13 Discrimination and preferences

> Whether used as mere incantation against the evils resulting from present-day economic policy or vigorously prosecuted [customs unions] will in either case be unlikely to prove a practicable and suitable remedy for today's economic ills, and it will almost inevitably operate as a psychological barrier to the realization of the more desirable but less desired objectives of the Havana Charter – the balanced multilateral reduction of trade barriers on a non-discriminatory basis.
>
> Jacob Viner
> *The Customs Unions Issue* (1950)

Introduction

Two constants mark the theory and practice of discrimination in trade relations. The first is that it has always been controversial among economists, many of whom share the misgivings that Adam Smith (1776: 460) expressed when he compared preferential trading arrangements to "[t]he sneaking arts of underling tradesmen" who "make it a rule to employ chiefly their own customers." In an anticipation of the argument that these arrangements are a second-best alternative to the first-best option of non-discriminatory liberalization, he declared "a great trader purchases his goods always where they are cheapest and best, without regard to any little interest of this kind." Viner (1950: 44) elaborated upon that argument when he distinguished between the trade-diverting and trade-creating effects of customs unions, each of which originated in a discriminatory agreement's twin effects of "shift[ing] sources of supply … either to lower- or higher-cost sources."

The other constant is that discrimination remains a favoured tool of statecraft. For two centuries, political leaders have employed bilateral, regional and even extra-regional trade agreements as a means of shoring up alliances, promoting regional peace and stability, and rewarding or inducing cooperation in fields other than commerce. The desire to maintain that option led the architects of GATT to "grandfather" existing preferential schemes and to permit countries to negotiate new ones. Political objectives also led them in later decades to approve waivers for programmes that extend preferential treatment to developed countries' imports from developing countries.

Viner's (1950) seminal study of customs unions inaugurated a third tradition, the perennial debate over the impact that discriminatory agreements and arrangements may have on the multilateral trading system itself. A committed multilateralist, Mr Viner viewed deviations from MFN treatment with great suspicion. His analysis is now dated in two respects – GATT and then the WTO would take the place of the Havana Charter, and free trade agreements (FTAs) would become more significant than customs unions – but the basic principles are unchanged. He was thus the first in a long line of economists to express the concern that customs unions and FTAs would be, in Lawrence's (1991) terms, "stumbling blocks" to multilateral agreements. Others with a more optimist turn of mind instead see these arrangements as "building blocks" for multilateral agreements, creating precedents as well as momentum for new liberalization.

The debate over the relationship between discrimination and multilateralism may be the single most important controversy in the WTO age. One of the ironies of the establishment of this organization is that it culminated a half-century of progress towards a multilateral trade regime, but did so just at the point when its members began negotiating discriminatory agreements in earnest. Almost all WTO members have devoted at least as much attention to the negotiation of bilateral and regional agreements as they have to the multilateral talks. Some argue that the trading system today is multilateral in name only, such that in recent years "trade liberalization has occurred everywhere *except* Geneva" (Dadush, 2009b: 3). That is more than a bit of hyperbole, ignoring the progress achieved in some WTO agreements reached before and during the Doha Round, but also contains more than a grain of truth.

Some terminology is in order before beginning this review, especially the distinction between discriminatory agreements and preferential arrangements. The former generally take the form of treaties, and may range in depth from partial scope agreements to common markets (see Box 13.1). The two major types are FTAs and customs union, both of which eliminate barriers between their members but differ in the treatment they extend to imports from third parties. Whereas the members of an FTA will each retain their own sets of tariffs to third-country goods, the members of a customs union will have a common external tariff. All of these reciprocal agreements are collectively referred to here as regional trade agreements (RTAs). Some authors alternatively call these instruments preferential trade agreements, but the acronym PTA is better used to mean preferential trade arrangements (i.e. those autonomous programmes that work solely on a one-way basis). The Generalized System of Preferences (GSP) is the principal example of a preferential arrangement, but other preferences extend more generous benefits to selected regions or partners. RTAs and PTAs differ in several respects, as discussed below, but both categories comprise significant exceptions to the general rule of most-favoured-nation (MFN) treatment in the WTO system.

Box 13.1. The taxonomy and terminology of regional trade agreements

The category of RTAs covers five different types of agreements, the most important being FTAs and customs unions. FTAs are defined in GATT Article XXIV:8(b) to be "a group of two or more customs territories in which the duties and other restrictive regulations of commerce … are eliminated on substantially all the trade between the constituent territories in products originating in such territories." They are to be distinguished from customs unions, which are defined in paragraph 8(a) of that same article to be "the substitution of a single customs territory for two or more customs territories, so that" not only are duties eliminated on substantially all the trade but also "substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union." Or in the simplest terms, a customs union is an FTA with a common external tariff.

Three other types of RTAs exist. One is the economic integration agreement (EIA), defined in GATS Article V to be an agreement on services that has "substantial sectoral coverage" and provides for the "elimination of existing discriminatory measures, and/or … prohibition of new or more discriminatory measures." In practice, it is not a distinct pact: virtually all agreements that are designated as EIAs are FTAs or customs unions that cover services as well as goods. Another category for which there exists no formal definition is a "partial scope agreement," or something that is similar to an FTA but covers only certain products. The Enabling Clause permits developing countries to reach partial scope agreements, and also subjects South–South RTAs in general to less strict scrutiny than North–South or North–North RTAs.

The deepest form of integration is a common market, which goes beyond a customs union to provide for the free movement of factors of production (i.e. capital, labour etc.). A common market may also feature a single currency, the harmonization of laws, and even the melding of national and regional institutions. There is no definition of a common market in WTO law, however, which treats such arrangements as customs unions.

The actual titles by which RTAs are known do not necessarily match these definitions. Some FTAs go under names intended to distinguish them from simple tariff agreements. Japan and the European Union prefer the sobriquet "economic partnership agreements", for example, and the United States styles some of its pacts as "trade promotion agreements". Some agreements that are called customs unions or common markets are more aspirational than actual, as they often exclude numerous items or entire sectors from the common external tariff.

The economics of RTAs

Harry Truman, who was president of the United States at the time that Viner (1950) wrote his seminal study of customs unions, famously yearned for a one-armed economist because he was tired of being told contrary things first on the one hand and then on the other. Viner himself reached clear conclusions about the consequences of customs unions for the multilateral trading system, but en route to those conclusions he devised a two-sided paradigm that spawned generations of study and debate: on the one hand RTAs create new trade, and on the other hand they divert trade. More than half a century of theoretical and empirical studies have failed to reach definitive conclusions about which hand carries the heavier weight.

Viner (1950: 43) noted that *trade creation* occurs when "one of the members of the customs union will now newly import [an item] from the other but which it formerly did not import at all because the price of the protected domestic product was lower than the price at any foreign source plus the duty." In other words, trade is created when the country switches from the inefficient output of its own protected domestic industries to the more efficient production of the trading partner. Conversely, commodities are subject to *trade diversion* when "one of the members of the customs union will now newly import [the items] from the other whereas before the customs union it imported them from a third country, because that was the cheapest possible source of supply even after payment of duty" (*Ibid.*). In this case, the two-tiered tariff structure encourages importers to switch from the more efficient producers in some third country to the less efficient (but now cheaper) producers in the partner country. From an economic standpoint, the key consideration is whether the trade created outweighs the trade diverted. Viner (1950: 44) argued that "whether a particular customs union is a move in the right or in the wrong direction depends … on which of the two types of consequences ensue" from the arrangement:

> Where the trade-creating force is predominant, one of the members at least must benefit, both may benefit, the two combined must have a net benefit, and the world at large benefits; but the outside world loses, in the short-run at least, and can gain in the long-run only as a result of the general diffusion of the increased prosperity of the customs union area. Where the trade-diverting effect is predominant, one at least of the member countries is bound to be injured, both may be injured, the two combined will suffer a net injury, and there will be injury to the outside world and to the world at large.

The basic outline of Viner's argument is elegantly simple but as yet there is no consensus among economists on whether discriminatory agreements offer a net benefit to the trading system. Some of the arguments for and against RTAs focus on the indirect effects that these agreements may have, such as providing model agreements that might be taken up multilaterally (thus contributing to the system) or by creating disincentives to the negotiation of multilateral deals that would erode the margins of preference in RTAs (thus detracting from the system). Those issues are explored later in this chapter.

The more direct and still-unresolved disagreement among economists concerns which half of this Vinerian paradigm predominates. Does the amount of trade created outweigh the trade diverted? The only way to get a clear answer to that question would be to confine one's reading to a few carefully selected authors, and then to ignore their refutations of what other scholars have to say. "[A]s the proliferation of PTAs increased in the 1990s," Eicher et al. (2008: 3) observed, "so did the number of theories predicting either increasing or decreasing trade flows among (non)members." Similarly, Clausing (2001: 678) noted that the empirical work has not answered "even the most basic issue regarding preferential trading agreements: whether trade creation outweighs trade diversion." While Adams et al. (2003) found that a majority of the RTAs that they studied are trade-diverting, Hufbauer

and DeRosa (2007) concluded instead "that the majority of preferential trade agreements in force today are, on balance, trade-creating rather than trade-diverting."

One way that economists attempt to resolve the issue is by distinguishing between types of RTAs. Some advance a "natural trading partner" hypothesis, arguing that RTAs between neighbours with significant bilateral trade are more likely to be net trade-creating (see, for example, Krugman, 1995; and Wonnacott and Lutz, 1989). Magee disagreed (2004: 15-16), finding that "while nearby countries are more likely to sign preferential trade deals, the agreements do not lead to more trade creation or less trade diversion" (see also Krishna, 2003). Frankel (1997: 229-230) gave a conditional answer, finding that "if the level of trade barriers against outsiders is left unchanged" in a regional arrangement then "the harmful effects of trade diversion are likely to outweigh the beneficial effects of trade creation." For this reason: "Policymakers should seek to maximize the likelihood that regional arrangements will help global liberalization."

That point leads to the all-important question of whether the parties to an RTA design it as a complement or a substitute for multilateral liberalization or, to use the jargon, whether it is an instrument of open regionalism or closed regionalism. Again, Viner spotted the pattern long ago. He noted that the tariff unification movement of the nineteenth century and beyond –

> was primarily a movement to make high protection feasible and effective for limited areas going beyond the frontiers of single states, and to promote self-sufficiency for these larger areas because self-sufficiency for single states was clearly impracticable or too costly; it was not a movement to promote the international division of labor (Viner, 1950: 68).

That same description may apply to some, although certainly not all, of the RTAs negotiated during the GATT and WTO periods. Several of the customs unions that developing countries created in the 1960s and 1970s were founded more upon a regional concept of import-substitution industrialization (ISI) than they were upon true free trade, and were intended to reduce the inefficiencies associated with ISI by providing for an expanded internal market. The original aims may change, as was shown by the transformation of the Andean Pact (founded in 1969) to the Andean Community in 1988. Whereas the original group was based on ISI and closed regionalism, the reformed organization reflected the Washington Consensus and represented a move to open regionalism. Other RTAs among developing countries have demonstrated varying degrees of attachment to these two different models.

