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MULTILATERALISM AND REGIONALISM: THE NEW INTERFACE

Chapter I: Multilateralism and Regionalism: The New Interface



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Chapter I

MULTILATERALISM AND REGIONALISM: THE NEW INTERFACE

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Introduction

The agenda of the eleventh Conference of UNCTAD (UNCTAD XI) centered on the coherence between national development strategies and global economic processes to promote economic growth and development, particularly of developing countries.² A central aspect of this agenda is international trade and trade negotiations both at the multilateral level under the WTO, and at the regional (including bilateral, subregional and interregional) level. The interface between the two processes has important implications for the trade and development prospects of developing countries. They can be complementary and coherent with the multilateral trading system (MTS), and thus facilitate international trade and enhance development prospects, or they can be divergent and hence undermine the collective and national effort to use international trade as an engine of growth and development. The coherence between multilateralism and regionalism becomes an opportunity and challenge for countries, as well as their regional arrangements and the WTO to manage in the evolving international trading system in order to maximize their potential benefits and minimize their potential adverse effects.

Effectively managing the interface between regional and multilateral initiatives requires greater synergy between national development objectives and external commitments. Central to this challenge facing developing countries is to design and implement an appropriate and strategic pacing and sequencing of national, regional and multilateral liberalization, so as to maximize development gains from these processes of trade liberalization and regulatory commitments, by rendering regional processes and multilateral liberalization mutually supportive and coherent. A challenge is that simultaneous participation by countries in a web of regional trade agreements (RTAs) while also engaging in the evolving MTS, both of which have overlapping agendas, increasingly affects sensitive development policies and overloads the limited negotiating capital of developing countries. Negotiating and benefiting from RTAs requires important human and institutional resources and infrastructures and resolving underlying asymmetries, including with respect to size and economic conditions. This new interface between multilateralism and regionalism in terms of coherence and compatibility deserves special attention by policy makers and requires careful and in-depth study.

This chapter provides some initial perspectives on the new interface between the post-WTO multilateralism, which is in flux, and the new-generation regionalism, which is in the process of expansion, with a view to identifying ways and means of addressing important policy challenges arising from the evolving interface between the two processes, and rendering such

¹ The authors wish to thank Mr. James Mathis of the University of Amsterdam and Mr. Bonapas Onguglo of the UNCTAD Secretariat for their insightful comments on an earlier draft of this chapter. Any remaining errors are the responsibility of the authors. Views expressed in this chapter are those of the authors and do not represent those of the UNCTAD Secretariat.

² TD/L.368, 17 May 2004.

interface a positive and sustainable one that acts to assure development gains from international trade and trade negotiations for developing countries and helping implement the Millennium Development Goals. Section I provides an overview of recent policy developments in the international trading system, and the evolution of the regional initiatives and integration processes. Section II takes stock of the effects of regional, as against multilateral, trade liberalization, and the pros and cons of the multilateral versus the regional approach to trade liberalization and their complementarity. Section III focuses on the general policy question of how developing countries could manage the parallel negotiations at the multilateral and regional levels in respect of WTO rules on RTAs, market access issues (agricultural and non-agricultural products, as well as services) and non-tariff barriers and regulatory issues. Section IV focuses on a specific form of RTAs, namely North-South agreements, while Section V is devoted to the potential of South-South trade cooperation and integration. Section VI concludes the chapter by drawing some policy recommendations.

I. The evolving multilateral trading system and “new generation” regional trade agreements

The conclusion of the Uruguay Round of multilateral trade negotiations in 1994, and the establishment of the WTO in 1995 to provide the institutional support to the multilateral trade agreements, constituted a significant milestone in the evolution of the multilateral trading system. The principle of “single undertaking” bound all WTO members to all the results of the Uruguay Round negotiations (with the exception of plurilateral agreements), thereby reinforcing the fundamental principle of most-favoured nation (MFN) treatment. With the conclusion of the Uruguay Round and the strengthened MTS, there was an expectation that exceptions to multilateralism, such as regional trade agreements, even though legally covered by the WTO under certain conditions, would either become less of an alternative policy option for countries or will need to be adapted and conducted in such a manner as to become outward-oriented, not inward-looking, and thus constitute building blocks for the new multilateralism ushered in by the WTO.

This objective has been continually emphasized in WTO Ministerial Declarations that reaffirm commitment to the supremacy of multilateralism while recognizing the important role that RTAs can play. This is apparent from paragraph 4 in the Doha Declaration where WTO Members stressed their “commitment to the WTO as the unique forum for global trade rule-making and liberalization, while also recognizing that regional trade agreements can play an important role in promoting the liberalization and expansion of trade and in fostering development”. In the work programme adopted at Doha, WTO Members also agreed to negotiations aimed at clarifying and improving existing WTO provisions applying to RTAs while taking into account their developmental aspects (paragraph 29). Such “developmental aspects” are a concrete expression of the wider emphasis in the DWP on development issues, including implementation-related issues and concerns, special and differential treatment and technical assistance.

As recognized by these Declarations, the growth, expansion and deepening of regional trade agreements has been remarkable. A total of 285 RTAs had been notified to the WTO by 2003, 215 of which are in force today, and the number will exceed 300 by 2007 if another 60 RTAs currently under negotiation and 30 at a proposal stage are concluded.³ Almost all countries in

³ WTO, “The changing landscape of RTAs”, paper prepared for the seminar on Regional Trade Agreements and the WTO held in Geneva on 14 November 2003.

the world and virtually all WTO Members (the exception being Mongolia) today are party to, or are in the process of negotiating, at least one RTA. Thus, regionalism has become a policy option for most countries and is a permanent feature of the international trading environment for the foreseeable future.

A notable feature in the recent rise of regionalism is that countries that have traditionally favoured the multilateral approach to trade liberalization, including Australia, New Zealand, Japan, Singapore, India and the Republic of Korea have joined the RTA bandwagon. The United States has also given more attention to concluding RTAs. A different composition of RTAs involving the widening of country coverage beyond the traditional regional zone has emerged. Significantly, RTAs have emerged between countries and entities in different regions/continents (e.g. EU-Mexico, EU-South Africa, US-Israel, Jordan, Morocco, Chile). In most cases, these agreements are bilateral in membership, concluded by two countries/entities, including the case of free trade agreements negotiated and concluded by the two distinct RTAs (e.g. EU-MERCOSUR under negotiation).

Table 1

Evolution of intraregional exports, and their share in world exports, of EU, NAFTA and FTAA (1990-2003, in millions of dollars and per cent)

	1990	1995	1999	2000	2001	2002	2003
World	3 491 451	5 137 956	5 667 125	6 364 080	6 121 807	6 396 697	7 443 692
European Union (25)	1 022 932	1 385 805	1 587 418	1 618 929	1 623 480	1 732 227	2 063 450
NAFTA	226 273	394 472	581 161	676 441	639 137	626 985	651 213
FTAA	300 700	525 346	734 848	857 839	814 620	797 612	841 264
<i>Share (%)</i>							
European Union (25)	29.3	27.0	28.0	25.4	26.5	27.1	27.7
NAFTA	6.5	7.7	10.3	10.6	10.4	9.8	8.7
FTAA	8.6	10.2	13.0	13.5	13.3	12.5	11.3

Source: UNCTAD Handbook of Statistics 2004.

The expansion, widening and deepening of RTAs has resulted in a situation whereby intra-RTA trade accounted for some 40 per cent of world trade (merchandise imports) in 2000 and will account for over 50 per cent in 2005.⁴ The large proportion of “global” intra-RTA trade would be accounted for by the existing large RTAs, including EU, NAFTA and eventually the proposed FTAA. In 2003, intraregional exports of the EU alone accounted for some 28 per cent of world merchandise exports, while NAFTA intra-exports represented around 9 per cent (see Table 1).

⁴ Based on 113 RTAs covering trade in goods notified to WTO and in force as of July 2000 using trade data for 1999. WTO, *World Trade Report 2003*, Geneva, 2003.

Table 2

Evolution of the share of intraregional exports in total exports of EU, NAFTA and FTAA (1990-2003, per cent)

	1990	1995	1999	2000	2001	2002	2003
European Union (25)	67	66	68	67	67	67	67
NAFTA	41	46	55	56	56	57	56
FTAA	47	53	60	61	61	61	60

Source: UNCTAD Handbook of Statistics 2004.

