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SWIMMING IN THE SPAGHETTI BOWL: CHALLENGES FOR DEVELOPING COUNTRIES UNDER THE "NEW REGIONALISM"

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ABSTRACT

Simultaneous developments in the WTO system and under regional integration initiatives are dramatically changing the trading environment for developing countries. The interface between these processes brings new and enormous challenges for those countries, with profound implications for their development prospects. These arise from key features of the "new regionalism", which reaches far beyond borders. Further challenges arise from the interface between developments in the WTO system and the new regionalism. A particular concern is the issue of preferential liberalization of trade in services, including the compatibility of the new regional integration agreements with the provisions of GATS Article V.

INTRODUCTION

The 1990s witnessed the resurgence of interest in regional trade agreements (RTAs)[1] throughout the world, with old schemes being revived and new ones emerging in an attempt to harness the forces of globalization for economic growth and development. Some 250 preferential trade agreements of different types have been notified to the GATT/WTO, almost 52 per cent of them were notified after January 1995. Of all notified agreements, over 170 are currently in force. An additional 70 agreements are estimated to be operational, although not yet notified. By the end of 2005 if all agreements planned or currently under negotiation come into effect the total number of RTAs might well approach 300 (WTO, 2003). More than half of world trade is now taking place within actual or prospective RTAs. In the case of the Western Hemisphere, for example, by the year 2004 some 86 per cent of total trade will be free of duty as the result of the implementation of those RTAs already in effect, without taking into account the future impact of the new agreements currently under negotiation. Nearly every country in the world is now a member of one or more RTAs. Even countries traditionally committed to MFN liberalization, such as Japan and the Republic of Korea, have shifted their long-standing policies and are now actively pursuing the regional option.

The overarching motive for this new drive towards regionalism among developing countries is the search for effective policy instruments to achieve sustainable development through the insertion of national economies into the globalization process. Also, a certain "domino effect" has been identified as playing an important role in promoting the new regionalism, with countries increasingly engaging in new RTAs as a means of counteracting perceived negative effects of discrimination and marginalization as others form RTAs. Developed countries, for their part, are increasingly engaged in "competitive regionalism", in part to secure their trade interests as well as to establish spheres of influence that include but also go beyond trade policy. Regional agreements continue to proliferate as an idea as well as a political-economic fact, and are likely to remain an enduring feature of the trading system.

The relationship between multilateralism and regionalism has been widely discussed in the literature.[2] Our purpose in this paper is not to engage in the traditional debate on regionalism as a "stepping stone or stumbling block" to multilateral efforts. Rather, it is to present some preliminary reflections, as food for thought, on the current challenges confronting developing countries as a result of the simultaneous processes taking place both in the multilateral trading system (MTS) and in the context of the "new regionalism" evolving in all regions of the world. In the MTS there are some new developments and contradictory forces at work creating a complex environment in which this new regionalism, radically different from that of the 1960s and 1970s, is being actively promoted by the majority of developing countries as a central instrument of their development efforts. The interplay between the events taking place in the MTS and the particularities of the new regionalism has brought enormous challenges for developing countries, having concrete expression

[1] The expression "regional trade agreements" refers throughout this text both to economic integration agreements and to trade preferential agreements of a different nature. When relevant, the distinction is made.

[2] See, for example, Laird (1999) for a review.

in ongoing trade negotiations, as well as in the evolution and functioning of existing RTAs. The outcome of the interface between these processes could have profound implications for the development prospects of developing countries.

This study analyses some of the challenges confronting developing countries with the purpose of identifying areas for further work and reflection in order to address issues that have emerged as a major area of concern for those countries. The first section offers a brief discussion of the main features characterizing the new regionalism, attempting to present the broader picture that should inform any discussion of its systemic and developmental implications. The second section highlights some of the major challenges confronting developing countries, which emerge from the interface between the new regionalism and events taking place in the MTS. The final section focuses on the issue of regionalism and trade in services, analysing some of the main issues that should be addressed in the ongoing negotiations in the WTO.

I. THE NEW REGIONALISM

There is an emerging consensus in the literature that the recent proliferation of RTAs constitutes a new phenomenon with potentially profound implications for the trading system. It is recognized that the "third wave of regionalism", or the "new regionalism" as it is called, is radically different from that of the post-war period. The concept of new regionalism goes beyond that of "open regionalism", usually utilized to portray integration efforts in the context of open and market-oriented economies. However, there are different interpretations regarding the driving force behind this process, with different authors highlighting distinct features of current regionalism as those conferring its novelty.[3] Some of the main characteristics of the "new regionalism" have been discussed elsewhere,[4] and a recent report by the Inter-American Development Bank (IDB) presents an interesting analysis of this phenomenon in the Western Hemisphere.[5] A comprehensive discussion of the new regionalism goes beyond the purpose of this paper. However, it is important to highlight the major features identified as conferring novelty on this process as they are relevant for the discussion of its possible systemic and developmental implications. Each of the features of the new regionalism opens up an interesting field for further analysis and research.

In the 1960s and 1970s, regionalism normally involved countries at more or less similar levels of development, usually in close geographical proximity and focused predominantly on the liberalization of trade in goods by dismantling tariffs and border measures affecting trade between the parties. Regionalism was conceived of basically as an instrument supporting national developmental policies, as it was mainly oriented to overcoming market-size limitations faced by import-substituting industrialization policies at the national level. Today, South-South regionalism is no longer conceived of as an instrument that is primarily intended to support national development strategies and policies, but as a developmental option in itself, promoting competitiveness and the effective insertion of economies into the international economy as the means to increase overall welfare in all members of the RTA. From this perspective, one might expect that developmental strategies and policies would be embodied in the norms and disciplines of the RTAs, but the absence of any such ideas in most regional agreements highlights the lack of clarity on what such strategies and policies should be. This is critical because the modern regional agreements, by locking in a wide range of policies and instruments, may well preclude policy options or policy space available for adopting adequate development-oriented policies. This is perhaps one of the more significant differences with earlier regionalism, and one of the main challenges currently confronting developing countries.

Debate on regionalism has mostly concentrated on its possible impact on the MTS. The analysis of the relationship between regionalism, as expressed in South-South agreements, and development has not yet received all the attention it deserves. According to the World Bank, although South-South agreements can be made to work, a number of regional

[3] For a recent discussion of the motivation and characteristics of the new regionalism, see for example Sampson and Woolcock (2003) and Okamoto (2003).

[4] Luis Abugattas, Presentation on Regional Integration and the Global Economy at the High-level Segment of the Forty-seventh Session of the UNCTAD Trade and Development Board, 16 October 2000.

[5] IDB (2002).

integration agreements have had negative or ambiguous effects on income, and agreements between richer and poorer developing countries are likely to generate losses for the poorer ones when their imports are diverted towards the richer member whose firms are not internationally competitive.[6] An OECD study, analysing the economic effects of RTAs, suggests that their impact on economic growth is quite limited.[7] For the IDB, the developmental promise of regionalism would only be realized to the extent that regional integration is an integral part of the structural reform process itself.[8] According to some studies, the overall economic effects of some South-South agreements are likely to be small and may even be negative for some members.[9] Other studies, on the contrary, conclude that in some cases there may be significant welfare gains for members of RTAs.[10]

Despite this lack of clarity about the welfare impact of RTAs and how to design them to ensure that they are welfare-enhancing, many developing countries are now investing considerable political capital in maintaining and attempting to foster their own economic integration schemes despite significant domestic, and even international, opposition to these endeavours. Clarity regarding the developmental impact of South-South regionalism, and on how to foster it and make it effective, is crucial to maintaining the political impetus for these efforts.