The rules of origin (ROOs) in RTAs and PTAs are another, more specific concern for economists. These rules are principally of statistical importance in non-preferential trade, determining the country to which imports should be attributed, but in preferential trade they decide whether or not imports will receive the benefits of the agreement or arrangement. ROOs can be designed in a way that deliberately exacerbates the problem of trade diversion,

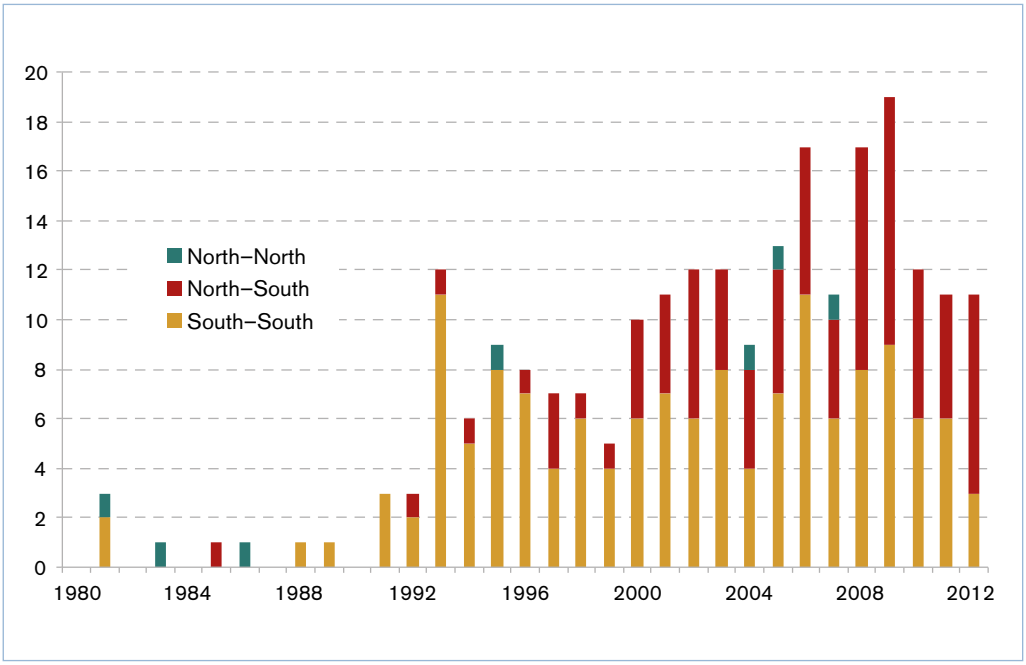
with the parties to an agreement (or the designers of an autonomous programme) manipulating them in ways that are intended to discourage trade with third parties. The ROOs for goods that are produced in transnational supply chains, for example, might be written in a way that reserves most or all of the processes and inputs to the members of an RTA. That practice is especially notable in the case of textile and apparel trade, as discussed later in this chapter. Beyond the problems that might arise in the ROOs of a specific agreement or arrangement, there is a collective concern: when multiple arrangements each have their own rules it can be difficult for multinational producers to access them all with the same production mix. Critics typically invoke the clichéd image of the spaghetti bowl (or sometimes the noodle bowl) to describe this problem, likening the multiplicity of rules to a tangle of pasta.

Discrimination in the GATT and WTO periods

Analysts and policy-makers may have very differing views about the consequences of discriminatory agreements and arrangements for the multilateral system, but one fact is indisputable: the number and significance of RTAs has grown rapidly. As can be seen in Figure 13.1, these agreements were scarce in the years prior to the Uruguay Round, but the rate picked up rapidly at the very end of those negotiations. The pace at which RTAs entered into effect rose from 2.1 per year in the late GATT years (1980-1994), most of them coming at the end of that period, to 9.0 per year from 1995 to 2003 and 13.3 from 2004 to 2012.[1] Nineteen RTAs entered into force in 2009 alone, or more than all the RTAs notified from 1980 to 1992.

The composition of the RTAs also changed as countries moved from agreements that were predominantly among immediate neighbours to negotiations that were extra-regional or between countries at very differing levels of size and income. The South–South agreements accounted for 78.1 per cent of the RTAs that entered into effect from 1980 to 1994, but then fell to 69.1 per cent from 1995 to 2003 and precisely half of those that entered into effect from 2004 to 2012. During those same three periods, the share of North–South RTAs rose from 12.5 per cent (1980-1994) to 29.6 per cent (1995-2003), and then to 47.5 per cent (2004-2012). North–North agreements remain a small minority of the total, but the few that are negotiated can cover large shares of global trade. The European Union is the biggest customs union in the world; even when one excludes intra-EU trade from the calculation this bloc accounted for 14.9 per cent of global exports and 16.2 per cent of global imports in 2011.[2] The FTA that Canada and the United States reached in 1988 was the largest bilateral FTA, but it was soon replaced by a North–South RTA when Mexico joined the trilateral North American Free Trade Agreement (NAFTA).

Figure 13.1. Regional trade arrangements notified to the WTO, 1980-2012



Source: Calculated from data in the WTO Regional Trade Agreements Information System at http://rtais.wto.org/UI/PublicAllRTAList.aspx.

Notes: Years in which RTAs entered into effect. The database does not include some RTAs that were in effect during part of the GATT period but were either abrogated or superseded by other arrangements.

North–North = RTAs in which all parties are developed.

North–South = RTAs in which at least one party is developed and at least one party is developing or transitional.

South–South = RTAs in which all parties are developing or transitional.

Table 13.1 shows that customs unions are far less common than FTAs. That is a simple function of geography: almost any pair or grouping of countries might negotiate an FTA, even if they are separated by vast distances, but customs unions tend to be concluded only by countries that are either contiguous or in the same vicinity. FTAs may therefore proliferate in absolute numbers, and could theoretically number in the thousands, but customs unions grow by accretion and face stricter natural limits to their number and size. Whether they are notified under GATT Article XXIV or the Enabling Clause (as explained below), customs unions account for almost precisely one tenth of all RTAs notified to the WTO. The share drops to 7.4 per cent if one leaves out the accessions to existing customs unions and FTAs.

Most of the customs unions still in effect date back to the GATT period or even earlier. The oldest of these are the Southern African Customs Union (established in 1910) and the Switzerland–Liechtenstein Customs Union (1924), though most are from the 1960s to the mid-1990s. Elements of the European Union originated in the European Coal and Steel Community (1951) and evolved through a series of treaties and accessions thereafter.[3] The

Table 13.1. RTAs notified to the WTO up to the end of 2012

	Accessions	New RTAs	Total (share in %)	
GATT Article XXIV	**7**	**209**	**216**	**(85.7)**
Free trade agreements	1	199	200	(79.4)
Customs unions	6	10	16	(6.3)
Enabling Clause	**2**	**34**	**36**	**(14.3)**
Partial scope agreements	1	14	15	(6.0)
Free trade agreements	0	12	12	(4.8)
Customs unions	1	8	9	(3.6)
Total	**9**	**243**	**252**	**(100.0)**

Source: Adapted from information on the WTO Regional Trade Agreements Information System at http://rtais.wto.org/UI/publicsummarytable.aspx.

Notes: Another 111 notifications were made under GATS Article V for RTAs that covered services as well as goods. These notifications are not shown here separately.

extant customs unions in the Americas began with the Central American Common Market (1961), followed by the Andean Pact (1969), the Caribbean Community (1973) and the Southern Common Market or MERCOSUR (1991). Two more African common markets came into being at the very end of the GATT period: the Economic Community of West African States in 1993 and the Common Market for Eastern and Southern Africa in 1994. African countries have also been active in creating new customs unions during the WTO period. These include the Economic and Monetary Community of Central Africa (1997), the Southern African Development Community and the West African Economic and Monetary Union (both in 2000), and the East African Community (2010). The only other new customs unions established since the start of the WTO period are the Eurasian Economic Community (1997), the Gulf Cooperation Council (2003) and the Customs Union of Belarus, Kazakhstan and the Russian Federation (2010). There are no other customs unions in Asia and the Pacific, although the level of economic coordination is high in the Association of Southeast Asian Nations, which was founded in 1967 and produced an FTA in 1992.

The real growth is in FTAs, which collectively account for 84.1 per cent of all notified RTAs (or 86.8 per cent if accessions are not counted). Table 13.2 shows how quickly RTAs have proliferated among selected WTO members, especially by comparison with the slow rates of growth in most of the GATT period. As of 1965 only three of the 20 future members of the WTO shown in the table had RTAs, but just before the start of the Uruguay Round over half of them did; by 2005 they all had at least one. The data show that the rate of increase stepped up after the WTO came into effect, with the average number of RTAs among these members more than doubling from 1985 to 1995, and then more than tripling from 1995 to 2005. They concluded more new RTAs in the seven years from 2005 to 2012 than in the preceding ten years.

Table 13.2. Cumulative notified RTAs of selected members, 1965-2012

	GATT period			WTO period		
	1965	**1975**	**1985**	**1995**	**2005**	**2012**
European Union	1	5	5	8	25	34
Switzerland	1	2	2	5	15	28
Chile	0	0	1	1	9	19
Singapore	0	0	0	1	9	18
Turkey	0	0	0	1	7	18
India	0	0	0	0	3	15
United States	0	0	1	2	8	14
Japan	0	0	0	0	2	13
Mexico	0	0	1	4	13	13
China	0	0	0	0	4	11
Peru	0	0	1	2	2	11
Korea, Republic of	0	0	0	0	1	10
Thailand	0	0	0	2	5	10
Australia	0	0	2	2	5	8
Costa Rica	1	1	2	3	6	8
Canada	0	0	0	1	4	7
Colombia	0	0	1	3	3	7
Israel	0	0	1	2	6	6
South Africa	0	0	0	0	3	4
Brazil	0	0	1	2	2	3
With RTAs	**3**	**3**	**11**	**16**	**20**	**20**
Average	**0.2**	**0.4**	**0.9**	**2.0**	**6.6**	**12.9**

Source: Tabulated from data in the WTO Regional Trade Agreements Information System at http://rtais.wto.org/UI/PublicMaintainRTAHome.aspx.

Notes: Includes FTAs and customs unions in effect at year's end; some RTAs cover multiple partners. Agreements providing for the enlargement of existing customs unions are not included. Some of the countries shown in the table were not contracting parties or members for all years shown. RTAs are classified here according to the year in which they came into effect rather than the year in which they were notified to GATT or the WTO.

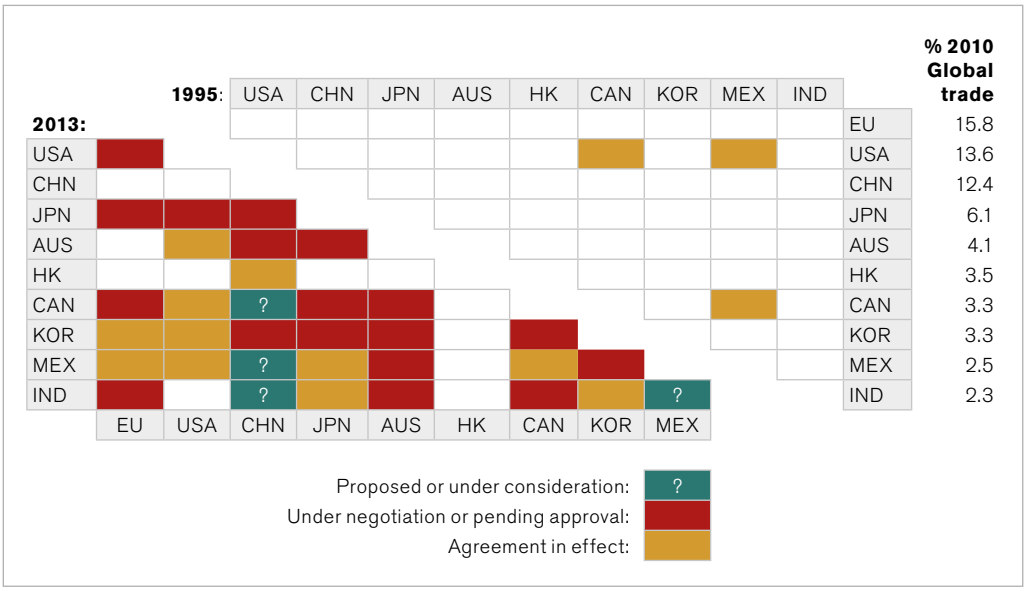
From a regime standpoint, two other points are more significant than the raw number of RTAs. One, as discussed later in this chapter, is the content and coverage of the RTAs. Another, as discussed here, concerns who is negotiating these RTAs with whom. It is one thing when small- or mid-sized trading countries strike bargains with their immediate neighbours, sometimes in the form of partial scope agreements that contain numerous exceptions, and something altogether different when those countries negotiate comprehensive, extra-regional agreements with the biggest players. The most consequential change comes when the largest players start to negotiate RTAs with one another.