Furthermore, intra-RTA trade has been significant, or has become more important for RTA members. EU intraregional trade, for example, accounts for some 66-68 per cent of the EU's total trade with the world, while in NAFTA the share of intraregional trade increased from 41 per cent in 1990 to 56 per cent in 2003 (see Table 2). Members of the proposed FTAA will trade among themselves over 60 per cent of their total trade. Thus, international trade flows are increasingly concentrated within regional groupings formed by large trading nations.

The qualitative dimension of RTAs in respect of coverage of policy areas has also evolved. Recent "new-generation" RTAs increasingly cover not only trade in goods, but also other "behind the border" regulatory areas, including trade in services, investment, competition policy, intellectual property rights, government procurement, labour, environment and development cooperation, thereby going beyond multilateral disciplines and liberalization commitments ("WTO-plus"). These are part and parcel of "deeper" integration efforts.

Developing countries are no exception to the process of expansion and reinvigoration of the RTAs.⁵ They have actively participated in regional trade agreements among themselves (South-South) and with developed countries (North-South). In Africa, some 14 RTAs are now in force, including UMA in North Africa and CEMAC, COMESA, EAC, IOC, ECCAS, ECOWAS, UEMOA, SACU and SADC in sub-Saharan Africa. These subregional groupings are expected to constitute a continental scale African Common Market under the auspices of the African Union by 2028. In the Asia-Pacific region, some 10 RTAs are currently in force, including ASEAN, SAARC, ECO in continental Asia and MSG, PICTA/PACER in the Pacific. ASEAN is the precursor RTA in the region and has established the ASEAN Free Trade Area (AFTA) with the internal liberalization objective set for achievement in 2020. SAARC has recently agreed upon transforming the entity into the South Asian Free Trade Area (SAFTA), while ECO has established the ECO Trade Agreement (ECOTA). The Bangkok Agreement is a preferential trade agreement that includes, India, the Republic of Korea and China. In the Americas, there is MERCOSUR, the Andean Community, CARICOM and CACM, and pan-American negotiations are underway for the FTAA to be completed by 2005. In the Middle East, GCC countries plan to establish an economic union by 2010. Negotiations for the Greater Arab Free Trade Area (GAFTA) were launched with a target date of 2008. Four Mediterranean-Basin countries⁶ have signed the Agadir Agreement as a stepping stone towards a Euro-Mediterranean FTA to be established by 2010.

⁵ United Nations, "Bilateralism and regionalism in the aftermath of Cancún: Re-establishing the primacy of multilateralism", synthesis note based on regional papers prepared by ECA, ECE, ECLAC, ESCAP and ESCWA, for the Round Table of Executive Secretaries of the United Nations: Regional Commissions at UNCTAD XI, São Paulo, 15 June 2004.

⁶ Egypt, Jordan, Morocco and Tunisia.

In addition to these subregional agreements, various bilateral preferential trade agreements (PTAs) have been launched among, or involving, developing countries, often on an interregional basis. This include recent initiatives for preferential agreements and closer cooperation under the India-Brazil-South Africa (IBSA) Dialogue Forum⁷, the EC-BIMST Free Trade Agreement,⁸ and bilateral initiatives being studied and launched by ASEAN with its external partners, including China, Japan, the Republic of Korea and India. Other bilateral initiatives include Singapore-Japan, Singapore-New Zealand, Thailand-China, Thailand-India and India-Sri Lanka. In the Western Hemisphere, this involves the following bilateral agreements: Chile-Mexico, Costa Rica-Mexico, Mexico-Nicaragua, Bolivia-Mexico, CARICOM-Dominican Republic and CARICOM-Costa Rica. MERCOSUR maintains bilateral FTAs with Chile, Bolivia and Peru. The United States has accelerated negotiations and conclusion of bilateral agreements with six Central American countries (CAFTA),⁹ Chile, Bahrain, Singapore, Morocco, SACU and Jordan.

II. Systemic implications of the new interface between multilateralism and regionalism

The debate on the interrelationship between MTS and RTAs is long-standing and well documented.¹⁰ It mainly pertains to the following two broad issues: (i) relative welfare effects of non-preferential across-the-board (MFN) liberalization versus preferential liberalization; and (ii) the political economy implications of RTAs for MTS, as well as those of MTS for RTAs.¹¹ While the first question asks which approaches to trade liberalization are superior in terms of trade and welfare gains for the members of RTAs, third countries and the world as a whole, the second question seeks to ascertain the systemic implications of RTAs for the MTS in general and multilateral trade negotiations in particular, i.e. whether regional integration constitutes a building block or stumbling block to multilateral trade liberalization and a more open and liberal multilateral trading system.

In the economic literature, it is well documented that regional integration would entail static and dynamic gain.¹² In a simple partial equilibrium model under perfect competition, an RTA may increase the level of trade between members at the expense of less efficient domestic producers (“trade creation”) or of more efficient third countries (“trade diversion”). The net effect of an RTA on welfare thus depends on the relative size of these two effects. This depends on a variety of assumptions and conditions, including complementarities of production structure among RTA partners and initial level trade barriers, and cannot be determined *a priori*. The dynamic effects resulting from regional integration include competition effects and scale effects. These dynamic effects of regional integration have been a major rationale for the formation of recent RTAs, including those arising from FDI flows, strengthened intellectual property rights protection, or the predictability of the trade regime

⁷ For a case study of South-South cooperation, see UNCTAD, “Regionalism and South-South cooperation: The case of Mercosur and India”, note by the UNCTAD Secretariat, prepared for a pre-UNCTAD XI Forum on the same title, 9 June 2004, Rio de Janeiro, Brazil.

⁸ Bangladesh, India, Myanmar, Sri Lanka, Thailand, Bhutan and Nepal

⁹ Costa Rica, Dominican Republic, El Salvador, Honduras, Nicaragua, Guatemala.

¹⁰ For a literature review of the debate, see, for example, Arvind Panagaria, “The regionalism debate: An overview”, *The World Economy*, vol. 22, no. 4, June 1999, pp. 477-512.

¹¹ The latter aspect of the issue- implications of MTS on RTA - is discussed more extensively in section III.

¹² The theory of customs union was pioneered by the seminal work of Jacob Viner in 1950 (*The Customs Union Issue*, New York: Carnegie Endowment for International Peace) and further improved by other trade theoreticians such as J.E. Meade, R.G. Lipsey and H.G. Johnson.

and institution building and governance. Such dynamic effects of RTAs have been observed most vividly in the EU and NAFTA, which not only increased their intraregional exports but also their trade with the rest of the world.

With regard to the political economic implications of RTAs vis-à-vis the MTS, various arguments have been advanced, both in favour of and against regionalism. On the positive side, RTAs enable participating countries to move closer and quicker to freer trade with stronger disciplines over a wider range of goods and services than could be attained at the multilateral level. RTAs could also act as laboratories for testing approaches to new issues, and their operating experiences can provide the basis for future multilateral trade negotiations for developing rules for application at the multilateral level. In this way, RTAs could be halfway houses or building blocks for a more open and liberal MTS. As regards the supremacy of the WTO over RTAs, the constituent treaties of many new-generation RTAs clearly state that these need to be consistent with WTO rules. This indicates that future RTAs would be built on the WTO, seeking to maintain compatibility with its disciplines. This points to a positive, dynamic interface between regional trade liberalization and disciplines on the one hand, and multilateral liberalization and disciplines on the other. Of course, in order for these intentions to become reality, all RTA provisions need to be WTO-compatible.

For developing countries in particular, RTAs tend to form the nucleus of a wider regional economic integration process that is an integral aspect of national development strategies. This is particularly so, given that developing countries have a limited number of policy options to maintain and increase their market shares in world trade in goods and services, promote sustained economic growth and development, and enhance their beneficial integration into the global economy. The formation of an enlarged regional market space through regional trade liberalization is not perceived as an end in itself but as a stepping-stone towards the future attainment of a single economic, social and cultural grouping spanning several countries. Developed countries (with the exception of the EU), in contrast, tend to emphasize the free trade agreement feature, which expands beyond trade in goods to cover services, investment and other trade-related issues (such as competition policy). This is clear from the many FTA initiatives launched primarily by developed countries, whereas in agreements to which developing countries are parties, the tendency is to include wider development partnership agreements such as between the ACP States and the EU. Regionalism could serve as a lock-in mechanism for domestic political and economic reforms in developing country RTA members. The consequences of such a locking-in of policies would require further study.

