

**Regional Co-operation within the Multilateral System of Rules:  
elements for a discussion from a legal/ institutional/ political  
perspective.**

Contribution to the Seoul 13th-14th of September 2002  
Conference on "The Evolving WTO Regime and Regional  
Economic Co-operation: Implications for Northeast Asia".

(Preliminary version to be rewritten after the Conference;  
footnotes and bibliography to be completed).

**Ramon TORRENT**

Professor of Political Economy and Director of the  
Observatory of Globalisation at the University of Barcelona.  
Former director of external economic relations in the Legal  
Service of the Council of the European Union.

# INDEX

## INTRODUCTION

### A) PREFERENTIAL TRADE AGREEMENTS AND WTO: ELEMENTS FOR THE DISCUSSION FROM A LEGAL/ INSTITUTIONAL/ POLITICAL PERSPECTIVE

- 1.- Why a legal/ institutional/ political perspective
- 2.- The strictly legal perspective: whose primacy?
- 3.- The "architectural" perspective. The argument of the blocks and the difference between FTAs and CUs
- 4.- The "mechanical" perspective. The argument of the "hub and spokes" and the intertwining of PTAs
- 5.- The "common house" perspective. PTAs with non-WTO Members
- 6.- The political perspective. The political specificity of some PTAs
- 7.- The development perspective

### B) REGIONAL COOPERATION/INTEGRATION BEYOND TRADE RULES

- 8.- The multiplicity of instruments for regional co-operation/integration
- 9.- The “effective content” of regional co-operation/integration

### C) CONCLUSIONS

## **INTRODUCTION**

The present paper is divided in three parts.

The first is the longer one and discusses the relationship between preferential trade agreements and the multilateral trading system. It elaborates ideas which were presented orally in the Conference on Regionalism and WTO organised in Geneva by the WTO Secretariat in April 2002. This first part refers to "preferential" and not specifically to "regional" trade agreements because it seems pretty obvious to me that not all preferential trade agreements create regions (if this word has to keep some recognisable meaning). As a matter of fact, this first part can be read as a contribution to answering the following question: when preferential agreements create regions compatible with WTO and when they simply establish a bi/plurilateral trade regime incompatible with the basic WTO principle of non-discrimination (MFN principle)?

The second is shorter and contributes two specific ideas on regional co-operation/integration.. The first is the criticism of the thesis that regional integration is a unidirectional process leading from free trade areas to broader and deeper forms of integration. The second is a specific way of looking at the effective content of regional integration, as "multilateral-plus" content. This second part summarises and develops some of the results of a piece of research commissioned by the Department of Trade and Integration of the Inter American Development Bank (*Regional Integration Instruments and Dimensions: An Analytical Framework*, in R. Devlin and A. Estevadeordal (eds), Trade and Regional Integration in the Development Agenda, Inter American Development Bank, Washington D.C. forthcoming in 2002).

Finally, some policy oriented Conclusions are drawn from the arguments developed in the paper.

## **A) PREFERENTIAL TRADE AGREEMENTS AND WTO: ELEMENTS FOR THE DISCUSSION FROM A LEGAL/ INSTITUTIONAL/ POLITICAL PERSPECTIVE**

### **1.- Why a legal/ institutional/ political perspective**

#### **1.1.- A fundamental question**

Which is the main function of the multilateral trading system, created by the WTO,

- to promote trade liberalisation, or
- to create a global system of rules, based on the principles of multilateralism and progressive liberalisation (binding of concessions plus rounds of negotiations) and able to prevent "trade wars", to build a co-operative approach to trade policy and to guarantee to all countries, big and small, an adequate insertion in the global trading system?

This question is a fundamental one, because each of the two alternative answers has different implications and leads to different conclusions. However, it is rarely asked (even more rarely answered) in a straightforward manner. When the multilateral system is "sold" to public opinion, in particular to developing countries (also to ONGs), it is the second alternative that is put forward. But, as a matter of fact, it is the first alternative (the promotion of trade liberalisation) that is dominant in practice as well as in academic literature.

It would be tempting to dismiss the question as a false one because the two functions are mutually compatible. The dismissal is not founded, however, if we refer to the main function of the multilateral trading system. If we discuss about priorities, the two alternatives are not compatible, in particular for the discussion of the relationship between preferential trade agreements and the multilateral system: the possible contribution of preferential agreements to trade liberalisation may be accompanied by harmful effects for the multilateral system as a whole (not simply because of trade diversion but for broader reasons: for example, because preferential agreements may

induce a competitive course to their signature in which some countries will necessarily be the losers, making more difficult for them their insertion in the global system).

The two alternative answers to the initial question do not only lead to two different approaches in terms of policy. They are also linked to two different methodological perspectives. If your focus is on trade liberalisation, you tend to emphasise the quantitative analysis of trade flows measured in economic terms. If your focus is on the existence of a global system of rules you must broaden your perspective to cover all the legal, institutional and political components of such a global system.

These two alternative methodological perspectives underlie also two different ways of discussing the compatibility of preferential agreements with GATT provisions. From the first perspective, you tend to emphasise a quantitative interpretation of the notion of "substantially all trade" of GATT's Article XXIV in order to use it as a benchmark for the analysis of preferential agreements. From the second perspective, without denying the importance of such a notion, which prohibits preferential sectorial agreements or agreements "à la carte", the attempt to give to it a precise quantitative meaning is quite irrelevant; indeed, the discussion of the coverage of the agreement is only an aspect of a much broader discussion on the systemic consequences of preferential trade agreements because their possible harmful consequences for the global trading system are not proportional to the coverage of the agreements measured in quantitative terms.

I give the second answer to the initial question. I naively believe that the arguments used to sell the multilateral system to public opinion are the right ones. As a consequence, the present paper tries to contribute to the development of the second methodological perspective just outlined.

### 1.2.- A reminder on multipolarism and multilateralism

There should be no need to remind the differences between multipolarism and multilateralism. Indeed, everyone should know that the multilateral system was created after the Second World War precisely as a reaction to (and a way to prevent the reappearance of) the multipolar system that, for decades, had generated economic, political and military conflicts all over the world.

