANIZATION

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REGIONAL TRADE AGREEMENTS AND THE WORLD TRADE ORGANIZATION [1]

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RESUMO

A década de 1990 foi marcada por uma considerável proliferação de Acordos Regionais de Comercio (ARCs). Esses acordos, que em princípio teriam caráter excepcional no sistema multilateral de comércio, espalharam-se por várias partes do mundo e, atualmente, são raros os casos de países que não participam de pelo menos um acordo preferencial. Este artigo tem como objetivo analisar os acordos preferenciais e suas implicações no sistema multilateral de comércio e, para tanto, são considerados os aspectos normativos e econômicos relacionados ao tema. Além disso, apresenta-se a sistematização das principais questões alusivas à interpretação das regras da OMC relativas aos acordos regionais de comércio. Finalmente, com o intuito de fornecer elementos adicionais para a avaliação do dos acordos preferenciais serão analisados os impactos econômicos de alguns dos principais acordos para o Mercosul.

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PALAVRAS CHAVES

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b. Acordos Regionais de Comércio
c. Multilateralismo
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ABSTRACT

The 1990's decade was characterized by a remarkable increase in the number of Regional Trade Agreements (RTA's). Those agreements, which in principle would have exceptional character in the multilateral trading system, proliferated throughout the world and currently there are rare cases where countries do not participate in at least one preferential agreement. The purpose of this article is to discuss the preferential trade agreements and their implications in the multilateral trade system. For this reason, it will analize the normative and economic aspects in connection with the subject matter. Then, it will be presented a systematization of the main issues pertaining to interpretation of WTO rules respecting regional trade agreements. Finally, with the purpose of providing additional elements to evaluate agreements of a preferential nature, we will analyze economic impacts of some of the main Mercosul-related agreements.

KEY WORDS

f. Preferential Trade Agreements
g. Regional Trade Agreements
h. Multilateralism
i. World Trade Organization (WTO)
j. Regionalism

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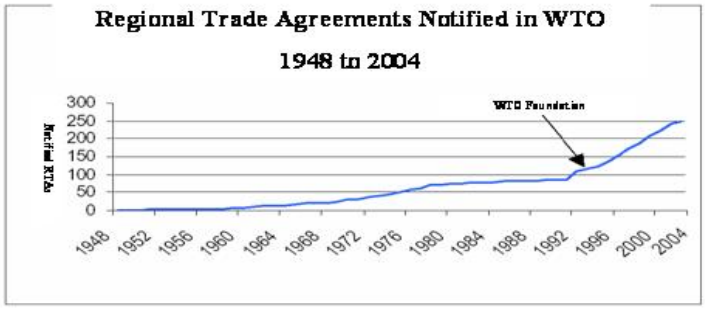
REGIONAL TRADE AGREEMENTS AND THE WORLD TRADE ORGANIZATION[2]

1. INTRODUCTION

The 1990's decade was characterized by a remarkable increase in the number of Regional Trade Agreements (RTA's). According to WTO's definition, regional trade agreements comprise "all bilateral, regional and plurilateral preferential agreements"[3]. Those agreements, which in principle would have exceptional character in the multilateral trading system, proliferated throughout the world and currently there are rare cases where countries do not participate in at least one preferential agreement. According to WTO data, more than 250 RTAs were already notified out of which approximately 208 were in force in May 2004.[4]



Source: WTO, *International Trade Statistics*, http://www.wto.org

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[3] Regional Trade Agreement (RTA) understood as "all bilateral, regional and plurilateral agreement of a preferential nature" in the General Council Decision of February 1996 establishing the Committee on Regional Trade Agreements Committee (CRTA)

[4] WTO: Reference http://www.wto.org/english/tratop_e/region_e/regfac_e.htm

Article I of the General Agreement on Tariffs and Trade (GATT/1947) coped with the so called principles of non-discrimination among member countries, also known as clause of Most Favored Nation (MFN)[5]. It was understood that the establishment of this principle would be the base for elimination of trading practices that prevailed in the period between the beginning of World War I (1914/1918) and the end of World War II (1939/1945) in International Trade. The MFN clause would prevent discrimination among member countries so as to promote a greater balance in the multilateral trade system and would encourage trade relations among member countries. Although exceptions were anticipated for application of MFN in the abovementioned Article I of GATT (1947), the phenomenon of proliferation of regional trade agreements is quite recent: since late 1970s.

However, Article I of GATT (1947) wording relating to exceptions to the MFN's principle is enough vague to allow very distinct interpretations. Similarly, Article XXIV of GATT (1947)[6] was also hardly specific as regards the topic of regional trade agreements was also hardly specific. In view of the accelerated growth of preferential agreements from late 70s onwards and the little specificity of the articles dealing with this subject in GATT (1947), many considered that a series of abuses were occurring among member countries. For this reason at the Uruguay Round attempts were made to discipline the subject. However, those efforts were unsuccessful. However, as the regional trade agreements proliferation issue only became more complex in recent years, the theme was again included in the current Doha Round.

The purpose of this Chapter is to discuss preferential agreements and their implications in the multilateral trade system. For this reason initially we will approach normative and economic aspects related to the subject matter. Then, we will present a systematization of the main issues pertaining to interpretation of WTO rules respecting regional trade agreements. With the purpose

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[5] Most Favored Nation (MFN) means "*toda vantagem, privilégio ou imunidade afetando direitos aduaneiros ou outras taxas que são concedidos a uma parte contratante, devem ser acordados imediatamente e incondicionalmente a produtos similares comercializados com qualquer outra parte contratante*" (Thorstensen, 1999, p.33).

[6] Normative aspects shall be dealt with on item 2 in this paper.

of providing additional elements to evaluate preferential agreements we will analyze economic impacts of some of the main Mercosur-related agreements. Finally, some final considerations will be presented as conclusion.