On the negative side, RTAs may result in inward-looking, discriminatory and protectionist trading entities competing for spheres of influence and becoming self-contained fortresses. In particular, large RTAs – those whose membership covers a large share of global trade – can potentially have harmful effects for non-members leading to net trade diversion rather than net trade creation. Much depends on the policies and disciplines of RTAs with regard to imports from non-participants, which need to be supportive and complementary to the greatest extent possible with the MTS in a way, which strengthens its credibility.

Furthermore, by enabling faster and deeper integration, new-generation RTAs may reduce incentives for countries to favour a multilateral approach to trade liberalization. In particular, in the areas of market access and standard-setting in new issues (IPR, investment or competition policy), such “WTO-plus” (or “WTO-minus” in the sense that developing countries enjoy a lesser degree of flexibility and policy space under these RTAs than under WTO) RTAs can act as negotiating forums virtually substituting for the WTO, thereby leading

to “forum shopping”, and posing a systemic risk to the viability of the MTS. The proliferation of RTAs, with more and more countries being members of several RTAs at the same time, could create competing and possibly antagonistic blocs that would erode the viability of the MTS. Such overlapping membership would also pose tremendous administrative burdens for small countries with limited negotiating and institutional capacities.¹³ RTA coverage and evolution of trade disciplines can pose the risk of fostering incompatibility with multilateral rules.

The recent conclusion of North-North RTAs on an interregional or continental scale may have significant implications for the MTS, as well as for developing countries trade (e.g. EU enlargement, United States-Australia FTA). Such agreements may reduce countries’ incentives to negotiate in the multilateral forums for improved market access opportunities with other developed countries. Given that MFN duty rates apply almost exclusively to other developed countries in many developed countries (owing to the existence of various preferential rates applicable to developing countries), MFN tariff reduction has become already relevant only for developed and some developing countries, as well as economies in transition, which are subject to MFN duties.¹⁴ Thus, the renewed prospects for increasing North-North RTAs may further reduce the incentive for developed countries to opt for the WTO for tariff negotiations.¹⁵

This leads to a concern over the “specialization” of forums enabling “forum shopping” between RTAs and the MTS, with the MTS progressively relegated to rule-making in an increasingly limited number of trade-related policies, most notably agricultural subsidies, and resolution of trade disputes, while RTAs become prevalent in market access in goods and services, as well as regional regulatory measures and standard-setting in a broad number of policy areas. While agricultural subsidies are often left for multilateral discussion under various North-South RTA negotiations despite the demand by some developing countries (e.g. FTAA, ACP-EU EPA negotiations), it can be argued that there is no *a priori* reason why agricultural subsidies cannot be addressed in a regional context. Thus, there appears to be significant risk that RTAs will increasingly serve as a “real” negotiating forum.¹⁶

For developing countries, deeper integration under WTO and, more significantly under RTAs, may constrain their ability to pursue proactive national development strategies addressing supply-side capacities. Such policy instruments include subsidies, investment incentive and performance requirements, domestic preference in government procurement and other industrial policies addressing development challenges aimed at increased competitiveness,

¹³ For instance, the administration of preferential rules of origin within a RTA with a given number of membership (P) would require the management of the $P*(P-1)$ number of bilateral relationship. Thus, FTAA with 34 member countries would create 1,122 bilateral relations for customs purpose.

¹⁴ For instance, MFN duty rates apply only to nine countries under the EU tariff schedule.

¹⁵ It appears that MFN tariff reduction under the WTO remains valid only to the extent that Quad countries do not form preferential RTAs among themselves. Thus, it can be argued that interregional North-North RTAs among major developed countries may represent a critical systemic risk for the viability of the MTS.

¹⁶ The reason why agricultural subsidies cannot be addressed in a regional context appears to pertain to the fact that agricultural subsidies, either domestic or export contingent, affect the trade of all countries, and are thus not limited to RTA partners. However, given that some regulatory measures and standards, such as IPR protection regime, are already being negotiated under RTAs and applied multilaterally to all countries to affect not only IPR rights of RTA partner nationals but also third country right holders, there seems to be no *a priori* reason why RTAs cannot address agricultural subsidies. The reason why some countries prefer to leave agricultural subsidies to multilateral negotiations appears to relate to rather political economic considerations, as in the case of tariff negotiations, whereby domestic producers need to be persuaded by reciprocity in reduction commitments by other (major subsidizing) trading partners which tend not to be their RTA partners.

enterprise development, diversification of production, rural development and poverty alleviation. WTO disciplines already place constraints on the use of some of these instruments although they do provide a certain flexibility, or policy space, including in the form of special and differential treatment. In this respect, more stringent commitments on a wider range of policy areas under RTAs may override such policy flexibility available under the MTS.

Furthermore, in the context of multilateral trade talks North-South RTAs may serve as negotiating leverage. Bilateral RTAs negotiated and concluded at a time when multilateral trade negotiations are underway may constrain solidarity between developing countries and affect their ability, to act collectively at the multilateral level, and thereby weaken their bargaining position. A suggestion has been made in this regard that, for the duration of multilateral trade negotiations, a moratorium should be imposed on launching and pursuing bilateral and regional trade negotiations, as they are likely to be prejudicial to the conduct of multilateral negotiations.

To be open and outward-oriented and thus supportive of the MTS, RTAs need to ensure that barriers to non-participants are being lowered concurrently with the deepening of liberalization within the RTA. Suggestions have been made, for instance, that in order to minimize the risk of trade diversion, RTAs need to commit to reducing MFN duties in a time-bound manner concurrently with the RTAs. Also, large RTAs would need to bear a special responsibility with regard to their impact on weaker trading partners, especially non-participants. These RTAs need to avoid, to the extent possible, adverse effects on market access conditions of developing countries in the course, for example, of admission of new members, and to assist developing countries in understanding their trading schemes and adjustment to the new trading conditions in the regional market.

III. Dynamism in the interface between regionalism and multilateralism: A post-Cancún perspective

In the context of the parallel negotiations at multilateral, interregional, regional and sub-regional levels, the interrelationship between the MTS and RTAs is relevant, especially in the context of the post-Cancún multilateral trade negotiations in the DWP. The setbacks experienced at the Fifth WTO Ministerial Conference have raised concern over the possible shift in emphasis among countries from the multilateral track towards the regional track of liberalization, thereby weakening the impetus for multilateral trade negotiations and eventually the MTS itself.

In concrete terms, the interface between the MTS and RTAs operates at three levels.¹⁷ At the first level are WTO rules governing the operations of RTAs. They define specific conditions under which RTAs are allowed to exist and to operate under the multilateral trading system. WTO rules governing RTAs include GATT Article XXIV on trade in goods, GATS Article V on trade in services, and the Enabling Clause on South-South (preferential) agreements. At the second level, market access commitments, be it goods or services, made on an MFN basis as a result of successive rounds of multilateral trade negotiations determine the degree of preferences available to RTA partners, hence the scope for preferential liberalization among RTA partners. At the third level, multilateral disciplines constitute a “floor”, or common minimum denominator, on trade and trade-related policy disciplines covered by the WTO,

¹⁷ Luis Abugattas Majluf, “*Swimming in the Spaghetti Bowl: Challenges for Developing Countries under the New Regionalism*,” Policy Issues in International Trade and Commodities Study Series No. 27; UNCTAD (2004).

including non-tariff barriers and behind-the-border regulatory issues. Such disciplines commit all WTO Members and determine the conduct of trade policy that has to be observed, including by the parties of RTAs. However, RTAs may lead to the commitments of a level higher than that statutorily defined under the WTO.¹⁸

(i) WTO rules on RTAs

RTAs are governed by Article XXIV of GATT 1994, Article V of the GATS and the Enabling Clause. All provisions allow WTO Members to depart from the cornerstone principle of the MFN under certain conditions, and establish the requirements to be fulfilled by members of RTAs to be compatible with the WTO. GATT Article XXIV requirements, which apply to FTAs, CUs and “interim arrangement” leading to either FTAs or CUs, essentially provide that duties and other regulations of commerce should be eliminated for “substantially all the trade” among RTA members, and that the barriers placed in the way of third countries should not be “on the whole higher or more restrictive”. These requirements are not applicable under the Enabling Clause (see Table 3). The Enabling Clause provides that the MFN clause of GATT Article I.1 is exempted for a limited number of preferential arrangements, including “regional or global arrangements entered into amongst less-developed countries for the mutual reduction of tariff reduction or elimination of tariffs” (paragraph 2c). Thus, it can be argued that the Enabling Clause sets out less stringent requirements than those contained in GATT Article XXIV. Indeed, a number of South-South RTAs have been notified under the Enabling Clause.¹⁹