A relevant research and policy question is the following one: are the political capital invested and the efforts undertaken by developing countries in strengthening South-South RTAs profitable from a developmental and welfare-enhancing perspective? Available evidence tends to suggest that regional integration between developing countries has promoted trade and export diversification allowing for increasing exports of manufactured goods to regional markets, and that inter-industry trade have evolved in the context of regionalism.[11] Furthermore, South-South RTAs have tended to be more trade-creating than trade-diverting.[12] Nevertheless, the developmental impact of regionalism should not only be evaluated in the realm of trade from a Vinerian perspective. Each agreement has to be evaluated in the light of the stated objectives of the grouping, which today often go far beyond increasing and diversifying trade, and incorporate a wide number of other social, economic, political and even security objectives. Also, there is the issue of regionalism as a possible provider of regional public goods (RPG) in a number of areas, for example democratic stability and consolidation through the incorporation of the "democratic clause" in the agreements.[13]

A comprehensive developmental audit of RTAs between developing countries raises various complex issues. First, it will require the definition of success indicators on the basis of the particular objectives of each agreement. A second methodological challenge is to isolate the impact of integration from other intervening variables on the observed results. And, finally it is necessary to confront the question: what would have happened in the absence of the RTA? Nevertheless, this is an area in which further work is urgently required in order to adequately inform policy makers in developing countries.

A novel development in the MTS is the emergence of North-South RTAs radically redefining the nature of the relationship between trading partners. The traditional relationship based on unilateral preferences granted for trade in goods to developing countries is being progressively transformed into reciprocal agreements encompassing a wide range of areas,

[6] World Bank (2002).
[7] OECD (2001).
[8] IDB (2002).
[9] Scollay (2001).
[10] Gilbert, Scollay and Bora (2001).
[11] IADB, 2002. op.cit. Also, Cernat (2003).
[12] Flores (1997).
[13] Devlin and Estevadeordal (2001).

and involving deep integration measures. This is the case, *inter alia*, of the North American Free Trade Agreement (NAFTA) incorporating Mexico, the United States and Canada; the agreements signed by the European Communities (EC) with a number of developing countries under the New European Mediterranean Policy; and the agreements reached by the EC with Mexico and Chile.[14] Currently, there are very ambitious processes being undertaken in the form of the creation of the Free Trade Area of the Americas (FTAA), covering all the 34 countries of the Western Hemisphere, except Cuba; the negotiations under way between the European Communities and the 79 ACP countries on the basis of the Cotonou Agreement; and negotiations for the establishment of a FTA between the EC and MERCOSUR. Furthermore, a growing number of bilateral agreements between developed and developing countries have been signed and put into effect, or are waiting domestic ratification.[15] A significant number of initiatives involving developed and developing countries are in the pipeline.

The emergence of RTAs between developed and developing countries is perhaps the new development in the trading system that is raising more concerns regarding systemic implications, the possible trade-diverting effects on non-members and the implications for the development prospects of developing countries. As can be deduced, at least from the current Latin American experience, most developing countries are increasingly participating in RTAs with developed countries, fundamentally motivated by the "fear of exclusion", including through uncertainties about the future of unilateral preferences, in particular those which provide additional preferences for sub-groups of countries (often linked to social programmes, labour conditions or the war against drugs). Recent challenges to discriminatory preferences granted to some developing countries under the Enabling Clause furthered concerns of preference-receiving countries, increasing their interest in consolidating market access conditions within the framework of RTAs.[16] There is a clear trend towards the establishment of at least two distinctive hub-and-spoke systems within the MTS – one based on the constellation of agreements promoted by the United States, and the other with the European Union as the hub. It remains to be seen whether another hub-and-spoke system would evolve around Japan as a result of its new regionalism activism. The possible systemic implications of hub-and-spoke system configuration have been widely analysed in the literature, and there tends to be agreement that this configuration is less conducive to promoting system-wide liberalization.[17]

North-South agreements raise a number of new and highly relevant issues for developing countries. There are relevant questions regarding the real negotiating leverage of developing countries in that context, and the developmental implications of those agreements. The question of special and differential treatment in North-South agreements is a matter of particular concern for developing countries in the light of the trend that can be perceived emerging from those agreements already negotiated, and also from those currently being negotiated, and surrounding the compatibility parameters imposed by Article XXIV of the GATT on RTAs. There are also concerns with respect to the future

[14] Agreements signed by the EC with Jordan, Tunisia, Algeria and Morocco.

[15] For example, the agreements between the United States and Chile, Viet Nam, Jordan and Singapore. Also the EC, have signed, are negotiating or are considering a number of association agreements with developing countries, for example the agreement with South Africa. Canada has been active also in signing an agreement with Chile, and is currently negotiating a FTA with CARICOM. Japan, traditionally foreign to RTAs is now showing a new activism in this regard, being involved in talks with Asian and other countries such as Mexico.

[16] Preferences granted by special programmes both by the United States and the EC have been challenged by India and Brazil in the WTO. The Appellate Body in a recent ruling reversed the conclusions of the Panel in the case presented by India against the preferences granted by the EC to the Andean countries, establishing that they can be maintained by the EC.

[17] For a review of the literature on the possible effects of a hub-and-spoke system, see Hoekman and Kostecki (2001).

of existing subregional agreements. Will they be absorbed by agreements with developed countries, or they will be able to maintain a separate identity and play a developmental role in the future? The extent to which North-South negotiations will become a forum for exerting pressure on those issues where developing countries are "demandeurs" or are facing demands at the WTO with implications for multilateral negotiations is also a matter of growing concern for developing countries.[18]

The burden of trade in goods liberalization in North-South RTAs weighs asymmetrically on the developing countries. There is an argument, notably by the World Bank (but still subject to empirical testing), that North-South agreements are more likely to improve welfare, in comparison with South-South agreements, because they result in lower trade barriers with less trade diversion, fewer behind-the-border measures, and greater security (less likelihood of reversals) in the liberalization implemented by the developing countries.[19] Also, it has been suggested that North-South RTAS will generate higher productivity gains in developing countries.[20] However, some studies tend to show that all their developmental promises might not materialize. For example, a study commissioned by the Secretariat of the Andean Community, even though it cannot be taken as conclusive, suggests that Andean countries cannot expect welfare gains from trade in goods within the FTAA context, while most countries would experience a net welfare loss, coupled with significant fiscal revenue losses. Some activities would also be significantly harmed by import competition.[21] Elsewhere, studies need to be carried out regarding the possible developmental impact of North-South agreements.

Concerning possible gains for developing countries, an issue that deserves analysis is to what extent these RTAs, besides conferring predictability on market access conditions, will in effect improve the overall conditions enjoyed by developing countries in developed countries markets. In the case of the FTAA, for example, there would not be much change in terms of current tariff preferences enjoyed by most of the region in acceding to the United States market under the CBI, the ATPA and the GSP. The marginal benefit in this regard of the future RTAs is limited to a reduced number of products currently excluded from the preferential schemes, with tariff peaks and affecting only some of the countries in the region. On the contrary, there is the concern that trade rules, in particular the rules of origin to be adopted, could in practice limit current market access opportunities of countries of the region to the United States market. There is also a real possibility that South-South trade will be affected more by North-South agreements than by South-North trade because of market liberalization in favour of products originating in developed countries, generating net welfare losses. Even though there has been wide concern regarding the issue of the possible impact of erosion of preferences as a result of multilateral liberalization in the WTO, much less attention has been paid to the possible impact on developing countries' trade and welfare of the erosion of regional preferences resulting from liberalization in the framework of RTAs with developed countries.

The participation of developing countries in North-South agreements is also promoted on the basis of potential dynamic benefits expected from the comprehensive set of third-generation disciplines incorporated in those agreements anchoring structural reform, and providing credibility being grounded in international

[18] There is strong evidence supporting the assertion that the United States Government exerted pressure on Latin American countries participating in the G-21 during the Cancún Ministerial Meeting on the basis that bilateral initiatives could be jeopardized as a result of such participation. A number of Latin American countries announced their dissociation from that Group after Cancún.

[19] World Bank (2000).

[20] Lopez-Cordova and Mesquita (2002).