The multilateral system is based, as Patrick Low will surely explain more aptly than me in his contribution, on the fundamental principle of non-discrimination among third countries, the very same principle a multipolar system necessarily violates because of the creation of zones of influence which receive, from each respective pole, a "preferential" treatment that is not extended outside the zone. Whether this preferential treatment has been willingly asked for by the countries of the zone of influence or has been imposed by the pole, if necessary through military occupation, constitutes a question of historical interpretation that can be left aside now for our discussion.

The reminder of these elementary ideas is necessary, however, because the multipolar thesis is regaining ground all over the world. I'll leave to Asian and to American participants the discussion of this development in their respective continents; I'll concentrate in mine, in Europe. It is extremely worrying that in the preparatory documents leading to the meeting of the European Council in December 2001 in Laeken that launched the new reform of the Treaties (the reform leading to a new "Constitutional Treaty"), the notions of multilateralism and multipolarism are used side by side as if they were not essentially contradictory<sup>1</sup>.

This is not simply a drafting mistake. It reveals, first of all, the confusion that exists on the questions we are discussing. Secondly, it reveals that the European Union continues to be unable to define a coherent approach to international relations (including international economic relations). Historically, the battle between bilateralists and multilateralists has been a chronic one within the European Commission as well as within the Council of the European Union and the governments represented in it. At present, it is true that Commissioner Lamy and D.G Trade try to strengthen the multilateral approach but it is completely uncertain whether they will be followed by the Commission as a whole and by the Council, much more receptive to the dangerous (and fruitless, at least for the moment) rhetoric of "Europe big power" than to the explanation or even the reminder of the virtues of the multilateral system.

---

<sup>1</sup> ...reference to the the "list of questions" submitted to the European Council that continues to be widely used in practice as an inventory of the problems to be solved by the new reform... (to be completed)...

The multipolar approach is very often put forward as an alternative to the "unipolar" world under US hegemony that has developed after the end of the Cold War and the decomposition of the Soviet Union and its zone of influence.

As a continent decimated a few times in history by the consequences of a multipolar system of power (and exporter of them to the rest of the world through the colonial system), Europe should be the first to know that the only way to oppose unilateralism by a "big power" is not through the multiplication of big powers but through the strengthening of the multilateral system. But apparently this is not the case. This (and the bad example it may give in other parts of the world) constitutes a decisive additional argument to give the second answer to my initial question. The multilateral system is something too important to be left in the hands of economists looking for a greater or lesser degree of trade liberalisation; the compatibility between preferential and WTO agreements is something too important to be left to quantitative interpretations of GATT's Art. XXIV notion of "substantially all trade" (a discussion which, by the way, has lead nowhere after decades of discussion).

## **2.- The strictly legal perspective: whose primacy?**

### **2.1.- The problem**

Preferential trade agreements and WTO agreements overlap: they create two different sets of rights and obligations related to the same subject-matter. These two different sets may be contradictory among them. The conflict that is created is not only legal; it is, first of all, political because the unsolved legal contradiction leads to policy choices favouring the preferential or the multilateral approach.

This problem is often analysed from the perspective of two or more countries (countries A and B, for example) which have different rights and obligations arising from different agreements (a PTA and a WTO agreement, for example); such a situation may give rise, *inter alia*, to the well known problem of "forum shopping": under which agreement to settle a dispute among the parties?. From this perspective (same parties and different agreements) the problem is a relatively easy one. Firstly, there are some rules of general

international law applicable to its solution. Secondly, it is a problem among the specific countries concerned that leaves relatively unaffected the multilateral system as such.

The real problem arises when the set of rights and obligations linking one country (country A, for example) to other countries (country B, for example) under a PTA are contradictory with the set of rights and obligations linking the same first country A to another set of third countries (country C, for example) under a WTO agreement. In more general terms, it is the problem of contradictory sets of rights and obligations among different parties to different agreements. This problem

- finds absolutely no solution under general international law<sup>2</sup> and
- affects the multilateral system as a whole.

The paradigmatic example of this real problem has been the "bananas war" involving the European Community, the countries parties to the Lomé Convention and a number of American countries. Leaving to a footnote a comment that does not concern us primarily<sup>3</sup>, I will recall that its main element, from our perspective, was the overlapping of two complex sets of rights and obligations among different parties under different agreements:

- that between the European Community and the countries from Africa, the Caribbean and the Pacific -"ACP countries"- parties to the Lomé Convention; by virtue of them, the Community had two main obligations: to treat ACP imports better than imports from non ACP countries and to guarantee them some minimum quantitative access;

---

<sup>2</sup> National legal orders give a solution to the problem of overlapping and conflicting legislations through different mechanisms: either establishing a hierarchy among them (or through the analysis of the competencies of the authorities that have enacted them if the State has a more or less federal structure) or through the application of principles so old-fashioned as a "legislation more specific prevails over one more general" or "a more recent legislation prevails over an ancient one". But national legal orders are able to do so because they are, in each case, a single order encompassing all the relations falling within its framework. In the international sphere, each agreement is somehow self-contained; it is not an agreement within the framework of a single constitutional order; there is no way to solve the contradiction between the rights and obligations of different parties to different agreements.

<sup>3</sup> It is very often forgotten that the main real economic conflict was not between ACP producers and Latin American producers but between EC producers and all the rest. It was the overprotection to EC producers that led to the introduction of restrictions on imports (from all countries in the world including the ACP). If this overprotection to EC producers (mainly in the Canary Islands in Spain) had been reduced (or replaced by subsidies not linked to banana production), the need to have recourse to quantitative restrictions (through prohibitive MFN duties plus discriminatory tariff-rate quotas) would have disappeared. With the disappearance of quantitative restrictions most of the problem would have also withered away.

This reminder is needed because the European Community has been very successful in presenting the "banana war" as a conflict between WTO and ACP countries instead of as a conflict between the European Community and all exporting countries.



- that between the European Community and non-ACP countries Members of WTO: by virtue of different GATT and GATS provisions, taken together with the specific waiver granted to the Community for the fulfilment of its obligations under the Lomé Convention, non-ACP countries had the right to a non-discriminatory participation in the tariff-rate quotas opened by the Community.