The examination of notified RTAs with regard to their compatibility with WTO rules is conducted by the Committee on Regional Trade Agreements (CRTA).²⁰ The CRTA has not been able to adopt final reports on its examination to date. This is in large part due to the very limited progress made by WTO Members in resolving “systemic issues” concerning WTO rules on RTAs. Systemic issues pertain to the interpretation of some of the terms and benchmarks in the provisions.²¹ For instance, there has been no agreement among WTO Members as to the exact meaning and measurement of key terms such as “substantially all the trade”, “not on the whole higher or more restrictive”, and “other regulations of commerce (ORC)”; and with respect to the treatment of preferential rules of origin, “other restrictive regulations of commerce (ORRC)” and obligations during transitional periods. The relationship between RTAs notified under the Enabling Clause and GATT Article XXIV has

¹⁸ Some perceive this differently; for example, the EC takes the view in the CRTA minutes that internally restrictive measures between RTA members are legal modifications (Vienna Convention on Law of Treaties, Article 41) and are permitted until third party rights are violated. The argument is that parties can freely modify WTO with internally restrictive measures in an RTA.

¹⁹ South-South RTAs notified under the Enabling Clause include the India-Sri Lanka FTA, EAC, CEMAC, SAPTA, AFTA, CAN, COMESA, ECO, MERCOSUR, the Trade Agreement among the Melanesian Spearhead Group Countries, the Lao People’s Democratic Republic-Thailand, GCC, LAIA, the Bangkok Agreement, PTN (Protocol Relating to Trade Negotiations among Developing Countries), GSTP, TRIPARTITE Agreement, and UEMOA. http://www.wto.org/english/tratop_e/region_e/provision_e.xls Caribbean Community and Common Market (CARICOM) were notified under GATT Article XXIV on 14 October 1974 most likely due to the non-existence of the Enabling Clause at the time. It has been reported that the SADC Trade Protocol would be notified under GATT Article XXIV despite the fact that its membership contains developing countries only.

²⁰ MERCOSUR was notified under the Enabling Clause but is being examined in the CRTA under both the Enabling Clause and GATT Article XXIV, which is a unique situation that has not been applied to any other notified developing country grouping since 1979.

²¹ Some rulings by WTO judicial bodies have brought some clarification on aspects of systemic issues. See, for instance, Panel and Appellate Body reports on *Turkey - Restrictions on Imports of Textile and Clothing Products* (WT/DS34/R, DS34/AB/R).

also been raised. Systemic issues with regard to GATS include the interpretation of “substantial sectoral coverage” and “absence or elimination of substantially all discrimination”.²²

Table 3
Comparison of requirements under GATT Article XXIV and the Enabling Clause²³

	ARTICLE XXIV of GATT 1994	ENABLING CLAUSE
Purpose	To facilitate trade between members and not to raise barriers to the trade of third countries (XXIV:4).	To facilitate and promote the trade of developing countries and not to raise barriers to or create undue difficulties for trade of third country (para. 3).
Trade coverage	Duties and other restrictive regulations of commerce (ORRC) should be eliminated on “substantially all the trade” among parties (XXIV:8 (a)(i) and (b)).	Not applicable.
Level of barriers to third countries	Duties and other regulations of commerce (ORC) shall not “on the whole be higher or more restrictive” than those applicable prior to the formation of an RTA (XXIV:5(a) (b)).	Not applicable. [Not to constitute an impediment to tariff reduction or elimination on a MFN basis.]
Interim agreement/transitional period	Interim agreement should include plan and schedule for the formation of FTA or CU, which should exceed 10 years only in “exceptional cases” (“reasonable length of time”) (XXIV: 5(c) and 1994 Understanding para.3).	Not applicable.
Notification	Notification to the Council for Trade in Goods (XXIV:7(a)). Any change in an interim agreement is to be notified to the Council for Trade in Goods (CTG). Consultation may be undertaken upon request (XXIV:7(c)).	Notification to the Committee on Trade and Development (CTD) when created, modified or withdrawn.
Examination	Examination by the CRTA, which would report to the CTG. The CTG may make recommendations (XXIV:7(a) and 1994 Understanding 7). The CTG may, if deemed necessary, make recommendation for interim agreements in particular on proposed time frame and on measures required (XXIV:7 (b)(c) and 1994 Understanding 8-10).	The CTD may establish a working party (or refer to the CRTA) to examine a RTA notified thereunder.
Periodical reporting	Biennial reporting is required on the operation of regional trade agreements (1994 Understanding 11).	Not applicable.

The improvement and the clarification of the WTO disciplines affecting RTAs are critical in disciplining RTAs in a manner supportive of the MTS – one which minimizes the harmful effects of RTAs on third countries and the MTS. In this respect, multilateral negotiations have been launched as provided for in the Doha Ministerial Declaration on WTO rules (paragraph 29) applying to regional trade agreements aimed at “clarifying and improving disciplines and

²² WTO, “Compendium of issues related to regional trade agreements”, background note by the Secretariat (TN/RL/W/8/Rev.1), 1 August 2002.

²³ Adapted from Bonapas Onguglo and Taisuke Ito, “How to make EPAs WTO-compatible?: Reforming the rules on regional trade agreements”, *ECDPM Discussion Paper* No. 40, July 2003.

procedures”, while taking into account their “developmental aspects”. Negotiations are currently underway in the Negotiating Group on Rules (NGR). Initial submissions by some Members propose a comprehensive review of the relevant provisions, seeking clarification of key benchmark requirements while taking into account the development dimension of RTAs, and the improvement of the WTO’s oversight function in terms of procedural requirements, i.e notification, reporting and examination procedures.

Box 1. Proposals for clarifying and improving GATT Article XXIV

Doha negotiations on WTO rules applying to RTAs, conducted in the Negotiating Group on Rules (NGR), are yet to fully address substantive “systemic issues”. Two proposals stand out in this regard in that they directly address the core disciplines of GATT Article XXIV in a concrete manner.

A proposal submitted by the ACP Group of States aims at formally incorporating special and differential treatment (SDT) in the application of conditions set out in the paragraphs 5-8 of GATT Article XXIV when they are applied to RTAs formed between developed and developing countries (i.e. North-South RTAs). With the recognition that the “less-than-full” reciprocity principle in tariff negotiations (thus a form of SDT) is being overridden by the reciprocity requirement of GATT Article XXIV, the ACP proposal calls for SDT in the application of GATT Article XXIV requirements, such as the “substantially all the trade” requirements, when it applies to the North-South RTAs. This is the first ever proposal that has explicitly called for such SDT treatment in the context of GATT Article XXIV for the purpose of North-South agreements. How to define in operational terms such “flexibility” available only for developing countries as a form of SDT would probably be the key issue for further discussion in terms of both systemic implications and transparency.²⁴

Australia, on the other hand, proposes to define “substantially all the trade” requirement as requiring tariff elimination of a minimum of 95 per cent of tariff lines at the six-digit level in the HS tariff classification lines. At the same time, in order to prevent the exclusion from a RTA of “highly traded” products, it also proposes to prohibit the exclusion of those products that constitute at least 2 per cent of trade between the parties. With regard to phase-in commitments during the transition period, it proposes to require the immediate elimination of 70 per cent of tariff lines at the HS six-digit level at the time of entry into force of the RTA. The proposal probably would render GATT Article XXIV disciplines more stringent than they are currently.

Ensuring that whatever new or modified disciplines emerge from the work in the NGR provide for the necessary flexibility for South-South agreements and for incorporating meaningful SDT provisions into North-South RTAs is an area that requires adequate and priority attention by developing countries. In this regard, the ACP Group of States recently submitted a comprehensive proposal (see Box 1 above).²⁵ To date, work has focused more on transparency, with discussions centered on when, how and to what extent Members should notify to the WTO the provisions of an RTA, and how the WTO can best review these provisions. Some developing countries oppose applying strengthened reporting and review provisions to RTAs notified under the Enabling Clause, while some European countries have proposed “grandfathering” pre-existing RTAs, exempting them from any new discipline that could emerge from the negotiations. Australia has submitted a detailed proposal aimed at defining quantitative benchmarks in defining some of the key systemic issues, including the “substantially all the trade” requirement.²⁶ (See Box 1 above) Work on substantive issues, clarification and improvement of WTO rules applying to RTAs, is yet to be fully addressed in the NGR.