2. NORMATIVE ASPECTS

In 1947 when GATT was established already existed agreements defining tariff preferences, of which a historic example is the Commonwealth Preference System, preferential agreements among Great Britain and its former colonies in effect since 1931. On the other hand there was very clear interest of the USA as well as of the Western European countries in the development of an European integrated space that would strengthen the security of those countries against threats posed by former Soviet Union as well as facilitate business activities of American companies in a more unified European market.

2.1. PREFERENTIAL AGREEMENTS

The trade preferential agreements regarding goods should be notified consonant with provisions of Article XXIV of GATT (1947) for approval thereunder. In the incorporation of GATT (1947) by GATT (1994) a Memorandum of Understanding was included to clarify the content of said Article XXIV.[7]

Article XXIV of GATT (1994) applies specifically to: (i) customs unions (removal of trade barriers and adoption of a common external tariff with regard to other countries), (ii) free trade areas (removal of trade barriers, however, with autonomy of the relevant parties to impose differentiated tariffs with regard to other countries) and (iii) transition agreements toward any of the aforementioned types of integration. In order to be consistent with GATT rules the foregoing agreements shall comply with the following provisions of Section 5 of the abovementioned Article:

[7] *Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade* 1994

- Avoid creating a post-agreement situation that is more restrictive in tariffs and/or trade rules for GATT members that do no participate in the relevant agreement. Which should take into consideration a general evaluation of weighted average tariffs and collected customs rights;
- Include, in the case of transition agreements, a timetable for implementation of the customs union or free trade area in a reasonable period of time, understood as not in excess of ten years.

In the definition of customs union and free trade area set forth in Section 8 of Article XXIV, the expression "with respect to substantially all the trade" allows a flexible margin so that agreements be considered valid even if tariff harmonization or elimination is not total.

Additionally, Section 10 of Article XXIV makes possible to approve proposed preferential agreements that bring about partial liberalization without the configuration of a free trade area even if they do not comply with provisions of sections 5 to 9. Which, however, needs the approval of two thirds of the members of GATT/WTO.

The possibility of agreements that create services-related preferences is defined by Article V of the ***General Agreement on Trade in Services*** (**GATS**). Article V of GATS establishes two preconditions for such agreements: (i) *substantial sectorial coverage*, as regards the number of sectors included, impacted trade volume and service rendering modes and there should not occur *a priori* exclusion of any service rendering mode; and (ii) absence or elimination of *substantially all discrimination* among the relevant parties for the covered sectors by means of elimination of existing discriminatory measures and/or ruling out of new or even more discriminatory measures, with some exceptions. Additionally, the same article anticipates a more flexible treatment for developing countries.

In evaluating service agreements it is necessary to take into account their relation with a broader process of economic integration among the related countries. In fact, many services agreements integrate a broader characteristic of free trade agreements.

2.2. NON-RECIPROCAL PREFERENTIAL AGREEMENTS

In addition to reciprocal preferences agreements – exchange of concessions among the involved parties – there are agreements that establish preferences without need of reciprocity. These are the so called non-reciprocal or unilateral preferential agreements.

In 1971 the "Decision on Waiver for the Generalized System of Preferences" made by GATT parties authorized the creation of a Generalized System of Non-Reciprocal Preferences that could be granted by developed countries to developing countries for a 10-year period initially.

At the end of the Tokyo Round (1973-1979), the GATT parties approved a "Decision on Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries" dated November 28, 1979. The foregoing Decision that became known as Enabling Clause[8] authorizes differentiated and more favorable treatment of developing countries, without need to extend it to other GATT parties in the following cases:

(a) Preferential tariff treatment granted by developed countries to products originated in developing countries consistent with the Generalized System of Preferences (GSP),

(b) Special and more favorable treatment with regard to GATT provisions as regards non-tariff measures governed by provisions of multilaterally negotiated instruments under GATT sponsorship;

(c) Preferential agreements between developing countries and/or less developed countries, for mutual reduction or elimination of tariffs and consistent with criteria and conditions defined by the parties to contract, for mutual reduction or elimination of non-tariff measures related toproducts imported among themselves;

(d) Special treatment to less developed countries among the developing countries in the context of any general or specific measures in favor of developing countries.

The Enabling Clause makes possible a differentiated treatment for countries categorized as "less developed" within the group of developing countries. However, a differentiation among the other developing countries is not specifically authorized. Yet, in a recent decision made at the Panel on European Communities – "conditions for granting tariff preferences to developing

[8] *Decision on Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries* (***Enabling Clause***), 1979

countries,"[9] the Appelate Body understood that the provisions in section 3(c) of said Clause allows to differentiate among developing countries consistent with their different financial and trade needs. This interpretation makes even more complex the task of defining limits for discretionary concession of preferences.

> In addition to the abovementioned provisions, there is the possibility of requesting an authorization to WTO for preferential agreements that do not fit in any of the examined provisions. In this case the authorization depends on the approval of three fourths of WTO Members. Fall into this category the non-reciprocal preference agreements granted by the European Union to African, Caribbean and Pacific countries (Cotonou Agreement) and by the United States of America to Caribbean Basin countries (Caribbean Basin Initiative) and Andes (Andean Trade Preference Act). In these arrangements the grantor countries discretionarily select beneficiaries which include not only countries in the less developed category which would make them fit for the Enabling Clause, but also some of the developing countries.

3. ECONOMIC ASPECTS

The main purpose of Article XXIV as it allows exception to MFN treatment by means of trade preferential agreements would be, in theory, to encourage free trade and, therefore, economic growth.

For classical trade theory commercial liberalization would allow countries to export domestically produced goods and services with greater efficiency and import less efficiently obtainable goods and services. This way countries could specialize in the production of goods and services they are more efficient at and benefit from comparative advantages. Production specialization would lead to greater labor productivity and consequently to increased income and well-being.