The result of the overlapping between these two sets of rights and obligations was that the solution chosen by the European Community<sup>4</sup> to fulfil its first set of obligations (under the Lomé Convention) contradicted its second set of obligations (under WTO agreements). The resulting damage (legal, political and economic) to the multilateral system (and to the relations among developing countries exporters of bananas) has kept no proportion to the quantitative importance of the dispute measured in terms of trade flows.

A second paradigmatic example is developing along the same lines with the US safeguards on steel imports. The US has accepted in the framework of PTAs the obligation to grant to parties to these agreements a better treatment on safeguards than that applied to third countries. This obligation may be in contradiction with the right of WTO Members to be treated in a non-discriminatory manner in this question. Here again, the damage to the multilateral system arising from this contradiction between rights and obligations of different parties to different agreements might be out of proportion with the volume of trade that is affected.

## 2.2.- The solution: the "conformity clause"

Analytically, there are only three possibilities in order to organise a system of overlapping international trade agreements, in particular PTAs and WTO agreements.

The first is that of renouncing to any organising mechanism: keeping the agreements side by side without any clause or provision establishing the relation between them. It is

---

<sup>4</sup> I use the expression "the solution chosen by the European Community" to underline that the establishment of tariff-rate quotas coupled with prohibitive MFN tariffs was not the only solution possible under the Lomé Convention. Liberalization not subject to tariff-rate quotas would also have been in conformity with the Lomé Convention and would have greatly minimised the conflict with WTO rules. (But it would have endangered overprotected domestic production...)

the model chosen by the bilateral or plurilateral agreements concluded by the European Community (alone or accompanied by its Member States). The risks of the model have just been analysed through the example of the bananas affair.

The second is that of inserting a provision in the PTA establishing its primacy over WTO agreements. The best example is NAFTA's article 103. It establishes:

1. *The Parties affirm their existing rights and obligations under the GATT and other agreements to which such Parties are party.*
2. *In the event of any inconsistency between this Agreement and such other agreements, this agreement shall prevail to the extent of the inconsistency, except as otherwise provided in this Agreement (emphasis added)*<sup>5</sup>.

This approach has the advantage of clarity and transparency. However, it runs completely opposite to the spirit and the letter of WTO agreements, proving, by the way, that the examination of the percentage of trade covered by the agreement (NAFTA in this case) is not a necessary condition for establishing the lack of conformity to WTO rules of at least some of its provisions.

NAFTA's Art. 103 legal and political logic is best understood through the comparison with Art. 104 of the same agreement. It establishes that

1. *In the event of any inconsistency between this Agreement and the specific trade obligations set out in ...(follows a list of environmental agreements)... such obligations shall prevail to the extent of the inconsistency, provided that where a Party has a choice among equally effective and reasonably available means of complying with such obligations, the Party chooses the alternative that is the least inconsistent with the other provisions of this Agreement (emphasis added).*

The situation, then, is clear: in environmental matters, NAFTA recognises explicitly the primacy of sectoral international agreements to which its Members are also Parties<sup>6</sup>; in trade matters, the primacy is reversed.

---

<sup>5</sup> Art. 802 is a concrete application of this general rule to the case of safeguards.

<sup>6</sup> See also Arts. 712 and 713 (sanitary and phytosanitary measures) and 905 (on standards in general).

The third is, of course, that of inserting in the preferential trade agreement a clause recognising the primacy of the WTO agreements. Such a clause would be the counterpart of Art. XVI.4 of the WTO Agreement that establishes that

*“Each Member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements”<sup>7</sup>.*

Such a clause would establish that in the case in which (and/or in the measure in which) the WTO competent organs would determine that a specific provision of the PTA is not in conformity with WTO rules, such provision would no longer apply between the parties to the PTA without any need to denounce the agreement or to renegotiate it. In order to facilitate the continuity of the bi/plurilateral relations regulated by the PTA, the conformity clause could be accompanied by a procedural clause establishing a simplified mechanism for the adoption of the adaptations necessary in order to bring that specific provision in conformity with WTO rules.

The introduction of a conformity clause along these lines was included by the Council of the European Union in the negotiating mandate given to the Commission for an agreement with South Africa in 1996. At the time, such an initiative was fiercely contested by the Commission services, which, at the end, were able to convince the Council to approve an agreement not containing it<sup>8</sup>. The Doha Round could be a good opportunity to take up again the idea. The greater respect for the multilateral framework that Commissioner Lamy tries to promote could help in this direction as well as the reminder of the paradox that the European Community and its Member States are reticent to the introduction of such a clause in the agreements they conclude with their countries while they continue to maintain in their own framework a provision that, as

---

<sup>7</sup> This provision was considered by the European Community and its Member States (and in particular by the European Commission) as one of the major victories obtained in the last stage of the Uruguay Round negotiations (mainly as a sort of “anti section 301 of the US Trade Act” provision). However, they were also the first to forget its significance, notably after the loss of the hormones case, in favour of the thesis that compensations (or acceptance of retaliatory measures) are a valid way of “conforming” to WTO rules (in spite of the fact that, as is well known, the Understanding on Dispute Settlement explicitly says the contrary).

<sup>8</sup> See on the substance of the conformity clause as well as in the agreement with South Africa’s precedent, Torrent 1998, chapter 9.

interpreted by the European Court of Justice, has much the same effect: Art. 307 (ex Art. 234).1 of the EC Treaty<sup>9</sup>.

### **3.- The "architectural" perspective. The argument of the blocks and the difference between FTAs and CUs**

The typical discussion on whether "regional" trade agreements constitute a building or a stumbling block of the multilateral system fails normally to recognise the essential difference between simple Free Trade Areas and Customs Unions.

Here again my initial question remains illuminating. Free Trade Areas (FTAs) may certainly be considered "building blocks" of the process of trade liberalisation but they do not create any block (and, in particular, any building block) of the multilateral system of rules, simply because each of its Members continue to participate in it on its own. Only if the multilateral system of trade rules is made synonymous with trade liberalisation, can FTAs be considered as constituting a block of it.