To summarize the patterns of RTA negotiations in rough periods, we may discern three and possibly four phases. The first lasted from the start of the GATT system through the early 1980s, when RTAs remained rare exceptions that were largely confined to the negotiation of partial scope agreements, FTAs, or customs unions among countries in the same region. These were common both to the developing countries and, in the case of Western Europe, the developed countries. The second phase, which roughly coincided with the period of the Uruguay Round, saw an increase in

extra-regional negotiations and a small but precedential number of North–South initiatives. The European Community and the United States each began to negotiate FTAs with developing countries at this time. The third phase began with the start of the WTO period. The only real difference between the second and third phases was in the quantity. Whereas there were still comparatively few RTAs being negotiated around the time of the Uruguay Round, the pace has accelerated greatly in the years since the establishment of the WTO.

A fourth phase may have begun around 2010. Whereas all of the major economies had been actively negotiating RTAs for years, they largely confined these negotiations to other, smaller partners and refrained from negotiating with one another. That point can be appreciated from the data illustrated in Figure 13.2, which shows the RTAs among ten members that collectively accounted for two thirds of global merchandise trade in 2010. There are 45 bilateral relationships (or dyads) among these ten members. There was only one RTA in effect among the ten members in 1995, with three of them joined together in NAFTA. That stands in sharp contrast to the data for early 2013, by which time the number of RTAs in force had grown to 11 (24.4 per cent of the 45 dyads), as well as 18 more under negotiation (40.0 per cent) and at least four others that were known to be in some stage of study or pre-negotiations (8.9 per cent). Altogether, nearly three quarters (73.3 per cent) of these dyads had already produced RTAs or appeared to be headed that way. The only one of these ten biggest traders that had not engaged in multiple RTA negotiations

Figure 13.2. RTAs among the ten largest WTO members, 1995 and 2013



Sources: Data on RTAs tabulated from the WTO Regional Trade Agreements Information System (http://rtais.wto.org/UI/PublicMaintainRTAHome.aspx) and other sources (principally the websites of the ten members' trade ministries). Trade data from the WTO www.wto.org/english/res_e/statis_e/its2011_e/charts_e/chart08.xls.

Notes: Shares of global trade are based on merchandise trade and exclude intra-EU trade. Data for 2013 based on information available through March.

with several of the others was Hong Kong, China, a special case whose economy is already the most open in the world. In 2012, there was at least a hint of a possible EU–Australia FTA negotiation (Markovic, 2012), leaving only three other potential agreements among these ten biggest traders that had yet to reach even the stage of formal (acknowledged) study: the US–India, EU–China and US–China configurations. Those are the only shards left in the glass ceiling.

The point is sharper still if one looks only at the four largest members in this group. China, the European Union, Japan and the United States collectively accounted for 44.1 per cent of global merchandise exports in 2011 and 49.6 per cent of imports,[4] and also have outsized influence in determining the direction of the multilateral trading system. These four, sometimes called the "new quad", have distinct histories of negotiating RTAs. The European Union and its predecessor arrangements came first, starting in the early 1950s. It began to negotiate FTAs with other partners in the 1970s, starting first in Europe and then going extra-regional. The United States then followed in the 1980s, as did China and Japan in the 2000s. All four of them thus had numerous agreements already in effect by 2013, averaging over 17 each, and sometimes with the same partners, but had hitherto been highly reluctant to negotiate with one another. Their cut-off point has been drawn at the next largest set of trading powers, with Australia, Canada and the Republic of Korea each having reached or launched negotiations with three of these four largest members. By about 2010, however, each member of this new quad began to consider other, bigger plans. The most significant developments came in 2013, which saw the initiation of Japanese negotiations with China, the European Union, and (by way of the Trans-Pacific Partnership negotiations) the United States, as well as negotiations between the European Union and the United States for either an FTA or its functional equivalent. Four of the six possible configurations among new quad were at some stage of development by early 2013, and the only two arrangements that policy-makers had yet to broach are those aforementioned US–China or EU–China agreements.

Preferences for developing countries

Special and differential (S&D) treatment is one of the most essential yet most contentious aspects of the global trading system. The concept of S&D treatment has developed gradually over several generations. In its more passive and protectionist form, this approach merely posits that countries at lower levels of economic development should not be obliged to open their markets at the same pace as more advanced competitors. This version of S&D treatment is at least as old as the late eighteenth century, when Alexander Hamilton devised the "infant industry" argument for protection. The German Historical School of economic analysis took up this same line of argument in the next century, which it elevated into a general law of economic statesmanship (see List, 1844). In the twentieth century came more active and affirmative forms of S&D treatment, especially preferential and non-reciprocal access to industrialized countries' markets.

Preferential trade programmes have some points in common with RTAs but differ in other respects. The most significant legal similarity is that they provide for discriminatory access to selected countries, and hence require leave for countries to deviate from the MFN requirement of GATT Article I. The legal differences are two-fold: preferences are one-way rather than

reciprocal, and they last only as long as the preference-giving country wishes to maintain this special treatment (and is given permission to do so via a WTO waiver). RTAs generally take the form of reciprocal treaties that are rarely abrogated, except in cases where one agreement is later replaced by a more comprehensive one, but most preferential programmes are based on the domestic law of the preference-giving country and are subject to expiration, repeal, amendment and administrative changes. In economic terms, the principal difference is in the product coverage. Most preferential programmes cover only certain products, and are comparable to partial scope agreements rather than FTAs. Often the excluded products or sectors are import-sensitive goods that can be subject to high MFN tariffs. This means that the items for which a developing country might most benefit from preferential treatment are also the ones that are least likely to be covered. The preferences extended under these programmes may be either complete, duty-free treatment or only a partial margin of preference, depending on how the preference-giving country chooses to structure the lists. Preferential programmes may be subject to rules that allow for the restriction or removal of products on either a global or a country-specific basis, or countries' graduation from the programme on economic grounds. Beneficiaries might also lose some or all of their preferences if they have economic or political disputes with the preference-giving country. For all of these reasons, preferential programmes are generally considered to be less comprehensive, permanent, generous and beneficial than are RTAs.

An RTA is more demanding of a developing country than is a preferential programme, insofar as it requires that country to reciprocate by opening up its own market, but that can be a benefit as well as a cost. An RTA has the twin benefits of enshrining the countries' market access in solemn treaty commitments, and also doing the same for any economic reforms to which the developing country commits in the agreement. That may result in a business climate that is, from the potential investor's perspective, more inviting and secure than one based on the autonomous economic policies of the developing country and the equally autonomous preferences of the developed country.

The evolution of what became the Generalized System of Preferences (GSP) illustrates how countries work around the sometimes fine line that can separate preferential treatment from managed trade. The original proposal for the GSP came at the first United Nations Conference on Trade and Development (UNCTAD I), where countries considered a plan by which "*quantitative targets* should be set for their entry into the industrial countries' market" in which "the industrial countries could establish a quota for admitting manufactured goods from the developing countries *free of duty*."[5] These preferences in results encountered strong objections from the industrialized countries, but were eventually negotiated down to less ambitious preferences in access. The developing countries won a commitment in principle for tariff preferences at UNCTAD II in 1968. Several more years passed before the programme entered into effect. One legal hurdle was the incompatibility of this programme with GATT Article I, which requires universal MFN treatment (i.e. generally prohibits discrimination). The GATT contracting parties originally granted a ten-year waiver for the GSP in 1971. Eight years later came the Enabling Clause, more properly known as the decision on Differential and More Favourable Treatment, Reciprocity, and Fuller Participation of Developing Countries.[6] It

provided (among other things) that, "[n]otwithstanding the provisions of Article I of the General Agreement, contracting parties may accord differential and more favourable treatment to developing countries, without according such treatment to other contracting parties." By that time, all of the major developed countries had instituted GSP programmes under the 1971 waiver. The European Community, Japan and Norway did so in 1971, followed by New Zealand and Switzerland in 1972 and Australia and Canada in 1974. The United States was the last of the major developed countries to institute its GSP programme, coming on line in 1976. Iceland and Turkey began programmes of their own in 2002.

Several countries also instituted special preference programmes for specific regions, sub-regions, or even individual partners. These programmes generally provide for more generous treatment than does the GSP, and are typically devoted to regions where the preference-giving country has historic ties or other political interests. Each of these programmes has required a separate waiver from GATT or the WTO, as discussed in the next section. The first of these came in 1981, when Australia and New Zealand concluded the South Pacific Regional Trade and Economic Cooperation Agreement. The United States has regional preferences for three sets of beneficiaries: the Caribbean Basin Economic Recovery Act (since 1984), the Andean Trade Preference Act (since 1991), and the African Growth and Opportunity Act (since 2000). The European Union has special trade preferences for the Western Balkans (since 2000), the Republic of Moldova (since 2008) and Pakistan (since 2012). Canada's Commonwealth Caribbean Countries Tariff, or CARIBCAN, has been in effect since 1986.

Nor are the developed countries alone in providing preferential treatment beyond the GSP. In a side event at the Seventh WTO Ministerial Conference in Geneva (2009), representatives from 22 developing countries agreed to a framework deal to cut tariffs and other barriers to each other's exports in order to boost South-South trade. This built upon the existing Global System of Trade Preferences among Developing Countries (GSTP), an arrangement reached under UNCTAD auspices that entered into force in 1989. The negotiations over the 2009 expansion of the programme first began at UNCTAD XI (2004), in São Paulo. The GSTP is considered in WTO terms to be an RTA, or more specifically a plurilateral, partial scope agreement. At the time of writing, it has 43 participants, including some countries that are not members of the WTO.[7]

Duty-free, quota-free treatment for the least-developed countries

The issue of duty-free, quota-free (DFQF) treatment for imports from least-developed countries (LDCs) is at the sometimes-difficult crossroads between WTO and UN rules. The UN system developed the DFQF pledge in principle as one of the Millennium Development Goals (MDGs), and several countries (developed and developing) have put DFQF programmes of their own in place, but this MDG has yet to be adopted as a binding commitment in the WTO. The most that has been accomplished at the time of writing is the approval of a waiver that makes countries' DFQF programmes WTO-legal, and the development of a text that could be a part of a final Doha deal. Until then, the DFQF pledge remains an option that countries are free to provide on an autonomous basis, but are not required to do so.

The DFQF commitment dates back to a year before the launch of the Doha Round. In September 2000, at the United Nations Millennium Summit, world leaders agreed to a set of time-bound and measurable goals and targets for combating poverty, hunger, disease, illiteracy, environmental degradation and discrimination against women. The summit's Millennium Declaration enumerated the MDGs, one of which called on the industrialized countries to adopt, preferably by early 2001, "a policy of duty- and quota-free access for essentially all exports from the least developed countries."[8] At the Third United Nations Conference on the Least Developed Countries in mid-2001, the assembled countries declared their aim to "improv[e] preferential market access for LDCs by working towards the objective of duty-free and quota-free market access for all LDCs' products in the markets of developed countries."[9] WTO members adopted this same commitment later that year at the Doha Ministerial Conference, where the trade ministers endorsed in paragraph 42 of their declaration "the objective of duty-free, quota-free market access for products originating from LDCs."

Since then the issue has faced two related divisions. One is between the preference-giving countries, some of which view the DFQF commitment as a suitable object of early-harvest treatment in the Doha Round and have implemented programmes of their own in advance. Others treat it as an item that may be included in the final results of a round; the United States is the principal advocate for holding back a definitive commitment on DFQF until the round as a whole is completed. The second division is among the LDCs themselves, some of which already enjoy a closer approximation of DFQF access to the US market than do others. Most sub-Saharan African LDCs receive duty-free treatment for most of their exports to the United States under the African Growth and Opportunity Act, and Haiti receives it under both the Caribbean Basin Initiative and special programmes, but Asian LDCs still face high MFN tariffs on nearly all of their exports of apparel to the US market. While all LDCs are committed in principle to the extension of DFQF treatment to all of them by all developed countries, in practice those LDCs that already have DFQF-like access to the US market are opposed to initiatives that would extend the same treatment to the other LDCs.