²⁴ The Commission for Africa (“Blair Commission”), an initiative of the UK Prime Minister, has recommended that “(a) review of Article XXIV of the General Agreement on Tariffs and Trade in order to reduce requirements for reciprocity and increase focus on development priorities may be useful.” Commission for Africa, *Our common interest: The report of the Commission for Africa*, March 2005, p. 71. See also DTI/DFID, “Economic Partnership Agreements: Making EPAs deliver for development”, March 2005.

²⁵ WTO document TN/RL/W/155, 28 April 2004.

²⁶ TN/RL/W/173/Rev.1, 3 March 2005.

(ii) RTAs and negotiations on agriculture and NAMA

The core market access negotiating agenda under the DWP concerns agriculture, NAMA and services. As regards trade in goods, since the principal aim of RTAs is to achieve the elimination of tariff and non-tariff barriers among RTA partners on a reciprocal basis, RTAs have direct relevance to the ongoing DWP negotiations on agriculture and NAMA. Developing countries engaged in RTAs need to take into account the implication of MFN liberalization and the appropriate level of preference for their RTA partners, while the supremacy of the multilateral trading system requires that such preferential treatment does not hinder multilateral efforts for across-the-board MFN tariff reductions. As exporters, they have to ascertain which forums, multilateral or regional, are the most suited for seeking increased market access in a given market or building one for coherence, and to get the best trade deals and opportunities for their exports. Erosion of preferential margins is the major issue for LDCs and those low-income countries that have enjoyed substantial preferential margins either under RTAs or unilateral preferences provided by major developed countries. Some compensatory or adjustment mechanism and trade solutions may need to be devised under WTO or otherwise so as to address serious adverse effects on the development prospects of these countries.

While some trade-distorting measures such as agricultural subsidies may be better addressed in the WTO (e.g. FTAA subsidy debate), certain market access barriers in sensitive sectors such as agriculture might be better addressed in the limited scope of the regional context. In this respect, it can be noted that protection prevalent on an MFN basis tends to persist under RTAs (e.g. agriculture, textiles).²⁷ While RTAs may be better suited for addressing specific highly protected sectors on a limited basis, the weaker bargaining position of developing countries in North-South agreements may not allow them to successfully address such barriers against powerful developed country partners.

(iii) RTAs and negotiations on services

The Uruguay Round negotiations on services have resulted in the establishment of GATS as a multilateral framework of principles and rules for trade in services with a view to the expansion of such trade under conditions of transparency and progressive liberalization and as a means of promoting the economic growth of all trading partners and the development of developing countries. GATS provides for a positive list approach to liberalization of services. "Positive list" refers to a liberalization mechanism that separates general obligations that apply to all countries (such as MFN treatment), from the negotiated specific commitments of market access and national treatment in respect of specific service sectors and activities, which can be subject to limitations and conditions.²⁸ The commitments undertaken during the Uruguay Round negotiations have largely reflected *status quo* except in respect of financial and telecommunication services sectors resulting in deeper commitments. Thus, the Doha negotiations on services are expected to achieve progressive and more substantial liberalization. Deeper liberalization has taken place in the regional context, where a number of RTAs including developing countries have embarked on preferential services liberalization

²⁷ WTO, "Coverage, liberalization process and transitional provisions in regional trade agreements", background survey by the Secretariat (WT/REG/W/46), 5 April 2002.

²⁸ The positive list approach would allow for each country to strategically select the individual services sector or transaction that would be liberalized. See Mina Mashayekhi, "GATS 2000 negotiations: Options for developing countries", *Trade-Related Agenda, Development and Equity* (T.R.A.D.E) Working Papers 9, South Centre, December 2000.

based on “GATS-plus” commitments, some under a negative list approach to provide preferential treatment to their RTA partners. Liberalization of services in the regional context may be beneficial in improving the cost efficiency of national economies as services account for a significant share of GDP for most developing countries and constitute major inputs to production of goods and services. Under GATS Article V, “flexibility” is allowed for developing countries forming regional integration agreements (RIAs), and additional flexibility is available for those RIAs formed among developing countries only.

Theoretically, it has been shown that liberalization of services tends to create static gains for liberalizing countries as compared with the status quo, be it on a preferential or a non-preferential basis.²⁹ This is because trade barriers in the services sector tend to be higher while being revenue-neutral for government. Gains are likely to be greater with multilateral than regional liberalization of services. The sequencing of liberalization matters more in the services sector than in the goods sector because of greater sunk costs and the incumbent advantages associated with some capital-intensive services. It has been estimated that the greatest gains under the DWP for developing countries would stem from liberalization of Mode 4. Winters et al. showed that a flow of natural persons equivalent to 3 per cent of the skilled and unskilled work forces in developed countries would generate an estimated increase in world welfare of over \$150 billion, shared fairly equally between developed and developing countries.³⁰ On mode 4-related access, progress may be more forthcoming in the regional context, including through recognition of qualifications and visas for service provider. This highlights the fact that the stakes are particularly high for developing countries in multilateral and regional negotiations on the liberalization of services. It should be noted that Article IV and XIX.2 of the GATS allows for a measure of flexibility for developing countries in respect of liberalization commitments and a commitment by developed countries to give priority attention to sectors and modes of interest to developing countries.

(iv) RTAs and regulatory measures and standards

In the area of the trade-related regulatory dimension, RTAs increasingly assume prominence as they embark on new trade-related behind-the-border regulatory measures. Multilateral rules in these areas are currently underdeveloped. Of particular relevance to developing countries are those areas where no multilateral rules exist. Some RTAs have given precedence, by way of “WTO-plus” agreements, to the multilateral rules, as was the case with investment under NAFTA, or competition policy and other economic policies under the EU. Some have seen this as evidence to support the “building block” thesis of the interrelationship between the MTS and RTAs, as RTAs serve as a platform for a new rule-making exercise. Others see such developments representing the potential risk of increased fragmentation of trade rules at regional levels, making it difficult to agree multilaterally on new issues.

Even where multilateral rules exist, negotiations for “WTO-plus” RTAs can transform themselves into standard-setting negotiations, thereby entailing the risk of upward harmonization of regulatory standards in developing countries. A case in point is intellectual

²⁹ Aaditya Mattoo and Carsten Fink, “Regional Agreements and Trade in Services: Policy Issues”, paper presented at a WTO seminar on the Changing Architecture of the Global Trading System: Regionalism and the WTO, 26 April 2002, Geneva, Switzerland.

³⁰ Alan Winters et al., “Liberalizing temporary movement of natural persons: An agenda for the Development Round”, *World Economy*, Vol. 26, pp. 1137-1161, August 2003.

property protection.³¹ While minimum statutory standards are provided in the multilateral rules, namely the TRIPS Agreement, in the absence of provisions equivalent to GATT Article XXIV or GATS V (or because it does not entail market access elements and preferential treatment may not in itself be desirable economically or practicable), IPR standards negotiated regionally are automatically multilateralized. It can be noted that, under the TRIPS Agreement, the only exception permitted to the MFN principle is “grandfathering” of preferential IPR protection under plurilateral treaties predating to the WTO.³²

The implication of the regulatory standard-setting nature of RTAs is particularly significant in the North-South context, as developing countries would be under pressure to adopt higher standards, such as patent protection in terms of coverage, level of protection or enforcement, with a consequent restriction of the scope of policy flexibility available under multilateral rules, including for the purpose of ensuring access to essential medicines for all. New issues are often negotiated and included in the North-South agreements, including investment, competition policy, government procurement, environment and labour standards. In this sense, RTAs may serve to bypass, dilute and override SDT for developing countries available under WTO rules and create new obligations in areas not covered by WTO, which would be higher than would have been agreed at the multilateral level.