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[9] WTO (2004). Report of the Appellate Body, *European Communities – conditions for the granting of tariff preferences to developing countries*, WT/DS246/AB/R. Adopted on April 7, AB-2004-1

The concept of comparative advantage[10] from classical trade theory justifies the most traditional method for appraisal if the intended well-being increase is being attained in a specific trade agreement of a preferential nature. So after the elimination of tariffs there will be trade creation if it occurs a substitution of domestic production carried out by inefficient suppliers with imports from more efficient intrabloc suppliers. On the other hand, there will be trade diversion if the trade preferential agreement leads to a substitution of efficient suppliers with imports from less efficient suppliers intrabloc. The net result of the effects of trade creation and trade diversion with regard to the group of tradable goods and services will indicate whether the preferential agreement is or not beneficial.

According to this criteria, if the net trade creation is positive, the preferential agreement is considered beneficial and would be contributing to attain the purpose of improved well-being by way of increased trade flow. Otherwise, that is, if the net trade creation is negative, the preferential agreement would not contribute for the attainment of this major target.

For example, empirical studies conducted by the World Bank in mid 1990s on Mercosur[11] suggested that a more intense growth of intrabloc trade generally involved goods in which production the bloc countries did not have comparative advantages and, therefore, would not be able to export in competitive manner to extrabloc countries, which represented a pattern consistent with the substantial trade diversion associated with said agreement.

However, the so called New Trade Theory[12] states that the conventional way to assess the economic impact of trade preferential agreements derives from little realistic presuppositions and takes into account only the static effects of changes promoted by the said agreements. The possible economic implications of regional trade agreements should be analyzed under an

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[10] Based on the concept of comparative advantage introduced by David Ricardo (1817), Jacob Viner (1950) theoretically dealt with effects of the selective trade liberalization resulting from the formation of customs unions. The presuppositions assumed are the same of the Ricardian model: perfect competition; constant returns to scale, improved technology accessible and constant. From Viner's theoretical argument derived the concepts of trade creation and trade diversion.

[11] Yeats, Alexander J. (1998): *Does Mercosur's Trade Performance Raise Concerns about the Effects of Regional Trade Arrangements*? The World Bank Economic Review **The World Bank**, Washington DC. Vol. 12, no. 1 : 1–28.

[12] The so called *New Trade Theory* assumes as presuppositions: the existence of imperfect markets, the possibility of increasing returns to scale and, technological change. See, for example, Frankel,J (1997)

additional perspective, that is, through a long term evaluation of the economic results of a trade preferential agreement as regards the cumulative increase in the growth rate of the involved economies. The abovementioned increase would result from economies of scale, greater competition and encouragement to investment. This way, at the same time the effect of trade creation and trade diversion derives from a static view based on little realistic presuppositions, the long term assessment is rooted in the analysis of dynamic effects from the trade preferential agreement in an economic environment considered closer to the real one.

An additional perspective considers that the analysis of impacts of trade preferential agreements should assess other effects of the integration process, such as: improved strategic position in multilateral negotiations among the participant countries; reformulation and update of local economic institutions; and consolidation of domestic economic reforms.

4. ANALYSES OF SYSTEMIC ISSUES RELATED TO RTAS

Until the end of the Uruguay Round (1994) and the foundation of WTO (1995) the analysis of regional trade agreements used to be carried out by individual working parties at GATT. Subsequent to WTO foundation and by decision of the General Council in its meeting dated February 1996 the Committee on Regional Trade Agreements (CRTA) was created. The Committee became the focal point for all analysis work on trade agreements and allowed improved examination procedures in addition to creating a forum for discussion of the so called systemic issues that repeatedly occur in trade agreements. Systemic issues deal with the understanding of rules created by the agreements in comparison with what was established by GATT (1994), Enabling Clause (1979) and GATS.[13]

4.1. COMMITTEE ON REGIONAL TRADE AGREEMENTS (CRTA)

The examination of a trade agreement at the Committee (CRTA) has two purposes: to ensure transparency of Regional Trade Agreements (RTAs) and allow Members to evaluate the consistency of trade agreement clauses with GATT provisions, Enabling Clause and GATS.

The examination process starts with the agreement notification to WTO. The CRTA Secretariat collects basic information and distributes them to the Members, which ask written questions with regard to items of the relevant agreement. The parties also provide written answers and the consolidation of those questions and answers is scrutinized in several meetings of the CRTA.

Once the examination process is over, the Secretariat writes a Final Report on the examined agreement and delivers it to the respective superior organization: the Council for Trade in Goods, Council for Trade in Services or Committee on Trade and Development. In the Final Report the CRTA only makes recommendations regarding eventual modifications that are to be

[13] Those issues are related to interpretation of some provisions of Article XXIV of GATT (of 1947 and its Understanding dated 1994) and of Article V of GATS

carried out by the parties, and the Councils or the appropriate Committee can adopt the necessary measures for implementation thereof.

RTAs related to Article XXIV are notified to the Council for Trade in Goods (CTG) which adopts the terms of reference and conveys the relevant agreement to CRTA for examination. Notifications on agreements related to Enabling Clause are made at the Committee on Trade and Development (CTD).

RTAs covering trade in services are notified to the Council for Trade in Services (CTS). The Council conveys the relevant agreement to CRTA for examination.

However, no report has been completed since 1996 due to lack of consensus among CRTA Members. The main difficulties in the reaching of consensus on agreements examination are the following:

1) utilization of the CRTA analysis with disputes solution process;

2) difficulty to interpret WTO provisions regarding RTAs;

3) difficulty to understand a few GATT rules, for example, rules of origin, safeguards, antidumping and antisubsidies.

The Committee is also responsible for analyzing systemic issues present in every agreement examination process.

In order to clarify major controversies relating to systemic issues the Secretariat prepared a series of documents containing a list of subject items for discussion of regional trade agreements[14]. Thus the Committee examines each item under three main perspectives: (i) the legal aspect taking into consideration the relevant WTO provisions; (ii) the horizontal comparison among RTAs; and (iii) the analysis of economic features of the agreements. (WT/REG/W/38).