Customs Unions (CUs), on the contrary, do constitute a block from the perspective of the multilateral system. In order to discuss adequately this point and its implications, it is necessary, however, to deal first with the definition of a Customs Union. Indeed, it is often asserted that a CU is a FTA with a common external commercial policy. This is not sufficient if the external commercial policy is just "common". For a FTA to become really a CU (at least from the perspective of the multilateral system), what is needed is not only a "common" but a "single" external commercial policy; more precisely, what is needed is the consolidation of the previous separate customs territories into a single one. It is too often forgotten that this is exactly how the GATT itself defines a Customs Union in its article XXIV.8.a)

*"a customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that..." (emphasis added: notice that the word used is "single" and not "common"),*

---

<sup>9</sup> It establishes that "the rights and obligations arising from agreements concluded before 1 January 1958 or, for acceding states, before the date of their accession, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of this Treaty".

before going on to the establishment of the conditions referring to the “substantially all trade” coverage and the substantial identity of the trade rules applied to third countries. In order to create a single territory the existence of a Common External Tariff (and other “common” trade regulations) is not enough; in practice (if not in theory), a single unified “Customs Code” is needed

The comparison between the European Community and Mercosur helps to elucidate the question.

Since the sixties, the European Community has consolidated a single unified customs territory embracing all its Members territories<sup>10</sup>; imports from third countries are "in free circulation" ("en libre pratique") in the whole customs territory once they have legally entered it and whatever the point of entry. This principle of free circulation of imports (enshrined in two basic provisions of the EC Treaty: Articles 23 and 24, former Arts. 9 and 10) was subject to some significant exceptions until 1972 (from bananas to automobiles)<sup>11</sup>. As a result, one could argue that the CU was "imperfect", but no one could deny that it existed, at least partially. In so far as it did exist, it replaced the Member States in their trade relations with third countries.

Mercosur is also often characterised as an "incomplete Customs Union". However, this characterisation is very misleading because its Members remain absolutely separate customs territories and there is no principle of free circulation of imports among them. As a consequence, it would be more correct to view Mercosur as a quite complete FTA whose Members have decided to embark in some degree of approximation of their external commercial policies.

A full-fledged CU that has become a single unified customs territory (with more or less exceptions) shares with a FTA the violation of the MFN principle. But it has undoubtful "architectural" advantages a FTA does not possess:

---

<sup>10</sup> To be precise, some parts of its Members sovereign territories are not included within the European Community customs territory. But this only proves the care with which the latter has been defined.

<sup>11</sup> And it continues not to apply to arms. But the exceptions were, at their turn, subject to a procedure implemented at Community level.

- it helps transparency as it reduces the number of rules applicable to extra-zone trade (in particular, but not only, rules of origin) and extends its geographical scope of application;
- it facilitates trade because it allows exporters from third countries to access a larger market through any of its points of entry;
- it allows its Members to "gain dimension" in order to actively participate into the global system (an effect that can be of paramount importance for developing and small countries).

Whether these architectural advantages are negatively compensated by the incentives that CUs create for more protectionist and inward-looking economic policies is something that remains to be proved and, in any case, is a discussion that falls outside the present paper's scope. In any case, it should never be forgotten that the possible negative effects of the establishment of a CU over trade liberalisation are already subject to a controlling procedure: that of GATT's Art.XXIV.9.

I think it is important, in this context, to remind the too much forgotten fact that the original drafting of GATT's Art. XXIV referred only to CUs. WTO's publication on "Regionalism and the World Trading System" (1995, pp. 9 and 10) reminds this fact, but some additional historical/legal research on this point would be most welcomed<sup>12</sup>. This publication quotes the arguments of the US negotiator explaining the architectural and economic advantages of CUs over FTAs. They continue to sound much more convincing than the arguments used by France to defend the thesis of extending the provisions of Art, XXIV to FTAs, the thesis that finally was accepted in 1948 leading to a modification of the original 1947 text.

#### **4.- The "mechanical" perspective. The argument of the "hub and spokes" and the intertwining of PTAs**

The application to PTAs of the "hub and spokes" metaphor has the advantage of emphasising the dynamic aspect of trade relations and regional integration: how do they

---

<sup>12</sup> See also Carmen Pont-Vieira's mimeo contribution to the workshop on "The regulatory framework of Globalisation" (Barcelona 2001).

move (or turn) and how their movement affects the multilateral system? However, the argument has first to be refined.

Indeed, sometimes the metaphor is presented as if one country was the hub and the other the spoke. This does not make sense: the spoke is the PTA that links one country (the hub) and the other (the outer point of the wheel). As a consequence, it should always be made clear which country do we take as the hub and which as the outer point of the wheel that turns around the hub with the PTA acting as a spoke. Politically correct language (the very same language that has christened all bi/plurilateral trade agreements as "regional") tends to hide the fact that, normally, the Parties to a PTA are not equal (either in political or in economic power) and that PTAs continue to be an instrument of influence by dominant countries. Agreements are certainly negotiated and willingly signed and concluded, but not necessarily all Parties get equally the best out of them. This is particularly so because PTAs are never pure trade agreements and never liberalise absolutely all trade: it is in the exceptions to liberalisation and in the additional provisions beyond trade rules that the effects of the inequality between the Parties are revealed. This problem concerns mainly the Parties to each PTA but does not leave the multilateral system unaffected if the number of PTAs concluded by an important WTO Member multiplies and such a Member uses them to influence the position of the Members which "turn" around it. Of course, the best example of this is the European Union as a whole (European Community plus Member States) and the use it often makes of its network of PTAs to influence the position taken in the WTO framework (and in other frameworks) by third countries which are Parties to them.

Once refined in this sense, the metaphor is very useful to illuminate and to present in an intuitive manner the main mechanical problem raised by the multiplication of PTAs: that of the simultaneous participation in different additional PTAs by different Members or Parties to any one of them (when country A, for example, that has a PTA in force with country B, is also Party to an additional PTA with country C to which country A is not a Party).