These differences are reflected in the Hong Kong Ministerial Decision on Duty-Free, Quota-Free Market Access. The ministers struck a compromise by agreeing that "developed-country Members shall … [p]rovide duty-free and quota-free market access on a lasting basis, for all products originating from all LDCs by 2008 or no later than the start of the implementation period." That commitment thus accommodated both those members that wanted to extend DFQF immediately and those that wanted it to be part of the overall deal. It was also restricted by a further proviso that "[m]embers facing difficulties at this time to provide market access as set out above shall provide duty-free and quota-free market access for at least 97 per cent of products originating from LDCs."[10] That 97 per cent figure is counted by tariff lines and not on a trade-weighted basis, meaning that a member implementing this commitment could exclude potentially large volumes of trade, especially import-sensitive apparel products.

Some countries have undertaken DFQF programmes on an autonomous basis. The European Union created an "Everything But Arms" (EBA) programme in 2001 that provides DFQF

treatment to all qualifying products imported from all LDCs other than weapons and ammunition. Other members that instituted programmes for LDCs from 2000 to 2010 included not just developed countries such as Australia, Canada and New Zealand, but also developing members China, India, the Republic of Korea, the Kyrgyz Republic, Morocco, Singapore and Chinese Taipei. The United States has no DFQF programme for LDCs *per se*, but the aforementioned programmes for Haiti and sub-Saharan African countries extend this treatment to the majority of the LDCs. Asian LDCs receive preferential access to the US market under the GSP, and the US version of that programme covers a wider range of products for LDCs than for other developing countries. The main *lacuna* remains preferential access to the US market for apparel exported by Asian LDCs, an issue to which we turn below.

WTO members have also approved a waiver allowing the extension of preferential treatment to the LDCs for trade in services. This waiver, as approved at the 2011 Ministerial Conference, allows members to grant LDCs greater access to their services markets even if in so doing they deviate from the MFN principle.[11] Any such preferences must be extended to the entire LDC group. This benefit remains more potential than actual, however, with no concessions having been requested or provided through early 2013.

The phase-out of textile and apparel quotas

Textiles and apparel traditionally offers the most important sector for preferential treatment of developing countries' exports to developed countries. This was an unintended consequence of the strict import quotas that countries first imposed in the early 1960s and evolved into the Multi-Fibre Arrangement (MFA) of 1974. Those quotas, coupled with high tariffs, protected apparel industries in the European Community, the United States and other developed countries from the output of low-wage developing countries. The quotas were more important than the tariffs for two reasons. The first is the economic principle that, all things being equal, quotas are more restrictive than tariffs. The second is that the quotas were distributed on a country-specific basis, and for countries that might not otherwise be competitive in this area the quotas were more in the nature of guaranteed access to a restricted market than limits on their access to an open one.

Over time, a system that was originally intended to provide protection to the textile and apparel industries in developed countries – and continued to serve that purpose until the final phase-out of the quotas – also developed the ancillary purpose of providing a hybrid form of managed trade and foreign assistance. That allowed the importing countries to allocate quotas to favoured partners, and by the mid-1980s they were supplementing this policy with special, preferential arrangements. Whether extended under programmes such as the (US) Caribbean Basin Initiative (CBI) or the FTA with Central America and the Dominican Republic that replaced that programme, these initiatives included ROOs that encouraged co-production. Preferential quota and tariff treatment on finished apparel products imported from the Caribbean Basin would be contingent upon the incorporation of US fabric in those goods. The United States had similar programmes in place with the beneficiary countries of the African Growth and Opportunity Act and the Andean Trade Preferences Act. Similarly, the

European Union's EBA programme for LDCs also included strict ROOs. If the apparel quota programmes had become a form of foreign assistance, these rules were the equivalent of tied aid.

The Agreement on Textiles and Clothing (ATC) is a Uruguay Round instrument that replaced the MFA and phased out its quota system from 1995 to 2005. The elimination of those quotas greatly reduced the value of the preferential treatment extended to developing countries under programmes such as the EBA and the CBI, as well as the RTAs that the European Union and the United States negotiated in the late 1980s and early 1990s. Those initiatives still extend preferential tariff treatment, which can be very significant for products that would otherwise be subject to tariffs of 15 per cent to 20 per cent or more, but with the end of the quotas the outcomes are determined much more by countries' underlying competitiveness than by the quota access they are granted. In some cases complying with the terms of a preferential agreement or arrangement may actually make imports from the partner country less competitive; that can happen if the difference between the price of inputs meeting the ROOs versus those sourced freely is greater than the margin of preference between the MFN tariff and the preferential rate.

Table 13.3 shows how the phase-out of the MFA quotas led to a consolidation of the global clothing market. It reports the shares of the market that leading providers held five years before the MFA phase-out began (1990), in the middle of that process (2000), and five years after it was complete (2010). The economies in the table accounted for 47.0 per cent of global clothing exports in 1990, 58.3 per cent in 2000, and 64.9 per cent in 2010. As of 1990, no one country held as much as 10 per cent of the global clothing market. Some of the higher-income developing economies in Asia were already losing market share by that time, this being a labour-intensive industry in which countries with higher wage rates are at a disadvantage. The sharpest drop came in Hong Kong, China, which went from being the second-largest supplier (after China) in 1990 to a negligible share of the global market in 2010. Other producers that had relatively high shares of the market in 1990 lost much of that share, either over the next ten years or after 2000, and still others retained approximately stable shares throughout the period. A small number of Asian countries saw their exports grow rapidly in absolute and relative terms. China's share of the global clothing market doubled from 1990 to 2000, and then doubled again over the next decade.

This consolidation of the clothing market contributed to a rift between different groups of LDCs. As discussed above, most sub-Saharan African LDCs receive DFQF-like access to the US market under the African Growth and Opportunity Act, and Haiti does under other programmes, but the United States does not extend preferential treatment to apparel imported from Asian LDCs such as Bangladesh and Cambodia. Proposals to extend DFQF to all products that the United States imports from all LDCs, whether they take the form of negotiations in Geneva or in legislative initiatives in Washington, divide African developing countries (and especially the LDCs in the region) from Asian LDCs. The textile and apparel sector is no longer subject to the same degree of management as it was when the MFA quotas system was still in effect, but it nonetheless remains a field that inspires zero-sum calculations and manoeuvres.

Table 13.3. Clothing exports of selected WTO members, 1990-2010

	1990		2000		2010	
	Value US$ m	Share %	Value US$ m	Share %	Value US$ m	Share %
Rising shares						
China	9,669	8.9	36,071	18.3	129,838	36.9
Bangladesh	643	0.6	5,067	2.6	15,660	4.5
Turkey	3,331	3.1	6,533	3.3	12,760	3.6
India	2,530	2.3	5,965	3.0	11,246	3.2
Viet Nam	–	–	1,821	0.9	10,839	3.1
Stable shares						
Pakistan	1,014	0.9	2,144	1.1	3,930	1.1
Malaysia	1,315	1.2	2,257	1.1	3,880	1.1
Tunisia	1,126	1.0	2,227	1.1	3,043	0.9
Six African countries[a]	627	0.6	1,580	0.8	1,983	0.6
Declined 2000-2010						
Indonesia	1,646	1.5	4,734	2.4	6,820	1.9
United States	2,565	2.4	8,629	4.4	4,694	1.3
Mexico	587	0.5	8,631	4.4	4,363	1.2
Sri Lanka	638	0.6	2,812	1.4	3,491	1.1
Cambodia	970	0.9	3,014	1.5	3,041	1.0
Honduras	64	0.1	2,275	1.2	2,915	0.8
El Salvador	184	0.2	1,673	0.8	1,697	0.5
Declined 1990-2010						
Thailand	2,817	2.6	3,759	1.9	4,300	1.2
Korea, Republic of	7,879	7.3	5,027	2.5	1,610	0.5
Chinese Taipei	3,987	3.7	3,015	1.5	963	0.3
Hong Kong, China[b]	9,266	8.6	9,935	5.0	417	0.1

Source: Calculated from WTO data at www.wto.org/english/res_e/statis_e/its2011_e/section2_e/ii70.xls. Some data include WTO Secretariat estimates and/or significant exports from processing zones.

Notes: Shares are percentages of total global exports. [a]The six African countries are Botswana, Kenya, Lesotho, Madagascar, Mauritius and Swaziland. [b]Includes only domestic exports, not re-exports. "Stable" is defined here as a change (up or down) of no more than 0.2 percentage points from one period to the next.

Legal issues in discrimination

The legal issues in discrimination start from a simple premise: these agreements and programmes are fundamentally incompatible with the core rule of the WTO system. GATT Article I requires unconditional and universal MFN treatment among all members, but the negotiators of GATT 1947 were political realists who built in four "political" provisions to the agreement that allow countries to deviate from Article I and other rules. These provisions allow an exception for measures taken in pursuit of a country's security interests (Article XXI); permit a country to withhold recognition of another's status in the GATT/WTO (GATT Article XXXV,[12] now WTO Article XIII); "grandfather" in the preferential arrangements that

existed in 1947 (listed in annexes A-F in GATT); and provide for the negotiation of new preferences in the form of FTAs or customs unions (Article XXIV).

RTAs are now permitted, and subject to disciplines, under a series of WTO rules, agreements and decisions. In addition to the inherited GATT Article XXIV and the Enabling Clause these include the Uruguay Round Understanding on the Interpretation of Article XXIV of the GATT 1994, GATS Article V (the services equivalent to GATT Article XXIV), and – as discussed below – the Transparency Mechanism inaugurated in 2006. Beyond these permanent elements of the WTO legal system, members may also grant waivers for specific preferential programmes.

The ambivalent views that economists express on discrimination, as noted above, have their equivalent in the law and diplomacy of RTAs. On the one hand, the instruments listed above set the standards that RTAs must meet, and subject them to transparency and surveillance. On the other hand, neither the GATT contracting parties nor the WTO members have ever found an RTA to be out of conformity with the parties' obligations, or required them to abrogate, adjust or renegotiate an agreement. Simply stated, in the WTO every member is prepared to raise questions about every other member's RTAs, but none of them want to set a precedent by which those questions might lead to the actual rejection of an RTA – either their own or anyone else's.

The requirements that RTAs must meet

The terms of GATT Article XXIV establish the legal framework that reconciles RTAs with the general GATT principles from which they depart. RTAs are permissible if they meet two requirements. The less controversial of these provides that tariffs and commercial regulations on third countries that are "imposed at the institution of" an RTA "shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable" before its formation. In practice, this provision affects only customs unions. These arrangements can sometimes result in tariffs being increased on imports from third countries, such as when a new country accedes and raises tariffs on some items that had previously been below the level of the common external tariff.[13] Third parties must be compensated for any increased tariffs through the reduction of some other tariffs in the customs union's CET. Negotiations over this type of compensation have taken place after each new enlargement of the European Union, for example, with the union as a whole "paying for" the accession of a new member.

The more controversial requirement in GATT Article XXIV:8 is that FTAs and customs unions must eliminate "duties and other restrictive regulations of commerce … with respect to substantially all the trade between the[ir] constituent territories." The problem is that the text does not provide any definitions or standards for determining what "substantially all" means. While proposals have been made at various times in GATT and WTO history to clarify this provision by establishing stricter criteria that are stated in either qualitative rather than quantitative terms – specifying, for example, a certain percentage of tariff lines that must be covered, or a percentage of total trade, or some mix of product sectors – none of these have been formally adopted. RTAs have, therefore, been examined on a case-by-case basis, without any overriding guidelines having been set beyond the plain language of Article

XXIV:8. The most that one can say with real confidence is that the imprecise phrase "substantially all" allows for some exceptions. These same observations apply to the corresponding provision of GATS Article V.