[14] TN/RL/W/8/Rev.1; WT/REG/W/8; WT/REG/W/12; WT/REG/W/16; WT/REG/W/17; WT/REG/W/17/Add.1; WT/REG/W/21; WT/REG/W/21/Add1; WT/REG/W/21/Rev.1; WT/REG/W/37;WT/REG/W/38; WT/REG/W/41

4.2. SYSTEMIC ISSUES

In 2002 the Rules Negotiating Group of WTO[15] proposed a systematization of the main aspects involved in discussions on Regional Trade Agreements. The need to systematize the most recurring issues was a result of the problems met by CRTA during analyses of trade preferential agreements. As a result a document[16] was prepared so as to put the relevant systemic issues in order and group them for discussion as follows:

1. Transparency;
2. Multilateral Supervision Mechanisms;
3. Relationship between RTAs Rules and WTO Rules;
4. Interdependence of specific RTAs rules;
5. Interpretation of specific terms of Article XXIV of GATT;
6. Interpretation of specific terms of Article V of GATS;
7. Regionalism and Multilateralism.

4.2.1. Transparency

The need for transparency has to do with the way agreements notification and examination process are carried out. As regards notification, the discussion is on the following aspects: when to notify, what to notify and how to notify an agreement. As regards examination of agreements, transparency is understood as the definition of periodicity, format and content of the reports delivered to CRTA.

The period in which a specific agreement should notified is not accurately defined by WTO rules. So, many RTAs are notified when their legal texts already were ratified by Members, or still, when the agreements already are in effect. This fact tends to limit the effectiveness of the examination process.

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[15] *Compendium on Issues Related to Regional Trade Agreements*, TN/RL/W/8/Rev.1, 1/08/2002, WTO

[16] TN/RL/W8/Rev.1, WTO

The terms *shall promptly notify* and *deciding to enter* present in Article XXIV Section 7 (a) allow to interpret that the notification and the delivery of information should occur at least before the RTA's legal effect.

The Committee considers necessary to deliver detailed and uniform economic statistics at notification time. The document WT/REG/W/46 attempts to standardize initial information for Members of RTAs. Since 1996 member countries of all notified RTAs have delivered information consistent with standards set. There is difference of opinion as regards the use of said more detailed information for the establishment of a tariff basis.

The follow-up reports required by CRTA are considered exceedingly important since they allow greater clarity of RTAs content and impact. In the 1999-2001 period most participants of RTAs delivered the required reports by CRTA. However, it remains a difficult task to collect and homogenize full statistical information on trade. An additional issue is if the requested information should be only quantitative or if it should be qualitative as well.

Since the foundation of WTO the pressure of members for greater transparency of Regional Trade Agreements is becoming increasingly higher. Which is also the reason why the Committee on Regional Trade Agreements was created. Yet, it has not been possible to reach consensus on format and content of RTAs reports, both the initial and the follow-up ones. Neither was defined whether the report analysis carried out by the Committee should be conclusive or not.

4.2.2. Multilateral Supervision Mechanisms

The second group of systemic issues comprises problems related to the multilateral supervision mechanism. In other words, its purpose is to analyze the homogeneity of supervision requirements and the legal status of RTAs in relation to WTO rules.

RTAs entered by developing countries are generally notified under the Enabling Clause and even where they create free trade areas, customs unions or transition agreements they do not need to be notified to CRTA as the Enabling Clause does not call for such examination. Extraordinarily, in the case of the Mercosur (Southern Common Market) entered by Argentina,

Brazil, Paraguay and Uruguay it was considered that due to its importance it ought to be examined also in accordance with the provisions of Article XXIV.

Status *vis-à-vis* RTAs examination process notified in GATT/WTO

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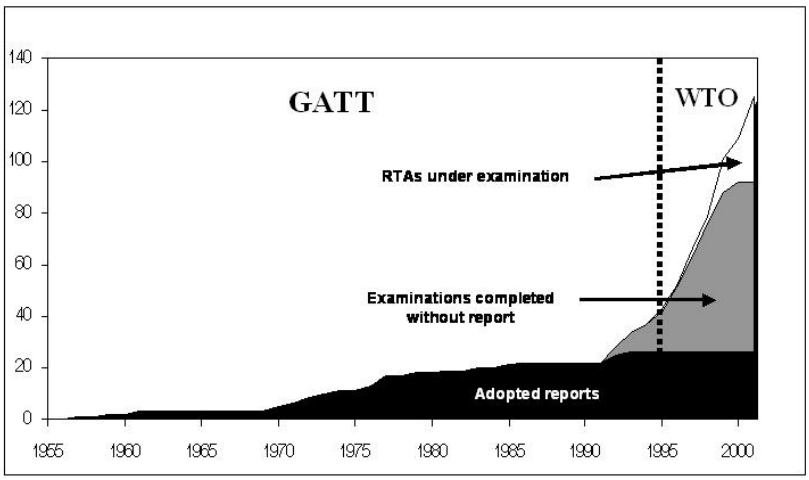

Source: TN/RL/W/8Rev.1

4.2.3. Relationship between RTAs rules and WTO rules

The third group of systemic issues analyses the relationship between specific RTAs rules and the other WTO rules. A clarifying example is the relationship between Article XXIV and Enabling Clause. Which questions whether Article XXIV should revoke only the MFN obligation (Article I of GATT) or also other provisions thereof. It has been noted that the use of waivers to negotiate agreements between developed countries and developing countries is also facing difficulties.

In this context and with the purpose of overcome said problem it has been suggested that negotiations should also take into account aspects related toRTAs development, so that any new rule could protect the interests of developing countries.

An additional example regarding the third group of systemic issues is the analysis of Article V at GATS. The discussion is around the reach of permitted exemptions to Economic Integration Agreements (EIAs). One of the interpretations is that Article V does not allow any other exemptions in addition to those already provided for in the MFN clause. Thus the GATS principles of transparency, fair management of regulations and emergency safeguards should not be revoked.