IV. Resolving underlying asymmetries: Development dimension in North-South agreements

A major innovation in the formation of RTAs is that developed country and developing country RTAs are also emerging. Traditionally governed by various unilateral preferences schemes, a number of agreements under negotiation are aimed at transforming the trade and economic relations that developing countries enjoyed with their previously preference-granting developed countries into reciprocal free trade areas, such as the pan-American negotiations for the FTAA, or wider partnership accords as is the case with the ACP-EU negotiations for the Economic Partnership Agreement under the Cotonou Agreement. Under the US African Growth and Opportunity Act, the possibility exists for the conclusion of FTAs with sub-Saharan African beneficiary countries. The Pacific Agreement on Closer Economic Relation (PACER) envisages launching FTA negotiations among the Pacific Island countries on the one hand, and Australia and New Zealand on the other, once the Pacific Island countries have launched FTA negotiations with any other developed countries such as with the EU. As noted, a variety of bilateral initiatives have been launched in the North-South context, most recently by the United States.³³ Another example is the Euro-Mediterranean agreements are aimed at establishing free trade between the EU and Mediterranean basin countries.

³¹ For a discussion of the role of RTAs in setting “WTO-plus” standards in the intellectual property protection regime, see, for example, David Vivas-Eugui, “Regional and bilateral agreements and a TRIPS-plus world: The Free Trade Area of the Americas (FTAA)”, *TRIPS Issues Paper 1*, QUNO/QIAP/ICTSD, Geneva, 2003; MSF, “Access to medicines at risk across the globe: What to watch out for in Free Trade Agreements with the United States”, *MSF Briefing Note*, May 2004.

³² Article 4 (d) of TRIPS Agreement provides that MFN obligation is exempted for any advantage, favour, privilege or immunity “deriving from international agreements related to the protection of intellectual property which entered into force prior to the entry into force of the WTO Agreements”.

³³ Such US bilateral initiatives include: FTAs concluded with Australia (May 2004), Morocco (March 2004), Central American countries (CAFTA) (December 2003), Chile (June 2003) and Singapore (May 2003). Negotiations were launched with Bahrain (August 2003), SACU (June 2003), Bolivia, Columbia, Ecuador, Peru (May 2004) and Panama (April 2004).

The underlying asymmetry between the two partners in size, conditions and capacity requires that corresponding asymmetry in obligations and commitments be embedded in the agreement so as to ensure equal treatment among “unequal” partners. Mechanisms including supply capacity and infrastructural, institutional and human capacity building for developing country partners would be a prerequisite for mutually beneficial arrangements and outcomes. In practical terms, this translates into ensuring market access and entry for exports of developing countries, while at the same time defining more carefully and clearly the coverage of the agreements and securing SDT under the agreement to address adjustment and social costs, including resource transfer through development assistance. There is also a preliminary asymmetry issue that would need to be taken into account, namely the capacity to choose a partner may often reside with the larger country. North-North regional integration arrangements, such as the EU enlargement, would also have implications for developing countries.

On the export side, since developing countries have enjoyed quite liberal market access conditions on preferential terms in developed country markets, it is not easy to ascertain the areas where those countries could gain from future agreements. This is particularly so as preference margins decrease as MFN and other tariff reduction progress. One obvious area where developing countries could expect gains is the residual market access barriers in sectors of export interest to them, most notably agriculture and labour-intensive manufactures. These remain important areas as some low-income, small and vulnerable developing countries still rely heavily on preferential access to developed country markets for their exports of a limited number of commodities. It may be noted, however, that these are the sectors where liberalization is highly sensitive in developed countries. The existing general incidence of preference margins needs also be taken into account in the context of parallel multilateral trade negotiations so as to maintain the existing level of preferences for developing countries.

Other possible areas of expected gains include market entry barriers, most notably technical, sanitary and environmental regulations, as well as rules of origin. RTAs could be designed to address market entry barriers of developing countries in a manner more effective than in the multilateral context, such as through simplified rules of origin. Mutual recognition of standards and testing results would be instrumental for the export expansion of developing RTA partners, as would trade facilitation measures. In particular, rules of origin need to be designed so as to promote an expansion in the exports and production base of developing countries while enabling them to retain increased value added domestically. Another area is the liberalization of trade in services, in particular a temporary movement of natural persons in Mode 4 of the GATS and recognition of qualification of services professionals. Progress has been slow in these areas. In addition, deeper non-trade and development support policy components in the global package of North-South agreements, such as resource transfer in the form of development, technical and financial assistance, as well as transfer of technology, can be of significant importance to developing countries.

Liberalization and reform of these non-tariff barriers would be particularly significant as they are conducive to expected dynamic benefits from liberalization. Indeed, North-South agreements are often promoted on the basis of their expected effect on FDI flows, the benefits of extended IPR protection, and the impact of these agreements on the predictability of the rules of the game and on institution building and governance.

On the import side, the costs of liberalization under North-South agreements are likely to be substantial for developing countries. Reciprocity under RTAs requires mutuality in opening of

markets and other commitments between RTA partners, and this applies also to North-South Agreements. In some proposed RTAs, concern over the WTO compatibility of pre-existing unilateral preferences (e.g. the EU's Lomé Convention) has underpinned the move from unilateral towards reciprocal trade agreements.³⁴ In this respect, given the level of tariff protection in developing countries and their incidence in total government revenue, costs are likely to be significant for developing countries with consequent development implications in terms of development finance in addressing domestic development and poverty alleviation challenges, in particular for LDCs and other low-income developing countries. There are also concerns with respect to de-industrialization. Developing countries therefore need an adjustment policy to guarantee the transition of production upon market opening and labour mobility across sectors, including social safety nets, and in dealing with the problem of de-industrialization and the structure of government finance, including tax reform. Experience shows that such an institutional and governance reform is particularly challenging, in particular for those small and vulnerable low-income countries and LDCs that rely heavily on tariffs for government revenue.

Prospects for significant adjustment costs associated with North-South agreements require that such an agreement incorporate effective and operational SDT provisions and elements of asymmetry, or "less than full reciprocity", in the level of tariff dismantling and other positive commitments on the part of developing countries, so as to ensure equal treatment among "unequal" partners. In this respect, WTO disciplines may limit the scope of such flexibility by the requirement of reciprocity under GATT Article XXIV, and to a lesser extent under GATS Article V.³⁵ Adjustment support towards development assistance and programme is also essential. Furthermore, the lack of corresponding provisions in TRIPS or the lack of multilateral rules at all in new areas of investment, competition policy or government procurement may lead to a higher level of commitments than would have been agreed upon at the multilateral level, thereby limiting policy space for developing countries.

V. South-South integration and cooperation: New trade geography

South-South trade and integration have formidable potential for boosting intraregional trade for greater integration of developing countries into international trade and the world economy. Today, South-South trade (exports) accounts for some 13 per cent of world total trade, representing 42 per cent of total developing country exports with the world (Tables 4 and 5). Over the past two decades or so, the importance of South-South trade in world trade nearly doubled, and the interdependence among developing countries for their exports increased significantly. It can be noted that such trade still concentrates on a limited number of developing countries most notably in East and South-East Asia, and there is need for greater

³⁴ A series of legal challenges raised against the EU regime for the importation, sales and distribution of bananas have led to the transformation of unilateral preferential regime under Lomé Convention into reciprocal economic partnership agreements under negotiations with the ACP States. See *European Communities - Regime for the Importation, Sales and Distribution of Bananas* (WT/DS27 series). Recent legal challenges brought against the unilateral preferential schemes and the rulings by WTO judicial bodies would have systemic implications to the viability of unilateral preferences, and possibly to the move towards North-South reciprocal free trade agreements. See, for instance, *European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries* (WT/DS246/R, WT/DS246/AB/R).

³⁵ "Flexibility" is provided under GATS Article V; thus there is scope for more favourable treatment for developing country Members of regional integration agreements in trade in services. See also the ACP proposal on GATT XXIV, op. cit.

participation of a broader range of developing countries in South-South trade integration.³⁶ Developing country exports increasingly cover new and dynamic sectors, including IT-enabled services (e.g. outsourcing).³⁷

South-South RTAs have been adopted as development strategy by many developing countries with a view to their gradual and strategic integration into world economy by exploiting economies of scale and scope. Such integration efforts are particularly beneficial to developing countries. Interregional South-South trade cooperation through the Global System of Trade Preferences among Developing Countries (GSTP) provides an important complementary avenue for developing countries to increase and expand their market access opportunities.