[21] Andean Community Secretariat (2003).

commitments. Nevertheless, no comprehensive evaluation has yet been undertaken of these alleged benefits. Perhaps the most publicized expected dynamic benefit for participating developing countries in North-South agreements is increasing inflows of FDI, in goods-producing activities and in services, with all the positive externalities. In this respect, current analysis within the Americas of the effect of North-South RTAs on FDI is strongly influenced by the examination of the Mexican experience in the NAFTA. However, this experience might not be comparable with that of other developing countries because of a number of factors that have been highlighted in the literature. Increasing FDI inflows might not necessarily be the case for all members of a RTA, and the recent process of investment running away from Mexico to other locations needs to be factored into the analysis. Moreover, while RTAs may bring more FDI, the benefits may not be evenly distributed: such FDI is often concentrated in the larger partners, allowing the realization of economies of scale in that market (e.g. Brazil within MERCOSUR), which becomes a platform to export to other members of the RTA. As the IDB points out, the big losers could be medium-size countries, as small countries are more likely to be supplied by trade rather than by FDI, with or without a RTA.[22] Trade liberalization in Latin America is already generating a pattern of relocation of tariff-jumping FDI to the detriment of some countries of the region. Thus, the issue of the distribution of benefits among participating countries in North-South RTAs deserves further analysis. Also, the impact of the policy constraints regarding the treatment of FDI incorporated in these agreements, in particular regarding policies to promote positive externalities, needs a full evaluation. Regarding FDI and North-South agreements, an issue that deserves special attention is the treatment of investment incentives. In the context of RTAs, competition for FDI by developing country members may become intensive, resulting in subsidy wars among members, providing disproportional benefits to foreign investors and eliminating or reducing the potential gains for developing countries. A matter of concern is the resistance showed by developed countries to incorporate disciplines on investment incentives in the framework of the different RTAs negotiated or under consideration.

A variety of different motives have been identified explaining the participation of developed countries in North-South RTAs. Obviously, there are the expected direct economic benefits to be derived by these countries from those agreements. However, other objectives weigh heavily in explaining their participation, and might be even more relevant. Some authors, for example, have highlighted security concerns as a basic motive behind the United States' policy shift regarding regionalism.[23] A closely related factor is the desire to limit migration from the poorer countries by raising living standards in the poorer countries. This was important in NAFTA as well as in the Euro-Mediterranean agreements.

Two objectives behind developed country participation on North-South RTAs deserve special attention in the light of their possible impact in developing countries that are partners in those agreements and on the MTS. One such explicit objective of developed countries is to influence domestic policies in developing countries through the RTAs' binding Washington Consensus-based structural reforms. For developed countries, and also for the multilateral financial institutions, it seems that the only true developmental content of this feature of the new regionalism is the possibility of locking in reforms through legally binding rule-based commitments which the developed partner(s) can use to enforce the terms of the agreements. Market logic, it seems, will do the rest. Some developing countries' governments have also participated in trade negotiations with this objective in mind, anchoring structural reforms to avoid possible reversal by future Governments (Mexico is one such example). In this regard, North-South RTAs bring the risk of locking in a single approach to

[22] IDB (2002, p. 232).
[23] Yamada (2003).

economic development that has proved, in the case of many developing countries, not always to produce the expected results.[24] Also, these agreements could seriously limit the policy space available to developing countries to define and implement development policies in the future.

Another stated objective of developed countries for their participation in North-South RTAs is to expand the trade agenda beyond what is currently possible in the MTS, and setting WTO-plus standards with the ultimate goal of spreading those standards worldwide, if possible through the WTO. This is the case, for example, with labour rights and environmental standards in agreements promoted by the United States, and also the case of the Singapore issues, and TRIPs-plus disciplines, on which rule-making is rapidly evolving in different RTAs. North-South agreements are not seen as competing with the MTS, but as a mechanism to foster developed countries' own trade agenda and as precedent-setting. Facing a "crisis of governance" in the MTS, as exemplified by the Seattle and Cancún failures, developed countries are giving priority to regional efforts to promote their interests. As a result of North-South RTAs, the rule-making space is progressively shifting from the WTO to the regional agreements. This suggests a new scenario in which rule-making spreads through a bottom-up approach, with profound implications for the governance of the MTS, and for the possibilities of developing countries effectively to influence the setting of multilateral norms and disciplines.

Another feature of the new regionalism is the introduction of "third generation agreements" that are highly intrusive in the realm of domestic policies. The nature of the renovated and new RTAs, both North-South and South-South, defies the sequence and the classical levels of economic integration ranked by scope and deepness of the commitments adopted by members.[25] RTAs increasingly include "deep integration" measures covering, *inter alia*, standards, sanitary measures, trade facilitation, liberalization of trade in services, investment and competition disciplines, IPRs, government procurement, and also the movement of natural persons with a set of related disciplines. They incorporate also policy areas that were previously a domestic preserve: macroeconomic coordination, policy and regulatory harmonization, cooperation measures in a variety of fields and infrastructure integration; and pursue a mix of political, social and economic objectives. Each RTA presents a different mix of these elements and differentiated disciplines, even though some harmonization is being attempted in the context of the hub-and-spoke systems. Also, no predetermined sequence for the introduction of elements into the agreement can be identified.

Faced with these new realities, the traditional analytical tools for evaluating the welfare impact of RTAs on members, non-members and the MTS as a whole seem rather inadequate. Indeed, the categories of RTAs recognized by Article XXIV of GATT, FTA and CU do not today find a direct correspondence with the realities. There are now much more complex phenomena, and the analytical tools must evolve to take into account these new realities. In this new context, for example, the impact of a RTA on trade of non-members might not necessarily derive from tariff preferences granted to members, but it could be the accumulative result of a number of variables, some even not directly related to trade rules as such. The effect of investment disciplines of RTAs in promoting FDI flows between some members have been highlighted, for example, as one of the measures with significant impact on trade creation, and as explaining the direction of trade

[24] See for example, Stiglitz (2003) and French-Davis (2003).

[25] The classical formulation was presented by Bela Balassa classifying RTAs: preferential trade agreements, free trade areas, customs unions, common market and economic union. Article XXIV of the GATT is mostly based on this categories, recognizing in its provisions FTA and CU, or interim agreements leading to the formation of one of these types of arrangements. Current RTAs simultaneously incorporate elements of the different categories and do not necessarily follow any predetermined sequence.

between members of a grouping. Also, infrastructure integration, through its impact on transport costs, or trade facilitation measures among members could have a greater trade impact than tariff preferences.

Another distinctive feature of the new regionalism is the simultaneous participation of countries in various RTAs, each one, in many cases, with highly differentiated trade rules (usually also being implemented over different periods). This phenomenon introduces new complexities at the systemic level, generating also new domestic requirements for the administration of the multiple and varied commitments.[26] The panorama is increasingly turning more complex because of the proliferation of agreements worldwide and the increasing cross-cutting membership between different agreements. Even more, in some instances parallel negotiating processes are taking place.[27] The situation emerging as result of this multiple and simultaneous participation by countries in RTAs, at different levels and of a differentiated nature, and the proliferation of agreements has been compared to a "spaghetti bowl". This panorama makes the definition of policies and instruments of regionalism as a development tool a very complex task, and also introduces significant complexity in evaluating the systemic and developmental impact of the new regionalism. Evaluating compatibility with GATT Article XXIV provisions becomes even a more complex task than in the past because of the simultaneous participation in different RTAs. How is it possible to evaluate intermingled and overlapping agreements?[28] How is one meant to understand the requirement of Article XXIV:8 (a) (ii), in the case of customs unions, that substantially the same regulations of commerce should be applied by each of the members of the union to trade of territories not included in the union? Also, this situation impacts significantly on the categorization of RTAs. With multiple and differentiated participation in RTAs by members of a grouping, the notion of a common external tariff, and therefore of a customs union, has little practical meaning as nominal tariffs are being eroded by the differentiated preferences granted by members of the grouping to third parties. How is this compatible with the requirements of GATT Article XXIV? In this new context, the evaluation of the impact of RTAs on third parties and the extent of trade creation or trade diversion has also become very difficult.