4.2.4. INTERDEPENDENCE OF SPECIFIC RTAS RULES

The fourth group comprises the interdependence of specific RTAs rules, that is, it raises questions on interpretation of some sections both in Article XXIV of GATT and in Article V of GATS.

With regard to internal questions related to Article XXIV there is an initial difficulty: the impact of measures resulting from trade preferential agreements on third countries.[17] This discussion is related to possible negative impacts (trade restriction) that a measure adopted inside a RTA to facilitate intrabloc trade would have with reference to third parties.

Another problem resulting from interpretation of Article XXIV refers to regional trade agreements that create customs unions or free trade areas.[18] According to the foregoing Article, the constitution of customs unions or free trade areas should not cause increased tariffs or intensification of other restrictions in comparison with existing ones prior to signature of the regional trade agreement of a preferential nature.

With regard to internal questions related toArticle V of GATS, the phrase *substantial sectorial coverage* brings about the following question: the examination should limit itself to parameters of the foregoing Article or should other factors also be examined, which question relates to the ambiguity of the Article itself.

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[17] Article XXIV, Section 8(a)(ii), GATT 1994

[18] Article XXIV, Section 5 (a) e Section 5(b), GATT 1994

4.2.5. CONSTRUCTION OF SPECIFIC PROVISIONS OF ARTICLE XXIV OF GATT

The fifth and largest group deals with interpretation of specific terms of Article XXIV. In Article XXIV, the term *substantially* appears in several places, such as in Section 8(a)(i) and Section 8(b), as *substantially all the trade*. There are two interpretations for the relevant term, a quantitative one based in statistical data such as a certain percentage of the trade between parties to a RTA and a qualitative one which deems that no sector (or at least the greater part of them) can be kept out of intrabloc trade.

The term *other restrictive regulations of commerce* (ORRCs) used in Section 8 was never defined in GATT/WTO. The list presented under Section 8(a)(i) and Section 8(b) lists cases of trade preferential agreements in which exceptions would be admitted as regards provisions of the following articles: **Article XI** (General Elimination of Quantitative Restrictions); **Article XII** (Restrictions to Safeguard the Balance of Payments); **Article XIII** (Non-Discriminatory Administration of Quantitative Restrictions); **Article XIV** (Exceptions to the Rule of Non-Discrimination); **Article XV** (Exchange Arrangements); and **Article XX** (General Exceptions) of GATT 1994.

However, important doubts remain as regards: safeguards; antidumping measures; and antisubsidies applied between the parties, or by one party against third parties. Even in case of internal application between parties that make up the agreement of a preferential nature there are discussions related tothe need to analyze the purpose and the application of said measures and how they impact other countries outside the agreement.

The term *other regulations of commerce* (ORC), present in Section 5 is under discussion since the negotiations around the text Understanding of Article XXIV of GATT 1994. In this context the main controversy is related torules of origin set forth in RTAs. The point is whether or not rules of origin constitute *other regulations of commerce* (ORC). There are four distinct positions in this regard.

The first asserts that rules of origin cannot be considered ORCs because they are not intended to regulate trade with third parties. The second position says that there is no clear definition of ORC in Article XXIV, which allows a generalization of the meaning of said term, referring it to all measures that affect trade. The third position draws attention to the trade restricting effect of rules of origin derived from trade preferential agreements. And finally, the fourth position asserts that rules of origin resulting from regional trade agreements encourage an integration of the parties thereto which would promote the intensification of trade relations all together.

4.2.6 Construction of specific terms of Article V of GATS

Just as there are doubts regarding terms used in Article XXIV of GATT, there is also a controversy with regard to the interpretation of specific terms of Article V of GATS. According to document TN/RL/W8/Rev.1 this constitutes the sixth group of systemic issues.

In Article V of GATS, the terms *substantial* and *substantially* appear, for example, in Section 1(a) in *substantial sectorial coverage*. The question is to determine what is the extent of liberalization.

Analyzing the footnote of Article V Section 1(a), we have a possible interpretation of the term: *understood in terms of number of sectors, volume of trade affected and modes of supply*, that is, in principle an Economic Integration Agreement (EIA) could not exclude *a priori* any of the four modes of service or sectors[19].

There is coexistence of two interpretations as regards the understanding of *substantial sectorial coverage*. According to the first interpretation, not all sectors should be covered.

[19]Article I of GATS lists the four service rendering modes: (i) from the territory of one member to the territory of any other member (mode # 1); (ii) inside the territory of one member for a service consumer from any other member (mode # 2); (iii) by a service provider from one member, by way of commercial presence for the territory of any other member (mode # 3); and (iv) by the service provider from one member through the presence of a natural person of one member in the territory of any other member (mode # 4). The services are classified in eleven sectors: services provided to companies, communications, civil construction and related engineering services, distribution, education, energy, environment, financial services, social and health care services, and tourism and transportation.

However, the second interpretation does not allow exclusion of any sector, since the term *substantially* does not allow the first interpretation above.

The term *coverage of modes of supply* also allows two interpretations: the first one states that Economic Integration Agreement (EIA) should include all service modes; and the second says that the EIA could *a priori* exclude investment and labor mobility.

There is also divergence with regard to the application of emergency safeguards between parties to an EIA. Basically there are the two following interpretations:

- Article X should be added to the list of exceptions so that safeguard measures could be applied.
- Safeguard measures should not be applied between parties to EIA since they would not result in the elimination of comparative advantages.

Still as regards safeguards, there is a question related to what other types of discriminatory measures could be considered legitimate exceptions as a result of the following phrase: *absence or elimination of substantially all discrimination*, set forth in Section 1(b).

Finally, in Section 1(b) the term *reasonable time-frame* is not clear as to a definition of the time period considered reasonable for elimination of discriminations. Some members support a 10-year period for integration in the area of goods. Other members consider ten years too long a period and support a 5-year period since a new round on negotiation in services should begin after five years of GATS legal effect. In addition, other members maintain that the period should be applied on case analyses made on a one-by-one basis and should not be formally defined.