This problem should be clearly differentiated from another one, with which it is often confused: that of all the Parties to a PTA signing a new PTA with another country (which will very probably be less deep or less broad than the initial one). It is the case

of a great deal of agreements signed by the European Community and its Members States with third countries (in Central and Eastern Europe or in the Mediterranean, for example); in a different way it would also be the case of NAFTA within a Free Trade Area of the Americas that was "NAFTA-minus". This situation can be analysed as one of more or less concentric circles: the initial one keeping its content within a larger, more shallow one. In terms of the metaphor of the hub and spokes, it would be a scheme in which the initial PTA as a whole functions as a hub. Such situations do not create any new specific problem for the global system of rules (apart from that created by PTAs in themselves).

The situation changes radically when different Parties to a PTA sign different additional PTAs with different third countries. Firstly, this situation multiplies the risks of trade and, mainly, investment diversion; as a matter of fact, this is very often the consciously pursued goal. Secondly, it prevents the development of any sentiment of "regionalism", because how can a country belong to different "regions", in each case with other different countries that do not share among them any sense of belonging to a region and might even have conflicting interests; in other terms, if regionalism is a political phenomenon, it requires the development of a feeling of loyalty that is incompatible with the situation we are analysing. Thirdly, it has a distorting effect on other countries, in particular neighbouring ones, which feel compelled to follow the same course in order not to lose the battle to attract foreign investment.

Of course, the best example of this strategy is that followed by Chile (but also by Mexico and more recently by Singapore): a) it explicitly and unequivocally looks to divert foreign direct investment from neighbouring countries; b) it is implemented without any appeal to "region building", c) it induces neighbouring countries to follow the same path of multiplying the signature of PTAs. As I shall discuss later, developed countries have a much greater responsibility than developing ones in strengthening the multilateral system. Therefore, the criticism to the Chilean strategy should not be addressed to Chile itself but to the developed countries that have accepted to be partners to it (beginning with Canada and the European Community and its Member States).

It is also this situation that really creates an inextricable "spaghetti bowl" of intertwined agreements all over the world. In the situation previously analysed under the image of



the concentric circles, the number of spaghettis pending from the fork is at any rate limited. When different parties to a PTA sign different additional PTAs with different third countries, the risk is that absolutely all the spaghettis of the bowl will follow any one of them that is being picked up.

The unmanageability of the problem is correctly described in terms of the hub and spokes metaphor: can a vehicle function when the outer points of the wheels are each one connected to different hubs by different spokes?

Again from this perspective, the advantages of CUs in relation to FTAs are beyond doubt: well consolidated CUs can only follow the "concentric circle" approach just outlined and prevent the separate participation of its members in different other PTAs, the main "mechanical" problem raised by the multiplication of PTAs.

#### **5.- The "common house" perspective. PTAs with non-WTO Members**

Enlargement of WTO membership in the last two decades has been impressive. After China's accession, WTO is really becoming a "common house" for all countries in the world. This should lead to a change in the traditional perspective of looking at GATT (or WTO agreements in general) as a kind of self-contained inward-looking system, not affected by what is going on in the outer world. Indeed, whatever the theory, the traditional practice has been not to look to the relations entertained by Members with no Members.

This should no longer be the case. It is absurd that WTO Members (and WTO Members relations with other Members) be subject to more stringent rules than non-WTO Members (or WTO Members relations with non-WTO Members). The MFN principle should work more strictly when applied to non-WTO Members than to Members. Of course, WTO cannot extend its jurisdiction to non-Members, but it can strengthen the obligations imposed to its Members on their relations with non-Members.

Here again, the argument is essentially political even if it looks very legalistic. The goal is to send a clear message to all countries (big and small) in the world that no "free rider" activity or "preferential treatment" is possible outside the "common house" -that

is, WTO-. To achieve this goal, three means, at least, are possible: a) clarification of the geographical scope of the MFN principle (unambiguously stating that Members can unconditionally claim the MFN treatment applied by a Member to non-Members and that the usual exceptions only apply among WTO members); b) a concentration of the activity of WTO's Regional Agreements Committee on the examination of PTAs between Members and non-Members; c) hopefully, some dispute brought before WTO's Dispute Settlement Mechanism by a Member claiming the treatment granted by another Member to a non-Member under a PTA between the latter.

## **6.- The political perspective. The political specificity of some PTAs**

Trade and trade rules do not exist in a political vacuum. As already mentioned before, the multilateral trading system was born mainly as a political instrument to prevent the reappearance of the multipolar system that damaged the world for decades. And everybody agrees that the main urge motivating regional co-operation/ integration is also political. Therefore, one of the main shortcomings of the analysis of the compatibility between regionalism and multilateralism through the GATT's Art. XXIV notion of "substantially all trade" is that of losing sight of the political, non-commercial, preconditions and goals of PTAs.

There are at least three elements that should be considered from a political perspective: geography, dimension and history. All of them can be taken in consideration in a "codified" manner without opening a Pandora box that would justify any violation of the MFN principle. A few examples may be useful to prove that.

Geography.- Geography continues to matter economically whatever the development of telecommunications and long distance transport. At least one geographical circumstance should be taken into account explicitly by WTO's law and practice: the fact that one country is completely surrounded by a few bigger ones. The paradigmatic example could be that of a country now negotiating its accession to the WTO: Andorra, a tiny State nestled in the Pirenees between France and Spain. Not to recognise to it the right (even the need) to keep preferential relations with the European Community (for matters falling under its competence) and with France and Spain (for matters remaining under Member State competence) is simply contrary to common sense. However, this

recognition should not necessarily extend to relations with other Member States of the European Union on matters remaining under Member State competence. Indeed, the justification applicable to France and Spain does not extend to Finland and Sweden, for example: the United States, Japan and all other WTO Members should accept in matters like transports or movement of workers the existence of a large degree of preferential relations between Andorra, France and Spain but they should maintain their right to MFN treatment by comparison to Finland and Sweden.

Dimension.- The dimension of States or regional economic integration organisations (REIOs) in terms of population and GDP matters also for the problem under discussion. This element, whose exact definition can only be arrived at through negotiation and goodwill but whose relevance seems out of discussion, should increase its weight when combined with some of the other two non-commercial elements under discussion (geography and history). Taking some concrete examples, it is again contrary to common sense to blindly apply the same rules to PTAs among small States and to PTAs involving at least a big State or REIO. Relations between Central American countries or between Baltic countries should not be considered equally than relations between Argentina and Brazil or between Poland and the European Community and its Members States, respectively (I take these examples and in this order not to mix the discussion on dimension with that on development which will come later). But here again the recognition of this fact should be subject to limitative criteria: the justification for a regional agreement covering (or open to) all Central American (or Baltic) countries does not apply to a spaghetti bowl of intertwined bilateral agreements between the different countries of the region or between them and the "big guys" of the multilateral system.