An interesting emerging feature of the new regionalism is the attempts to negotiate RTAs between regional integration groupings. Such "bloc-to-bloc" negotiations constitute a relatively novel exercise, bringing new challenges and additional rule-making requirements for successful integration. Bloc-to-bloc agreements will also bring new complexities for evaluating Article XXIV compatibility, in particular in the case of RTAs between two customs unions. As yet there is no agreement of this type in full effect, but initiatives of this type include the ongoing negotiations between MERCOSUR and the EC, CARICOM-CACM, SACU-SADC, and the

[26] The case of Bolivia, for example, indicates the complexity of this issue. Bolivia is a full member of the Andean Community, and at the same time is an associate Member of MERCOSUR, and full member of the Latin American Integration Association (LAIA). Each of these groupings has differentiated trade rules, is actively participating in the FTAA negotiations, and has bilateral agreements with a number of countries in the hemisphere. Bolivia is also participating on both sides of the negotiations between the Andean Community and MERCOSUR. Being both members of the Andean Community, Bolivia and Peru have a bilateral agreement that is being currently renegotiated.

[27] For example, Central American countries and the United States are actively participating in the negotiations on the Free Trade Area of the Americas (FTAA), encompassing all countries in the hemisphere except Cuba, but at the same time parallel bilateral negotiations between them have been launched for establishing the CA FTA. In the same vein, MERCOSUR is participating in the FTAA while negotiating a RTA with the European Community, and an agreement with the Andean Community, while some of its MERCOSUR partners are negotiating bilateral agreements with other countries.

[28] This would be, for example, the case of a future bilateral agreement between the United States and Central America, the CAFTA. This agreement will be evaluated in itself, or also taking into account the FTAA of which both will be full members.

convergence process between MERCOSUR and the Andean Community, close to been finalized.[29] Analysis of this latter negotiation, which has been ongoing for some time, has pointed up the enormous complexities involved in attempting to integrate two groupings with different sets of trade rules. Also, the practical difficulties encountered in the negotiating process itself, demanding the development first of a common position by members of each bloc incorporating a variety of interests and sensitivities, before engaging in bloc-to-bloc negotiations. Furthermore, this experience has highlighted the practical problems confronted in adjusting positions as negotiations proceed.[30] Bloc-to-bloc negotiations highlight the need for capacity building in developing countries to engage in this type of endeavour, and to develop a negotiating approach that would ease this type of negotiation. Making the rules in effect in each bloc compatible so as to facilitate trade have also proved to be a complex undertaking. The analysis of these processes and the problematic of RTAs articulation is a highly relevant issue to be addressed, given that the convergence of RTAs is perceived as the preferred mechanism, in the context of some regional initiatives, to progressively multilateralizing regionalism. These could be, for example, the cases of the proposed Arab Free Trade Area effort launched by the Arab League, or the African Union involving the different subregional agreements already in effect.

The launching of interregional agreements, another feature of the new regionalism, challenges "geographical proximity" as a necessary element promoting and making integration viable that constituted a core element of our understanding of earlier regionalism. Increasingly, RTAs are being agreed between countries of different regions, for example the recently finalized trade agreement between Chile and the Republic of Korea, the agreements between the United States and Singapore and Viet Nam, and negotiations between India and MERCOSUR, Japan and Mexico, among many other current initiatives. This is an indicator that "economic distance" is no longer perceived as a factor affecting the competitiveness of products originating in distant trading partners and impeding trade. These agreements are also challenging the traditional notion of *region*, and should promote a revision of our understanding of the requirements for successful integration. Finally, the new regionalism is characterized by attempts by regional or subregional economic groupings to pursue a common external economic policy and to emerge as a *collective entity* in the international arena, thus bringing interesting and complex new challenges for developing countries.[31] One of the perceived benefits of RTAs among developing countries is their increasing leverage in the international arena, allowing them to promote their trading interests more efficiently, and emerge as valid counterparts in the different negotiating instances. However, there are both centripetal and centrifugal forces acting at the same time that have turned these attempts into very difficult, and some times even frustrating, exercises.[32] The definition of a common external policy and the implementation of mechanisms allowing effective international collective action are another pending challenge that developing countries must face in the near future.

[29] The last meeting, the ninth one between the parties, took place in Lima from 26 to 30 April. It was not possible to complete pending work.

[30] For a discussion of the dynamics of the MERCOSUR-AC negotiations see Abugattas (1999a).

[31] Most integration groupings among developing countries are developing institutional arrangements for jointly conducting international trade negotiations. However, the mechanisms that have been put in place are different between the groupings, and also within the same grouping according to the different negotiating processes. In the case of CARICOM, for example, the Member States have instituted the CARICOM Regional Negotiating Machinery (RNM), which has been created to develop the negotiating position and strategy for the grouping. In the Andean Community and MERCOSUR the negotiating position and strategies are developed in intra-governmental meetings, with participation of the relevant national authorities of all Member States, depending on the issue on the negotiating agenda.

[32] For a discussion of some of the problems confronting Latin American and Caribbean countries in articulating a common external policy and negotiating positions, see Phillips (2002).

II. CHALLENGES FACING DEVELOPING COUNTRIES

This section briefly discusses under four main headings some of the interrelated challenges arising from the interface between the MTS and the new regionalism that developing countries are currently facing.

A. Building on quicksand

A major challenge for developing countries is the promotion and implementation of the new regionalism as an effective instrument of development while confronting at the same time a MTS in constant flux. The relationship between the MTS, as expressed in the WTO Agreements, and the new regionalism has three main dimensions in which new developments are taking place: (i) the degrees of freedom that Members have to engage in preferential arrangements are defined by different provisions of WTO Agreements which set the parameters of compatibility of regionalism with the MTS; (ii) the WTO rules and disciplines constitute the floor, or the minimum common requirement, for all other agreements in those areas governed by the WTO Agreements; and (iii) the space for preferential trade liberalization at the regional or subregional level is largely defined by market access commitments, both in goods and in services, adopted in the WTO.

Regionalism is governed by Article XXIV of GATT (1994), by Article V of the GATS and by the "Enabling Clause". These provisions establish the conditions to be fulfilled by RTAs in order to be compatible with the MTS, providing therefore for the degrees of freedom allowed to depart from the MFN cornerstone principle of the MTS. As provided by paragraph 29 of the Doha Ministerial Declaration, economic integration provisions in the WTO Agreements are under review. The Doha Ministerial Declaration mandated negotiations "aimed at clarifying and improving disciplines and procedures under existing WTO provisions applying to regional trade agreements" and that negotiations "shall take into account the developmental aspects of regional trade agreements". Discussions are being undertaken in the Negotiating Group on Rules (NGR). Initial submissions by WTO Members propose a comprehensive review of the relevant provisions, seeking clarification of key benchmark requirements while taking into account the development dimension of regional trade agreements; and the improvement of the WTO oversight function with respect to regional trade agreements in terms of procedural requirements, i.e. notification, reporting and examination procedures.[33] Work in the NGR has been mostly concentrated on other issues on its agenda, and not much progress has been achieved to date on the review of the provisions dealing with economic integration. Regional integration issues were not contentious in the Cancún preparatory stage. The Cancún Draft Ministerial Declaration submitted by the Chairman on his own responsibility, noting the progress that has been made in the negotiations on improving transparency in regional Trade Agreements, "encourage the Group to reach a provisional decision soon on its work on transparency and to accelerate its work on the clarification and improvement of RTA disciplines under existing WTO provisions, taking into account the developmental aspects of RTAs".[34] The draft remained unchanged during the Cancún Ministerial Meeting.

[33] Australia (TN/RL/W/2 and TN/RL/W/15), EU (TN/RL/W/14), Chile (TN/RL/W/16), and Turkey (TN/RL/W/32).

[34] WTO. Job(03)(150)/Rev.1.