4.2.7. REGIONALISM AND MULTILATERALISM

Finally, the seventh group of systemic issues relates to the debate between Regionalism and Multilateralism. At WTO's 4th Ministerial Conference, in Doha (2001), WTO members recognized that RTAs can have an important role both in the trade liberalization process and in the promotion of economic development. For this they highlighted the need to harmonize the relationship between multilateral and regional processes. In this sense, the Ministers agreed to

start negotiations aimed to clarify and perfect the disciplines and procedures under WTO provisions applied to RTAs.[20]

The questions arising from confrontation between regionalism and multilateralism are based on the discussion of the role of RTAs as either catalysts or blockers of the multilateral trade system.

It can be confirmed that as regional trade agreements involve a smaller number of participants and deal with more convergent economic interests, they would be easier and quicker to be implemented than multilateral agreements.

Based on the abovementioned observation, some authors maintain that RTAs would be important promoters of greater trade liberalization, the very last objective of a multilateral trade system. An emblematic case is the European Union's. It has been considered that the formation, consolidation and expansion of the European Union has represented an important encouragement of the progress of multilateral agreements. Consistent with this viewpoint, there would be a great synergy among regional trade agreements and the multilateral trade system.

Recently the concept of "competitive liberalization" has been used to qualify the process of "dispute" between regional and multilateral agreements that would lead to a coalition of winners. The agility in proposing and obtaining trade preferential agreements would represent a greater ability of certain countries to perceive and to benefit from opportunities resulting from trade liberalization. Those countries would lead countries less inclined to free trade to accept rules negotiated in a regional context of the multilateral system.

However, some authors maintain that preferential agreements instead of encouraging the trade liberalization process and increase trade flow, actually represent a hurdle. The traditional

[20] Doha Ministerial Declaration Section 29: "*We also agree to negotiations aimed at clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements. The negotiations shall take into account the developmental aspects of regional trade agreements*".

economic reasoning is based on the fact that the creation of preferential rules could oppose the market and cause inefficiency.[21]

An additional and less conventional reasoning is that regional agreements reflect more clearly the existing asymmetries between countries, as most such agreements are proposed by developed countries with obvious intention of controlling the relevant income generation and absorption processes. Consequently for developing countries or less developed countries regional trade agreements would be far from being a possibility to reduce the existing asymmetries.

In the discussion between regionalism there is also an issue regarding the effects that the superposition of preferential agreements would have on the multilateral system. There are two conflicting viewpoints in this regard.

The critical view of the multiplication and superposition of regional trade agreements point toward the increasing difficulty to conciliate the rules of the various RTAs among themselves and with regard to multilateral rules. The diversified groups of trade rules resulting from the fast growth of trade preferential agreements, as well as the expansion of the existing blocs would increase the complexity of existing requirements in trade relations.

RTAs are considerably heterogeneous among themselves and present different degrees of coverage, which is seen as a hurdle for expansion of trade flow. The trade regimes established by preferential agreements could be conflicting with multilateral rules. For example, with reference to rules of origin, antidumping rules used against third parties, competition rules among the parties, and dispute resolution mechanisms. The existence of disciplines pertinent to each RTA is seen as a threat to the multilateral system. Additionally, preferences defined among countries at a certain point in time could be eliminated as a result of new agreements that are being entered by the parties, which would erode earlier preferences.[22]

Those that understand hat the RTAs proliferation process is essentially positive in character maintain that since preferential agreements are more enterprising on elimination of non-tariff barriers they promote multilateral negotiations and expand and consolidate the promarket economic reforms of the 1990s.

5. RTAS: EMPIRICAL EVIDENCES

[21] Classic argument for trade diversion already mentioned.

[22] See, for example, *Erosao das Preferencias Comerciais Brasileiras na America Latina* in Barbosa, R et al. (2004)

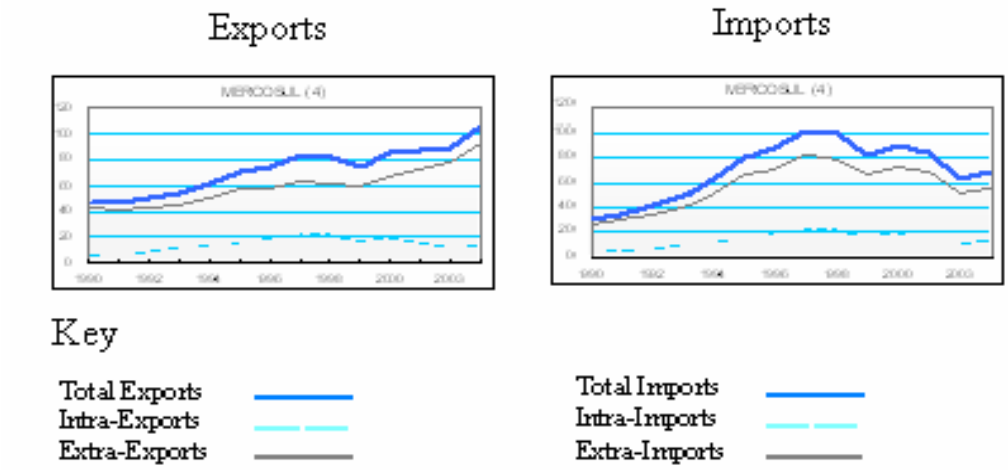
The real impact of the proliferation of preferential agreements can be analyzed under several points of view. One methodology frequently used is the case analysis because if facilitates the observation of facts that could often be generalized. However, the lack of homogeneity of regional trade agreements makes it difficult to reach more general conclusions.

5.1. ECONOMIC IMPACTS

One way to measure the economic impacts of preferential agreement is to analyze the evolution of participation in intrabloc trade flow compared with extrabloc exports/imports and totals thereof.