History.- It is also absurd to forget that our system of international economic relations is historically conditioned. Two recent processes, at least, should be explicitly taken into account (at least through generous transitory provisions): a) secession or disintegration of a State in several new ones; b) transition to market economies. As the rationale for both cases seems nearly self-evident, it is better to emphasise, here again, through some examples, the limitative criteria that could apply:

- a PTA agreement between the Czech Republic and Slovakia trying to establish a common framework for what had been for decades the economy of a single State

seems perfectly justifiable; but this justification runs contrary to a course of additional bilateral agreements concluded separately by each new State (trying in fact to divert investment from the other and all neighbours of both);

- some kind of regional agreements between Central and Eastern countries former members of COMECON could have been considered a justifiable element of their common transition to market economies; but this justification does not apply to a spaghetti bowl of intertwined bilateral agreements among all of them taken two by two nor to the competition to conclude preferential agreements with the European Community and its Member States.

## **7.- The development perspective**

There is an ongoing debate on whether regional integration among developing countries does really contribute to their development or it is rather the "North-South" variety of regionalism that promotes development<sup>13</sup>. From the perspective of the relationship between regionalism and WTO, this debate is largely irrelevant, because, from this perspective, what matters is not the answer to this question but to that of which variety of PTAs damages more the multilateral system: North-South or South-South. Once the question is put in this way, the answer is quite clear.

From an economic point of view, nobody denies that access to developed countries market favours development. North-South agreements discriminate against developing countries not Parties to them and, as a consequence, hinder, at least potentially, their development. South-South agreements, whatever their beneficial or harmful effects on the Parties, at least do not create an additional difficulty for other developing countries' access to developed countries market; therefore, the risks they generate for the rest of developing countries (and for the multilateral system as a whole) are lesser than the North-South variety.

From an "architectural"/political point of view, and, more specifically, from the perspective of the insertion of developing countries into the global system, North-South agreements create a two-tier system among developing countries: some of them can

---

<sup>13</sup> See, in favour of the second alternative, *Trade Blocs*, World Bank, 2000.

play both the games of multilateralism and of bilateralism while some other can only play the first.

This argument does not necessarily lead to the conclusion that South-South agreements are inconsequential for the multilateral system. Rather, common sense indicates that they can also have harmful effects for some countries, in particular neighbouring ones. Therefore, they should be kept under surveillance from WTO. But the argument emphasises that multilateral rules and surveillance should focus in particular the North-South variety of PTAs in order to protect the legitimate interests of developing countries left aside by the agreement. The multilateral system should emphasise the developed countries responsibility to ensure non-discriminatory access to their markets for developing countries.

It should be made clear, from this perspective, that, in a North-South PTA, the responsibilities by reference to the multilateral system are not equally shared by Parties from the North and Parties from the South. Behind the legal equality of the Parties to the agreement lies a fundamental political and economic inequality: in practice a developing country cannot refuse a PTA with a big developed country (the US or the European Community, for example); as a matter of fact, it is the developed country which picks and chooses among developing countries (depending, of course, on its interests). The best example to discuss this point is the recently signed agreement between Chile and the European Community and its Member States. It is not the responsibility of Chile to justify the agreement but that of the European Union as a whole (European Community + Member States): why do they grant to Chile a treatment that they do not extend to all its neighbouring countries, with the risk of investment diversion that this generates and all the other more general policy distorting effects to which I'll refer just below. The main answer is pretty obvious: Chile is not an exporter of basic agricultural commodities as Argentina and Brazil (an exporter also of aircraft and steel) are. But is this answer consistent with the spirit of the multilateral system?

Two additional architectural consequences of North-South PTAs (clearly negative the second one whatever the judgement on the first) are that, in real practice, they discourage (consciously or unconsciously) South-South integration and are (or may be) used as instruments to influence other developing countries policies according to criteria

imposed by the North. The agreement between Chile and the European Community and its Member States is again a good example of the first effect: it is used by Argentinean segments of public opinion contrary to Mercosur integration as an argument that Argentina would be better off negotiating alone with the European Community and its Member States than doing it together with Mercosur's other three partners<sup>14</sup>.

The best example of the second effect is the European Community and its Member States repeated strategy of "awarding" PTAs to countries (in Central and Eastern Europe but also in Central Asia or in the Arab world) that "comply" with certain political and economic criteria and accept some exceptions to trade liberalisation. The United States has also used this strategy (with Israel and Jordan for example), but to a lesser degree; however, it may gain new force at least as a tactical instrument (or a threat) to convince countries and segments of public opinion contrary to the Free Trade Area of the Americas project ("if you, Brazil, for example, reject the FTAA project, we, the US, will sign bilateral agreements with all your neighbours diverting trade and investment from you"). In any case, all the examples prove the existence of a face in North-South agreements that politically correct language again tends to hide: their face as instruments of influence of "big powers" in the North.

Multilateral institutions should at least impose on developed countries a burden of proof on their agreements with developing countries: the burden of proving that they do not hinder the development of countries which are not Party to them. This burden of proof could easily be enshrined in a rule, making it mandatory in the notification procedure of PTAs to WTO.

---

<sup>14</sup> This thesis is very naïf because it fails to understand, as I have just mentioned, that the essential difference between Chile and Argentina is not whether they negotiate or not alone but the composition of its exports, highly competitive, in the Argentinean case, of overprotected European Community agricultural production. But leaving aside its naïveté, it constitutes an additional difficulty for an already embattered Mercosur integration.