The review of economic integration provisions in the WTO Agreements is an area that needs adequate and priority attention. The result of the review can seriously affect current integration agreements and initiatives, and at the same time the revision of those provisions should provide an adequate opportunity to accommodate the realities of the new regionalism, discussed above, while taking into account the concerns of non-Members. Different possible outcomes can be conceptually visualized from the overall work of the NGR regarding provisions dealing with RTAs. The optimum outcome would be a comprehensive review of WTO provisions dealing with economic integration, overcoming the difficulties confronted in the past with the application of Article XXIV, and incorporating effective SDT provisions in order to address the new North-South Agreements and current challenges to the applicability of the Enabling Clause.[35] (GATS Article V has not yet been in practice put to the test; however, it mirrors Article XXIV and transmits to the case of trade in services all the problems faced in the past with the application of Article XXIV, even increasing the complexities in evaluating WTO compatibility of agreements covering trade in services. GATS Article V is discussed in the third section of this study). New provisions on economic integration should provide a clear and predictable framework on which regional integration can be adequately promoted, while taking into account systemic issues, the concerns of non-Members and preserving policy space to accommodate development strategies and policies. Renovated WTO provisions on regional economic integration should incorporate and respond to the realities of the "new regionalism", taking into account the new models and dimensions of economic integration, as well as North-South agreements carving out for those cases the required space for the effective implementation of SDT regional provisions,[36] and also addressing the new complexities arising from bloc-to-bloc arrangements. Also, those provisions should address some other specific issues currently on grey areas, *inter alia*, preferential rules of origin, safeguard action, and collective remedy undertakings.

Bearing in mind that the Enabling Clause does not cover North-South agreements, carving out the required space for SDT in the context of general provisions dealing with RTAs should constitute a major area of concern for developing countries in current negotiations in the NGR. Different options could be explored for introducing substantive SDT provisions related to RTAS.[37] One option that has been suggested is the review of specific provisions of Article XXIV, introducing flexibility in the case of RTAs in which developing countries participate, in particular the improvement of Article XXIV (5)(c) on transitional periods, and paragraph (8) on "substantially all trade requirements". Another option could be the introduction of generic provisions on SDT within Article XXIV in favour of developing countries. Some guidance on such an option could be drawn from GATS Article V, which provides flexibility for developing countries in integration agreements liberalizing trade in services. Also, clarifying and improving the Enabling Clause by extending its scope to cover agreements between developed and developing country Members has been proposed. Finally, improvement of Part IV of GATT on non-reciprocity, making it enforceable and rendered applicable to negotiations of RTAs, has been presented as a possible alternative for achieving this objective. Moreover, the SDT dimension of RTAs can be linked to the Doha negotiations on generic SDT provisions "with a view to strengthening them and making them more precise, effective and operational" as provided in paragraph 44 of the Doha Ministerial Declaration.

[35] For a review of the issues related to RTAs generated by the work within the Committee on Regional Trade Agreements and discussions in other WTO bodies refer to WTO (2002).

[36] Compatibility benchmarks should be made sufficiently flexible to allow for meaningful SDT for developing countries participating in RTAs, incorporating to some degree the Enabling Clause in the new WTO provisions on economic integration.

[37] Options for addressing this issue are discussed in Davenport (2002). See also Onguglo and Ito (2003).

Another possible outcome of work in the NGR, as some WTO Members have already proposed, could be the introduction of some meaningful changes in existing provisions on economic integration in WTO Agreements, "grandfathering" existing agreements. In this case, the review might not go as far as developing new provisions, but clarifying the existing ones and strengthening the compatibility benchmarks and procedural requirements. In this case, a dual set of rules would be crystallized, differentiating existing from new integration agreements. A danger associated with such an outcome would be that North-South RTAs being currently negotiated could be subjected to more stringent rules, possibly limiting the required flexibility for effective SDT in agreements with developed countries or for accommodating particular needs in the context of agreements between developing countries. A third possible outcome of the work in the NGR could simply be the introduction of some cosmetic changes in existing provisions, leaving the situation practically unchanged. This would maintain the framework of uncertainty in which regionalism has evolved in the past, resting more on the lack of action of the CRTA than on the effective application of the relevant multilateral provisions. Since only one agreement has ever been approved in the last 50 years (the Czech-Slovak Customs Union) and none have ever been rejected, this would leave further interpretation of WTO rules in this area open to judicial review in dispute settlement cases, as is now starting to happen (e.g. the India-Turkey case on textiles and clothing).

A second dimension of the relationship between the MTS and regionalism is that WTO Agreements constitute the "floor", or a common minimum denominator, of provisions in RTAs dealing with regulated issues under the WTO. Members of the RTAs are already bound to each other by WTO norms and disciplines. Therefore, any modification of WTO provisions would have an immediate impact not only on the RTAs, but also on every ongoing trade negotiating process that would have to take account of the changing developments in the multilateral framework.[38] WTO Agreements increasingly establish the policy space available for defining and implementing national and sectoral development policies and programmes, setting limits to the possible developmental content of RTAs.[39] Two main issues can be highlighted in this respect. One is the existence of conflicting trends on the possible future direction of the MTS, including the potential review of existing provisions. The other pertains to the eventual incorporation of new policy areas under the WTO framework.

In the MTS, two main trends can be clearly perceived. On one hand, there is the drive for enlarging the scope and depth of multilateral norms and disciplines, manifest already since the Tokyo Round of Multilateral Trade Negotiations. The incorporation of new policy areas under the WTO and the introduction of more stringent obligations for Members are actively promoted in particular by developed countries. New issues – TRIPS, TRIMS and services – were introduced in the Uruguay Round, and the Doha Work Programme (DWP) contemplates the possible addition of other emerging issues to the multilateral agenda.[40] On the other hand, as a result of the entry into force of the WTO Agreements, opposing forces are becoming more evident each day. In view of the growing awareness of the negative effects on development and welfare of some of the provisions of the WTO Agreements and of the concrete implementation problems faced by a large number of Members, a review has been launched of some of the agreements, and the lifting of some of the obligations is being actively pursued. Examples of these trends running counter to enlarging the scope and to deepening commitments in the

[38] For example, one of the major current challenges confronting Latin American and Caribbean countries in the FTAA negotiations and in regional initiatives derives from the uncertainty surrounding future developments in the WTO in some crucial normative areas.

[39] Abugattas (2002).

[40] Trade and environment, electronic commerce, trade debt and finance, transfer of technology, trade facilitation, competition, and the relationship between trade and investment.

MTS include the following: the Declaration on the TRIPS Agreement and Public Health emanating from the Doha Ministerial Conference; the decision to extend the transition period under Article 27.4 of the Agreement on Subsidies and Countervailing Measures and the manner in which the decision is being implemented; waivers being sought by WTO Members from obligations under different agreements; the review mandate of all special and differential treatment provisions incorporated in the DWP; and the strong resistance of many developing countries to launching negotiations on the Singapore issues. Attempts are being made at the MTS level to allow more policy space for developing countries to autonomously implement developmental policies. However, in North-South negotiations this trend is reversed, with strong pressures to move towards adopting WTO-plus obligations in the same areas where developing countries are demanding a review, even a reversal, of obligations in the MTS.

Regarding the relationship between norms and disciplines at the WTO and regional levels, a main issue for developing countries is the coherence between commitments and negotiating positions in the distinct processes.[41] There is also the issue of the possible evolution of disciplines in the MTS covering areas currently being negotiated in other arenas, as is the case, for example, with investment and competition policy. The challenge in this regard is twofold. On the one hand, it is important to ensure that the disciplines that are finally adopted in the regional initiatives effectively respond to the developmental needs of the developing countries. On the other hand, it is equally important to ensure that whatever disciplines might be developed in the MTS do not jeopardize achievements at the regional level. This is an area where developing countries might usefully try to achieve positive cross-fertilization between the regional and the multilateral processes.