Mercosur Trade Volume in the 1990-2003 period

(in US$ Billion)[23]



On the other hand it should also be highlighted that provisions of a given agreement could benefit not only the intrabloc trade flow but also the total exports/imports of countries that constitute the said bloc.

[23] Source: WTO Elaboration- Merchandise trade of selected regional integration arrangements, 1990-03, International Trade Statistics, 2004, www.wto.org

Therefore, considering the difficulty to separate RTA effects on countries that are parties thereto from other conditioning factors that affect international trade based on those simple indicators, economists make use of two additional tools for analysis:

1) Computable general and partial equilibrium models are based on the presupposition that tariff changes have an effect on prices of imported goods in relation to domestically manufactured goods. This change in relative prices alters the portion of total demand that is covered by imports;
2) Gravitational econometric models that are so named because as in Newtonian analysis the trade between countries increases in relation to the size of the said economies and their geographic proximity, which allows the evaluation of trade agreements after they had entered into force.

Computable general and partial equilibrium models such as, for example, the *General Trade Analysis Project* (GTAP)[24] allow simulations of agreement impacts prior to their execution. They are important for the analysis of free trade agreements as they measure sectorial integration within agreements and provide data on interregional trade flows. The general equilibrium model adopted by GTAP is characterized by its power to cover all trade and production worldwide; and take into consideration that companies operate under constant returns to scale and perfect competition.[25]

Gravitational models[26] allow analyses of bilateral trade flows by means of a gravitational equation comprising economic variables (GDP, per capita GDP), geographic variables (territory size, distance between countries, common geographic borders) and even linguistic variables.

In order to minimize distortions in results of gravitational equations, in addition to the abovementioned variables some scholars include the relative distance. The concept of relative distance relates to the degree of isolation a given country has in relation to its trade partners that have greater economic weight worldwide (Polak (1996) and Smarzynska (1999)). Without the presence of the latter variable the trade carried out among countries located at a greater distance of economic hubs would be overestimated while the trade among countries near the said hubs would be underestimated.

5.2. MAP OF RTAS IN EFFECT

[24] Visit http://www.gtap.agecon.purdue.edu/

[25] For additional information see: Itakura, Hertel and Reimer. The Contribution of Productivity Linkages to the General Equilibrium Analysis of Free Trade Agreements. GTAP Working Paper No.23. March 2003

[26] See Frankel, Stein and Wei. Regional Trading Arrangements: Natural or Super-Natural?, National Bureau of Economic Research, January 1996

Frankel (1997)

As pointed out in the foregoing sections the difficulties related to trade preferential agreements include not only the punctual follow-up by WTO of all agreements in force but also the impact measurement with regard to each agreement.

The initial challenge is to accurately identify how many agreements are currently in force. According to World Bank,[27] the time gap between agreement signature and notification thereof is approximately 354 days. Out of the more than 250 notified agreements WTO understands that 208 were in force on May 1st, 2004. It has been confirmed that in current arrangements the developing countries are getting progressively closer to developed countries by extending the South-South agreement model (between developing countries) to a North-South agreement type (between developed countries and developing countries).

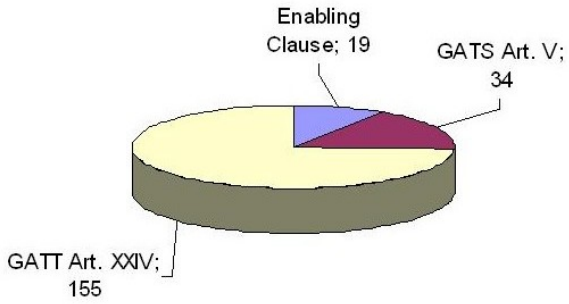
With regard to the regional distribution ofpreferential agreements, they are concentrated in the Americas and Europe. It is worthy mentioning, however, that this is a dynamic distribution since minor agreements are continually incorporated into wider agreements as in the case of bilateral agreements that existed between the European Union and its ten new members prior to European Union's enlargement on May 1st, 2004.

5. 3. CLASSIFICATION OF RTAS NOTIFICATIONS WITH REGARD TO PROVISION, TYPE OF AGREEMENT AND CRTA EXAMINATION STAGE.

In may 2004 the number of agreements notified to GATT/WTO was 208 including twelve notifications of accession and one hundred and ninety-six notifications of new RTAs. Out of the 208 notifications, 155 were registered under Article XXIV, 19 were registered under the Enabling Clause (including Mercosur - see below) and 34 were registered under Article V of GATS. A considerable number of regional agreements involves the EC which participates in 53 agreements (including European Union enlargement agreements), particularly with Eastern European countries. The European Free Trade Association (EFTA) is involved in 24 agreements, the United States of America is involved in nine agreements (including NAFTA) and Latin America

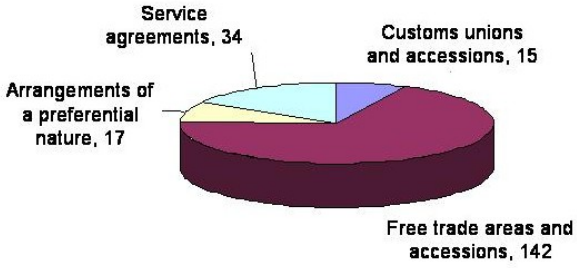
[27] World Bank – Global Economic Prospects 2005 – *Trade, Regionalism and Development,* Washington, 2005

is involved in at least in 20 agreements (including Mercosur, NAFTA and several other bilateral agreements with Chile and Mexico).