## **B) REGIONAL COOPERATION/INTEGRATION BEYOND TRADE RULES**

### **8.- The multiplicity of instruments for regional co-operation/integration**

Regional co-operation/integration is not a unidirectional process, proceeding in stages from the creation of a free trade area to wider and deeper forms of integration; rather, it follows different paths that may lead in different directions, even if these paths all share some common elements. Regional integration/co-operation aims to mould social and economic preconditions (which are different in each process) in order to reach some objectives (which are also different in each case) using certain instruments. These instruments are also very diverse and can be classified in four types: regional rules, public activities, income redistribution through budgetary transfers and diplomatic instruments. They must be distinguished from the institutional arrangements used to adopt and implement them.

#### **8.1.- Regional Rules**

Regional rules can cover any social and economic situation. From an analytical perspective, it is best to analyse the subject-matter of the rules under the heading of content (see next section) rather than under instruments for regional integration. The analysis of rules as instruments must relate to the three main approaches (or instrumental ways) of international rules for promoting integration. The first is to impose obligations on liberalisation and access to markets. The second is to impose certain obligations of non-discrimination on the legal framework applicable to transactions and operations covered by the agreements—basically most-favoured-nation (MFN) status or national treatment (NT) obligations—while leaving domestic legislation intact. The third is to create uniform legislation establishing a common legal framework for transactions and operations covered by the agreement. These three approaches differ legally and in terms of their political and economic implications.

The obligations that accompany liberalisation are strictly limited in scope to international transactions. Obligations as regards treatment (in particular if they apply to treatment of foreign firms and professionals after their establishment in the host

country) as well as uniform or harmonised rules apply essentially to internal transactions. They are much more intrusive politically (and, as a consequence, much more difficult to tackle) than the former. But many argue that integration cannot rely solely on liberalisation obligations in order to make sense in legal terms. Furthermore, it is becoming even clearer from a strictly economic perspective that market integration is not achieved by simply liberalising access as long as internal rules continue to differ.

## 8.2.- Public Activities

States do more than just enact and implement general legislation. For example, they also finance and manage public services like education, build physical infrastructure, and subsidise specific economic activities. I refer to these as public activities and not as policies because policies can also be implemented exclusively through general rules (on environment, social and labour standards, or education, for example).

The same distinction applies at the regional level. Public activities can play a relevant role in some regional integration schemes. It could even be argued that some regional public activity must be carried out in order to avoid regional integration becoming simply a politically correct remake of market liberalisation. Here again, the subject matter for these activities fits best under contents. What must be emphasised under instruments is that such activities may be needed in order to enact liberalising rules. The European Community's Common Agricultural Policy is the main example of this.

In the 1950s, when the European Community Treaty was negotiated, agriculture posed two major problems as a sector. First, national budgets heavily subsidised it, and this would create huge distortions for competition if intrazone trade were liberalised. Second, public intervention was linked to the existence of producer organisations and systems of price controls that constituted a clear infringement of norms on the principles of free competition and antitrust. The alternatives were either to exclude agriculture from the scope of the treaties or to bring the issue as part of the common policies. Member states chose the second alternative: in order to bring agriculture within the general framework of integration, a specific set of common rules for agricultural production and markets was created that would be inconceivable outside the realm of agriculture. Throughout the history of the Common Agricultural Policy, these rules have involved price controls,



public purchases, and buffer stocks, as well as cartels with ceilings on production and penalties for exceeding them.

Leaving aside their merits in terms of economic policy, public activities can have very positive effects on the integration process. I shall not refer to the impact of creating powerful sector lobbies in favour of regional action, because critics can neutralise this effect. I refer here to the definition and management of such policies, which keeps regional integration going even in periods of stagnation, and the fact that regional integration is about real economic life and not simply about politics.

### 8.3.- Income Redistribution through Budgetary Transfers

All public activities may affect income distribution. Income redistribution becomes a specific regional instrument when it targets specific categories of beneficiaries defined in terms of their income or some other broad economic characteristic. This instrument is, for the moment, typically European and I will not discuss it further.

### 8.4.- Diplomatic Instruments

As an international phenomenon, regional integration relies on the typical international diplomatic instruments of dialog and co-operation. Their use may promote the emergence of a proper regional policy (implemented through legislation or public activities), but this is not necessarily or commonly the case.

These instruments are diplomatic in origin, and extend to all other areas covered by each process, in particular the economic areas. This development goes beyond regional integration, as the number of international forums on all areas of economic, social, and political life has multiplied. Their effects on integration are greatly enhanced when they are able to effectively involve social and economic actors, in particular in businesses, promoting exchanges and common activities among them.

### 8.5.- Conclusion

This brief analysis proves that trade liberalisation is not necessarily the most important aspect (nor the first unavoidable step) of regional co-operation/integration. Well-designed public activities can foster integration much more than the multiplication of trade liberalising rules that may either fail (because they are violated) or become inconsequential (because trade liberalisation does not result in an effective augmentation of trade flows<sup>15</sup>). Even if the focus is on rules and not (or not only) on public activities, obligations of treatment or adoption of uniform law may be more relevant than simple trade liberalisation. Regional co-operation can also be conceived, particularly among small States, as “institution building”: pooling together resources and capabilities at the regional level in order to achieve results (institutions, public activities, rules) that could not be achieved separately at State level. Finally, the role of traditional diplomatic instruments should not be dismissed out of hand as irrelevant. The danger is that of presenting them to public opinion as being more than they are (a strategy that in the long run ends up by creating frustration and weakening the process), but, adequately used, they may consolidate and strengthen political commitment to the regional co-operation process and create a valuable framework for *de facto* economic integration by private operators.

## **9.- The “effective content” of regional co-operation/integration**

### **9.1.- Width and Depth**

The width of any international agreement or organisation (including regional ones) can be defined in terms of the number and scope of the areas it covers. Depth refers to the degree in which these areas are subject to common rules or public activities. An example taken from the multilateral level helps to differentiate both notions. The General Agreement on Trade in Services (GATS) is wide because it covers all service sectors and all aspects of post-establishment treatment of foreign firms; but it is not very deep (and unequally deep at any rate) because the market access and national treatment commitments in members’ respective schedules are quite limited.

---

<sup>15</sup> Recent research commissioned by European Commission’s D.G. Trade tends to prove that this possibility becomes a reality more often than it would seem. Martin-Prada and Rossi’s contribution to this Conference touches this point.