Table 4

Evolution of the share of exports from developing countries by destination: The importance of South-South trade in exports of developing countries (1980-2002, per cent)

	1980	1990	1998	1999	2000	2001	2002
World	100	100	100	100	100	100	100
Developed economies	69	58	57	58	57	56	55
Developing economies	26	34	39	38	39	40	42

Source: UNCTAD Handbook of Statistics 2003 and 2004.

Table 5

Evolution of the share of South-South exports in world exports: Importance of South-South trade in world total exports (1980-2002, millions of dollars and per cent)

	1980	1990	1998	1999	2000	2001	2002
World	2 000 949	3 436 380	5 383 780	5 571 175	6 287 738	6 065 269	6 306 330
South-South trade	155 144	278 327	592 597	624 873	784 462	749 845	836467
Share (%)	7.8	8.1	11.0	11.2	12.5	12.4	13.3

Source: UNCTAD Handbook of Statistics 2003 and 2004.

As regards the net welfare effects of South-South agreements, it has been argued that RTAs among developing countries may generate potential adverse effects on trade patterns among RTA members and between them and third countries. World Bank research has concluded that South-South regional blocs are problematic in several respects. Apart from small non-economic benefits, South-South RTAs between two or more poor countries are very likely to generate trade diversion, especially when external tariffs are high.³⁸ Similarly, another study,

³⁶ The 12 leading exporters among developing countries accounted for some 73 per cent of the total developing country exports of goods (2002) and 71 per cent of their total exports in services (2003). The leading exporters include China, Hong Kong (China), Republic of Korea, Mexico and Taiwan Province of China. UNCTAD, "Trade in services and development implications" (TD/B/COM.1/71), 20 January 2005.

³⁷ The product composition of developing country exports has evolved so that they have become major players in markets for many "dynamic sectors". Developing countries account for 30 percent of world exports of the 20 most dynamic products. UNCTAD, "Strengthening participation of developing countries in dynamic and new sectors of world trade: Trends, issues and policies", background note by the UNCTAD secretariat (TD/396), 17 May 2004. See also UNCTAD, "Trade and development aspects of professional services and regulatory frameworks" (TD/B/COM.1/EM.25/2), 25 November 2004.

³⁸ World Bank, *Trade Blocs*, New York: Oxford University Press, 2000.

based on data from sub-Saharan Africa, concluded that, judged by the variance in their trade patterns from what current comparative advantage would predict, intraregional trade has potential adverse effects on non-RTA members.³⁹ By contrast, some recent studies have demonstrated that South-South RTAs — particularly African RTAs — are net trade creating, in many cases more than doubling the trade among South-South RTA members.⁴⁰ Increased trade with both regional partners and third countries in the case of South-South RTAs might be explained by the removal of a variety of tariff and non-tariff barriers and as a result of trade facilitation measures implemented upon the establishment of RTAs.

Table 6

Evolution of the intraregional exports, and their share in the groupings' total exports, of selected South-South RTAs
(1990-2003, millions of dollars and per cent)

	1990	1995	1999	2000	2001	2002	2003
ANCOM	1 312	4 812	3 929	5 116	5 461	5 070	4 781
CACM	667	1 594	2 175	2 418	2 394	2 598	3 288
CARICOM	456	877	1 146	1 076	1 231	1 252	1 538
MERCOSUR	4 127	14 199	15 313	17 910	15 760	10 573	13 383
COMESA	890	1 027	1 122	1 281	1 385	1 465	1 812
ECCAS	163	163	179	196	217	193	236
ECOWAS	1 532	1 875	2 285	2 811	2 767	3 192	3 541
SADC	1 058	4 124	4 224	4 453	4 122	4 240	5 345
CEMAC	139	120	126	101	119	120	157
UEMOA	621	560	805	741	775	857	1 043
ASEAN	27 365	79 544	77 889	98 060	86 331	91 765	102 281
ECO	1 243	4 746	3 903	4 473	4 505	4 955	6 696
GCC	6 906	6 832	7 306	7 218	6 943	6 905	7 864
SAARC	863	2 024	2 180	2 593	2 827	2 998	3 869
Share (%)							
ANCOM	4.1	12.0	8.8	8.5	10.3	9.5	7.4
CACM	15.2	21.8	13.6	14.8	15.5	11.0	11.9
CARICOM	8.0	12.1	16.3	14.4	13.9	12.5	12.5
MERCOSUR	8.9	20.3	20.6	20.0	16.9	11.3	11.8
COMESA	6.3	6.0	6.3	4.9	6.1	5.4	5.8
ECCAS	1.4	1.5	1.3	1.1	1.3	1.1	1.1
ECOWAS	8.0	9.0	10.3	9.5	9.6	11.5	9.8
SADC	3.1	10.6	11.9	12.0	10.2	9.3	10.0
CEMAC	2.3	2.1	1.7	1.0	1.3	1.4	1.4
UEMOA	13.0	10.3	13.1	13.1	13.6	12.1	12.8
ASEAN	19.0	24.6	21.7	23.0	22.4	22.7	21.2
ECO	3.2	7.9	5.8	5.6	5.6	5.9	6.0
GCC	8.0	6.8	6.7	4.5	4.5	4.6	4.2
SAARC	3.2	4.4	4.0	4.1	4.3	4.2	4.5

Source: UNCTAD Handbook of Statistics 2004.

³⁹ Alexander J. Yeats, "What can be expected from African regional trade arrangements? Some empirical evidence", *World Bank Working Paper* No. 2004, Washington DC, World Bank, 1998.

⁴⁰ See, for example, Lucian Cernat, "Assessing Regional Trade Arrangements: Are South-South RTAs More Trade Diverting?" *UNCTAD Policy Issues in International Trade and Commodities Study Series* No. 16, United Nations: New York and Geneva, 2003.

The degree and evolution of integration have not been even among South-South integration groupings, and they are yet to exploit the full development potential of their RTAs. While some groupings have succeeded in deepening their integration to a significant degree, others have yet to ensure effective implementation of their constituent agreements.

Table 6 summarizes the evolution of the value and the share of intraregional trade between 1990 and 2002. The share of intraregional trade is generally low in South-South agreements as compared with North-North agreements (see Table 2 in Section I), and the variations in the share across groupings are significant. ASEAN, for example, has maintained and reached relatively a high degree of regional trade, as its intra-grouping trade was 21 per cent in 2003. The share of intraregional trade of CACM, UEMOA, CARICOM, MERCOSUR and SADC ranged between 10-14 per cent. On the other hand, corresponding figures for some RTAs in Asia and sub-Saharan Africa were still substantially low.

Over the years since 1990, some South-South RTAs have increased significantly their intraregional trade in absolute and relative terms. MERCOSUR has increased the value of intraregional trade by a factor of three since 1990; as a result, its share of regional trade rose from 9 per cent in 1990 to 12 per cent in 2003. CARICOM and SADC also increased their share, while ASEAN maintained a relatively high intraregional trade share in the order of 20-25 per cent during the same period.

Table 7

Evolution of the value of intraregional and total exports of selected RTAs (1990 = 100)

		1990	1996	1997	1998	1999	2000	2001	2002	2003
CARICOM	Intra-group	100	200	214	225	251	236	270	275	337
	Total	100	116	111	99	113	123	147	168	207
MERCOSUR	Intra-group	100	414	501	493	371	434	382	256	324
	Total	100	138	148	144	139	168	183	195	236
COMESA	Intra-group	100	139	134	129	126	144	156	165	204
	Total	100	138	136	118	126	188	161	196	224
SADC	Intra-group	100	443	442	365	399	421	390	401	505
	Total	100	113	116	101	94	99	109	125	145
ASEAN	Intra-group	100	307	312	255	285	358	315	335	374
	Total	100	221	231	222	240	281	256	267	324

Source: UNCTAD Handbook of Statistics 2004.

The degree of intraregional trade is more pronounced when measured against the overall trade performance of these groupings (Table 7). In this respect, some RTAs have increased both their intraregional and total trade in value terms, while in others increased intraregional trade was offset by a decrease in the share of extraregional trade. For example, ASEAN's increased intraregional trade was underpinned by the increase in its overall trade with the world. This was the case to a lesser degree with MERCOSUR. On the other hand, some South-South RTAs contrast sharply with ASEAN and MERCOSUR, as their total trade with the world remained rather constant despite the absolute increase in the value of intraregional trade. In such cases, increased intraregional trade appears to have been offset by a decrease in exports to non-RTA partners.