Finally, market access commitments in goods and services agreed in WTO negotiations limit the space available for preferential trade agreements. The wider and deeper the commitments in the MTS, the less space there is for preferential trade liberalization among members of RTAs, possibly diminishing the expected returns from regionalism. Conversely, developments in the MTS could be stepping stones or stumbling blocks for regional efforts. For example, the stalemate in agricultural negotiations in the WTO is creating pressures and complications in some regional initiatives such as the FTAA and the EC-MERCOSUR agreement. The issue of the erosion of unilateral trade preferences granted by developed country Members as result of WTO commitments has received some attention in relation to the possible effect on preference-receiving countries. The possible impact of WTO commitments on North-South agreements should be equally evaluated. For example, the erosion of regional preferences, as a result of market access commitments in the WTO by developing countries that could have a significant impact on trade among developing countries by developing countries, needs attention. To illustrate, there is some evidence to suggest that RTAs between developing countries have been an important contributing factor in their export diversification. In the new trading environment, preserving some space for preferential liberalization in the area of services might be equally relevant.

B. Swimming in a spaghetti bowl

The situation emerging as the result of multiple and simultaneous participation by countries in trade agreements, at different levels

[41] Situations such as that concerning performance requirements on services should be avoided in the future. For example, Latin American countries that have joined NAFTA-type agreements have given up the right provided by Article XIX:2 of the GATS to attach conditions when granting market access to foreign suppliers of services, by committing themselves, in bilateral or regional agreements, not to impose performance requirements on investors of the Parties to the agreement or on any other investors from third countries. This has seriously limited their possibilities in the current request/offer process of negotiating specific commitments under the GATS.

and of a differentiated nature, and the proliferation of agreements described above has been described by Jagdish Bhagwati as a "spaghetti bowl". However, the situation has become even more complex than that envisaged by Bhagwati as a result of the new obligations created in the Uruguay Round and proposals for further change in the Doha work programme of the WTO, as well as an even more rapidly growing web of regional agreements that increasingly infringe on sensitive development policy areas. In such a context, developing countries are confronting the complex challenge of completing and perfecting the regional integration schemes as a vehicle for development while managing and adapting to a rapidly changing trading environment. There is therefore a need to bring some coherence to this overlapping agenda and to ensure that it works to facilitate rather than compromise the development process. The identification of those elements that will give the grouping its individuality within the changing trading environment, while effectively promoting sustainable development, should be a primary focus of attention by developing countries involved in RTAs.

The effective management of the interface between national development objectives, regional initiatives and the overall trading environment demands the synchronizing of domestic developmental requirements and objectives with external commitments in different layers of integration. This in turn requires the development of a comprehensive development-oriented trade policy, and that there be a clear picture of the developmental implications of norms and disciplines being developed in the different layers of integration. Additional space available for policies promoting development in the context of RTAs must be clearly identified. RTAs will only make sense to the extent that they incorporate a "plus" element over WTO Agreements, promoting stronger and deeper rules and disciplines, and also differentiated specific liberalization commitments. This relation also holds true for agreements at other levels. For example, in the Western hemisphere the FTAA will only make sense if it is WTO-plus. Equally, a subregional or a bilateral agreement, within the hemisphere, will have to be FTAA-plus, and so on. The identification of the required "plus" elements demands a comprehensive analysis of the different rule-making developments in the different layers – multilateral, hemispheric, regional and bilateral – and identification of additional space available for action in each level. The real political viability of adopting further commitments should be evaluated, realistically assessing what would be possible to achieve and in what time framework. In this regard, the following are relevant questions: what is the politically available space at each level of negotiation to introduce the elements that would confer a developmental friendly "plus" or bonus characteristic on the agreements? What would differentiate agreements to be implemented at different levels? And what issues should be incorporated in the different layers of integration?

C. The imperative of innovative thinking

A major concern of developing countries in the MTS is carving out the necessary policy space for implementing developmental policies. In the context of RTAs, their objective is to identify ways and means of turning those agreements into viable developmental options. Both of these goals require clarity regarding a sound development policy and about those instruments more adequate for achieving developmental objectives. However, developing countries are currently facing a growing disenchantment with the "sound economic policies" proposed, and implemented, during the 1990s, while still trying to define viable alternative development strategies and policies allowing increasing competitiveness and achieving a effective insertion into the world economy. Privatization, trade liberalization and deregulation were the common building blocks of the economic reforms implemented by a large number of developing countries during the 1990s. This view also produced the paradigm shift regarding SDT that took place in the MTS during the Uruguay Round. It was conceived that WTO Agreements embodied that sound

economic policies, therefore SDT should not be implemented through *"cop out"* provisions, but merely through transition periods necessary for adaptation and the provision of technical assistance to allow adequate implementation of the commitments. Domestic reforms supported by commitments in the MTS were expected to address developmental needs of developing countries. The old SDT approach was deemed perverse because it allowed developing countries the possibility of departing from sound economic and trade policies and legitimized the "free riding on the part of developing countries.[42]

As noted earlier, empirical evidence suggests that reforms implemented by developing countries have not always fulfilled their promises and have sometimes produced negative development effects.[43] The conventional wisdom of the 1990s (the so-called Washington consensus) has been questioned both by policy makers and by analysts.[44] This wisdom is more often seen today as a "damaged brand",[45] limiting the policy space in most developing countries. Also, there is the issue of "reform fatigue" in many developing countries confronting unexpected results. Clarity on the policies and instruments that would allow the developmental, trade and financial needs of developing countries to be faced is a precondition to turn both South-South and North-South RTAs into effective vehicles of development, and also for carving out needed space for development policies in the WTO Agreements. The analysis of development strategies and policies should receive priority attention in the context of the current efforts of developing countries to engage in RTAs; such analysis would also lift the level of the debate of SDT in the MTS. In particular, as stated above, the relationship between regionalism and development should receive as much attention as that being given to the relationship between regionalism and multilateralism.

D. Getting the act together: Institutional requirements to confront the new trading environment

In order to be able to adequately manage the complex interface of agreements in a constantly evolving "spaghetti bowl", capacity building is a central challenge for developing countries confronting the new realities of the trading environment. As has been stated, "getting capacities right is at least as important as getting prices and markets right".[46] Capacity constraints are hampering effective participation in the different negotiating processes, and also are evident in the daily administration of the existing agreements in which developing countries participate. The difficulties facing developing countries with the implementation of the WTO Agreements, and even with the notification requirements, and also problems faced ineffectively engaging in the current negotiations in the WTO, and in other instances, attest to existing serious institutional weakness.[47] This capacities deficit is being increasingly aggravated by the multiplicity of processes in which developing countries are simultaneously participating. In a complex trading environment evolving on the basis of a negotiated framework, developing countries cannot expect to be able to promote their interests and obtain benefits unless they have the capacity both to negotiate and subsequently to administer and participate simultaneously in the RTAs and in the MTS. Capacity building emerges as an imperative that developing countries must address urgently.

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[42] Fukasaku (2000); C. Michalopoulos (2000).

[43] See, for example, UNCTAD (2002).

[44] UNDP (2003). See also the collected papers in Fine, Lapavistsas and Pincus (2001).

[45] Naim (2002).

[46] Malik (2002).

[47] At the time of writing, for example, only a limited number of developing countries have been able to elaborate and present their initial requests in the services negotiations to other WTO Members.

III. SERVICES PREFERENTIAL TRADE LIBERALIZATION AND THE GATS

One of the salient features of the new regionalism is the importance that countries are attaching to the liberalization of trade in services in the context of RTAs. Interest in the area of services liberalization by developing countries is relatively recent, having begun in the course of the Uruguay Round, and is linked to the increasing awareness of the importance of having access to services at world prices even to compete in trade in goods, as well as to the growing capacity of developing countries to provide services such as tourism and labour. Now, ambitious efforts are under way to incorporate services within the scope of many of the subregional arrangements, and this trend is also occurring at the broader regional level. Agreements for the liberalization of trade in services can be found both in South-South and in North-South RTAs. RTAs on services are built around a number of core elements: coverage, liberalization principles, liberalization approach and related disciplines. According to the nature and scope of commitments around these elements, a number of different types of RTAs have been concluded, with significant differences among them.[48] This section focuses on the relationship between the MTS and regionalism as it relates to services.