Apparently, width can easily be determined by looking at the subject matter of the different regional instruments that are being used. This apparent ease does not exist in relation to rules because the width of rules must be analysed in terms of a matrix: vertically when referring to sectors (such as agriculture or financial services) and horizontally (taxation, competition, labour standards, etc.). Depth is not easy to determine, in particular in relation to rules. The best criterion for determining depth is the extent to which member states remain free to regulate specific topics differently; the more they do, the shallower the process will be in terms of depth. Application of this criterion requires careful analysis of the relevant legal provisions for establishing actual regulatory meaning, especially because ambitious language may often mask a lack of actual regulatory effect.

For analytical purposes, the distinction between width and depth is perfectly sound but can also be misleading. Indeed, width and depth are not independent characteristics of integration. What matters is the content of the process, and width and depth are but two aspects of it that must be considered jointly. Reality offers us plenty of examples of bilateral economic agreements that are wide in terms of scope, but with no depth in terms of obligations or effective co-operation. They end up being little more than political declarations of intent.

## 9.2.- Content versus effective content

As regional co-operation/integration processes occur within a multilateral system in which members have already accepted obligations, to get to actual regional co-operation/integration value added requires analysing the effective content of the processes and not merely their content. Effective content must be defined as regional content minus multilateral obligations. Here again, reality offers plenty of examples of bilateral/regional agreements that attempt to increase their content by simply restating already accepted bilateral and multilateral obligations, or even falling short of this. This strategy is very risky. It creates confusion, reduces transparency, and weakens the multilateral system without making any meaningful contribution to integration.

An illustrative example is Mercosur's 1997 Montevideo Protocol on services, sometimes presented as proof of Mercosur's ambitions. Wouldn't it be better to view

this as proof of Mercosur's inability to advance further in the integration process? The Protocol is certainly wide, but it has little depth; and, in any case, it falls short of specific obligations already accepted by its four member states in the framework of GATS because it does not incorporate their respective schedules of commitments. So its effective content is negative (although its MFN clause does not allow for exceptions)<sup>16</sup>.

### 9.3.- Conclusion

The political logic behind GATT's Art XXIV (and GATS Art. V) is not simply that of an exception (in the sense of other exceptions in the WTO system that are either motivated by exceptional circumstances –and are temporary- as those on Balance of Payments and sectoral safeguards, or are the result of “trade overriding” considerations as those of GATT's Art. XX and XXI). The exception on regional integration could be interpreted as meaning “if you, WTO Members, want to go further than WTO obligations among you, you may, even without extending your reciprocal preferences to other, provided some conditions are met”. In this perspective, the “effective content” of the regional scheme (in the sense just defined) matters a lot: a) the greater this effective content, the more the violation of the MFN principle gets “submerged” in (and probably justified by) a broader political context; b) if the regional effective content does not go beyond the subject matter of WTO obligations, the MFN violation is simply that, a MFN violation whose only sense is that of creating a preferential regime among the Parties.

Here again, this point should be easily taken account of in any examination of the WTO compatibility of regional co-operation/integration.

---

<sup>16</sup> Sectoral annexes and schedules of commitments were later added but neither the Montevideo Protocol nor the addition of the sectoral annexes and the lists of commitments have yet entered into force, pending ratification. Therefore, Mercosur's effective content on this topic continues to be negative with reference to WTO's commitments.

## **C) CONCLUSIONS**

From the perspective of the multilateral system, seven policy-oriented conclusions follow from the previous arguments. All of them could be easily coached in new provisions to be introduced in a revision of WTO rules on regional agreements.

- 1.- All WTO Members should have the unconditional right to claim MFN treatment by reference to the treatment any WTO Member grants to a non-Member. Transitory provisions could be introduced (subject to a deadline and a periodic process of examination) grandfathering existing situations.
- 2.- A “conformity clause” with WTO agreements should be introduced in all preferential agreements. Any new preferential agreement not containing such a clause would be considered contrary to WTO rules and would not give to Parties to it the right not to extend to other WTO Members such preferential treatment . Transitory provisions could be introduced for already existing agreements. However, as the multilateral obligation for preferential agreements to be in conformity with WTO rules exists already and has been accepted by all WTO Members (and the introduction of the conformity clause in the bi/plurilateral agreement simply “bi/plurilateralises” it), these transitory provisions should determine an explicit deadline for such an introduction.
- 3.- The new rules should clearly recognise the architectural advantages of Customs Unions by reference to Free Trade Zones. This recognition could be linked to strengthened rules and procedures guaranteeing that the creation of a CU does not reduce the levels of liberalisation previously bound by the WTO Members that create it.
- 4.- More stringent rules should be introduced in relation to WTO Members participation in different PTAs with different Parties (multiple membership in the sense discussed in point 4 above).
- 5.- Specific provisions should be introduced in order to allow for the consideration of a well determined set of “non-commercial” conditions (geography, dimension and history), as discussed in point 6 above.
- 6.- Provisions on the consideration of PTAs from the development perspective should be clarified and strengthened. First, it should be explicitly recognised that PTAs among developing countries are subject to less stringent rules than PTAs where developed countries are Parties. Second, some kind of burden of proof should

be imposed on developed countries: they should provide written arguments on the positive effects of any PTA in which they participate on the development of developing countries not Party to it.

- 7.- As discussed in points 8 and 9 above, the “WTO-plus” criterion should be explicitly recognised as a criterion to be taken into account when examining the conformity to WTO of PTAs. This conformity should be made dependent (in a positive manner) on the “effective content” of the agreement (in the sense explained in point 9).

Someone could argue that the new set of rules would make the examination of the conformity to WTO of preferential trade agreements much more complex. This is true. However, in the problem under discussion, complexity is not necessarily a disadvantage. Firstly, because if the reality to which the rules must apply is complex, it is better to design appropriate rules to deal with it than trying to insert it into a legal mould into which it does not fit. Secondly, because the adequacy of the new rules should not be judged in absolute terms but by comparison to that of the existing ones. And, from this perspective, nobody can deny that the existing rules have been completely unable to cope with the proliferation of PTAs in the last decade. At least, this is what WTO Members seemed to think when they included the relation between regionalism and WTO as a topic to be discussed in the new Round of Negotiations.