Two very general rules seem to govern the positions that countries take on the review of RTAs. The first is that countries that did not negotiate RTAs at all were more likely to take a "strict constructionist" view of the Article XXIV requirements, and to be critical of (for example) wholesale exclusions of agriculture or other sectors from the product coverage. That general rule is less relevant now that every WTO member either has, or is in the process of negotiating, at least one RTA. The second general rule remains valid: members tend to interpret the rules in ways that accommodate the types of agreements that they negotiate, but may take a stricter view of third-party agreements that deviate from their own models. Beyond these generalizations, Crawford and Lim (2011: 8) summarized the positions of key players:

> [S]ome Members had pressed for a stricter interpretation of existing GATT disciplines while others have advocated a looser approach. Australia, Japan, Hong Kong China, India, New Zealand and to a lesser degree Korea (i.e. Asia and Australasia) were advocates of strict regulation, while Canada, the EC, Argentina, Brazil and Turkey tended to take a more flexible view. The US, while favouring enhanced scrutiny of all RTAs, has generally taken the position that GATT Article XXIV and GATS V already provide a balanced set of rights and obligations and should remain unchanged.

Members do scrutinize, question, and criticize one another's RTAs, but only to a point. GATT and WTO rules do not require that these arrangements be given formal approval, yet neither do they explicitly allow for the rejection of agreements that do not meet these rules. "During the GATT years only the agreement between the Czech Republic and Slovakia was unanimously considered to be in line with Article XXIV," as Lacarte noted (2011: 79), although "other agreements were approved with reservations." Nor have matters improved under the WTO, in which "not one single agreement has been found to be in line with Article XXIV, leaving them in a legal limbo pending the approval that never comes" and "[t]acitly, governments have agreed to refrain from disputing each others' agreements" (*Ibid.*).

The Transparency Mechanism

WTO members have not departed from the GATT practice of leaving RTAs in a kind of limbo, neither explicitly approved nor formally condemned, but have taken a more regular approach to collecting and reviewing information on these agreements. The Transparency Mechanism (TM), which the General Council approved in late 2006,[14] provides for the early announcement of any RTA negotiation, notification of the RTAs that result from these talks, and their review by members. It makes the process of review more regular. The old system had required the establishment of a new working party for each RTA and for which the main source of information was the parties to the agreement. In this new arrangement the Secretariat prepares information on each new RTA for consideration by a permanent committee.

This mechanism had been mandated by paragraph 29 of the Doha Ministerial Declaration and is the only "early harvest" to come out of the round. It is thus analogous in more ways than one to the Trade Policy Review Mechanism (TPRM), which was an early harvest from the Uruguay Round's mid-term review (see Chapter 8). Like the TPRM, the TM aims to provide fuller information to the membership at large about specific members' trade practices. This newer arrangement, which might be deemed a TPRM without the PR, differs from the TPRM in being focused more narrowly on one type of policy and in being invoked only as required rather than on a rotating basis. Both of these mechanisms demonstrate that members tend to confine any early harvests in a round to systemic matters, rather than to agreements that directly affect trade.

The TM process begins when the parties to an RTA notify the Secretariat of an agreement, followed by the Secretariat's preparation of a factual presentation. That presentation forms the basis for a review in the Committee on Regional Trade Agreements (CRTA).[15] Members may submit questions in writing to the parties to the agreement, and the parties are expected to provide written answers in advance of the CRTA meeting. They are further required to notify changes affecting the implementation of an RTA, such as the accession of a new member. If the agreement also covers trade in services, the members must make an additional notification under Article V of the GATS.[16] Parties are also to submit to the WTO a report on the realization of the liberalization commitments contained in the RTA at the end of the agreement's implementation period.

The transparency mechanism provides for review and revision of its terms. In 2011, Chairman Dennis Francis (Trinidad and Tobago) of the Negotiating Group on Rules reported on the negotiations over the proposed changes in its operation. Most of the proposals concerned marginal issues such as whether notifications should be made jointly by the parties to an RTA and what time should be allowed for specific steps in the process.[17] The review did not suggest any fundamental alterations in the purpose and operation of the mechanism itself.

The TM is complemented by the WTO Regional Trade Agreement Information System (RTA-IS), a comprehensive database of all notified RTAs.[18] Launched in 2009, this online resource allows users to search and export available information on any notified RTA, as well as on the consideration process of a particular RTA. The WTO followed up with a similar initiative in 2012, the Database on Preferential Trade Arrangements.[19] It too includes details on the preferential treatment that members provide under the GSP and other programmes.

Waivers and challenges to preferential treatment

The legal basis for preferential trade programmes is different from that of RTAs. Whereas GATT Article XXIV is an organic and permanent part of the WTO system, preferential programmes are based on waivers. The most important of these is the Enabling Clause of 1979, which provides a permanent waiver for the GSP. Other preferential programmes receive time-bound waivers. As summarized in Table 13.4, these include seven waivers from the GATT and early WTO periods that had expired by 2013, and another ten that were still in effect. Some of those waivers are extensions of earlier instruments that had originally been approved as far back as 1948.

Table 13.4. WTO waivers for preferential trade arrangements

	Decision	Expiry
Active		
Preferential Tariff Treatment for Least-Developed Countries	15 June 1999	30 June 2019*
Preferential Treatment for Services and Service Suppliers of Least-Developed Countries	17 December 2011	17 December 2026
Canada – CARIBCAN	14 October 1996	31 December 2013*
European Union – The ACP–EU Partnership Agreement	14 November 2001	***
European Union – Application of Autonomous Preferential Treatment to the Western Balkans	8 December 2000	31 December 2016*
European Union – Application of Autonomous Preferential Treatment to Moldova	7 May 2008	31 December 2013
United States – African Growth and Opportunity Act	27 May 2009	30 September 2015
United States – Andean Trade Preference Act	14 October 1996	31 December 2014*
United States – Caribbean Basin Economic Recovery Act	15 November 1995	31 December 2014*
United States – Former Trust Territory of the Pacific Islands	8 September 1948	31 December 2016*
Expired		
European Community/France – Trading Arrangements with Morocco	14 October 1996	**
European Community – Fourth ACP–EC Convention of Lomé	14 October 1996	29 February 2000
European Community – Transitional Regime for the EC Autonomous Tariff Rate Quotas on Imports of Bananas	14 November 2001	31 December 2005
European Community Preferences for Albania, Bosnia and Herzegovina, Croatia, Serbia and Montenegro, and the former Yugoslav Republic of Macedonia	28 July 2006	31 December 2011
South Africa – Paragraph 4 of Article I of the GATT 1994	14 October 1996	31 December 1997
Switzerland – Preferences for Albania and Bosnia-Herzegovina	18 July 2001	31 March 2004
Turkey – Preferential Treatment for Bosnia-Herzegovina	8 December 2000	31 December 2006

Source: WTO Secretariat.
Notes: Most of these waivers concern GATT Article I:1, but some additionally or alternatively waive GATT articles I:4, XIII, XIII:1, and XIII:2. *The original waiver expired; the expiry date shown is for a subsequent renewal. **Until entry into force of EU–Morocco RTA. ***December 31, 2007 or upon entry into force of new EU tariff regime.

Where WTO members hesitate to challenge one another's RTAs directly, they are not quite as reticent in the case of preferential trade programmes. In addition to the differing views among LDCs over preferential access to the US apparel market, as discussed above, two other controversies may be cited to illustrate the dynamics. For several years, the United States was technically out of compliance with its WTO obligations due to a delay in granting its requests for new or renewed waivers on three preferential trade programmes: the African Growth and Opportunity Act (AGOA), the Andean Trade Preferences Act (ATPA) and the Caribbean Basin Economic Recovery Act (CBERA). A waiver for the CBERA expired at the end of 2005, one for the ATPA expired at the end of 2001, and the AGOA had not yet been covered by a WTO waiver. It was not until 24 March 2009 that the Council on Trade in Goods agreed to grant these waivers. The principal difficulty had been Paraguay's insistence that it be included among the ATPA beneficiary countries. This would require a change in US law, which provided only for the designation of the Plurinational State of Bolivia, Colombia, Ecuador and Peru to this programme. In 2008, a change of government in Paraguay led to a

decision to withdraw its objections. The Plurinational State of Bolivia also raised objections after it was removed from the ATPA programme in 2008, and for a time it threatened to block the approval of these waivers unless its ATPA status was restored, but ultimately joined the consensus.

Another and more confrontational dispute arose over the EC GSP programme, which includes provisions intended to promote compliance with environmental, labour and drug policies. The 1999 to 2001 GSP regulations[20] provided incentives to reward Central and South American countries that cooperate in fighting drug-trafficking, as well as incentives to any GSP beneficiary that were contingent upon a government incorporating into its laws the standards laid down in International Labour Organization conventions on the right to organize and to bargain collectively and on the minimum age of admission to employment. The regulations also provided for reduced benefits for countries that permitted slavery or forced labour, the export of goods made by prison labour, shortcomings in customs controls on drug trafficking, failure to comply with international conventions on money laundering, or infringement of the objectives of international conventions on the conservation and management of fishery resources, among other objectives.

India brought a complaint to the Dispute Settlement Body in 2002, stating that the conditions created undue difficulties for India's exports and violated EC commitments under the Enabling Clause. The dispute settlement panel report found against the EC GSP scheme in 2003, and in 2004 the Appellate Body upheld part of the panel's findings. On the one hand, the Appellate Body agreed that the drug arrangements were not justified under the Enabling Clause because the measure did not set out any objective criteria that would allow other developing countries that are similarly affected by the drug problem to be included as beneficiaries. On the other hand, it also found that not every difference in tariff treatment of GSP beneficiaries necessarily constituted discriminatory treatment, as the Enabling Clause allows the granting of different tariff preferences to products originating in different GSP beneficiaries when the relevant tariff preferences respond positively to a particular development, financial or trade need and are made available on the basis of an objective standard to all beneficiaries that share that need. The European Community repealed the special arrangements to combat drug production and trafficking in 2005 and promulgated a new regulation that complied with the DSB's recommendations and rulings. India expressed doubts and reserved its right to return to this matter in the future.

One analyst cautiously observed that "it is difficult to predict to what extent this case may signify the beginnings of a more intrusive approach by WTO dispute settlement bodies regarding the use of unilateral trade measures," as the decision "only has direct ramifications for the EU GSP scheme" (Harrison, 2007: 117). He nonetheless speculated that it may represent "the beginning of a legal 'test' by which the legitimacy of human rights conditionality in GSP schemes could be gauged," and one in which "human rights conditionality in GSP schemes would be more likely to be considered to be legitimate if preferences were granted, reviewed and withdrawn on the basis of international human rights conventions" (*Ibid.*: 116).

The politics of RTAs

Patterson (1966: 4) observed in his classic study of the early GATT period that the "more persistent" arguments in favour of RTAs and other forms of discrimination in his day "were essentially political rather than economic." The same could be said of RTAs in the WTO period. All forms of discrimination are inherently more political than non-discriminatory initiatives. RTAs range from the subtly to the overtly political, and the strategic objectives that inspire their negotiation can range from the cooperative to the coercive.

This is not to say that only RTAs are political and that the multilateral trading system itself is dissociated from the larger international order of which it forms a part. As was discussed in Chapter 2, one cannot understand the establishment and development of the GATT system or its later replacement by the WTO without taking high politics into consideration. The rise of discrimination in the trading system may nevertheless be seen as further evidence of the changes in the global distribution of power. Here one finds a similarity in the trajectories that the trading system followed during the UK and US hegemonies, with each going through a comparable evolution in the way they structured their bilateral agreements. The treaties that the British started to negotiate in 1860, and the tariff-reduction agreement the United States began pursuing in 1934, each included MFN clauses that formed the foundation of the multilateral systems in their respective eras. Each of these hegemons later turned to discriminatory alternatives when their competitiveness declined. Beginning in the late nineteenth century and culminating in the set of restrictive Imperial Preferences negotiated at the Ottawa Conference in 1932, the United Kingdom went from negotiating bilateral agreements on a non-discriminatory basis to discriminatory commonwealth agreements that threatened to undo that accomplishment. The United States in turn began to negotiate FTAs during a period when there were serious doubts over the US competitive position vis-à-vis Japan, and some see the proliferation of RTAs over the past few decades as a sign of declining US interest in supporting the multilateral system.