The General Agreement on Trade in Services enables WTO Members to be parties to preferential agreements aimed at the liberalization of trade in services. One of the two MFN exemptions in the GATS is for preferential treatment accorded under GATS Article V on Economic Integration, which corresponds to GATT Article XXIV for trade in goods. Preferential agreements liberalizing trade in services must be compatible with the provisions of GATS Article V, and are to be notified to the WTO Council for Trade in Services. These RTAs in services, as in the case of goods (notified to the Council for Trade in Goods), are then referred to the Committee on Regional Trade Agreements (CRTA) to evaluate their consistency with Article V, and recommendations, if appropriate, may be made to the parties.[49]

Detailed consideration of the systemic issues raised by Article V only began in late 1998, and WTO Members have reported that progress in the adoption of the reports on the compatibility of RTAs with WTO requirements has been impeded by the lack of consensus on the interpretation of the rules relating to RTAs. Furthermore, many of the RTAs covering trade in services have not yet been notified to the WTO for examination by the CRTA, and are therefore without any effective multilateral oversight. This lack of compliance with one of the basic requirements of GATS regarding RTAs is clearly a matter of concern. Several countries have proposed the revision and, if necessary, clarification and reinforcement of Article V because ambiguities surrounding crucial provisions leave the compatibility of RTAs with Article V largely uncertain. Without clarification of the provisions of Article V, the systemic implications of preferential agreements on trade in services will remain controversial, and the link

[48] For a discussion of the different options for RTAs in services refer to Abugattas (1999b) and Abugattas and Stephenson (2003).

[49] Article V 7 (a) and (b) provides that the Council may establish a working party to examine the agreements and to report to the Council on consistency with Article V. The Council for Trade in Services is referring the notifications received to the CRTA.

between regionalism and multilateralism imprecise and undefined. Also, because most regional agreements covering trade in services have introduced an MFN exemption to treatment granted to third parties under Article V compatible agreements, clarification of regional integration provisions in the GATS is necessary in order to provide a predictable and secure framework in which regional initiatives could be promoted. In the context of the review provided for by paragraph 29 of the Doha Ministerial Declaration, WTO Members need to address those issues affecting the evaluation of compatibility of RTAs with Article V.

In order to be compatible with the GATS, an agreement liberalizing trade in services must fulfil two basic conditions: (i) it must have "substantial sectional coverage" in terms of sectors, volume of trade affected and modes of delivery, and (ii) it has to provide for national treatment for services providers of Members eliminating "substantially" all discrimination. These conditions must be met either on the entry into force of the agreement or within a "reasonable" time frame. Article V provides for flexibility on these two basic requirements in two cases: when developing countries are members of a preferential agreement in services, both between developing countries and RTAs with developed countries,[50] and when such an agreement is related to a wider process of economic integration or trade liberalization. Flexibility should be understood to mean that such agreements might cover fewer sectors, a lower volume of trade and fewer modes of delivery, while also maintaining a wider spectrum of limitations to national treatment.

In keeping with the provisions in Article XXIV of GATT, from which they were basically derived, the provisions of GATS Article V introduce a high level of complexity for the actual evaluation of RTAs covering trade in services. Discussion on the issues surrounding GATS Article V have been held in the WTO, and the WTO Secretariat has produced a compilation of all the issues that have been raised regarding Article V.[51] Our intention here is to highlight those issues that should be given particular attention by developing countries in the work being undertaken in the NGR.

The requirement for "substantial sectoral coverage in Article V (1)(a), understood in terms of numbers of sectors, volume of trade affected and modes of supply, has already been subjected to different interpretations by WTO Members. Furthermore, the actual measurement of coverage will be an enormously difficult task in the absence of uniform classification to be utilized in all RTAs, and measurement of value of trade will be very difficult, if not impossible, to nail down because of the limited statistics available in the area of services. With respect to the substantial coverage requirement there are two approaches. One view is that not all sectors necessarily have to be covered, and the other is that the flexibility provided by Article V (1)(a) does not allow for the exclusion of any complete sector from an agreement. In practice, most agreements that have come into effect to date exclude, besides services provided in the exercise of governmental authority, some specific sectors from their coverage. In some cases, even important sectors, or modes of delivery, have been excluded, for example financial services in the Canada-Chile Agreement, or, for all practical purposes, Mode 4 in the case of the NAFTA-Type Agreements. Maritime cabotage services, air transport and audiovisual services are, *inter alia*, other preferred exclusions. In this regard, an emerging problem is that countries participating in preferential agreements are autonomously defining compatibility standards. For example, the EC concludes in relation to its agreement with Mexico: "Although certain services sub-sectors i.e. audio-visual, air transport … as well as maritime cabotage are explicitly excluded from the coverage of the agreement, it should still be considered to

[50] There is no such flexibility for RTAs in the area of goods: when there is a developed country partner, an RTA in goods must satisfy the full rigour of GATT Article XXIV, although there has been some flexibility in practice in favour of developing country participants among agreements which, admittedly, have never been approved.

[51] Major issues raised have been summarized by the WTO Secretarial in TN/RL/W/8/Rev.1, 1 August 2002.

have 'substantial sectoral coverage' in the sense of Article V:1 (a)".[52]

The problem is that, instead of being determined on the basis of the principles of GATS Article V, sectoral coverage is being defined pragmatically on the basis of the specific interests of the parties, establishing a regrettable precedent for a multilateral understanding of the scope of the substantial sectoral coverage requirement.

This same problem of coverage also arises regarding the coverage of modes of delivery, where the treatment of Mode 4 in North-South agreements is of particular interest to the developing countries. The issue of *a priori* exclusion also brings great ambiguity surrounding compatibility requirements. GATS Article V establishes that RTAs should not provide for the *a priori* exclusion of any mode of supply. What exactly should be understood as *a priori* exclusion? Does this mean a legally explicit exclusion from coverage of the agreement? Or does it imply a *de facto* exclusion resulting from the particular commitments adopted by members or from the implementation of the agreements?

Another crucial issue concerns the interpretation of the extent of flexibility provided by paragraphs 2 and 3(a) of Article V of the GATS when the liberalization of trade in services is part of a wider process of economic integration or trade liberalization, and when developing countries are parties to an agreement. There are different interpretations of the flexibility allowed by Article V. The more restrictive interpretation suggests that the limitations to sectoral coverage and the maintenance of discriminatory measures with respect to national treatment should be minimum. On the basis of such interpretation, RTAs should encompass the four modes of delivery without reservation as to national treatment, while the exclusion of sectors should be limited to exceptional cases. A different interpretation suggests that there is a significant margin of flexibility to exclude modes of delivery and sectors as well as to allow for the maintenance of discriminatory measures with regard to national treatment when developing countries are parties to an agreement liberalizing trade in services.

This issue of flexibility goes far beyond academic interest. In practice, some agreements that are already in effect appear to be attempting to set standards for regional agreements on services. For example, the more restrictive interpretation seems to be behind the European Communities Association Agreement with Jordan. The agreement itself recognizes that in its current form it does not constitute an "economic integration agreement as defined by Article V of the GATS". In this case the stated objective of the parties is to develop Title III of the agreement "with a view to the establishment of an economic integration agreement as defined in Article V of the GATS".[53] However, the EC-Jordan agreement incorporates significant liberalization commitments in its current form that, according to the alternative interpretation of Article V paragraphs 2 and 3(a), would make it fully compatible with Article V even at this stage. At their current stage of development, it is likely to be in the interests of developing countries to maintain some flexibility, which seems to be precluded by this relatively restrictive interpretation of Article V.

The exact meaning of paragraph 2 – that "consideration may be given to the relationship of the agreement to a wider process of economic integration or trade liberalization among the countries concerned" – is another issue that deserves clarification. Should it be understood that in those cases there is more flexibility to depart from provisions of paragraph 1 (b)? What is the extent of that flexibility? What should be the nature of the integration agreement and the scope of trade liberalization among the partners to such an agreement to qualify under paragraph 2?