The product composition of intraregional trade tends to differ substantially from that of interregional trade with the rest of the world. In most cases intraregional trade is mainly

composed of manufactured goods with higher value added in contrast with trade with the rest of the world, which is dominated by one or two basic commodities. In the case of ASEAN, the major product categories traded intraregionally in 2001 were machinery and electrical products (HS84-85) (54 per cent of the total), followed by mineral products (HS25-27) (11 per cent).⁴¹ In the case of MERCOSUR, it was reported that 47 per cent of total Brazilian exports to MERCOSUR covered durable goods and goods diffusers of technical progress, while its exports to the United States of those categories of goods represented only 30 per cent of its total exports. By contrast, commodities and traditional manufactures account for some 42 per cent of total Brazilian exports to the United States.⁴² Thus, the importance of the share of intraregional trade aside, the significance of South-South RTAs lies in their potential for the diversification of exports towards higher-value-added products.

While the degree of intraregional trade share is in no way the sole measure of success of regional integration efforts — it is a function of a variety of variables, including market size, existing production structure and trade infrastructure — the generally low degree of intraregional trade indicates that many South-South RTAs are yet to exploit their full potential for intraregional trade through, *inter alia*, effectively implementing their internal liberalization programmes and by encompassing a wider range of economic objectives and a “deep integration” agenda. Significant trade barriers to regional trade, including residual duties, quantitative restrictions, other non-tariff measures such as rules of origin, and other market entry barriers such as technical, sanitary and environmental standards, as well as market structure and infrastructure networks. “Deep integration” measures addressing regulatory barriers to trade, infrastructure and trade facilitation could provide further opportunities for increased South-South trade. As many South-South RTAs are still in their preliminary stages of “deep integration”, its full development potential could be substantial.

At the interregional level, the GSTP provides enhanced prospects for South-South cooperation. The GSTP was established in 1988 at a Ministerial Meeting of the Group of 77 held in Belgrade as a framework for the exchange of trade preferences among developing countries to promote trade among themselves.⁴³ The agreement includes results of the first round of negotiations conducted between 1986-1988, and entered into force in 1989 after 44 countries ratified the agreement. Following a comprehensive review of the operations of the agreement, the GSTP Participants recently decided to launch a new round of negotiations to broaden and deepen the scope of tariff preferences. Ministers of GSTP participants met in São Paulo, Brazil, in June 2004 to launch the new negotiations.

⁴¹ During the period between 1993 and 2001, the most dynamic products in intra-ASEAN trade include machinery and chemical (HS25-27) which increased by 148 per cent since 1993, followed by other (147 per cent); prepared food stuff (HS16-24) (135 per cent); chemicals (HS28-38) (122 per cent); optical, precision and musical instruments (HS 90-92) (98 per cent); and pulp and paper (HS47-49) (96 per cent).

⁴² ECLAC, Latin America and the Caribbean in the World Economy 2003.

⁴³ The GSTP is based upon the following principles and features: (i) the GSTP is reserved for the exclusive participation of members of the Group of 77 and China; (ii) the GSTP must be based and applied on the principle of mutuality of advantages in such a way as to benefit equitably all participants, taking into account their respective levels of economic development and trade needs; (iii) the GSTP recognizes the special needs of the LDCs and envisages concrete preferential measures in their favour; (iv) tariff preferences are bound and form part of the Agreement; (v) the GSTP is negotiated step-by-step and improved and extended in successive stages, with periodic reviews; and (vi) the GSTP must supplement and reinforce present and future subregional, regional and interregional economic groupings of developing countries.

VI. Conclusion: Positive coherence between multilateralism and regionalism

From the above discussions, the following preliminary conclusions may be drawn:

- Regional trade agreements have proliferated in number, expanded their membership, and deepened their integration since the creation of WTO, and in particular since the launch of the Doha Work Programme. Both developing and developed countries have been actively participating in these processes by establishing and reinvigorating North-South and South-South agreements, often on an inter-regional basis.
- The systemic interface between multilateralism and regionalism manifests itself in both positive and negative forms. On the positive side, RTAs promote quicker, freer and deeper integration with strong disciplines on trade-related policies, act as laboratories of new disciplines and serve as an incubator of export expansion and diversification for developing countries. Developing countries have adopted RTAs as the nucleus of national development strategies for their progressive and strategic integration into the world economy. On the negative side, RTAs may prove to be inward-looking, protectionist blocs, which reduce incentives for multilateral trade negotiations by enabling “forum shopping”; they may also lead to fragmentation of regional rules, and constrain developing countries’ negotiating and administrative capacities and business abilities to exploit preferences.
- The MTS affects RTAs at three levels: (i) through WTO rules on RTAs; (ii) market access commitments; (iii) and other trade-related rules and disciplines. Negotiations have been launched under the DWP on these aspects, thereby affecting the scope and viability of RTAs. An overarching negotiating objective for developing countries under both processes may be to ensure greater market access and entry opportunities while securing sufficient policy space for the implementation of domestic development objectives.
- As regards North-South agreements, the development dimension needs to be taken into account in respect of both market access and entry opportunities and domestic policy space. North-South RTAs may address market entry barriers, most notably rules of origin. They can also result in deeper Mode 4 commitments and facilitated recognition of qualification. Adjustment costs may be significant for developing countries, and this requires meaningful special and differential treatment, including resource transfer for development purposes, to be incorporated in the agreements.
- As regards South-South agreements, the potential for trade expansion is significant, while a number of South-South integration groupings have yet to exploit their full potential for export expansion and diversification. Deep integration would prove to be beneficial under South-South agreements.
- At the interregional level, the GSTP provides enhanced prospects for South-South cooperation.

Effectively managing the interface between RTAs and the MTS requires, at the national level, comprehensive development-oriented trade policies and a clear assessment and awareness of the impact of the norms and disciplines being entered into at the different levels of trade integration. Clarity of policies addressing the development, trade and financial needs of developing countries is necessary in order to mould RTAs into effective instruments for development. Development objectives deserve priority attention in RTAs and in the WTO, including in the context of questions touching upon special and differential treatment issues. At the regional level, ensuring additional policy space and flexibility available for promoting development in the context of RTAs is necessary. The emergence of issues related to “WTO-

plus” and “WTO-minus” demands comprehensive analysis of the different regulatory developments in the multilateral and regional contexts, and identifying additional policy space available for action at the regional level. At the multilateral level, it is important to strengthen the rules affecting RTAs in order to guarantee that RTAs are indeed instruments for promoting trade liberalization globally, while at the same time the rules needed to allow for special and differential treatment for developing countries to make use of flexibility available to them.

An open, equitable, rule-based, predictable and non-discriminatory multilateral trading system represents the best guarantee for assuring development gains for weaker members of the system. The evolution of the MTS in the context of a vibrant regionalism in the form of RTAs poses a major policy challenge. The proliferation of RTAs has generated calls for the MTS and rules affecting RTAs to be strengthened in order to minimize the possible harmful effects of RTAs on third countries and on the cardinal principles of non-discrimination. They also appear to be instruments to extend the scope and the depth of trade liberalization to areas not covered (multilaterally) by, or to the degree higher than that stipulated in, WTO, e.g., intellectual property rights, investment and government procurement. On the other hand, regional integration comprises an aspect of development strategy for many developing countries and thus such regional policy space should not be unnecessarily constrained by the MTS. The new interface in terms of coherence and compatibility with multilateralism in the process of expanding and deeper regionalism is a major challenge and opportunity to be addressed by countries, their regional organizations and the WTO.

UNCTAD, through its three pillars of work – namely, intergovernmental deliberations and consensus building, research and analysis and technical cooperation and capacity building – could contribute to the clarification and better understanding of the interface between RTAs and MTS, as well as human, institutional and trade policy capacity building of developing countries relating to such interface. UNCTAD examines and monitors the interface, including in respect of SDT, and supports regional integration and the promotion of South-South trade. Research and analysis is undertaken to explore development implications of the interface and developmental impact assessment of RTAs. Exchange of experiences and best practices and networking among the secretariats of regional integration groupings could be promoted and institutionalized. Technical cooperation and capacity-building activities could support regional integration efforts, regional trade policy capacity and institution-building.