The relationship between the relative decline of the United States and the rise of discrimination in the system has long been a matter of active debate among political scientists, a group whose collective take on RTAs can be just as ambivalent as those of the economists and the lawyers. "Although the available evidence suggests that [preferential trade arrangements] did become more pervasive as hegemony eroded," Mansfield and Milner (1999: 620) noted in a review article early in the WTO period, "what underlies this relationship, how it bears on regionalism's welfare consequences, and whether receding hegemony affected prior episodes of regionalism remain matters of dispute." Subsequent scholarship has not resolved that question, the answers to which may have as much to do with one's assumptions about the way the world works as they do with specific empirical evidence.

RTAs as instruments of high politics

The differences between FTAs and customs unions go well beyond the tariffs that they impose on third parties. At first glance, a customs union appears to be just an FTA that has taken the additional step of ringing a CET around its members. From that one point, however,

spring more and greater differences. Establishing a CET can be a first step towards closer integration of the members' trade policies, which may lead them to operate as a bloc in negotiations with third parties. In some cases, a customs union may be the precursor to consolidation into a single country. Economic and political unification can come either simultaneously (as was the case in the US Constitution of 1788)[21] or sequentially (as was the case for the German *Zollverein* in the nineteenth century).[22] The European Union can be seen as part of a similar process by which economic unification is a precursor to a gradual, if incomplete, political consolidation.

There are a few historical constants in the approaches that one finds towards RTAs in different regions. These have always had their proponents in Europe and in Latin America, and for a long time as well in the Middle East, but for decades were viewed with greater reluctance by the United States and are a very new phenomenon in Asia. France repeatedly proposed European economic integration before the Second World War, with a view towards alleviating both economic and political conflicts, and French officials even maintained their interest while the war was raging and they were in exile (United Nations, 1947: 22-24). At a time when one might have thought that other matters crowded out considerations of low politics, the French government requested in 1944 that the League of Nations (also in exile) undertake a study of the customs union problem (*Ibid.*: v). Latin American countries explored the RTA option on and off in the decades following independence, especially in the inter-war period. Argentina and Chile made numerous proposals for regional unions in the 1920s and 1930s, and several groups of countries in the region reached bilateral or sub-regional agreements from 1933 to 1943. As for the Middle East, RTAs have been seen as an instrument of pan-Arab solidarity since the dissolution of the Ottoman Empire.

The US stance on discrimination throughout much of the twentieth century stemmed from its opposition to the Ottawa system. Apart from an exceptional trio of preferential arrangements that carried over from the Spanish-American War of 1899 (i.e. with Cuba, the Philippines and Puerto Rico), and one new responsibility that it took on in the immediate aftermath of the Second World War (i.e. the Trust Territory of the Pacific Islands), the United States conducted its trade on the basis of strict MFN treatment in the early years of the GATT system. "Throughout the entire history of the negotiation of the [Havana] Charter and the [GATT]," Brown (1950: 279) noted, "United States leadership was directed towards the elimination of preferences."

When countries assembled after the war to negotiate the Havana Charter and GATT they thus came to the table with different experiences and expectations of the role that discriminatory arrangements might play in the post-war world. France, Latin American countries and the Lebanese Republic hoped to promote regional integration programmes, and each pressed for provisions that would permit regional arrangements. Discrimination was as bad as protection, from the US negotiators' point of view, and hence they argued in favour of a strict MFN provision. Debate centred primarily on the well-established notion of a customs union, but "the Lebanese delegation opened up a quite different line of approach" when it "proposed that members be allowed to set up 'free trade areas' within which there

would be almost complete free trade between the participants, but which would not maintain a single common tariff against other countries." The FTA concept "was warmly supported by France since the French desired to see arrangements of the same sort developed in Europe," and the "general principle was agreed to by the United States" (Brown, 1950: 155-156). Chile was a leading advocate for regional exceptions in the diplomacy that produced the Havana Charter and GATT, where it "pressed hard for a general exception to the rule of most-favored-nation treatment that would allow Latin American countries to continue to grant particular advantages to their neighbors" (*Ibid.*: 72).

Another and related issue concerns the efforts on the part of great powers not just to negotiate RTAs of their own but to encourage economic integration in regions where they hope to promote prosperity and stability. That was the case for the United States after the Second World War, for example, when the imperatives of the early Cold War trumped the long-standing US opposition to discriminatory trade arrangements. Despite the fact that integration in Western Europe might come at some economic cost to itself, the United States had strong political reasons to support the steps that France, Germany and their neighbours were taking towards economic unity. For their own part, statesmen from the European Union have since encouraged countries in other regions to emulate the approach they took towards peace and political union through economic integration.

The end of colonialism provided another rationale for the negotiation of North–South RTAs, prompting former metropolitan countries to conclude agreements with their former colonies. The RTA with the Republic of Korea, which entered into force in 2011, is the sole exception to a general rule by which all of the agreements that the European Union negotiated through 2012 were either with other countries in Europe (all of which are actual or potential candidates for EU membership) or with former colonies, protectorates or mandate territories of one or more EU member states. Whether they were once part of the Belgian, British, French, Portuguese or Spanish empires, the majority of the RTA negotiating partners of the European Union enjoy special relationships with their former mother countries and, through them, the union as a whole. At the start of 2013, however, that pattern appeared to be broken by the planned negotiations with Japan and the United States.[23] For its part, Japan's decision to negotiate an FTA with Peru was undoubtedly influenced by the presence of a large diaspora community in that country.

RTAs can be an instrument not just of peace but of alliances. When the United States began negotiating tariff-reduction agreements in the 1930s it dealt principally with countries that would join or support the Allies in the coming war, and during that conflict Washington and Ottawa explored the possibility of a free trade agreement. FTA negotiations have a long association with the cluster of US goals in the Middle East, which combines the promotion of peace in the region with opposition to terrorism and the pursuit of US energy security.[24] The very first FTA that the United States negotiated was with Israel, and Jordan was (after Canada and Mexico) the fourth US FTA partner. The profile of RTAs in US policy towards this region rose when President George W. Bush (2003) proposed "the establishment of a US-Middle East free trade area within a decade." This policy led to FTAs with the Kingdom of Bahrain, Morocco and Oman, as well as failed talks with the United Arab Emirates[25] and the exploration of negotiations with Egypt and the

State of Kuwait. Even FTA negotiations with countries outside the Middle East became linked to these issues, having been a factor both in the negotiation of the FTA with Australia and in the endgame of the US–Chile FTA.[26] Siracusa (2006: 45), for example, observed that the US–Australia FTA was "widely viewed as a reward for Australian loyalty in the war on terrorism."[27] Nine of the 14 countries with which the United States negotiated FTAs from 2003 to 2006 were part of the Coalition of the Willing in Iraq; three of the remaining five were moderate Arab or majority-Muslim countries that were seen to be partners in the Middle East peace process.

The RTAs that China and Chinese Taipei negotiated before 2010 were also caught up with the question of these two WTO members' diplomatic recognition. That competition was especially intense in Latin America (see Erikson and Chen, 2007). China's FTA negotiation with Costa Rica, for example, "was formally kicked off only one year after the tiny Latin American country switched alliances to China by breaking up with Taiwan" (Gao, 2010: 9). These issues also arose in Chinese Taipei's efforts to negotiate an FTA with Paraguay in 2004. The fact that Paraguay recognizes Chinese Taipei but its MERCOSUR partners recognize China complicated the efforts to conclude an FTA (Bishop, 2004). The cross-straits competition over RTAs subsided with the conclusion of the Economic Cooperation Framework Agreement between Beijing and Taipei City in 2010. In addition to being an FTA, this initiative offers a framework through which China is expected no longer to object to Chinese Taipei's negotiations of FTAs with third parties (Jennings, 2010).

Leverage and linkage in RTAs

There is a compelling logic to the largest economies' concentration on smaller countries as RTA partners. From the perspective of a small and relatively trade-dependent country, a trade agreement is fundamentally that: an agreement about trade. The most attractive partners for a small country will generally be either their immediate neighbours or the largest markets in the region or the world. For large and less trade-dependent countries, however, by-passing the players that are in the same league fits with a fundamental precept of economic statecraft: a country's ability to leverage RTAs for non-economic ends will be greater when the relationship is asymmetrical. Again, Jacob Viner spotted the differences early. In his review of the history of customs unions he observed that:

> Of the more serious movements which involved a great power and a small country or number of small countries, it appears to have been the case without exception for the great power that political objectives were the important ones, while the economic consequences of customs unions were regarded without enthusiasm or even accepted only as the necessary price which had to be paid to promote a political end. For small countries considering customs unions with great powers, on the other hand, only the economic consequences as a rule were regarded as attractive, while the political aspects were thought of as involving risks which might have to be accepted for the sake of the economic benefits with which they were unfortunately associated (Viner, 1950: 91-92).

Even before Viner, Albert Hirschman emphasized that discrimination can be a tool by which larger states deliberately seek to increase smaller states' dependence upon them. In his classic examination of Nazi Germany's trade policy he generalized from the particular to argue that in a "world of many sovereign states it [is] an elementary principle of the power policy of a state to *direct its trade away from the large to the smaller trading state*" (Hirschman, 1945: 31; emphasis in the original). The increase in the smaller country's dependence on the larger is not merely a mundane fact of economic life, in this view, but something that the larger state will seek to magnify economically in order to exploit politically.

These encounters between high politics and low politics sometimes involve major issues at the strategic level and can sometimes play out in briefer, tactical exchanges. That can be illustrated by one episode from the Doha Ministerial Conference, where Chile and the United States had very different positions on the proposed negotiations over anti-dumping rules (see Chapter 11). The US negotiators hoped that the US–Chile FTA, which was then still under negotiation, would give them leverage over their Chilean counterparts. There had already been a few shouting matches over the anti-dumping issue between Ambassador Robert Zoellick and the Chilean and South African delegations, at which point Mr Zoellick told one of his officials to deal with it. As Alejandro Jara would later recall, this US official –

> proceeded to call the ambassador of Chile in Washington, who proceeded to call … President Lagos [of Chile], saying, "This is what's happening, Chile's taking a very vocal position, that the United States does not agree with it, they're seeking too much on anti-dumping, etc. etc. etc., and this is putting into risk a free trade agreement between the US and Chile." And it so happens that … one main person of the team was Lagos' son, who then talked to his father in my presence and explained it to him. His father laughed, and he said, "Oh, so this is it?" "Yeah." "Okay. No problem. Carry on. And send Alejandro my regards and tell him not to be afraid." *Voilà*! So we negotiated the mandate.[28]

The same two countries clashed again at the Cancún Ministerial Conference, this time over agricultural issues, but this confrontation came two months after the US Congress had already approved the implementing legislation for the FTA and President Bush had signed it into law.[29] Chile was then a member of the G20 coalition that opposed the EU–US position on agriculture (see Chapter 12), and Mr Zoellick made it a priority to bust that coalition. One approach he took was to propose FTA negotiations with members of this group, and did so with some success: Colombia, Costa Rica and El Salvador each took up the US offer while also leaving the G20 coalition.[30] The United States also hoped to persuade both Chile and Mexico to leave that group, but Mexico already had its FTA in hand and Chile very nearly did. These two countries were thus in a stronger position to deflect any persuasion or pressure. The twin episodes from 2001 and 2003 suggest that even while FTA negotiations may provide an opportunity for the larger partner to exercise leverage over the smaller, the results are not always a foregone conclusion, and that moreover the window of opportunity is limited to the period in which the agreement is under negotiation and awaiting approval. Once the agreement enters into effect, the threat to abrogate it is not likely to be credible in anything

other than a major confrontation. If Hirschman is correct about discrimination leading in the long term to a higher level of dependence of the smaller on the larger party, however, the negotiation of an RTA may – if it does lead to a higher level of trade and investment between the partners – have a subtler effect over time by shifting the smaller country's perceptions of its interests and options.