A related issue concerns the situation of stand-alone sectoral agreements. A great number

[52] European Commission, EU-Mexico Free Trade Agreement, 2000.

[53] Article 40 Euro-Jordan Agreement.

of such agreements currently cover a number of services activities, and the legal status of those agreements is unclear at present. Agreements that provide for statutory preferential treatment better than the one provided to other WTO Members should have been notified as part of Annex II of MFN exemptions, or they should have been the subject of a waiver request under Article IX (3) of the Marrakesh Agreement Establishing the WTO, under paragraph 2 of the Annex on Article II Exemptions. However, there have been no requests made for waivers on services measures.[54] Article II exemptions should not exceed a period of 10 years (i.e. they should not extend beyond 2005) and extensions are currently subject to negotiation as agreed in the Guidelines and Procedures for the Negotiations adopted by the Council for Trade in Services. Some developing country Members have inscribed as Article II exemptions some measures that fall under Article V. If those measures are not withdrawn from Annex II exemptions they will have to be extended to all Members in 2005, potentially compromising their regional integration efforts. Current negotiations under Article XIX should provide the opportunity for addressing this issue.

Under Article V, the compatibility conditions must be met either upon the entry into force of the agreements or "on the basis of a reasonable time-frame".[55] Contrary to the case of trade in goods, for which the reasonable length of time of Article XXIV has been established by the WTO Understanding on the Interpretation of Article XXIV as not exceeding 10 years, save in exceptional cases, Article V does not set any reference for the time in which an agreement liberalizing trade in services for compliance. What is to be considered to be reasonable time frames is left to evaluation on a case-by-case basis in the CRTA, leaving some uncertainty as to the outcome of the evaluation. Regarding time frames, as reference it may be noted that in the case of recent agreements intended to liberalize trade in services among developing countries, for example the Andean Community and MERCOSUR, the time frame for achieving substantial sectoral coverage and full liberalization of trade in services has been set at 10 and 8 years, respectively. In the EU agreements, a 10-year period has been considered a reasonable period. However, for many developing countries, the 10-year time frame of GATT Article XXIV may be insufficient in the case of services, in particular in North-south agreements, because of the need to establish a satisfactory regulatory and institutional capacity as a precondition for liberalization of services trade.

Interestingly enough, GATS Article V does not envisage any obligation to eliminate market access limitations in the sense of GATT Article XVI. This raises all the same questions regarding those cases where a measure defined in Article XVI also denies national treatment which have been extensively discussed in the Committee on Specific Commitments and in the Council for Trade in Services in relation to the scheduling of specific commitments. There is ambiguity as to how to interpret this provision. Does it mean that there is no obligation to eliminate Article XVI limitations? Are discriminatory measures against foreign providers limiting market access to be considered denial of national treatment? Is there in fact the possibility of progressively eliminating market access limitations under services regional integration agreements as there is for goods under GATT Article XVI? In this case, does the requirement of "reasonable time frame" also hold?

[54] For a discussion of this issue, refer to Stephenson (2000).

[55] According to some interpretations – not shared by the author – Article V(1)(b) might only set a time constraint on the elimination of discrimination between parties through eliminating existing discriminatory measures, and/or prohibition of new and more discriminatory measures in the sense of Article XVII, that is regarding national treatment. No time constraint would exist on achieving substantial sectoral coverage. A flexible interpretation of these provisions would allow Article V compatibility of agreements with very limited initial sectoral coverage. An alternative, more rigid, interpretation would require agreements to have substantial sectoral coverage from their entry into effect. In practice, the majority of RTAs covering services contemplate a progressive sectoral incorporation into the liberalization commitments.

Another condition included in Article V (4), and derived from the equivalent provisions of Article XXIV of the GATT, is that the RTAs in services shall not in respect of any Member outside the agreement raise the overall level of barriers to trade in services within the respective sectors or sub-sectors relative to the level existing prior to the agreement. It would be useful to clarify whether this requirement applies to all sectors or sub-sectors covered by RTAs regardless of whether a country has made a specific commitment in its schedule in the GATS with respect to that sector or sub-sector. An interpretation that it applies to all sectors covered by the RTA independently if Members of the RTA have made commitments in the GATS would imply the binding in favour of all WTO Members of all existing limitations in the countries members of the RTAs. As the only barriers to trade in services that exist in the legal framework of GATS are those bound by Members in their national schedules, this interpretation would be very fragile one. As in the case of goods, this provision introduces certain complexities when evaluating the compatibility of RTAs with Article V. Besides the enormous difficulties associated with measurement in the case of services of "the overall level of barriers to trade" *ex ante* and *ex post* to the integration agreement, there is the problem of defining the evaluation period for those agreements with mandates to liberalize trade in services progressively.

In the case of an agreement involving only developing countries, paragraph 3(b) of Article V allows the granting of more favourable treatment to juridical persons owned or controlled by natural persons of the parties. That is, it leaves open the possibility of introducing or maintaining discrimination on the basis of nationality, even though those juridical persons could be constituted under the laws and in the territory of one of the parties. This provision could allow, for example, the limiting of the benefits of liberalization of trade in services for companies owned and controlled by nationals of the parties to an agreement. Notwithstanding this possibility granted to developing countries, the different agreements in operation for the liberalization of trade in services among developing countries have not as yet introduced provisions of this kind. Although paragraph 6 seems to contradict the provisions of paragraph 3 (b), paragraph 6 should be understood as the general rule, while the provisions of paragraph 3 (b) may be regarded as an exception in favour of developing countries.

The issue of recognition of education, experience, requirements to be met, and licences or certifications of services providers is of particular importance for developing countries, especially in relation to the prospects for exporting services through Mode 4. Article VII of GATS provides that Members recognizing qualifications of suppliers from other Members shall afford adequate opportunity to any other interested party to negotiate their accession to any existing agreement or arrangement, or if a Member accords recognition autonomously it shall afford adequate opportunity to any other Member to demonstrate that qualifications of its services providers should be also recognized. More than 28 notifications have been presented under Article VII, mostly by developed countries. The relationship between Article VII and Article V needs further clarification. A number of recognition arrangements have been included in general notifications under Article V, and the question arises whether recognition arrangements notified in the context of RTAs are in fact subject to the disciplines of Article VII. There are different interpretations in this regard. One view is that Article V, providing for an exception to the non-discrimination requirement of Article II, also covers similar obligations in other Articles, including Article VII. An opposite view argues that recognition agreements are covered by Article VII regardless of whether they are between parties to a RTA or under which Article they were notified to the WTO. It has been noted that the first interpretation may reflect the desire of some Members to avoid the obligations under Article VII.2.[56]

[56] This issue is discussed in OECD (2003).

Another question that is not clear in relation to GATS Article V concerns the possible implications of the recommendations by WTO Members emanating from the examination of a particular agreement on services. Although this might seem rather academic, given the almost complete lack of progress in reviewing agreements in the CRTA, the issue was clarified for Article XXIV in the Understanding reached in the Uruguay Round, but there are no similar provisions for Article V in the GATS.

IV. CONCLUSIONS

The new wave of regional trade agreements is raising a number of issues for developing countries that need some serious research and considerable technical support since the development impact is far from clear and it seems that a number of policy options are being foreclosed without due consideration of the consequences. This derives from the fact that these new agreements, particularly those that are being established on a North-South basis, seem intended to pre-empt discussions within the WTO as well as reducing policy space for the developing countries. Another issue is the complex web of agreements, within and across regions, that are being negotiated in parallel with the WTO's post-Doha work programme. Nowhere are the issues more complex than in the area of services, where there is no road map comparable to that which has been sketched out in the area of goods over the last 50 years (where the signposts still seem rather confusing). This study has attempted to set out a number of the issues that require more attention by researchers and policy makers as they seek to reconcile their development agenda with the new demands that are being made of them.

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