Source: WTO

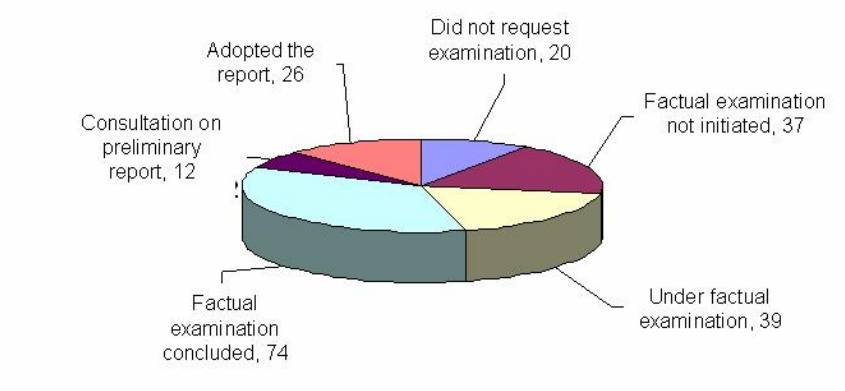
Furthermore, with regard to the 208 notifications, 15 are grouped as customs unions (including Mercosur) or accessions, 142 are grouped as free trade areas or accessions, 34 are grouped as service agreements or accessions and the remainder 17 are grouped as arrangements of a preferential nature.



Source: WTO

By May 2004 the reports on 26 notifications had been adopted, 12 were in preliminary report consultation stage, 74 had their factual examinations concluded, 39 (including Mercosur) were still under factual examination, 37 still did not have their factual examinations initiated and,

lastly, 20 did not request examination (so including those notified under Enabling Clause, exempt from said examination[28]).



Source: WTO

6. CONCLUSIONS AND RECOMMENDATIONS

Two representative characteristics of contemporary capitalism are globalization and regionalization. This new capitalism has emerged both from relevant technological transformations initiated on the second half of the 1970s and from an economic policy identified as a market-friendly economic policy and described by such words as deregulation, privatization and, most importantly, liberalization of financial flows.

The economic internationalization process – expressed in the continuous and faster growth of financial flows, direct investment and trade than of product growth – has increased the interdependence of national economies. The technological revolution – characterized by the way information is handled and transmitted in real time – intensified and made possible this increased approximation among the various markets. Therefore, the so called globalization phenomenon has the attribute of intensifying the interdependence relationship among the various economies.

[28] As we shall see hereinafter, the Mercosur formation agreement was notified under the Enabling Clause, however, due to its substance the agreement is also being examined under Article XXIV.

On the other hand competitive advantages have assumed increasingly regional characteristics. Space concentration strengthens opportunities in production and services and consumer markets in geographically near economies. Those two forces – globalization and regionalization – can, therefore, be understood as complementary dimensions of contemporary capitalism dynamics.

As its main result, this new capitalism characterized by globalization and regionalization has deeply modified relationships between nations. As regards trade relations, the multilateral dimension maintained and expanded has been intensely supplemented by regional trade agreements. The US position is an example of this process: if the US has been responsible for the introduction of numerous new themes in a multilateral circuit – and, in this sense the Uruguay Round is the fundamental milestone – on the other hand they also intensified the preferential agreements in the same period.

Even in developing countries a much more active participation in a multilateral forum has been intertwined with regional agreements initiatives, seen as strategic for the maintenance and attainment of competitive advantages in a globalized economy.

For this reason, the lack of forward progress in multilateral negotiations does not seem to be the either the only or the main cause of the proliferation of preferential agreements, as mentioned by several authors. Considering the characteristics of contemporary capitalism one should expect the proliferation of regional trade agreements so as to ensure the expansion of business. It could further be stated that such a plethora of preferential agreements is also related to reasons that go beyond the economic rationale. This way, geopolitical motivations should also be taken into consideration in the analysis of actual cases.

For example, in Latin America the proliferation of preferential agreements so as to constitute free trade areas is quite remarkable.[29] Several of those agreements follow a business rationale but some have purposes that are not directly economic. However, a common feature in

[29] According to Granados (2004) data the Latin American countries participate in five regional agreements involving more than two countries of the region, seven North-South type agreements of a preferential nature (free trade area), four South-South type free trade agreements. Additionally, fifteen new agreements of a preferential nature are currently being negotiated in the region.

these agreements is that they do not solve the problem of access for agricultural products and for this reason the progress of agriculture-related negotiations in the Doha Round is crucial. Also, the escalation of these agreements has eroded preferences previously negotiated at ALADI (Associacao Latino Americana de Integracao)[30]. In summary, actual interests of the countries from this region have fostered preferential agreements but the multilateral trade system is definitely necessary.

This is the reason why the discussion on coordination and compatibility of regional agreements with the multilateral trade system was included in the Work Program of the Doha Mandate. The final purpose of this Round as regards the subject matter is "....*aimed at clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements. The negotiations shall take into account the developmental aspects of regional trade agreement*." [31]

However it is recognized that due to the complexity of the systemic issues related to regional trade agreements it will be considerably difficult to set forth clearer and definitive rules on this subject matter in the current round of negotiations at WTO. Consequently, it is believed that the multilateral dispute settlement mechanism shall be increasingly set in motion to eliminate doubts, handle pendencies and equate differences among participant countries that are members of preferential agreements.

It is also worthy mentioning that the General Agreement on Tariffs and Trade (GATT/1947) represented a significant landmark to reduce and discipline the proliferation of preferential agreements that prevailed prior to World War II. As it was said before, the adoption of the principle of Most Favored Nation meant a relevant type of trade protection for member countries and also a decisive step for trade liberalization. Currently, however, it has been

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[30] For additional information in this area see Barbosa (2004)

[31] Doha Ministerial Declaration / Work Program / Rule Section 30 "*We also agree to negotiations aimed at clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements. The negotiations shall take into account the developmental aspects of regional trade agreement.*."WTO,2001

observed that under multilateral system rules the regional agreements are yet again proliferating in a vigorous and disorganized manner.

In this sense the role played by WTO as discipliner of regional agreements is of the foremost importance. Which role shall be fulfilled from the confirmation of the economic complexity imposed by reality. Therefore, WTO could emphasize its function of harmonizing and supervising the various sets of rules so as to effectively maintain its fundamental purpose of intensifying trade relations among the countries and collaborate for an increased well-being of the society as a whole.

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