The relationship between RTAs, preferences and the multilateral system

For over half a century, economists, lawyers, political scientists, negotiators and policy-makers have argued over the impact that discriminatory agreements have on multilateralism. On the positive side, RTAs may constitute down payments that countries might later incorporate, in whole or in part, in their commitments at the multilateral level, while also establishing precedents for the inclusion of new issues within the scope of trade policy. On the negative side, the proliferation of RTAs may contribute to a balkanization of the trading system, the multiplication of competing rules of origin, and the creation of captive markets favoured by national constituencies that are more interested in preserving the existing preferential arrangements than in promoting new global deals. Some political economists conclude that on balance the discriminatory agreements contribute more than they detract from the trading system, and that RTAs are therefore beneficial; for example, see Schott (1989). Others argue that discrimination can serve to advance issues that might otherwise stagnate (Oye, 1992; Rhodes, 1993), and to make agreements more enforceable (Yarbrough and Yarbrough, 1986). Critics nevertheless charge that the economic benefits of discriminatory liberalization run a distant second to multilateralism (Bhagwati and Panagariya, 1996), and some contend that the potential for abuse makes the very term "bilateralism" a virtual synonym for "protectionism" (Krueger, 1995). Some detractors associate discriminatory forms of trade policy with exploitation of the small and poor by the large and wealthy, the deepening of dependency and even economic warfare (Hirschman, 1945; Diebold, 1988).

Competitive liberalization

Competitive liberalization is a strategy that treats bilateral, regional and multilateral negotiations as progressive steps towards the shared objective of open markets. It can be pursued in either of two ways. One is the more cooperative, "bandwagon" variant in which a country encourages its trading partners to climb aboard in order to enjoy the best access to the largest market at the earliest time. There is no promise here that the preferential access of an RTA will be exclusive; its margins of preference will be diluted by the subsequent negotiation of like agreements at the regional level, and further eroded by the hoped-for multilateral agreements. The other approach is more confrontational, threatening actual or potential partners that if they do not negotiate the issues and agreements that the country proposes at the multilateral level they may find themselves left behind when this spurned suitor turns instead to bilateral and regional alternatives.

The stricter version of this strategy dates from the late GATT period, and was part of the US efforts to advance what were then known as the "new issues" of services, intellectual property rights and investment. It is no coincidence that the negotiations over the US–Canada FTA (begun in 1986 and concluded in 1988) and then NAFTA (begun in 1991, concluded in 1992 and revised in 1993) came during the start- and end-games, respectively, of the Uruguay Round. The first of these FTAs was intended by US policy-makers not only to govern the world's largest bilateral trade relationship, but also to set significant precedents for the multilateral system; the second FTA demonstrated that these same issues can be negotiated in a North–South agreement. The first step in the US strategy was to respond to the preoccupation of Canadian trade officials over Washington's apparent move towards protectionism, as manifested in the increasing use of the trade-remedy laws, by agreeing to negotiate an FTA as long as it met US terms. "The US Administration has indicated it is prepared to consider our key concerns" on trade-remedy laws and other matters, the Canada Department of External Affairs (1985: 5) noted, "as long as we are prepared to consider their key objectives" on issues such as services. Launching those bilateral talks signalled to other GATT countries that the United States was prepared to "go bilateral" if the proposed new round did not include the new issues. The Uruguay Round was in fact launched four months after the bilateral talks began in May 1986.

James Baker, who served as US treasury secretary in the Reagan administration and secretary of state in the George H.W. Bush administration, reiterated the threat to rely on bilaterals after the US–Canada negotiations ended in 1988. He wrote that:

> If possible, we hope this follow-up liberalization will occur in the Uruguay Round. If not, we might be willing to explore a "market liberalization club" approach, through minilateral arrangements or a series of bilateral agreements … Other nations are forced to recognize that the United States will devise ways to expand trade – with or without them. If they choose not to open markets, they will not reap the benefits (Baker, 1988).

Mr Zoellick initially pursued the more cooperative, bandwagon version of the competitive liberalization strategy when he became the US trade representative. He said in 2002 that the United States sought to "creat[e] a competition in liberalization, placing America at the heart of a network of initiatives to open markets" by proceeding "with countries that are ready" and putting pressure on the rest to follow (quoted in Destler, 2005: 299-300). This approach appealed to free-traders who approved of the upward cycle of negotiations. "[T]he North American Free Trade Agreement preferences in the US market induce other Latin American countries to create a Free Trade Area of the Americas," as Bergsten (2002) observed, just "as an FTAA would in turn spur the Doha round."

The United States kept the strategy in place after the Doha Round suffered a setback in the 2003 Cancún Ministerial Conference, but now it had a sharper edge. Mr Zoellick distinguished between what he called the "can-do" and the "won't-do" countries, expressing his disgust with "the transformation of the WTO into a forum for the politics of protest." After two years of

pushing "to open markets globally, in our hemisphere, and with sub-regions or individual countries," he warned, the United States would not wait any longer, but would instead "move towards free trade with can-do countries" (Zoellick, 2003: 3). It was at that point that the pace of US FTA negotiations accelerated. The United States had FTAs in place or under development with just five partners at the start of 2003; over the next three years, it would initiate negotiations with 22 countries and conclude them with 14.

How did the strategy of competitive liberalization fare? There is evidence to suggest that bilateral agreements do encourage more of the same. Solís and Katada (2009: 15), for example, advanced a "diffusion" hypothesis with two variants, one being emulation ("[c]ountries will copy the FTA policies of their socio-cultural peers") and the other being competition ("[c]ountries will counteract the FTA policies of their competitors"). The evidence is much weaker on the question of whether these smaller agreements effectively encourage larger ones at the regional and then the multilateral levels. As time went on, negotiations floundered. The FTAA negotiations ground to a near-halt by 2003, the progress in the Asia-Pacific Economic Cooperation forum also slowed, and the Doha Round went into a lower gear at about the same time. Criticism of the strategy then mounted. "[I]f multilateralism and leading regional trade initiatives remain stalled," Evenett and Meier (2007: 27) observed, "then Competitive Liberalization may amount to little more than bilateral opportunism masquerading as high principle with an apparently compelling narrative."

It can be difficult to disentangle the viability of the strategy from the challenging times in which it was pursued. The consequences can depend greatly on how the smaller partner in an RTA views the purpose of the agreement, and there are numerous examples of countries that actively pursue an "all of the above" approach to trade negotiations. Consider the case of Canada in the late GATT period, which did not by any means view the RTAs with its neighbour as a substitute for multilateralism: Ottawa proposed the creation of the WTO during the interval between its bilateral and trilateral negotiations with the United States (see Chapter 2). Diplomats from other countries that negotiate multiple RTAs insist that they see these agreements and the WTO as complementary. They stress that they need the protection of the WTO because it provides a more certain legal environment than would be the case if their relations with larger partners were determined solely by the terms of their FTAs; that they hold out hope that the WTO can be the site for new commitments on issues that cannot be effectively addressed in bilateral deals, such as agricultural subsidies and reform of the trade-remedy laws; that support for the WTO demonstrates their commitment to developing countries; and because of a philosophical commitment to the concepts of international law and governance in general, and the multilateral trading system in particular.

That positive view is more common in mid-sized developed countries such as Canada and Switzerland and in middle-income countries such as Chile, Costa Rica, Mexico and Singapore than it is in poorer, smaller countries. There multilateralism and non-discrimination are often seen as substitutes rather than complements for RTAs and PTAs, and for poorer and less competitive countries those discriminatory options are usually preferred over global deals. Preference erosion is typically a top concern for these countries, where policy-makers worry

that when multilateral agreements reduce MFN tariffs they also reduce the margins of preference that their exporters enjoy under programmes and agreements. That is a point to which we will return shortly.

RTAs as precedents and fall-backs

FTAs are not simply scaled-down versions of multilateral trade agreements, but will of necessity take qualitatively different approaches to several of the issues that they cover. On some topics an RTA can do more than the WTO, and on others it may do less; still other issues may appear in an RTA even though they are not yet part of the WTO system.

For the most traditional issue, an RTA is by definition WTO-plus: where the multilateral system works to reduce most tariffs and to eliminate some, an RTA eliminates substantially all of them. Market access commitments for services are more complex, given the great amount of water that one finds in GATS schedules. The concessions that countries make in RTAs are often more liberal than what they commit in the GATS, both because they tend to be GATS-plus and may be negotiated in a different fashion,[31] but it can be difficult to determine whether the difference is nominal or real.[32] It can be unclear whether the liberalization offered to RTA partners is restricted to them. For practical reasons, regulators may find it necessary to extend to service providers from all parties, albeit on a *de facto* basis, whatever liberalization is agreed to in an RTA. Other issues are much better handled in a multilateral agreement than in an RTA. That is most clearly the case for agricultural production subsidies, and is a simple function of how they operate: whereas it is quite simple to discriminate among partners in the application of tariffs on imports, there is no practical way to restrict the impact of production subsidies to some countries while exempting others.

A third set of issues are those that the WTO membership as a whole may be unwilling to take up in multilateral negotiations but that can be addressed by a subset of these members in RTA negotiations. There are several variations on this theme. One option is for the *demandeur* on a new issue to use RTAs as a "policy laboratory", demonstrating to other members how the issue might be handled if it were taken up multilaterally. In another variation, the *demandeur* that has been rebuffed at the multilateral level may repair instead to bilateral and regional negotiations, seeking from selected partners the satisfaction that it was denied at the global level. That second variation does not preclude a return to the first. It is possible that the resistance in the WTO may abate, allowing the precedents set in the RTA negotiations to be taken up in a global deal. Yet another approach is to pursue these initiatives in a complementary fashion, setting one level of commitments in the WTO but then establishing stricter, WTO-plus commitments in the RTA.

The first of these sequences is best demonstrated by the approach that the United States took in the 1980s towards what were then the new issues of investment, services and intellectual property rights. While the US–Israel trade relationship in 1985 was relatively small, the precedents set by the FTA negotiated that year were large. This was the first agreement covering the new issues, and preceded the launch of the Uruguay Round by a year. Subsequent US RTAs expanded greatly on its toeholds, as shown in Table 13.5, and also set

Table 13.5. Issue coverage of selected FTAs of the European Union and the United States

	FTAs of the European Union				FTAs of the United States			
	Andorra	Tunisia	Chile	Korea, Rep. of	Israel	NAFTA	Chile	Korea, Rep. of
	1991	1995	2002	2010	1985	1993	2003	2007
Uruguay issues								
Intellectual property	–	●	●	●	⊙	●	●	●
Services	–	●	●	●	⊙	●	●	●
Singapore issues								
Competition policy	–	●	●	●	–	●	●	●
Government procurement	–	⊙	●	●	⊙	●	●	●
Investment	–	⊙	⊙	●	⊙	●	●	●
Trade facilitation	–	⊙	⊙	●	–	●	●	●
Other issues								
Labour rights	–	–	⊙	⊙	–	●	●	●
Environment	–	⊙	⊙	●	–	●	●	●
Electronic commerce	–	–	⊙	●	–	–	●	●
Geographical indications	–	○	○	⊙	–	⊙	⊙	⊙

Notes: Years indicate date of signature.

● = Full chapter, annex, appendix or other section or side agreement devoted to the issue.

⊙ = One or more full articles devoted to the issue.

○ = Other coverage of the issue (e.g. language within the terms of an article dealing with a related issue).

– = No coverage.

precedents of their own on other new issues. The expansion in the EU RTAs is even clearer, with the issue coverage of sequential agreements increasing both in width and in depth. The data in Table 13.4 show how RTAs offered Brussels an alternative means of promoting the so-called Singapore issues of competition policy, government procurement, investment and trade facilitation after taking three of these issues off the table in the Doha Round. Most of the FTAs that the European Union and the United States reached after Cancún include not only the Singapore issues but also other topics that never made it onto the table in Doha, especially labour and the environment.

What implications do these WTO-plus commitments have on the WTO itself? The answer depends in part on how one views the specific issues at hand. As was discussed in Chapter 10, the issue of Trade-Related Aspects of Intellectual Property Rights (TRIPS) and public health is one of the most divisive topics in contemporary trade policy. One way that it plays out is in the TRIPS-plus provisions that the United States seeks in its FTAs. The TRIPS-plus provisions in the FTAs of the United States include rules that (among other things) bring more subject matter within the terms of intellectual property protection, have stronger enforcement mechanisms, and weaken the flexibilities and special and differential treatment granted to developing countries (Mercurio, 2006). This is a practice that led Bhala (2007) to label the US strategy of "competitive imperialism". Shaffer (2005b: 133-34) described the strategy less provocatively:

> The United States and EU enhance their leverage in WTO multilateral negotiations through forum-shifting. They play countries off each other through engaging in simultaneous bilateral and regional negotiations, thereby threatening to deny benefits to some countries that they offer to others. Weaker states may agree to US and EU demands under a bilateral agreement so as to gain or retain access to US and EU markets, and, in the process, obtain an advantage over developing country competitors.

Other trade specialists present a more positive view of the ways that WTO and RTA agreements can strengthen disciplines. Cernat and Laird (2005) observed that multilateral rules may act as a "policy anchor" that constrains the degree of discrimination and backsliding in RTAs, and RTAs may further act as "policy transfer mechanisms" towards the multilateral system by introducing new or more far-reaching rules that had not been on the WTO agenda. "[I]nvestment and competition policy are areas where RTAs have moved ahead of the WTO system," they note, "while developments on services at the WTO level were influenced by progress in NAFTA and the EU" (*Ibid.*: 73).

Much depends on how ambitious a given RTA is, with North–North agreements generally being deeper, and hence less susceptible to backsliding, than South–South agreements. On this point, former US Trade Representative Susan Schwab criticized "the negotiation of often lower-quality bilateral and regional trade agreements" that "eroded support and political will for the pursuit of a strong multilateral deal among other countries" (Schwab, 2011: 112). By this argument, it is the quality and not the quantity of RTAs that most affect the integrity of the multilateral trading system. The negotiators for the Trans-Pacific Partnership (TPP) thus call their undertaking a "twenty-first century trade agreement", hoping that it will set new precedents to be taken up either in the WTO or in other bilateral and regional agreements. One of them is former WTO Director-General Mike Moore, once a critic of discriminatory agreements who came to believe that with the Doha Round stalled his country had "to do what you have to do." He hopes "that with TPP we'll drive up some models that can go back to Geneva on [state-owned enterprises], on intellectual property, on a whole series of matters, on trade facilitation, that can be useful to the WTO."[33]

The position that developing countries take on new issues in the WTO can be affected by the RTAs that they negotiate. A country that may have bargained hard on new issues when an RTA was still under negotiation but was ultimately persuaded to adopt commitments, whether by the force of arguments or the inducement of concessions on other issues, may be less inclined thereafter to oppose the inclusion of the issue in multilateral negotiations. "Once a developing country agrees to such demands," Shaffer (2005b: 133-34) observed, "it will more likely favor their multilateral application, such as over intellectual property protection, so that it is not disadvantaged against developing country competitors in that particular domain." That appears to have been the case for countries such as Chile and Mexico, for example, which took somewhat different views before and after concluding FTAs with the European Union and the United States.

Preference erosion

Not all countries see complementarity between discrimination and multilateralism, and some are more devoted to maintaining the margins of preference that they enjoy under RTAs and preferential programmes than they are to negotiating new agreements in the WTO. Countries that undertake preferential trade initiatives "are in pursuit of the economic rents resulting from the trade diversion associated with trade preference (or discrimination)," Andriamananjara (2003: i) observed, and because "multilateral trade liberalization reduces those rents [it] is likely to be resisted by members of trade-diverting preferential blocs." Officials in some developing countries see multilateralism as a threat to their margins of preference, and conversely their efforts to retain those margins can constitute a threat to the multilateral negotiations. These concerns are especially high among those smaller and poorer countries that generally negotiate few RTAs outside of their own regions, but rely on preferential programmes for their access to developed markets. Preference erosion is an especially important concern for the G90 countries.

Studies disagree on the seriousness of the problem. Bouët et al. (2005) found that the threat of preference erosion from the Doha Round is real insofar as trade preferences play a key role in the world trading system, and especially in rich countries' pro-poor policies. Others look at the specific sectors at issue and find a less daunting challenge. "Relatively few countries face potentially high losses," according to Milner et al. (2009: 8), "and these are typically related to specific products." Low et al. (2005) concluded that the sectors most susceptible to preference erosion are textiles and clothing, fish and fish products, leather and leather products, electrical machinery and wood and wood products.[34] Several other studies conclude that preference erosion is a less serious problem for preferential programmes than it is for RTAs for the simple reason that the benefits of these programmes tend to be small. Francois et al. (2005) found that administrative burdens result in preferences being underutilized, thus significantly reducing their value and the magnitude of erosion costs. Amiti and Romalis (2007) argued that actual preferential access for many developing countries under existing preferential programmes is less generous than might appear because of low product coverage and complex rules of origin, and that lowering tariffs on an MFN basis is likely to offset the losses from preference erosion and lead to a net increase in market access. One way to deal with preference erosion is to provide some form of compensation to the countries that are most affected. Hoekman and Prowse (2005: 21) suggested that while the problem of preference erosion requires a multilateral solution "in the sense that the financial transfers that are called for are best allocated through existing multilateral aid mechanisms" (e.g. along the lines of the Enhanced Integrated Framework), the funding should be determined bilaterally.

Endnotes

1 Note that all data on RTAs presented here are based on the WTO Regional Trade Agreements Information System at http://rtais.wto.org/UI/PublicMaintainRTAHome.aspx, which is in turn based on the information that members provide to the Secretariat. It does not include any RTAs that, for whatever reason, may not have been notified.

2 WTO data at www.wto.org/english/res_e/statis_e/its2012_e/section1_e/i08.xls.

3 Some agreements between the European Union and its partners take the form of customs unions (e.g. with Turkey). Note also that the European Free Trade Association (established in 1960) is an FTA rather than a customs union.

4 Calculated from WTO data at www.wto.org/english/res_e/statis_e/its2012_e/section1_e/i08.xls.

5 See UNCTAD (1964: 143-44). Emphasis in the original.

6 See GATT document LT/TR/D/1, adopted 28 November 1979.

7 The GSTP participants are Algeria, Argentina, Bangladesh, Benin, the Plurinational State of Bolivia, Brazil, Cameroon, Chile, Colombia, Cuba, the Democratic People's Republic of Korea, Ecuador, Egypt, Ghana, Guinea, Guyana, India, Indonesia, Iran, Iraq, the Republic of Korea, Libya, Malaysia, Mexico, Morocco, Mozambique, Myanmar, Nicaragua, Nigeria, Pakistan, Peru, the Philippines, Singapore, Sri Lanka, Sudan, Tanzania, Thailand, the former Yugoslav Republic of Macedonia, Trinidad and Tobago, Tunisia, the Bolivarian Republic of Venezuela, Viet Nam and Zimbabwe.

8 Part of MDG III.15, as recorded in *United Nations Millennium Declaration*, UN document A/RES/55/2, 18 September 2000.

9 See paragraph 6 of the *Brussels Declaration*, UN document A/CONF.191/12, 2 July 2001.

10 See *Doha Work Programme: Ministerial Declaration*, WTO document WT/MIN(05)/DEC, 22 December 2005.

11 See *Preferential Treatment to Services and Service Suppliers of Least-Developed Countries*, WTO document WT/L/847, 19 December 2011.

12 Note that GATT Article XXXV was not part of the original agreement, but was instead an amendment approved in 1948.

13 Another scholar has argued more recently that the origins of GATT Article XXIV can be traced to the brief and ultimately failed efforts of the United States and Canada to conclude a free trade agreement immediately after the Second World War. Citing archival evidence, Chase (2006) showed that the evolving US position on relatively lax GATT/ITO policing of free trade agreements versus relatively strict rules on customs unions may be traced to the fact that, at the time, the United States was interested in pursuing the former but not the latter with its northern neighbour.

14 See *Transparency Mechanism for Regional Trade Agreements*, WTO document WT/L/671, 18 December 2006.

15 RTAs that are notified under the Enabling Clause are considered by the Committee on Trade and Development.

16 If an agreement covered only services, the notification under GATS Article V would be the only one required, but in practice all RTAs that cover services have also covered goods.

17 See *Negotiations on Regional Trade Agreements: Transparency Mechanism for Regional Trade Agreements*, WTO document TN/RL/W/252, 21 April 2011.

18 The database is accessible at http://rtais.wto.org/UI/PublicMaintainRTAHome.aspx.

19 The database is accessible at http://ptadb.wto.org/?lang=1.

20 See Council Regulation (EC) No 2820/98 of 21 December 1998 applying a multiannual scheme of generalised tariff preferences for the period 1 July 1999 to 31 December 2001, *Official Journal* L 357, 30 December 1998, pp. 0001-0112.

21 One of the major concerns that led to the Constitution was the concern that the loosely confederated American states were erecting barriers to trade with one another. The Constitution banned internal trade barriers and established a common external tariff.

22 It should also be noted that this sequence is not universal, and that sometimes political unification may precede the economic variety. Both Canada and Italy achieved their respective confederations in the 1860s, for example, but each of them took much longer (decades in Italy and more than a century in Canada) to bring the country's level of economic unity in line with its political counterpart. The break-up of Czechoslovakia in 1993 was a *sui generis* case, as it was accompanied by the simultaneous creation of the Czech and Slovak Customs Union.

23 Even in the case of an EU–US RTA, one could see this as a negotiation with a former colony, albeit one whose independence dates back to the year that Smith published his *Wealth of Nations*. By that standard, the only exceptions to the rule would be the actual RTA with the Republic of Korea and the one with Japan for which negotiations began in 2013.

24 For more details on the role of RTAs in US Middle East policy, see VanGrasstek (2003).

25 The FTA negotiations with the United Arab Emirates were suspended in 2006, due in part to a political dispute over the proposed operation of US ports by Dubai Ports World.

26 The debate over approval of the FTA in the US Congress coincided with Chile's tenure on the United Nations Security Council and the deliberations over a US invasion of Iraq. The resulting friction between the United States and Chile did not ultimately prevent the approval of the FTA by Congress, but did produce concerns and delays. For accounts of how these matters came to be linked, see *El País* (2007), Muñoz (2008) and Weintraub (2004: 91).

27 See also Galasso (2011).

28 Author's interview with Mr Jara on 23 September 2012.

29 The signing of this bill into law was not the same as the entry into force of the agreement; that is a later step that was authorized, but not automatically accomplished, by enactment of the bill.

30 This was not the only issue related to these countries' negotiation of an FTA with the United States, as was already discussed above in relation to the Coalition of the Willing; each of these three countries also became a member of that coalition. It should also be noted that not all of the original G20 members with which the United States negotiated FTAs in 2003 to 2006 left that coalition.

31 As explained in Chapter 9, while services commitments in the GATS are made on the basis of a positive list in some RTAs they are negotiated through negative lists.

32 Roy et al. (2008: 80-81) found that "in terms of the breadth of commitments, [RTAs] have provided for spectacular advances" in services commitments vis-à-vis GATS. They also find that RTAs "often induce 'real' liberalization, as exemplified by a number of commitments providing for the phasing out of restrictions in place" (*Ibid.*: 104). They nevertheless acknowledged that "further empirical research would seem warranted so as to better assess the economic consequences flowing from the implementation" of RTAs (*Ibid.*: 107).

33 Author's interview with Mr Moore on 20 February 2013.

34 See also Rahman and Shadat (2006).